

Exercise 8

Production

Part I.

Exercises 5.B.1, 5.B.2, 5.B.3, 5.C.9, 5.C.10

Part II

Ms. A. is the sole owner and manager of company B. The company is able to produce one output, gadgets, using a single input, widgets. The company is a price-taker in both the widget and the gadget markets. The company must open a branch in one of two countries, L or R. In country L both the widget wages w_L and gadget prices p_L are subject to uncertainty, while in R they are certain and equal to the mean values in L (i.e. $w_R = E(w_L)$; $p_R = E(p_L)$; assume all prices are strictly positive). Only one branch may be opened, and widgets must be bought and gadgets sold in the country where the branch is located. Assuming Ms. A is risk neutral, where will the company open the branch?. Explain every step.