

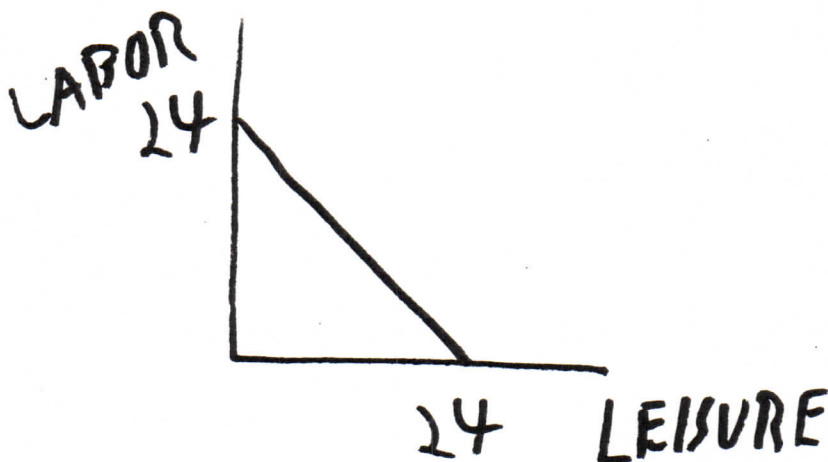
(H.21) CONSUMER CHOICE

- WHY DO PEOPLE DEMAND WHAT THEY DEMAND?
- TRADEOFFS:

ONE GOOD OVER ANOTHER
CONSUME INSTEAD OF SAVINGS
DONATE TO CHARITY OVER CONSUME
LABOR OVER LEISURE

① TOOL 1: BUDGET LINE

- LIMITS OF OUR CONSUMPTION
- " " TIME
- POSSIBLE CONSUMPTION BUNDLES



SUMMER 2008 - ECON. STIMULUS CHECKS - \$600 = I

2 GOODS $\rightarrow$ MOVIE TICKET $\rightarrow P = \$10$

$\hookrightarrow$ "ALL OTHER GOODS" $\rightarrow P = \$1$

ALL
OTHER
GOODS
600
 $\frac{I}{P_Y}$

$\hookleftarrow$ \$600 ON STUFF
 $\hookleftarrow$ \$0 ON MOVIE TIX

$\hookleftarrow$ slope = $\frac{-600}{60} = -10 = \frac{-P_X}{P_Y} = \frac{-10}{1}$

$\hookrightarrow$ RELATIVE PRICES OF GOODS

NEW TICKET PRICE = \$15

SLLOPE = $\frac{-15}{1} = \frac{-P_X}{P_Y}$

$\hookleftarrow$ 60 MOVIE TIX
+ \$0 ON STUFF

NEW I = \$300

$P_X = 10$

$P_Y = 1$

$\frac{I}{P_X} = 40$

$60 = \frac{I}{P_X}$

MOVIE
TICKETS

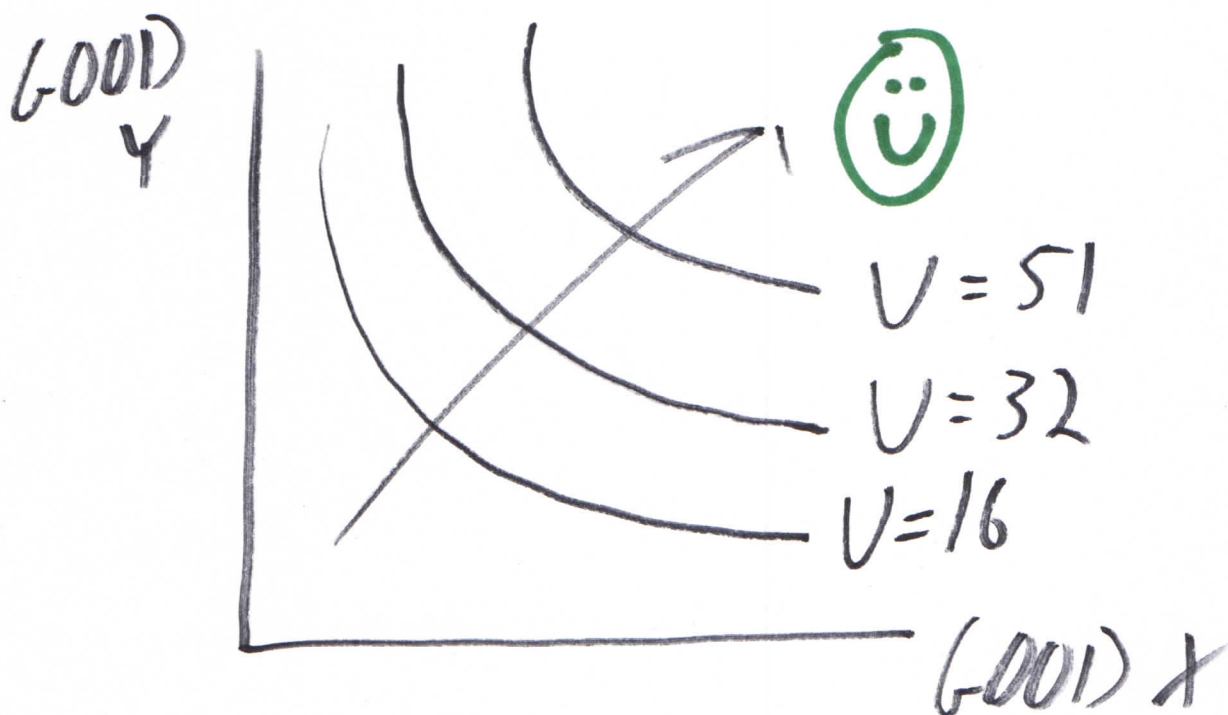
[CH. 21] INDIFFERENCE CURVES

- RANKING OF PREFERENCES
 - DIFFERENT PEOPLE HAVE DIFFERENT PREFERENCES
- THEORY OF UTILITY (HAPPINESS)
- $V = F \times C$
- INDIFFERENCE CURVES SHOW ALL CONSUMPTION BUNDLES ~~THAT~~ THAT PROVIDE THE SAME LEVEL OF UTILITY
- EXAMPLE $\rightarrow U = 16$
 - $1F + 16C, 2F + 8C, 4F + 4C, 8F + 2C$
 - $16F + 1C$

[CH. 21] MORE CONSUMER CHOICE

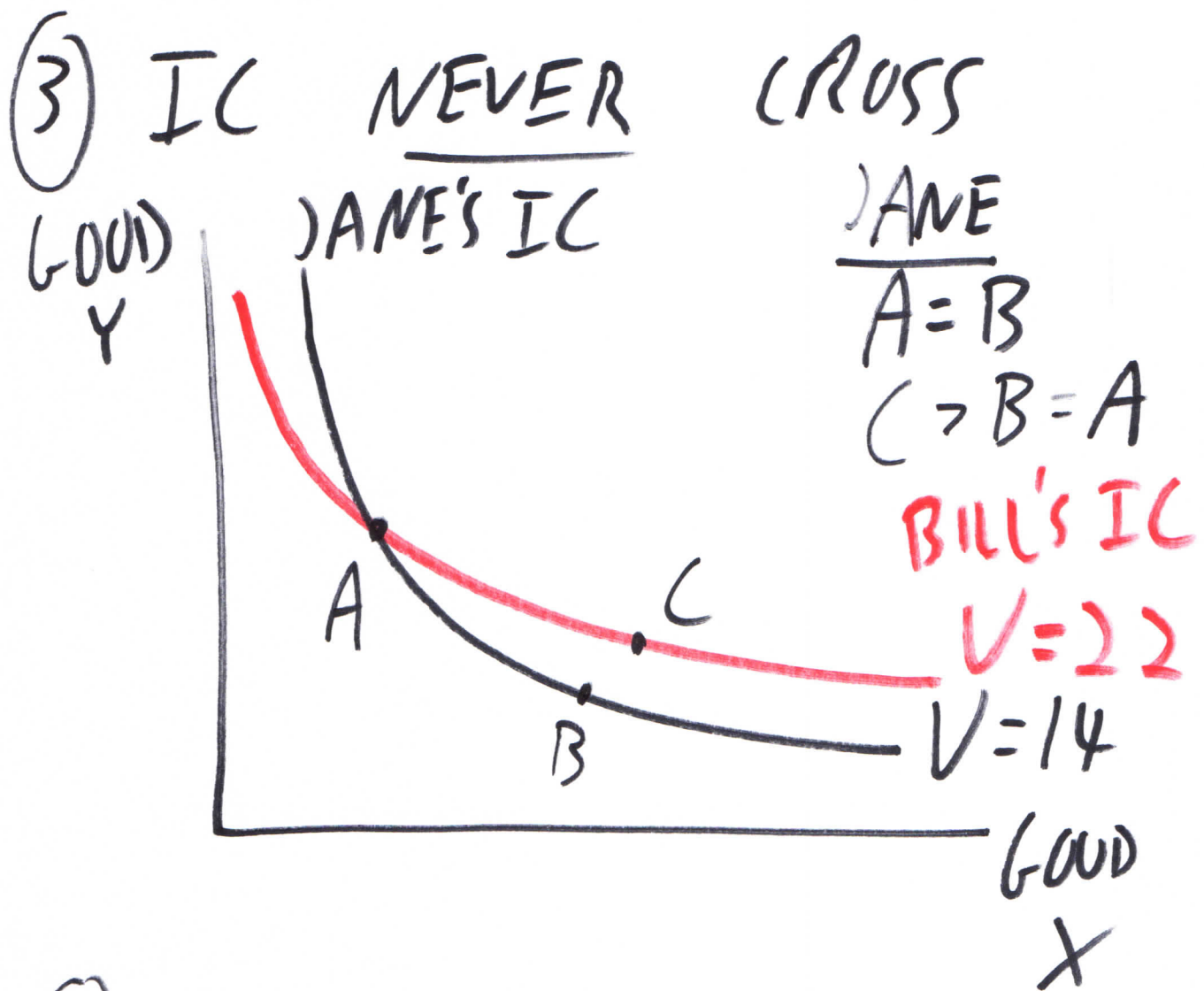
RULES OF INDIFFERENCE CURVES

- ① HIGH INDIFFERENCE CURVES ARE BETTER THAN LOWER IC



- ② IC SLOPE DOWNWARD

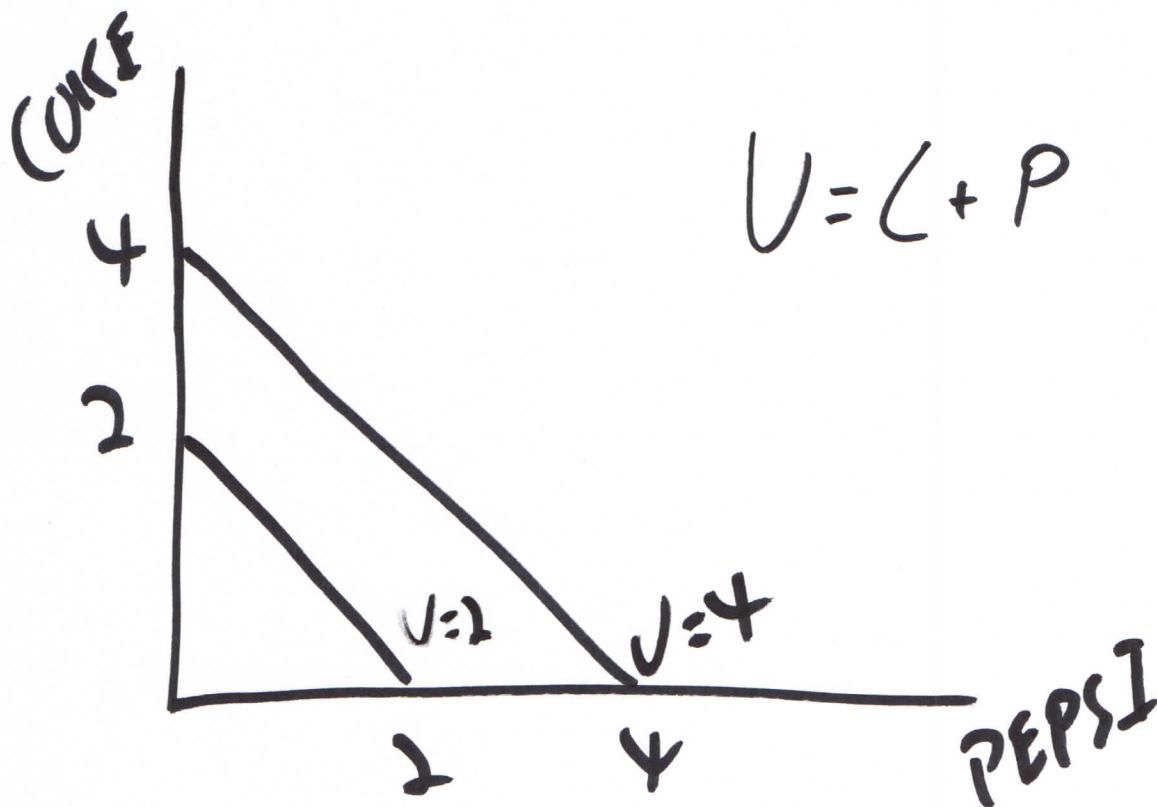
- ④ IC ARE USUALLY BOWED INWARDS



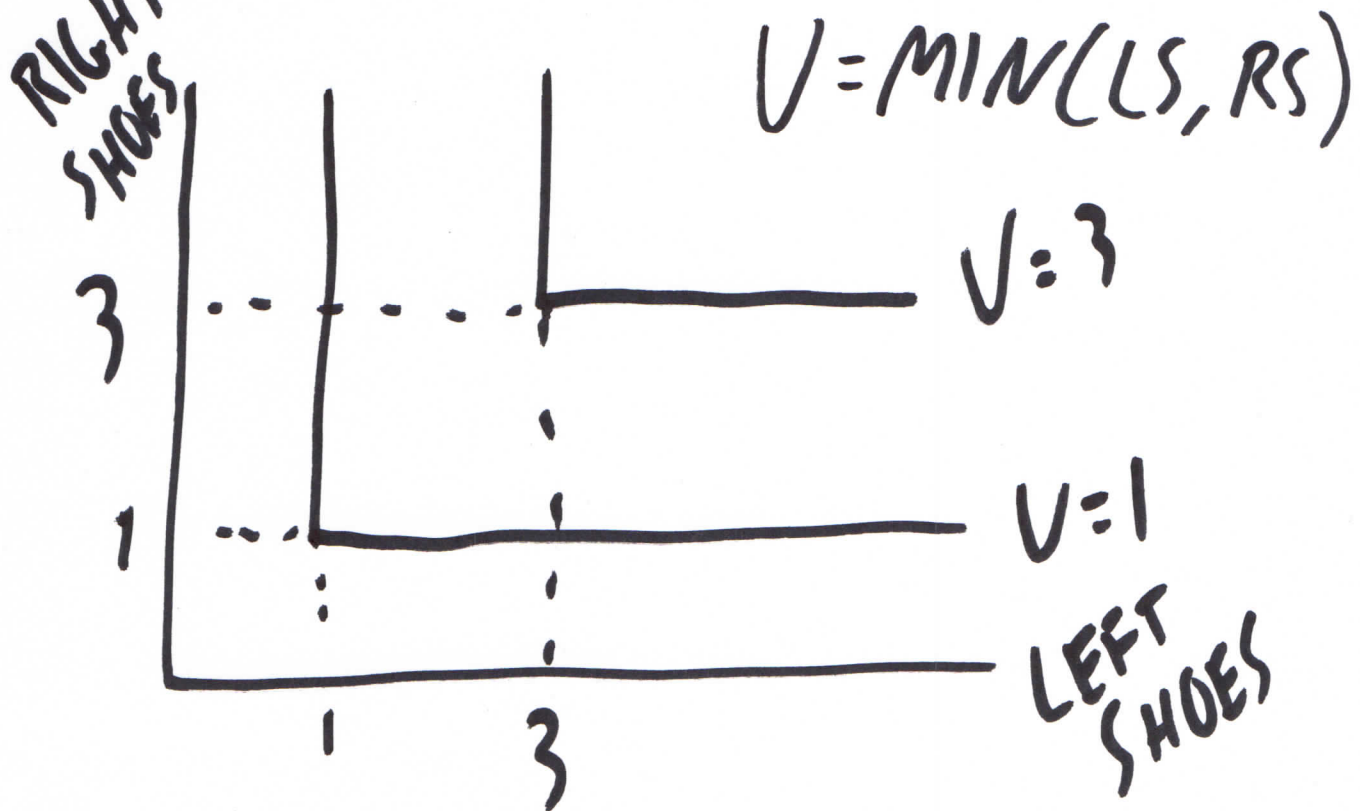
(5) SLOPE IC = MARGINAL RATE OF SUBSTITUTION (MRS)

MRS: THE RATE AT WHICH A CONSUMER WILL SUBSTITUTE ONE GOOD FOR ANOTHER

PERFECT SUBSTITUTES

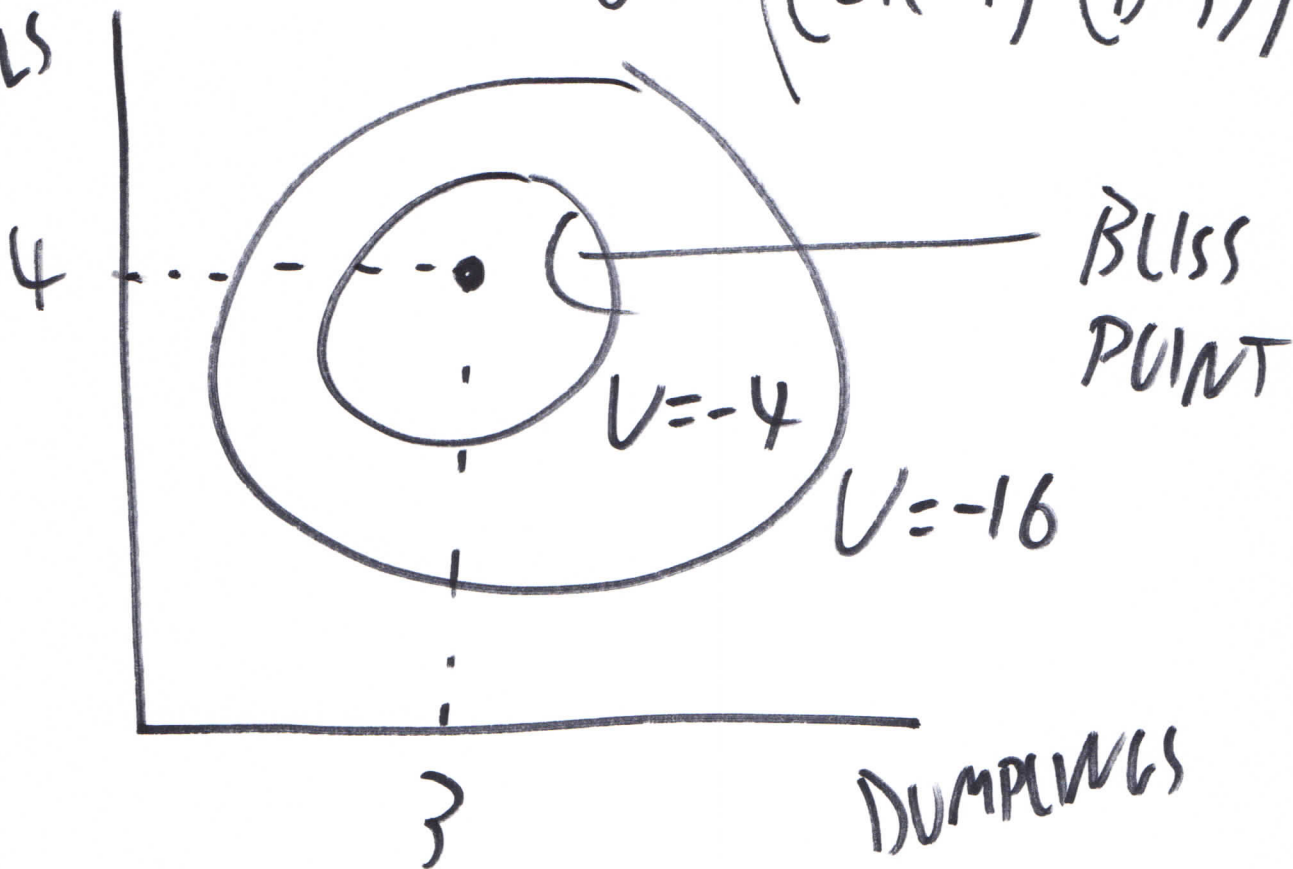


RIGHT PERFECT COMPLEMENTS



EGG
ROLLS

$$U = -((ER - 4)^2 + (D - 3)^2)$$



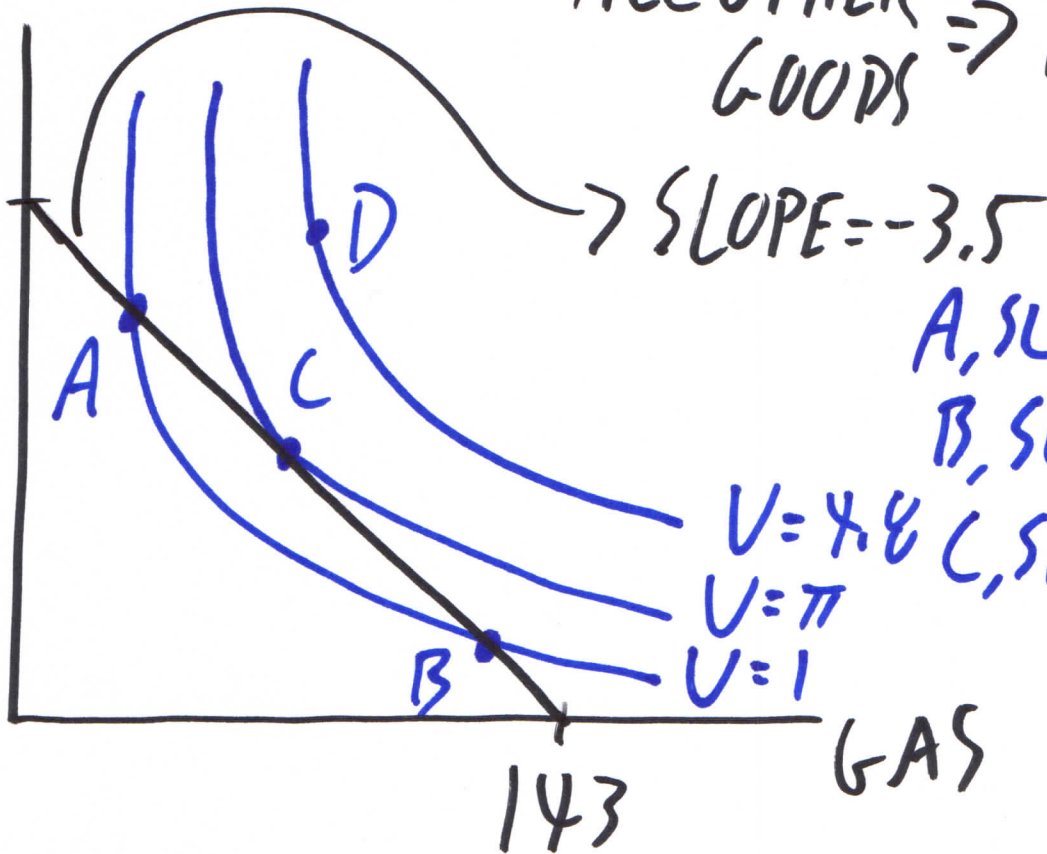
OPTIMIZATION

$$I = 500$$

$$\text{GAS} \Rightarrow \$3.5$$

$$\text{ALL OTHER GOODS} \Rightarrow P_A = 1$$

ALL
OTHER
GOODS
500



$$A, \text{SLOPE} = -10$$

$$B, \text{SLOPE} = -\frac{1}{2}$$

$$C, \text{SLOPE} = -3.5$$

AT OPTIMAL POINT

$$\hookrightarrow \text{SLOPE IC} = \text{SLOPE BC}$$

REVEALED PREFERENCE - WHAT WE

SEE PEOPLE DO (OR BUY) IS THE BEST
ACTION AVAILABLE TO THE
INDIVIDUAL

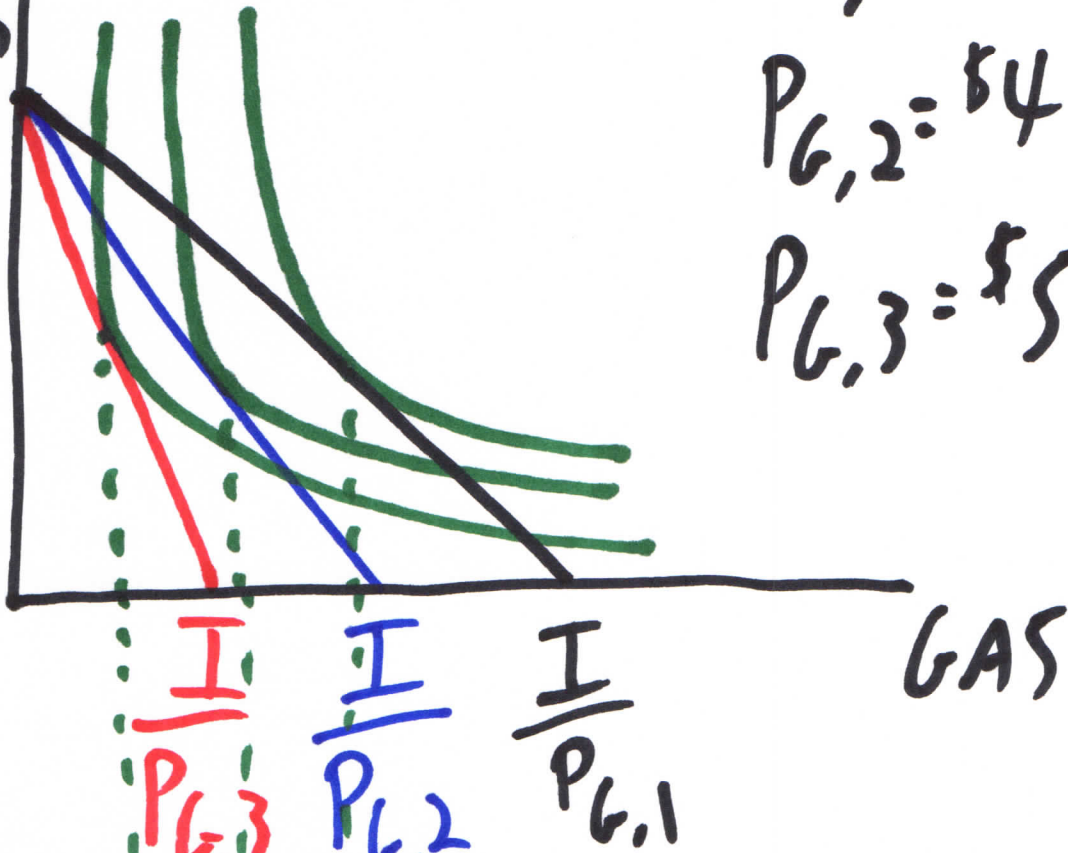
DEMAND FOR GAS

ALL
OTHER
GOODS
I

$$P_{G,1} = \$3$$

$$P_{G,2} = \$4$$

$$P_{G,3} = \$5$$



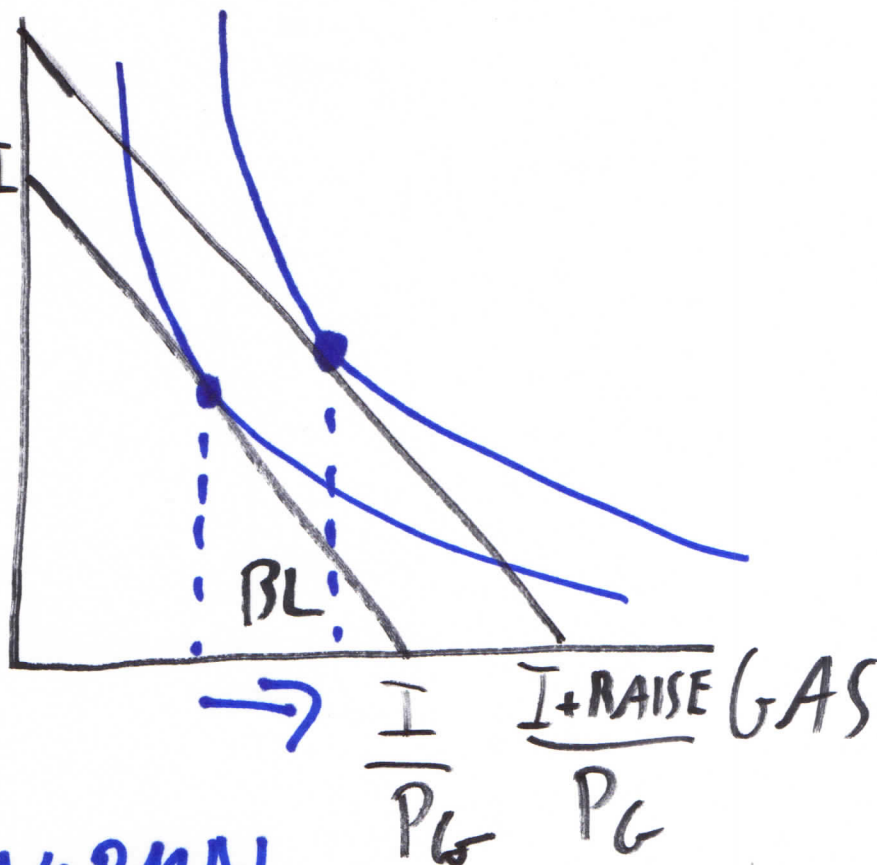
PRICE

\$5
4
3

D_{GAS}

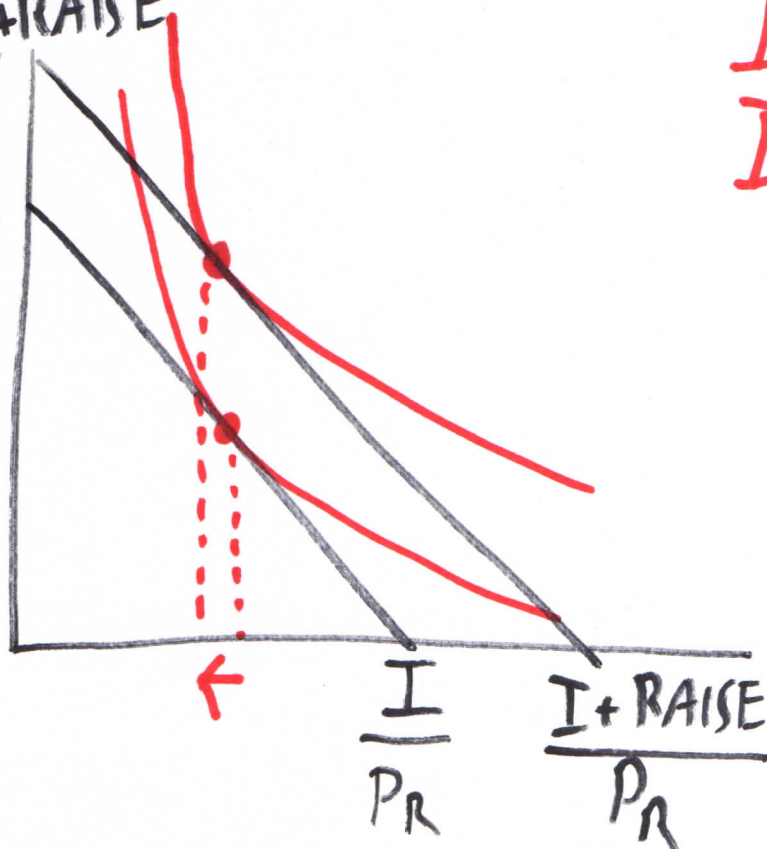
Q_{GAS}

ALL OTHER
GOODS I



NORMAL
 $I \uparrow \rightarrow GAS \uparrow$

ALL OTHER
GOODS I



INFERIOR
 $I \uparrow \rightarrow RAMEN \downarrow$

RAMEN

HEALTH INSURANCE $\rightarrow$ PREMIUM

$\rightarrow$ DEDUCTIBLE

$\rightarrow$ CO-INSURANCE RATE

