

WHEN X AND Y ARE PERFECT SUBSTITUTES

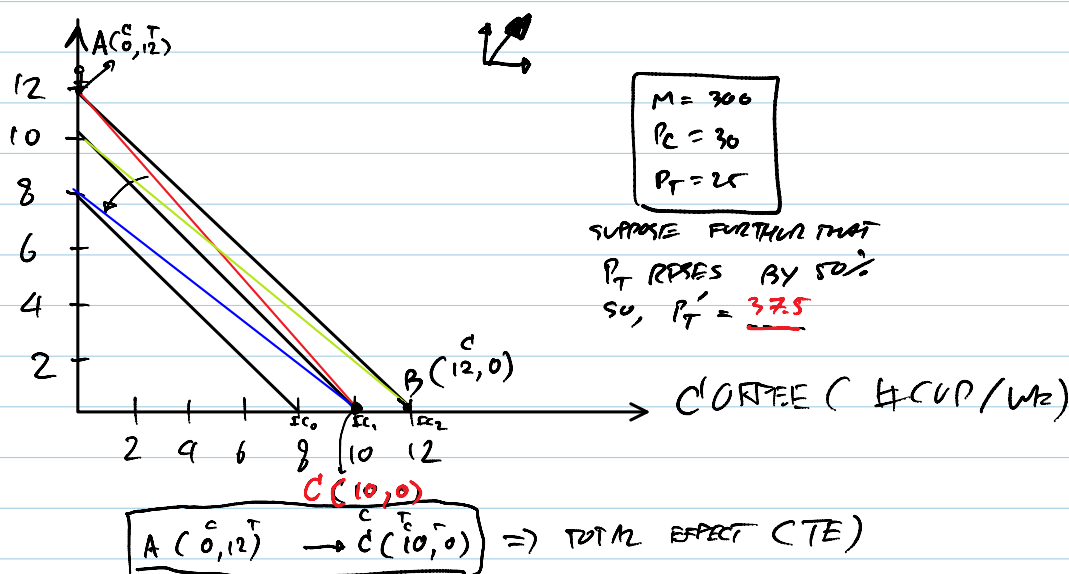
• CONSIDER TWO GOODS: COFFEE & TEA

• SUPPOSE THAT OUR REPRESENTATIVE CONSUMER VIEWS COFFEE & TEA AS "PERFECT SUBSTITUTES"

• $M = 300$ BAHT / WK

$P_C = 30$ BAHT / CUP

TEA (# CUP / WK) $P_T = 25$ BAHT / CAP



FOR SE: WE ASK "FACING THE NEW RELATIVE PRICE, IF THE GUY WERE TO HAVE ENOUGH INCOME TO REMAIN HAPPY AS BEFORE (ON IC_2) HE WOULD CONSUME ONLY COFFEE!!"

$A(0, 12) \rightarrow A'(0, 12) \Rightarrow$ SE

FOR IE: BUT ACTUALLY HIS REAL INCOME OR PURCHASING POWER FALL!, HE COULD ONLY BUY 10 CUPS OF COFFEE.

$A'(0, 12) \rightarrow C(10, 0) \Rightarrow$ IE

IN THIS CASE: SE IS RELATIVELY

$$B(14,0) \rightarrow C(10,0) \Rightarrow IE$$

IN THIS CASE: SE IS RELATIVELY LARGE COMPARE TO IE.

TAKE-HOME MESSAGES:

- (I) THE SUBSTITUTION EFFECT IS **HUGE** WHEN THE GOODS ARE VERY CLOSE SUBSTITUTES.
- (II) THE SUBSTITUTION EFFECT IS **SMALL OR TINY** WHEN GOODS ARE NEARLY PERFECT COMPLEMENTS (I.E., SKI BOOTS & SKI GLOVES)

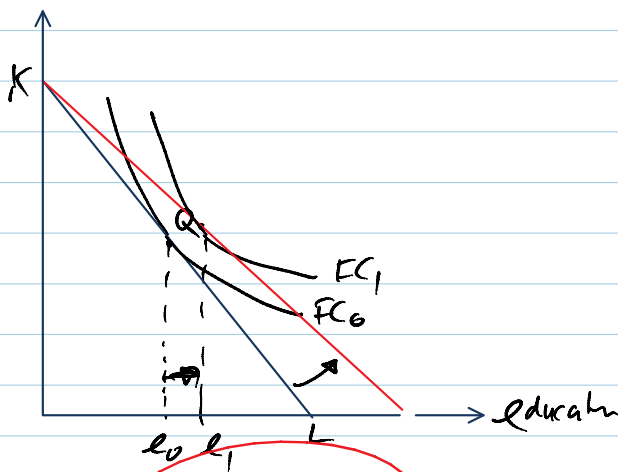
APPLICATIONS

SUBSIDY

VERSUS

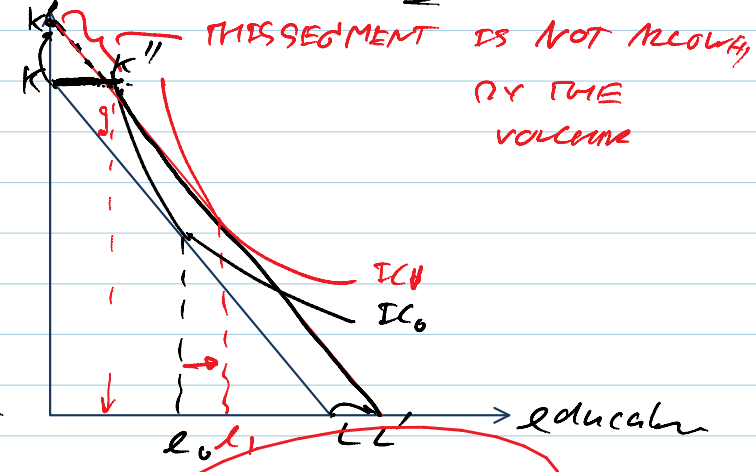
VOUCHER

ALL OTHER GOODS



EFFECT OF SUBSIDY

ALL OTHER GOODS



EFFECT OF VOUCHER

RESULT: NOT SURPRISING...

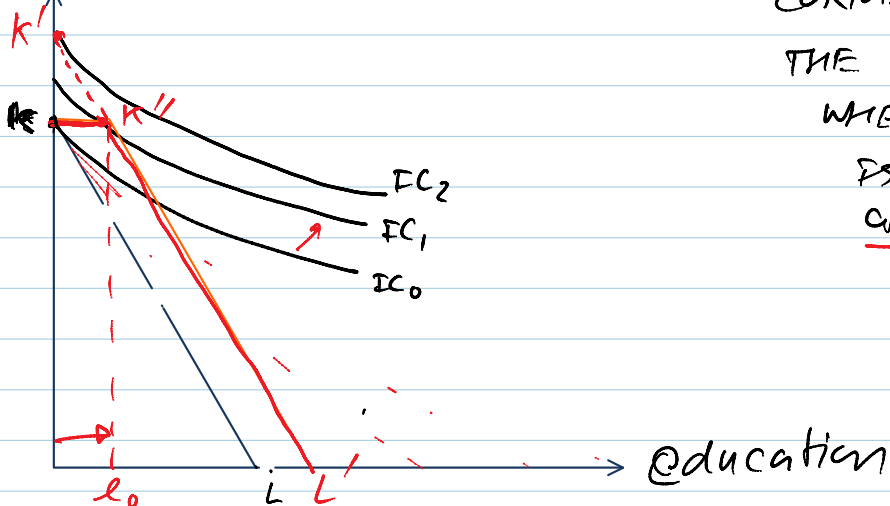
BOTH MEASURES INCREASE LEVEL OF EDUCATION AS LONG AS EDUCATION IS NOT INFERIOR GOOD.

BUT, ...

ALL OTHER GOODS

BUT, . . .

ALL OTHER GOODS



CORNER SOLUTION:

THE CONSUMPTION CHOICE
WHERE ALL INCOME
IS SPENT TOWARD
ONLY ONE GOOD,

CONCLUSION:

FOR FAMILIES WHO HAD "PREVIOUSLY" NOT
CONSUMED EDUCATION AT ALL, VOUCHERS
ALMOST ALWAYS INCREASE CONSUMPTION OF
EDUCATION.