

The following homework assignment is to be submitted via email to Dorothy Kemboi at dck00004@mix.wvu.edu with a “cc” to me at roger.congleton@mail.wvu.edu. The answers are due before class time at on Thursday, October 12. They should be typed up and emailed to Dorothy in Word before class that day. Dorothy will grade them and return them within a few days.

- (1) Suppose that Al will attend 4 years of university at a cost of \$20,000 per year and will earn an extra 10,000 per year for the next 30 years as a consequence. What is the present discounted value of her college education at the moment that she begins to attend college if the interest rate is 2% , if it is 7%?
- (2) Suppose that Al purchase a lottery ticket for 1 dollar that has one chance in a million of winning 10,000/year for 40 years beginning a year after she purchase the ticket if she wins. What is the expected present value of her ticket at the time of purchase if the interest rate is 2%, if it is 7%?
- (3) Suppose that Al is thinking about purchasing a good from a local seller, Bob, that is known to have low quality units $P\%$ of the time and good units $(1-P)\%$ of the time. Al has two different net total benefit functions, one for the low quality good and the other from the high quality good. Both are strictly concave and increase as her personal income increases. Determine her demand function for this merchant’s product if she cannot determine the difference between high- and low-quality units at the time of purchase.
- (4) Suppose the local seller in 3 realizes that by increasing the probability of high-quality units, that his demand and profits may be higher. He can do so by monitoring his production process more carefully. (a) Characterize both his monitoring effort and the price that he’ll charge if he has N customers similar to Al. (b) Discuss the sense in which Bob can be said to be a productive part of the production process in this case.
- (5) Suppose that Bob’s the number of customers that Bob serves every day are distributed normally with mean 50 and standard deviation 10. (a) If each customer purchases 5 units of the product that he sells in a typical visit, how many units should he produce (or purchase to sell from a wholesaler) every day if he wants to “run out” less than 5% of the time? (b) Less than 1% of the time? (b) Write an expected value equation for sales (using the continuous form expected value equation) that explains your conclusion.