**Exercises**

1. Consider an economy with an employee and employer. The employee invests $h$ in human capital and the employer invests $k$ in capital, and the total output is

$$q=k^{a}h^{1-a}.$$

The bargaining power of the employee is $β$ so she maximizes

$$βq-\frac{h^{2}}{2}.$$

The employer solves

$$\left(1-β\right)q-k.$$

1. Find the bargaining power of the employee that would maximize the total output.
2. Explain why $β=0$ or $β=1$ would not be a solution to part (a).
3. Turkey used low interest rates to boost consumption demand during early 2000s. This economic policy is often seen as the root cause of the current financial problems of the Turkish economy. Explain how progressive redistributive policies could be an alternative as a tool to increase demand.
4. Güneş Taner, the Minister of State from the governing party in Turkey in 1989, ANAP, said: “I would finish him in 24 hours” referring to Cavit Çağlar, one of the wealthiest industrial businessman in Turkey at the time. Cavit Çağlar, however, became the Minister of Finance in 1991 from DYP. Adnan Kahveci from ANAP commented: “Delegating public banks to Cavit Çağlar is the proof that liver is guarded by the cat.” Indeed, Cavit Çağlar massively reduced his debt to public banks while in office.

How would Stiglitz argue that these developments are related to income inequality?

1. In their election manifesto, Labor Party in the UK proposed taxing the rich and using the extra tax revenues for services that would benefit the poor. ButLabor is massively defeated in the most recent elections. In the class, we discussed several models that explain why the poor do not support the economic policies that favor them. If you were the leader of Labor, which model would you prefer to explain your party’s defeat? Explain the model with an example with three voters.