18. Constrained Optimization I: First Order Conditions

The typical problem we face in economics involves optimization under constraints. From supply and demand alone we have: maximize utility, subject to a budget constraint and non-negativity constraints; minimize cost, subject to a quantity constraint; minimize expenditure, subject to a utility constraint; maximize profit, subject to constraints on production. And those are just the basic supply and demand related problems. Then there are other types of constrained optimization ranging from finding Pareto optima given resource and technology constraints to setting up incentive schemes subject to participation constraints.

The generic constrained optimization problem involves a thing to be optimized, the objective function, and one or more constraint functions used to define the constraints.

It often looks something like this.

\[
\begin{align*}
\max \ f(x) \\
\text{s.t. } g_i(x) &\leq b_i, \text{ for } i = 1, \ldots, k \\
\quad & \quad \quad h_j(x) = c_j, \text{ for } j = 1, \ldots, \ell
\end{align*}
\]

Here \( f \) is the objective function, the equations \( g_i(x) \leq b_i \) are referred to as inequality constraints, while the equations \( h_j(x) = c_j \) are called equality constraints.\(^1\)

\(^1\) The letters “s.t.” can be read as “subject to”, “such that”, or “so that”. However one renders it, it indicates the constraint equations.
18.1 Two Optimization Problems of Economics

Sometimes a problem will have only one kind of constraint. An example is the following consumer’s problem defining the indirect utility function \( v(p, m) \). It only has inequality constraints.

\[
v(p, m) = \max_x u(x) \\
s.t. \quad p \cdot x \leq m \\
\quad x \geq 0.
\]

Here \( p \) is the price vector, \( u \) is the utility function, and \( m \) is income. All the constraints here are inequality constraints. The constraints \( x_i \geq 0 \) (\( x \geq 0 \)) are known as non-negativity constraints. The solutions depend on the prices of consumer goods \( p \) and consumer income \( m \). We write the solution as \( x(p, m) \), and refer to them as the Marshallian demands.

Another example is the firm’s cost minimization problem which defines the cost function \( c(w, q) \).

\[
c(w, q) = \min_z w \cdot z \\
s.t. \quad f(z) \geq q \\
\quad z \geq 0.
\]

Here \( q \) is the amount produced, \( w \) is the vector of factor prices, and \( f \) is the production function. The solutions, now dependent on factor prices \( w \) and output \( q \) are the conditional factor demands, \( z(w, q) \).
18.2 A Simple Consumer’s Problem

We start by examining a simple consumer’s problem with two goods and a single equality constraint, the budget constraint. This consumer’s problem is

$$\max_x u(x_1, x_2)$$

s.t. $p_1 x_1 + p_2 x_2 = m$.

We’re dropping the usual non-negativity constraints in the interest of simplifying the problem.

Consider the geometry of the solution. As we teach in undergrad micro, the indifference curve must be tangent to the budget line at the utility maximum. That is, the slopes of the two curves must be the same. This is illustrated in Figure 18.4.1. We have extended the budget line because we did not impose any non-negativity constraints.

![Figure 18.2.1: Three indifference curves are shown in the diagram. Indifference curve $u_2$ is the highest indifference curve the consumer can afford. This happens at $x^*$ where the indifference curve is tangent to the budget line.](image-url)
18.3 Solution to the Simple Consumer’s Problem

Aligning the tangents for the budget line and indifference curve can be accomplished by making sure they have the same slope. Both slopes are negative. The absolute slope of the budget line is the relative price \( p_1/p_2 \) while the absolute slope of the indifference curve is the marginal rate of substitution, \( MRS_{12} = (\partial u/\partial x_1)/(\partial u/\partial x_2) \). Those two slopes must be equal at the utility maximum \( x^* \),

\[
\frac{p_1}{p_2} = \frac{\partial u/\partial x_1}{\partial u/\partial x_2}.
\]

This can also be expressed in terms of the marginal utility per dollar, which must be the same for both goods. If not, the consumer would gain by spending more on the good with greater per dollar value, and less on the good with less bang for the buck.

\[
\frac{\partial u/\partial x_1}{p_1} = \frac{\partial u/\partial x_2}{p_2}.
\]

Another way to think about this is that we are lining up the tangent spaces of both the budget constraint and the optimal indifference curve. Both the budget line and the indifference curves are level sets of functions. As such, their tangent spaces are the null spaces of their derivatives.

The tangents \( v \) to the budget line obey \((p_1, p_2)v = 0\) and the tangents \( w \) to the optimal indifference curve obey \([Du(x^*)]w = 0\). This implies that the normal vectors \( \nabla u(x^*) \) and \( p = (p_1, p_2)^T \) must be collinear. Thus \( \nabla u(x^*) = \mu p \) for some \( \mu \in \mathbb{R} \).
18.4 Solution to the Simple Consumer’s Problem II

We could alternatively write the problem as maximizing $u$ over the line $-p \cdot x = -m$. It is the same set, but has a different derivative. We could use $\alpha p \cdot x = \alpha m$ for any $\alpha \neq 0$. Each $\alpha$ gives a different derivative to the constraint.

We don’t have the freedom to alter the direction of $\nabla u(x^*)$ because it points in the direction of maximum increase of $u$. Reversing the direction would reverse consumer preferences. What was better would become worse and vice-versa.

![Figure 18.4.1](image-url): Here $x^*$ is the consumer’s utility maximum. At the maximum, the vectors $p$ and $\nabla u(x^*)$ are collinear, with the heavier arrow being $\nabla u(x^*)$. With an equality constraint, it doesn’t matter whether the vectors point in the same or opposite directions. It will matter for inequality constraints. The right panel writes the budget constraint as $-p \cdot x = -m$ to emphasize that we flipped the direction of $p$. Either way, there is a $\mu \in \mathbb{R}$ with $\nabla u(x^*) = \mu p$. 
18.5 More on the Simple Consumer’s Problem

If the tangents (or gradients) don’t align, the constraint set and the indifference curve must cut through each other. Then the intersection $x^*$ does not maximize utility. In that case there is a $v$ with $p \cdot v = 0$ and $\nabla u(x^*) \cdot v > 0$. In such cases, travelling along the tangent to the budget constraint (i.e., along the budget frontier) in the direction $v$ will increase utility, as illustrated in Figure 18.5.1.

Figure 18.5.1: Here the prices have been changed to $p'$ so that the indifference curve $u_2$ (blue tangent) and the budget line are no longer tangent.

At the new prices, we can move along the budget line in the direction $v$ to increase utility. Because of the acute angle between $v$ and $\nabla u(x^*)$, moves in the direction $v$ increase utility. Here, we can also see that utility has not only increased from $u_2$, but is even above $u_3$ at $x^* + v$.

The situation is similar when $x^*$ is a minimum.

The argument above is a key part of the proof of the upcoming Tangent Space Theorem.
18.6 Optimization Under Equality Constraints

We can use the tangent spaces to find a necessary condition for constrained optimization when the constraints are equality constraints.

Consider the problem

\[
\begin{align*}
\max_{\mathbf{x}} & \quad f(\mathbf{x}) \\
\text{s.t.} & \quad h_i(\mathbf{x}) = c_i, \, \text{for} \, i = 1, \ldots, \ell.
\end{align*}
\]

That is, we are attempting to maximize \( f(\mathbf{x}) \) under the constraints that \( h(\mathbf{x}) = \mathbf{c} \). The key result is the Tangent Space Theorem.\(^2\)

**Tangent Space Theorem.** Let \( U \subset \mathbb{R}^m \) and \( f: U \to \mathbb{R} \), \( h: \mathbb{R}^m \to \mathbb{R}^\ell \) be \( C^1 \) functions. Suppose \( \mathbf{x}^* \) either maximizes or minimizes \( f(\mathbf{x}) \) over the set \( M = \{ \mathbf{x} : h(\mathbf{x}) = \mathbf{c} \} \) with \( Df(\mathbf{x}^*) \neq \mathbf{0} \) and \( \text{rank } Dh(\mathbf{x}^*) = \ell \). Then the tangent space \( TF \) of the differentiable manifold \( F = \{ \mathbf{x} : f(\mathbf{x}) = f(\mathbf{x}^*) \} \) at \( \mathbf{x}^* \) contains the tangent space at \( \mathbf{x}^* \) of the differentiable manifold \( M \). Moreover, there are unique \( \mu_j^* \), \( i = 1, \ldots, \ell \) with \( \sum_{j=1}^\ell \mu_j^* Dh_j(\mathbf{x}^*) = Df(\mathbf{x}^*) \).

\(^2\) The name Tangent Space Theorem is not in general use. I gave it a name since we use it a number of times.
18.7 Notes on the Tangent Space Theorem

In our simple consumer’s problem, $m = 2$ and $\ell = 1$, so both the indifference curve $F$ and the budget constraint $M$ are one-dimensional manifolds. The tangent spaces were also one-dimensional, and so had to coincide. Here the tangent space of $F$ is $(m - 1)$-dimensional and the tangent space of $M$ is $(m - \ell)$-dimensional.

Because the dimensions are different if $\ell > 1$, the tangent spaces cannot coincide. The best we can do in that line is for the smaller space $T_{x^*}M$ to be contained in the larger space $T_{x^*}F$.

The proof shows that if movement in a direction $v$ is allowed by the constraints, and if $v$ is not in $T_{x^*}F$, then the objective $f$ can be increased. This means that at the maximum, the constraints can only allows moves in directions in $T_{x^*}F$.

The condition that $\text{rank } D_h(x^*) = \ell$ is called the non-degenerate constraint qualification condition (NDCQ) at $x^*$. It ensures that $M$ is a regular manifold of dimension

$$m - \text{rank } D_h(x^*) = m - \ell.$$ 

Theorem 15.38.1 then gives us its tangent space, $\ker D_h(x^*)$.\(^3\)

This happens even if $\text{rank } D_h(x^*) = 0$. In that case, the tangent space, the null space of $D_h(x^*)$, is the zero-dimensional set $\{0\}$. Of course, $m < \text{rank } D_h(x^*)$ is not possible because $D_h(x^*)$ is an $\ell \times m$ matrix.

Finally, the numbers $\mu_1^*, \ldots, \mu_\ell^*$ are called Lagrange multipliers.\(^4\)

---

\(^3\) Be careful, the notation differs. The $m$, $\ell$, and $m - \ell$ on this page are the $m + k$, $k$, and $m$ of Theorem 15.38.1. The notation is the way it is in order to highlight different things in the two sections.

18.8 Proof of the Tangent Space Theorem I

Proof of Tangent Space Theorem. Suppose $x^*$ is a maximum. Because $\text{rank } D h(x^*) = \ell$, there is a neighborhood $U$ of $x^*$ where $\text{rank } D h(x) = \ell$. By Theorem 15.38.1, we can define a chart $(\mathcal{U}, \varphi)$ from $\mathcal{U} \cap \mathcal{M}$ to $\mathbb{R}^{m-\ell}$. It follows that the tangent space at $x^*$, $T_{x^*}\mathcal{M} = \ker D h(x^*)$, is $(m - \ell)$-dimensional.

Similarly, $\mathcal{F}$ is a $(m - 1)$-dimensional differentiable manifold, with an $(m - 1)$-dimensional tangent space $T_{x^*}\mathcal{F}$ at $x^*$.

By way of contradiction, suppose there is $v \in T_{x^*}\mathcal{M}$ with $v \not\in T_{x^*}\mathcal{F}$. Then $[D h(x^*)]v = 0$ and $[D f(x^*)]v \neq 0$. The latter is a real number, so if $[D f(x^*)]v < 0$, we may replace $v$ by $-v$, ensuring $[D f(x^*)]v > 0$.

This is the same situation we saw in Figure 18.5.1, repeated below at a smaller size.

![Figure 18.5.1](image)

**Figure 18.5.1:** The budget line in the diagram is $\mathcal{T}\mathcal{M}$ and the tangent (blue) to the indifference curve $u_2$ is $\mathcal{T}\mathcal{F}$. Of course, $u$ is the objective. As you can see, movements in the direction $v$ increase utility when the tangent spaces are not colinear.

Take a curve $x(t)$ from $(-1, 1)$ to $\mathcal{M}$ with $x(0) = x^*$ and $x'(0) = v \in T_{x^*}\mathcal{M}$. This is possible because the tangent space $T_{x^*}\mathcal{M}$ can also be defined as the set of tangents at $x^*$ of curves in $\mathcal{M}$ through $x^*$. The path can be defined by defining it in a coordinate patch and mapping it back to $\mathcal{M}$.

Proof continues ...
18.9 Proof of the Tangent Space Theorem II

Remainder of Proof. Use the continuity of $Df(x)$ to pick $\varepsilon > 0$ so that $[Df(x)]v > 0$ for $x \in B_\varepsilon(x^*) \subset U \cap M$. Apply the Mean Value Theorem to $\phi(t) = f(x(t))$ and use the Chain Rule to obtain

$$f(x(t)) = f(x^*) + Df_{c(t)}(x'(t))$$

for some $c(t) \in \ell(x(t), x^*)$. For $t$ small enough that $x(t) \in B_\varepsilon(x^*)$, we have

$$f(x(t)) = f(x^*) + Df_{c(t)}v > f(x^*),$$

showing that $x^*$ is not a maximum, just as in Figure 18.5.1. This contradicts our hypothesis and so establishes that $T_{x^*}M \subset T_{x^*}F$.

Now for any pair of sets in $\mathbb{R}^m$, $A \subset B$ implies $B^\perp \subset A^\perp$, where $A^\perp$ denotes the orthogonal complement, the set of vectors perpendicular to every vector in $A$.\(^5\)

Applying this to the tangent spaces, we find $(T_{x^*}F)^\perp \subset (T_{x^*}M)^\perp$. This implies $Df(x^*) \in (T_{x^*}M)^\perp$. Since $Df$ is in the span of $Dh$, there are $\mu_j^*$, $j = 1, \ldots, \ell$ obeying

$$Df(x^*) = \sum_{j=1}^\ell \mu_j^* Dh_j(x^*).$$

By NDCQ, $\text{rank } Dh(x^*) = \ell$. This means the $\ell$ vectors $Dh_j$ are linearly independent, implying that the $\mu_j^*$ are unique. ■

\(^5\)Suppose $A \subset B$. The orthogonal complement of $A$ is the set of all vectors perpendicular to everything in $A$. That is, $A^\perp = \{x : x \cdot a = 0 \text{ for all } a \in A\}$. Since $A \subset B$, there are additional conditions that must be met to be in $B^\perp$. Such vectors must not only be perpendicular to all elements of $A$, but also those elements of $B$ that are not in $A$. So $B^\perp \subset A^\perp$. 
18.10 The Lagrangian

The first order conditions for an optimum are usually written using the Lagrangian,

\[ \mathcal{L}(x, \mu) = f(x) - \mu^T(h(x) - c) = f(x) - \sum_{j=1}^\ell \mu_j (h_j(x) - c_j). \]

This allows us to rewrite the key conclusions of the Tangent Space Theorem as follows.\(^6\)
18.11 The Lagrangian and Optimization

**Theorem 18.11.1.** Let \( U \subset \mathbb{R}^m \) and \( f: U \to \mathbb{R}, \ h: \mathbb{R}^m \to \mathbb{R}^\ell \) be \( C^1 \) functions. Suppose that \( x^* \) solves

\[
\max \ (\min) \ f(x) \\
\text{s.t.} \ h_j(x) = c_j, \ \text{for} \ i = 1, \ldots, \ell
\]

and that \( \text{rank} \ D h(x^*) = \ell \) holds, the non-degenerate constraint qualification condition (NDCQ). Then there are unique multipliers \( \mu^* \) such that \((x^*, \mu^*)\) is a critical point of the Lagrangian \( \mathcal{L} \):

\[
\mathcal{L}(x, \mu) = f(x) - \mu^T(h(x) - c).
\]

That is,

\[
\frac{\partial \mathcal{L}}{\partial x_i}(x^*, \mu^*) = 0 \quad \text{for} \ i = 1, \ldots, m, \ \text{and}
\]

\[
\frac{\partial \mathcal{L}}{\partial \mu_j}(x^*, \mu^*) = 0 \quad \text{for} \ j = 1, \ldots, \ell.
\]

**Proof.** If \( Df(x^*) \neq 0 \), this follows immediately from the Tangent Space Theorem.

If \( Df(x^*) = 0 \), the fact that \( \text{rank} \ D h(x^*) = \ell \) means that the \( \ell \) rows of \( D h \) are linearly independent, so \( \mu^* = 0 \) is the unique vector with

\[
Df(x^*) = (\mu^*)^T D h(x^*) = \sum_{j=1}^{\ell} \mu_j D h_j(x^*).
\]
18.12 Solving a Simple Consumer’s Problem, Part I

Consider the consumer’s problem

\[ v(p, 100) = \max_x u(x) \]

s.t. \( p \cdot x = 100 \)

where \( p \in \mathbb{R}^3_{++} \) and

\[ u(x) = \begin{cases} 
  x_1^{1/6} x_2^{1/2} x_3^{1/3} & \text{when } x_1, x_2, x_3 \geq 0 \\
  0 & \text{otherwise.}
\end{cases} \]

Since \( m > 0 \), any solution other than zero must have every \( x_i > 0 \). Theorem 30.3.1 then ensures that this problem has a solution.

In many economic problems, we will make assumptions that have an impact on optimization via the Lagrangian. Here, \( Dh = p \gg 0 \). The NDCQ condition is satisfied.

Now we form the Lagrangian

\[ \mathcal{L}(x_1, x_2, x_3, \mu_1) = x_1^{1/6} x_2^{1/2} x_3^{1/3} - \mu(p \cdot x - 100) \]

Critical points of the Lagrangian must obey

\[ \frac{u(x)}{6x_1} = \mu p_1, \quad \frac{u(x)}{2x_2} = \mu p_2, \quad \frac{u(x)}{3x_3} = \mu p_3, \quad p \cdot x = 100 \]

Another important feature of this problem is that income is positive. With positive price, that means that the budget line contains points that are strictly positive. For a Cobb-Douglas utility function, as we have here, this means that the maximum utility is positive and that \( x^* \gg 0 \). As a result \( Du(x^*) \gg 0 \). It follows from the first order equations above that \( \mu^* > 0 \).
18.13 Solving a Simple Consumer’s Problem, Part II

We can rewrite the first three equations by dividing them in pairs, eliminating both \( \mu \) and \( u(x) \). Thus

\[
\frac{x_2}{3x_1} = \frac{p_1}{p_2}, \quad \frac{x_3}{2x_1} = \frac{p_1}{p_3}, \quad \frac{3x_3}{2x_2} = \frac{p_2}{p_3}
\]

The third equation is redundant, being the ratio of the other two. That leaves us with

\[
p_2x_2 = 3p_1x_1 \quad \text{and} \quad p_3x_3 = 2p_1x_1. \quad (18.13.1)
\]

Notice that \( x_1 \) determines \( x_2 \) and \( x_3 \) in equation (18.13.1). Substituting in our remaining equation, the budget constraint, we obtain

\[
p \cdot x = p_1x_1 + 3p_1x_1 + 2p_1x_1 = 6p_1x_1 = 100.
\]

Then by equation (18.13.1),

\[
x_1 = \frac{100}{6p_1}, \quad x_2 = \frac{100}{2p_2}, \quad x_3 = \frac{100}{3p_3}
\]

This implies the indirect utility function is

\[
v(p, 100) = u(x^*) = \frac{100}{(6p_1)^{1/6}(2p_2)^{1/2}(3p_3)^{1/3}}
\]

The multiplier \( \mu^* \) is also easily calculated and is positive.

\[
\mu^* = \frac{u(x^*)}{100} = \frac{1}{(6p_1)^{1/6}(2p_2)^{1/2}(3p_3)^{1/3}}.
\]
18.14 Solving Standard Consumer’s Problems

The basic steps used to solve the problem above pertain to many standard consumer’s problems.

The steps were:

1. Rewrite the first order conditions as \( \text{MRS}_{ij} = \frac{p_i}{p_j} \) to eliminate the multiplier \( \mu \).
2. Write spending on each good in terms of spending on good one.
3. Substitute into the budget constraint so that everything is in terms of good one.
4. Solve for \( x_1 \), then substitute back to solve for the other \( x_j \), and anything else that needs to be calculated (e.g., multipliers).

This often suffices to solve the problem, provided the equations involved are tractable.
18.15 Inequality Constraints: Binding or Not

Although our simple consumer’s problem in $\mathbb{R}^3$ involved only a single equality constraint, that is not typical. The consumer’s problem in $\mathbb{R}^3$ usually involves four inequality constraints—three non-negativity constraints and the budget constraint. Other economics problems, such as the firm’s cost minimization problem, or the consumer’s expenditure minimization problem also use inequality constraints.

It will be helpful to distinguish cases where a particular constraint matters and where it does not. We say that a constraint $g(x) \leq b$ binds at $x^*$ if $g(x^*) = b$. Otherwise the constraint is non-binding.

The binding constraints are the ones that matter.
18.16 A Single Inequality Constraint

Let’s start by investigating the case of a single inequality constraint. We will write the maximization problem in the following form:

$$\max_x u(x)$$

subject to $$g(x) \leq b$$

Figure 18.16.1 illustrates two possibilities that we need to consider. It shows that the sign of the multiplier matters when we have an inequality constraint. Both $$\nabla u$$ and $$\nabla g$$ must point in the same direction, otherwise we find ourselves minimizing utility over the constraint set as in the right panel of Figure 18.16.1.

*Figure 18.16.1:* Here $$x^*$$ is the consumer’s utility maximum with $$u(x^*) = u_2$$. At the maximum, the vectors $$\nabla g(x^*)$$ and $$\nabla u(x^*)$$ are collinear, with the heavier arrow being $$\nabla u(x^*)$$. With an inequality constraint, like we have here, the two vectors must point in the same direction. Then $$\nabla u(x^*) = \lambda \nabla g(x^*)$$ for some $$\lambda \geq 0$$.

If $$\nabla g(x^*)$$ pointed in the opposite direction, it would mean that the region above $$u_2$$ would have lower values of $$g$$, as shown in the right panel. In that case utility is not maximized at $$x^*$$, since higher indifference curves such as $$u_3$$ can be attained.

Another way to think about it is that when $$\nabla u(x^*) = -\lambda \nabla g(x^*)$$ for $$\lambda > 0$$, a small move in the $$\nabla u(x^*)$$ direction will reduce $$g$$, and move into the interior of the constraint set while increasing utility. Even if $$\lambda = 0$$, we can still increase utility for free. As in the proof of the Tangent Space Theorem, the Mean Value Theorem can be used to show this formally.
18.17 Inequality Constraints: Complementary Slackness

The Tangent Space Theorem can be easily modified to ensure that the multiplier is non-negative. However, there is another issue that might arise. The point $x^*$ could be in the interior of the constraint set, where $g(x^*) < b$. The Tangent Space Theorem does not apply there. However, $x^*$ is then an interior point, so $Du(x^*) = 0$.

This can be interpreted as the multiplier being zero, just as we did in the equality constraint case when $Df(x^*) = 0$.

There is a useful condition that lets us package this up using the Lagrangian framework. We impose the complementary slackness condition that

$$\lambda (g(x) - b) = 0.$$ 

If the constraint $g(x) \leq b$ binds, the complementary slackness condition tells us nothing. It’s already zero. If the constraint doesn’t bind, we have $g(x) - b < 0$. This forces the corresponding multiplier to be zero. This trick also works if we have several inequality constraints.
18.18 Maximization with Complementary Slackness

We sum up our discussion of complementary slackness in the following theorem.

**Theorem 18.18.1.** Let \( U \subset \mathbb{R}^m \) and suppose \( f : U \to \mathbb{R} \) and \( g : U \to \mathbb{R}^k \) are \( C^1 \) functions. Suppose that \( x^* \) solves

\[
\max_x f(x) \\
\text{s.t. } g_i(x) \leq b_i.
\]

and that \( \hat{k} \leq k \) constraints bind at \( x^* \). Let \( \hat{g} \) be the vector of functions defining the binding inequality constraints at \( x^* \) and \( \hat{b} \) the corresponding constant terms. Form the Lagrangian \( \mathcal{L} \):

\[
\mathcal{L}(x, \lambda) = f(x) - \lambda^T (\hat{g}(x) - \hat{b}).
\]

If rank \( D\hat{g}(x^*) = \hat{k} \) holds (NDCQ), then there are multipliers \( \lambda^* \) such that

(a) The pair \( (x^*, \lambda^*) \) is a critical point of the Lagrangian:

\[
\frac{\partial \mathcal{L}}{\partial x_i}(x^*, \lambda^*) = 0 \quad \text{for } i = 1, \ldots, m \\
\frac{\partial \mathcal{L}}{\partial \lambda_j}(x^*, \lambda^*)g_j(x^*) - c_j = 0 \quad \text{for } j = 1, \ldots, k,
\]

(b) The complementary slackness conditions hold:

\[
\lambda^*_i [g_i(x^*) - b_i] = 0 \quad \text{for } i = 1, \ldots, k
\]

(c) The multipliers are non-negative: \( \lambda^*_1 \geq 0, \ldots, \lambda^*_k \geq 0 \),

(d) The constraints are satisfied: \( g(x^*) \leq b \).
18.19 Equality Constraint? Or Two Inequality Constraints?

Now that we have a new tool, inequality constraints, you might be tempted to view an equality constraint as two inequality constraints. For example, you can write

\[ p_1 x_1 + p_2 x_2 = m \]

as

\[ p_1 x_1 + p_2 x_2 \leq m \]
\[ -p_1 x_1 - p_2 x_2 \leq -m. \]

This doesn’t work. It runs afoul of the NDCQ. When both bind, as they must if both are obeyed, we have

\[ D \hat{g} = \begin{pmatrix} p_1 & p_2 \\ -p_1 & -p_2 \end{pmatrix}. \]

This has rank 1 when it needs rank 2. In this case, the failure of constraint qualification is minor. If you do this with Cobb-Douglas utility, you won’t be able to uniquely determine the two multipliers. However, you can determine their difference.
18. CONSTRAINED OPTIMIZATION I: FIRST ORDER CONDITIONS

18.20 Solving a Cobb-Douglas Consumer’s Problem I

The key to understanding how to use Theorem 18.18.1 is that complementary slackness conditions are a way of checking all the possible cases where some, but not all, constraints bind. Let’s look at a concrete problem in $\mathbb{R}^2$ to see how this works. Our problem is a consumer’s utility maximization problem with a particular Cobb-Douglas utility function.

$$\max_x x_1^{1/3} x_2^{2/3}$$

s.t. $p_1 x_1 + p_2 x_2 \leq m$
$$x_1 \geq 0, x_2 \geq 0.$$ 

Where $p_1, p_2, m > 0$.

We form the Lagrangian by first rewriting the non-negativity constraints in the proper form: $-x_1 \leq 0, -x_2 \leq 0$. The Lagrangian is

$$\mathcal{L} = u(x) - \lambda_0(p_1 x_1 + p_2 x_2 - m) - \lambda_1(-x_1) - \lambda_2(-x_2)$$
$$= u(x) - \lambda_0(p_1 x_1 + p_2 x_2 - m) + \lambda_1 x_1 + \lambda_2 x_2.$$ 

In utility maximization problems, non-negativity constraints always yield terms of the form $+\lambda_i x_i$. 
18.21 Solving a Cobb-Douglas Consumer’s Problem II

We now turn to constraint qualification. Consider

\[
Dg = \begin{pmatrix}
  p_1 & p_2 \\
  -1 & 0 \\
  0 & -1
\end{pmatrix}
\]

Now if only constraint \(i\) binds, we must have \(Dg_i(x^*) \neq 0\), and we do. If two constraints bind, the matrix \(Dg(x^*)\) obtained by deleting the non-binding row must be invertible, which it is. It is not possible for all three constraints to bind at once as we would have \(0p_1 + 0p_2 = m > 0\). The NDCQ condition is satisfied no matter which set of constraints binds.

Figure 18.21.1 shows how the various constraints relate.

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**Figure 18.21.1**: Without complementary slackness, we would have to check separately for maxima seven ways: at each of the three corner points, in the relative interior of each of the three boundary segments of the budget set, and in the interior of the budget set.
18.22 Solving a Cobb-Douglas Consumer’s Problem III

Now differentiate $L$ with respect to $x_1$ and $x_2$.

$$0 = \frac{\partial L}{\partial x_1} = \frac{1}{3} \left( \frac{x_2}{x_1} \right)^{2/3} - \lambda_0 p_1 + \lambda_1$$

$$0 = \frac{\partial L}{\partial x_2} = \frac{2}{3} \left( \frac{x_1}{x_2} \right)^{1/3} - \lambda_0 p_2 + \lambda_2.$$

With $m > 0$, we know that positive utility is possible. Positive utility requires both $x_1 > 0$ and $x_2 > 0$. The complementary slackness conditions for the non-negativity constraints are $\lambda_1 x_1 = 0$ and $\lambda_2 x_2 = 0$ which imply $\lambda_1^* = \lambda_2^* = 0$.

We can now simplify the first order conditions:

$$\lambda_0 p_1 = \frac{1}{3} \left( \frac{x_2}{x_1} \right)^{2/3}$$

$$\lambda_0 p_2 = \frac{2}{3} \left( \frac{x_1}{x_2} \right)^{1/3} \quad (18.22.2)$$

Because the right-hand side must be positive at $x^*$, $\lambda_0 > 0$. Complementary slackness for $\lambda_0$ now yields $p_1 x_1 + p_2 x_2 = m$. The budget constraint must bind. At this point, we have used complementary slackness to reduce the possible locations of solutions to a single region, the relative interior of the budget frontier.
18.23 Solving a Cobb-Douglas Consumer’s Problem IV

We now eliminate \( \lambda_0 \) from the first order conditions of equation (18.22.2) by dividing the top line by the bottom line.

\[
\frac{p_1}{p_2} = \frac{1}{2} \frac{x_2}{x_1}
\]

implying

\[
p_1 x_1 = \frac{1}{2} p_2 x_2.
\]

We substitute in the budget constraint to find \( 3p_1 x_1 = m \), so the Marshallian demands are

\[
x_1^* = \frac{m}{3p_1} \quad \text{and} \quad x_2^* = \frac{2m}{3p_2}.
\]

Substituting in equation (18.22.2), we find

\[
\lambda_0^* = \frac{2^{2/3}}{3p_1^{1/3} p_2^{2/3}}.
\]

Finally, the indirect utility function is

\[
v(p, m) = u(x_1^*, x_2^*) = \frac{2^{2/3} m}{3p_1^{1/3} p_2^{2/3}}.
\]
18.24 Complementary Slackness Gone Wild: I

Let’s try to maximize a linear utility function in $\mathbb{R}_+^3$. One thing that’s different about this problem is that it is purely an exercise in complementary slackness.

The problem is:

$$\max_{x} u(x) = a_1 x_1 + a_2 x_2 + a_3 x_3$$

s.t. $p_1 x_1 + p_2 x_2 + p_3 x_3 \leq m$

$x_1 \geq 0, x_2 \geq 0, x_3 \geq 0$.

Where $p \gg 0$, $m > 0$, and each $a_i > 0$. Theorem 30.3.1 guarantees that the problem has a solution via Weierstrass’s Theorem.

We next check constraint qualification. Here

$$Dg = \begin{pmatrix} p_1 & p_2 & p_3 \\ -1 & 0 & 0 \\ 0 & -1 & 0 \\ 0 & 0 & -1 \end{pmatrix}.$$ 

It is impossible for all four constraints to bind. If they did, we would have $x_1 = x_2 = x_3 = 0$ and $0 = p \cdot x = m > 0$. Any collection of 1, 2, or 3 rows of $Dg$ is linearly independent, so constraint qualification (NDCQ) is satisfied everywhere else.
The Lagrangian is

\[ \mathcal{L} = a_1 x_1 + a_2 x_2 + a_3 x_3 - \lambda_0 (p \cdot x - m) + \lambda_1 x_1 + \lambda_2 x_2 + \lambda_3 x_3. \]

We compute the first order conditions:

\[ 0 = \frac{\partial \mathcal{L}}{\partial x_1} = a_1 - \lambda_0 p_1 + \lambda_1 \]
\[ 0 = \frac{\partial \mathcal{L}}{\partial x_2} = a_2 - \lambda_0 p_2 + \lambda_2 \]
\[ 0 = \frac{\partial \mathcal{L}}{\partial x_3} = a_3 - \lambda_0 p_3 + \lambda_3. \]

We then rewrite the first order conditions as

\[ \lambda_0 p_1 = a_1 + \lambda_1 \]
\[ \lambda_0 p_2 = a_2 + \lambda_2 \]
\[ \lambda_0 p_3 = a_3 + \lambda_3. \]

At this point, you may be wondering how to proceed with such first order conditions. None of the variables are in the first order equations! None!

What can we do?
What can we possibly do??
18.26 Complementary Slackness Gone Wild: III

The solution is to use complementary slackness.

To recapitulate, we have the following first order conditions:

\[
\begin{align*}
\lambda_0 p_1 &= a_1 + \lambda_1 \\
\lambda_0 p_2 &= a_2 + \lambda_2 \\
\lambda_0 p_3 &= a_3 + \lambda_3.
\end{align*}
\tag{18.26.3}
\]

Now \( \lambda_1 \geq 0 \), so \( \lambda_0 p_0 \geq a_1 > 0 \). This implies \( \lambda_0 > 0 \). Complementary slackness tells us that

\[
\lambda_0 (p \cdot x - m) = 0.
\]

Since \( \lambda_0 > 0 \), that means \( p \cdot x = m > 0 \). The consumer spends their entire budget.

At this point, we don’t know whether or not the maximum is in the relative interior of the budget frontier.

Figure 18.26.1: The budget frontier is the green triangle in \( \mathbb{R}^3 \) with vertices \((m/p_1, 0, 0)\), \((0, m/p_2, 0)\), and \((0, 0, m/p_3)\).
Dividing each line of equation (18.26.3) by $p_i$ tells us

\[
\lambda_0 = \frac{a_1}{p_1} + \frac{\lambda_1}{p_1} \geq \frac{a_1}{p_1}
\]
\[
\lambda_0 = \frac{a_2}{p_2} + \frac{\lambda_2}{p_2} \geq \frac{a_2}{p_2}
\]
\[
\lambda_0 = \frac{a_3}{p_3} + \frac{\lambda_3}{p_3} \geq \frac{a_3}{p_3}.
\]  

(18.27.4)

Then

\[
\lambda_0 \geq \max_{i=1,2,3} \{a_i/p_i\}.
\]

If $\lambda_0 > \max_{i=1,2,3} \{a_i/p_i\}$, then each $\lambda_i > 0$ for $i = 1, 2, 3$. Complementary slackness requires that $\lambda_i x_i = 0$ for $i = 1, 2, 3$, implying that $x_1 = x_2 = x_3 = 0$. But this is impossible because we know that $p \cdot x = m > 0$.

At least one $x_i$ must be positive, and for that $i$, $\lambda_0 = a_i/p_i$. So we can write

\[
\lambda_0 = \max_{i=1,2,3} \left\{ \frac{a_i}{p_i} \right\}.
\]
18.28 Complementary Slackness Gone Wild: V

We are now prepared to find the solution. If \( a_i / p_i < \lambda_0, \lambda_i > 0 \) and so \( x_i = 0 \). The only goods that are consumed are goods \( h \) for which

\[
\frac{a_h}{p_h} = \max_{i=1,2,3} \left\{ \frac{a_i}{p_i} \right\}.
\]

There is at least one such good. There may be 2 or 3, depending on the \( a_i \)'s and \( p_i \)'s. If goods one and two are both consumed and good three is not consumed, then

\[
u(x) = a_1 x_1 + a_2 x_2 = \lambda_0 p_1 x_1 + \lambda_0 p_2 x_2 = \lambda_0 m.
\]

Utility doesn’t depend on how consumption is distributed between the goods that are consumed, so there are many solutions when 2 or 3 goods maximize \( a_i / p_i \).

That principle applies regardless of which goods are consumed. Therefore the solution to the problem is that our consumer consumes only goods \( h \) obeying \( a_h / p_h = \max_i \{a_i / p_i\} \), and the any distribution of consumption over those goods that spends all of the available income \( m \) is optimal.
18.29 Example: Quasi-linear Utility I

Now consider maximizing the quasi-linear utility function \( u(x, y) = x + \sqrt{y} \). We must solve:

\[
\begin{align*}
\max_x & \quad x + \sqrt{y} \\
\text{s.t.} & \quad p_xx + p_yy \leq m \\
& \quad x \geq 0, y \geq 0.
\end{align*}
\]

As in the last two problems, and most standard consumer’s problems, the NDCQ condition is satisfied. The Lagrangian is

\[
\mathcal{L} = x + \sqrt{y} - \lambda_0(p_xx + p_yy - m) + \lambda_xx + \lambda_yy
\]

yielding first order conditions

\[
\begin{align*}
0 &= \frac{\partial \mathcal{L}}{\partial x} = 1 - \lambda_0 p_x + \lambda_x \\
0 &= \frac{\partial \mathcal{L}}{\partial y} = -\frac{1}{2\sqrt{y}} + \lambda_y.
\end{align*}
\]
18.30 Example: Quasi-linear Utility II

We rewrite equation (18.29.5) as

\[
\begin{align*}
\lambda_0 p_x &= 1 + \lambda_x \\
\lambda_0 p_y &= \frac{1}{2\sqrt{y}} + \lambda_y.
\end{align*}
\]

(18.30.6)

The top line of equation (18.30.6) implies \( \lambda_0 \geq 1/p_x > 0 \). By complementary slackness, the budget constraint must bind: \( p_x x + p_y y = m \). This is the usual result in standard consumer’s problems.

There are now three cases to consider, depending on which constraints bind. **We organize these based on the variables.** This is usually better than trying to organize based on the multipliers because when a multiplier is zero, that constraint may still bind. The values of the multipliers do not translate nicely into information about which constraints bind.

The cases to consider are

I. \( x > 0 \) and \( y = 0 \),
II. \( x = 0 \) and \( y > 0 \), and
III. \( x > 0 \) and \( y > 0 \).

By using complementary slackness, we have reduced the original seven cases to three.
18.31 Example: Quasi-linear Utility III

Our first order conditions are

\[ \lambda_0 p_x = 1 + \lambda_x \]
\[ \lambda_0 p_y = \frac{1}{2\sqrt{y}} + \lambda_y. \]  

(18.30.6)

**Case I:** Here \( x > 0 \) and \( y = 0 \). The complementary slackness condition \( \lambda_x x = 0 \) tells us that \( \lambda_x = 0 \). By the top line of equation (18.30.6), \( \lambda_0 = 1/p_x \). The second equation of equation (18.30.6) becomes

\[ p_y/p_x = \frac{1}{2\sqrt{y}} + \lambda_y. \]

But this is impossible to satisfy since \( y = 0 \). **Case I is out.**

**Case II:** Here \( x = 0 \) and \( y > 0 \). The complementary slackness condition \( \lambda_y y = 0 \) implies \( \lambda_y = 0 \), so the bottom line of equation (18.30.6) becomes

\[ \lambda_0 p_y = \frac{1}{2\sqrt{y}} \]

The budget constraint together with \( x = 0 \) tells us \( y = m/p_y \). It follows that \( \lambda_0 = 1/2\sqrt{p_y m} \). By the top line of equation (18.30.6),

\[ \frac{p_x}{2\sqrt{p_y m}} = 1 + \lambda_x \geq 1. \]

This solution works if \( p_x^2 \geq 4p_y m \).
18.32 Example: Quasi-linear Utility IV

Case III: Here $x, y > 0$. By complementary slackness $\lambda_x = \lambda_y = 0$, so the first order conditions (18.30.6) are

$$\lambda_0 p_x = 1$$
$$\lambda_0 p_y = \frac{1}{2\sqrt{y}}.$$

Then $\lambda_0 = 1/p_x$ and $p_y/p_x = 1/2\sqrt{y}$. It follows that $y = p_x^2/4p_y^2$. Using the budget constraint, we find $p_x x = m - p_y y = m - p_x^2/4p_y$. We’ve assumed $x > 0$, which requires $m - p_x^2/4p_y > 0$. In other words, Case III requires $4p_y m > p_x^2$.

So what happens now? Which solutions do we use.

- Case I didn’t have solutions,
- Case II only worked when $p_x^2 \geq 4p_y m$, and
- Case III required $p_x^2 < 4p_y m$.

It all comes down to the parameter values $p_x, p_y, m$.

Organizing the results by the parameter values, we obtain

$$(x, y) = \begin{cases} 
(0, \frac{m}{p_y}) & \text{when } p_x^2 \geq 4p_y m \text{ (Case II)}, \\
\left( \frac{m}{p_x - p_x^2/4p_y}, \frac{p_x^2}{4p_y} \right) & \text{when } p_x^2 < 4p_y m \text{ (Case III)}. 
\end{cases}$$

If we apply the case III formula to $p_x^2 = 4p_y m$, it agrees with case II.
18.33 Failure of Constraint Qualification I

In some cases, the failure of constraint qualification is quite serious, serious enough that it prevents us from solving the problem as advertised. Consider this example borrowed from section 19.5 of Simon and Blume.

\[
\begin{align*}
\text{max } & \quad x \\
\text{s.t. } & \quad x^3 + y^2 = 0.
\end{align*}
\]

Suppose we blindly charge ahead, setting up the Lagrangian

\[
L = x - \mu(x^3 + y^2).
\]

The critical points of the Lagrangian solve

\[
1 = 3\mu x^2, \quad 0 = 2\mu y, \quad \text{and} \quad x^3 + y^2 = 0.
\]

There are no solutions.

Since \(0 = 2\mu y\), so one of \(\mu\) or \(y\) must be zero. Suppose \(y = 0\). Then \(x = 0\) by the constraint, so \(1 = 3\mu x^2 = 0\), which is impossible. Suppose \(\mu = 0\), we again have \(1 = 0\), another impossibility.

Neither \(y\) nor \(\mu\) can be zero. Our method has failed!
18.34 Failure of Constraint Qualification II

So what went wrong. Constraint qualification fails because $Dh = (3x^2, 2y)$ has a critical point, $(x, y) = (0, 0)$. This is a problem because the maximum is also at $(0, 0)$.

How do we know? The constraint says $x^3 = -y^2$, so $x^3 \leq 0$, implying $x \leq 0$. Of course, we can maximize $x \leq 0$ by setting $x = 0$, which is feasible. All we have to do is set $y = 0$, landing us on the critical point of the constraint.

![Figure 18.34.1](image)

**Figure 18.34.1:** The graph of the constraint is illustrated in the diagram. It’s pretty obvious from the graph that the maximum value of $x$ on the constraint is 0 and occurs at $x^* = (0, 0)$.

In section , we will see that this type of problem can be solved using a modified Lagrangian.
18.35 Mixed Constraints

Finally, we state a combined theorem incorporating both equality and inequality constraints.

**Theorem 18.35.1.** Let $U \subset \mathbb{R}^m$ and suppose $f : U \to \mathbb{R}$, $g : U \to \mathbb{R}^k$, and $h : \mathbb{R}^m \to \mathbb{R}^\ell$ are $C^1$ functions. Suppose that $x^*$ solves

$$\max_x f(x)$$

s.t. $g_i(x) \leq b_i$, for $i = 1, \ldots, k$

$h_j(x) = c_j$, for $i = 1, \ldots, \ell$

and that $\hat{k}$ inequality constraints bind at $x^*$. Let $\hat{g}$ be the vector of functions defining the binding inequality constraints at $x^*$ and $\hat{b}$ the corresponding constant terms. Form the Lagrangian:

$$\mathcal{L}(x, \lambda, \mu) = f(x) - \lambda^T (\hat{g}(x) - \hat{b}) - \mu^T (h(x) - c).$$

Set

$$G(x) = \begin{pmatrix} \hat{g}(x) \\ h(x) \end{pmatrix}$$

If $\text{rank} \, DG(x^*) = \hat{k} + \ell$ holds (NDCQ), then there are multipliers $\lambda^*$ and $\mu^*$ such that

(a) The triplet $(x^*, \lambda^*, \mu^*)$ is a critical point of the Lagrangian:

$$\frac{\partial \mathcal{L}}{\partial x_i}(x^*, \lambda^*, \mu^*) = 0 \quad \text{for } i = 1, \ldots, m$$

$$\frac{\partial \mathcal{L}}{\partial \lambda_i}(x^*, \lambda^*, \mu^*) = \hat{g}(x) - \hat{b} = 0 \quad \text{for } i = 1, \ldots, k \text{ and binding},$$

$$\frac{\partial \mathcal{L}}{\partial \mu_j}(x^*, \lambda^*, \mu^*) = h_j(x) - c_j = 0 \quad \text{for } j = 1, \ldots, \ell,$$

(b) The complementary slackness conditions hold:

$$\lambda_i^* [g_i(x^*) - b_i] = 0 \quad \text{for all } i = 1, \ldots, k$$

(c) The multipliers are non-negative: $\lambda_1^* \geq 0, \ldots, \lambda_k^* \geq 0$,

(d) The constraints are satisfied: $g(x^*) \leq b$ and $h(x^*) = c$.

The constraint involving $h$ appears twice, in both parts (a) and (d).
18.36 Example with Mixed Constraints I

Consider the problem

$$\max_x f(x, y) = x^2 - y^2$$

s.t. $x \geq 0, y \geq 0$

$$x^2 + y^2 = 4.$$ 

The constraint set is compact, and the function is continuous, so it will have both maxima and minima by the Weierstrass Theorem.

The matrix DG will be a submatrix of

$$
\begin{pmatrix}
2x & 2y \\
-1 & 0 \\
0 & -1
\end{pmatrix}.
$$

Any $2 \times 2$ submatrix of this has rank 2 and the top row is positive because $x^2 + y^2 = 4$ and $x, y \geq 0$. Finally, it is impossible for all three constraints to bind, implying the NDCQ condition is satisfied.
18.37 Example with Mixed Constraints II

Form the Lagrangian

\[ \mathcal{L} = x^2 - y^2 - \mu(x^2 + y^2 - 4) + \lambda_x x + \lambda_y y. \]

The first order conditions are

\[
0 = \frac{\partial \mathcal{L}}{\partial x} = 2x - 2x\mu + \lambda_x \\
0 = \frac{\partial \mathcal{L}}{\partial y} = -2y - 2y\mu + \lambda_y \\
0 = \frac{\partial \mathcal{L}}{\partial \mu} = -x^2 - y^2 + 4
\]

The last one is the equality constraint. The solution must also obey the two complementary slackness conditions

\[ \lambda_x x = 0, \quad \lambda_y y = 0 \]

and the non-negativity constraints

\[ x \geq 0, \quad y \geq 0, \quad \lambda_x \geq 0, \quad \lambda_y \geq 0. \]
18.38 Example with Mixed Constraints III

We rewrite the first order conditions

\[2x + \lambda_x = 2\mu x\]
\[2y + 2\mu y = \lambda_y\]

Multiply the first equation by \(x\) and the second by \(y\), obtaining

\[2x^2 + \lambda_x x = 2\mu x^2\]
\[2y^2 + 2\mu y^2 = \lambda_y y\]

Apply complementary slackness to both: \(\lambda_x x = 0\) and \(\lambda_y y = 0\). Then

\[2x^2 = 2\mu x^2\]
\[2y^2 + 2\mu y^2 = 0.\]

From the first equation, if \(x > 0\) then \(\mu = 1\), while according to the second equation, if \(y > 0\), \(\mu = -1\). One of \(x\) and \(y\) must be zero. They can’t both be zero due to the constraint \(x^2 + y^2 = 4\).

That gives us two cases to consider: (I) \(x > 0, y = 0\), and (II) \(y > 0, x = 0\).

Case I: \(x > 0\) and \(y = 0\). Here \(\mu = +1, \lambda_x = 0\) and \(\lambda_y = 0\). Since \(x^2 + y^2 = 4\) and \(x \geq 0\), this solution is \((2, 0)\) with \(f(2, 0) = 4\).

Case II: \(x = 0\) and \(y > 0\). Here \(\mu = -1, \lambda_x = 0\) and \(\lambda_y = 0\). Since \(x^2 + y^2 = 4\) and \(y \geq 0\), this solution is \((0, 2)\) with \(f(0, 2) = -4\).

Based on these results, \((2, 0)\) is the maximum point and \((0, 2)\) is the minimum point.
18.39 Minimization with Inequality Constraints

When we only had equality constraints, the same conditions found critical points for both maxima and minima. That is no longer true when there are inequality constraints as the sign of the associated multipliers depends on whether we are maximizing or minimizing.

There are various ways to handle minimization problems with inequality constraints. One of the more obvious is to maximize $-f$ instead of minimizing $f$. That yields Lagrangian

$$\mathcal{L}(x, \lambda, \mu) = -f(x) - \lambda^T (g(x) - b) - \mu^T (h(x) - c).$$

Multiplying by $-1$, we obtain

$$f(x) + \lambda^T (g(x) - b) + \mu^T (h(x) - c).$$

Since the sign of $\mu$ doesn’t matter, this is equivalent to using the Lagrangian

$$\mathcal{L}_1(x, \lambda, \mu) = f(x) + \lambda^T (g(x) - b) - \mu^T (h(x) - c).$$

where $\lambda \geq 0$ or using

$$\mathcal{L}_2(x, \lambda, \mu) = f(x) - \lambda^T (g(x) - b) - \mu^T (h(x) - c).$$

with $\lambda \leq 0$. Yet another method is the one favored in the book, writing the inequality constraints the opposite way, setting $g' = -g$ and $b' = -b$, yielding constraints $g'(x) \geq b'$ instead of $g(x) \leq b$. We will state the result in this form, which is more natural when thinking about duality.

It doesn’t really matter which form of Lagrangian you use. Just be sure not to mix them!
18.40 Minimization with Mixed Constraints I

Here’s a version of Theorem 18.35.1 that works for minimization problems.

**Theorem 18.40.1.** Let $U \subset \mathbb{R}^m$ and suppose $f: U \to \mathbb{R}$, $g: U \to \mathbb{R}^k$, and $h: \mathbb{R}^m \to \mathbb{R}^\ell$ are $C^1$ functions. Suppose that $x^*$ solves

$$
\min_x f(x) \\
\text{s.t. } g_i(x) \geq b_i, \text{ for } i = 1, \ldots, k \\
h_j(x) = c_j, \text{ for } i = 1, \ldots, \ell
$$

and that $\hat{k}$ constraints bind at $x^*$. Let $\hat{g}$ be the vector of binding inequality constraints at $x^*$ and $\hat{b}$ the corresponding constants. Form the Lagrangian $\mathcal{L}$:

$$
\mathcal{L}(x, \lambda, \mu) = f(x) - \lambda^T (g(x) - \hat{b}) - \mu^T (h(x) - c).
$$

If

$$
\text{rank } D \begin{pmatrix} \hat{g}(x^*) \\ h(x^*) \end{pmatrix} = \hat{k} + \ell
$$

holds (NDCQ), then there are multipliers $\lambda^*$ and $\mu^*$ such that
18.41 Minimization with Mixed Constraints II

Theorem 18.40.1 conclusion.

(a) The triplet \((x^*, \lambda^*, \mu^*)\) is a critical point of the Lagrangian:

\[
\frac{\partial L}{\partial x_i}(x^*, \lambda^*) = 0 \quad \text{for } i = 1, \ldots, m
\]
\[
\frac{\partial L}{\partial \lambda_i}(x^*, \lambda^*, \mu^*) = g_i(x) - b_i = 0 \quad \text{for binding } i = 1, \ldots, k,
\]
\[
\frac{\partial L}{\partial \mu_j}(x^*, \lambda^*, \mu^*) = h_j(x^*) - c_j = 0 \quad \text{for } j = 1, \ldots, \ell,
\]

(b) The complementary slackness conditions hold:

\[
\lambda_i^* \left[ g_i(x^*) - b_i \right] = 0 \quad \text{for all } i = 1, \ldots, k
\]

(c) The multipliers are non-negative:

\[
\lambda_1^* \geq 0, \ldots, \lambda_k^* \geq 0,
\]

(d) The constraints are satisfied: \(g(x^*) \geq b\) and \(h(x^*) = c\).
18.42 A Cost Minimization Problem I

Suppose a firm uses two inputs, \( K \geq 0 \) and \( L \geq 0 \) with Cobb-Douglas production function \( f(K, L) = K^{1/2}L^{1/2} \). The firm tries to produce a quantity \( q > 0 \) of output in the cheapest possible manner, given that the price of \( K \) is \( r \) and the price of \( L \) is \( w \). This gives us the following cost minimization problem:

\[
c(r, w, q) = \min_{(K,L)} K^{1/2}L^{1/2}
\]

s.t. \( K \geq 0, L \geq 0, \quad K^{1/2}L^{1/2} \geq q. \)

For minimization, we use the Lagrangian

\[
\mathcal{L} = rK + wL - \lambda_0(K^{1/2}L^{1/2} - q) - \lambda_K K - \lambda_L L.
\]

The first order conditions are

\[
r = \frac{\lambda_0 L^{1/2}}{2 K^{1/2}} + \lambda_K
\]

\[
w = \frac{\lambda_0 K^{1/2}}{2 L^{1/2}} + \lambda_L.
\]
18.43 A Cost Minimization Problem II

Since \( q > 0 \), we must have both \( K > 0 \) and \( L > 0 \). Then \( \lambda_K = \lambda_L = 0 \) by complementary slackness.

It follows that \( \lambda_0 > 0 \). We now divide the first order conditions to obtain

\[
\frac{w}{r} = \frac{K}{L}.
\]

Then \( (w/r)L = K \). Substituting in the constraint \( K^{1/2}L^{1/2} = q \), we find the solutions, the conditional factor demands

\[
L^* \sqrt{\frac{w}{r}} = q \quad \text{or} \quad L^* = q \sqrt{\frac{r}{w}}
\]

and

\[
K^* = q \sqrt{\frac{w}{r}}.
\]

Finally, the minimum cost is

\[
c(r, w, q) = rK^* + wL^* = 2q \sqrt{rw}.
\]

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