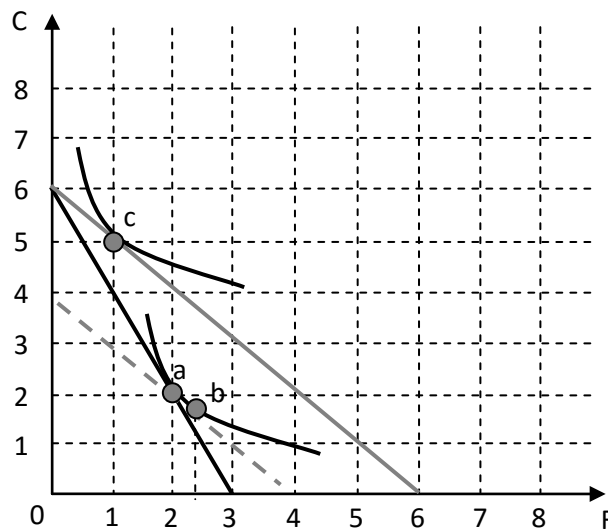


Quiz 2: Consumer Behavior

Answer all the questions in 10 minutes.

1. There are only two goods, C and F, available. A consumer has total income of 12 baht.
 - a) (2 points) Initially, the price of C is $P_C = 2$ baht and the price of F is $P_F = 4$ baht. This consumer consumes at $C^* = 2$ units and $F^* = 2$ units. Draw the budget line and the related indifferent curve of the consumer in the provided diagram. (Point a)
 - b) (2 points) Later, the price of F reduces to $P_F = 2$ baht, while the price of C stays the same. This consumer changes his consumption bundle to $C^{**} = 5$ units and $F^{**} = 1$ unit. Draw the budget line and the related indifferent curve for this case in the provided diagram. (Point c)



- c) (6 points) Decompose income effect and substitution effect of this consumer. Draw the related point(s), line(s), or curve(s) into the provided figure and explain your answer below.

Moving from point a to point b represents the substitution effect. This is because we exclude the change in income by constructing an imaginary budget line with new prices, but at the original real income level (The grey dashed line). Moving from point b to point c represents the income effect. This change occurs with no change in price.

In this case, we can observe that the good F is inferior. The income effect of the good is negative, which means an increase in income, with no change in prices, reduces demand for good F. This makes the two effects work in the opposite direction. As price of F becomes relatively cheaper, substitution effect makes the consumer to consume more F. However, as income effect is negative, the increase in real income causes the reduction in F consumption. The situation in the picture is that income effect is a lot stronger than substitution effect. Hence, we see F as a giffen good. That is as price of F goes down, the amount of F consumption goes down as well.