

EE311

Chapter 2: Consumer Behaviour and Demand Theory

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Consumer Preferences

- Indication of how an individual would rank (compare the desirability of) any two *baskets*, assuming the baskets were available at no costs.
- Basket (sometimes called a *bundle*) is defined as a collection of goods and services that an individual might consume.

Assumptions about Consumer Preferences

- Preferences are complete;
 - The consumer can state his/her preference according to one of the following possibilities (1) $A > B$; (2) $A < B$; (3) $A = B$
- Preferences are transitive.
 - If $A > B$ and if $B > E$, then $A > E$
- More is better.
 - In other words, *more is preferred to less*.

Indifference Curve: Characteristics

- When the consumer likes both goods i.e. MU_x and MU_y are both positive.
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- Indifference curves cannot intersect
- Indifference curves are not “Thick
- The MRS: ***Marginal Rate of Substitution*** is the rate at which the consumer will give up one good to get more of other, holding the level of utility constant. MRS is negative; and MRS varies with the combination of consumption.

Shapes of Indifference Curves

Perfect Substitutes

Perfect Complements

Neutrals

Bad

Consumption Equilibrium

- Introducing Budget Constraint

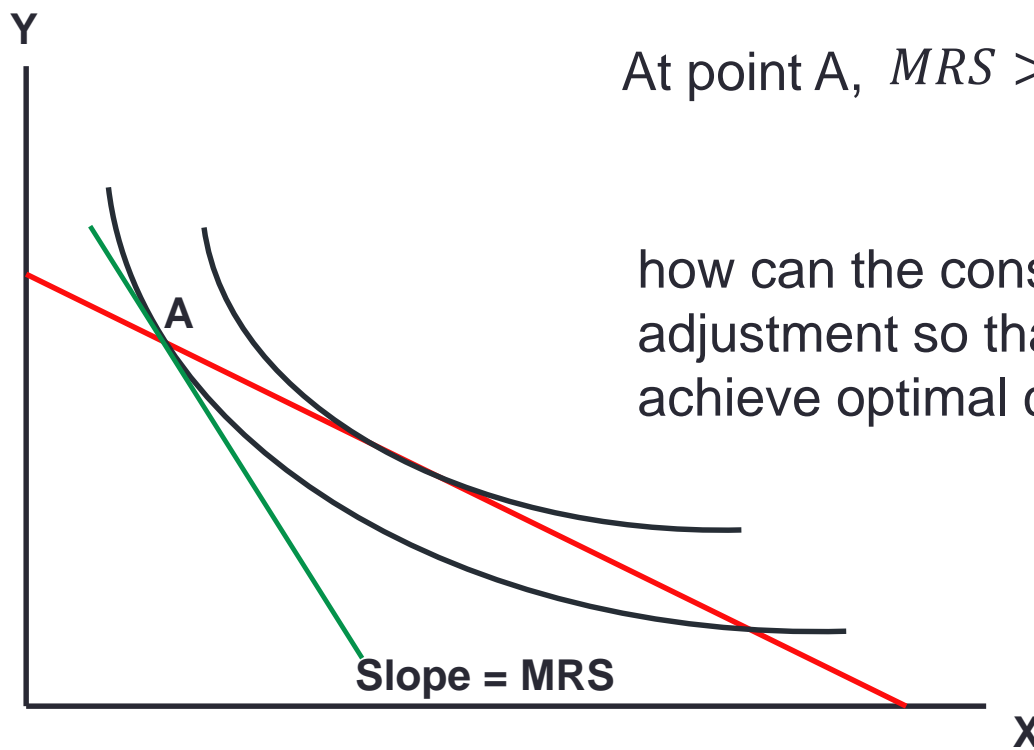
$$P_x + P_y \leq I$$

- What do BL tell us?
 - Vertical and horizontal intercepts? How about slope?
- Effect of a change in income
- Effect of a change in price

Optimal Choice

- Maximising utility with a given budget.

Adjustment towards Equilibrium



Change in Equilibrium

Change in Price	Change in Income

An Application: Voucher vs Subsidy

A monthly allowance of 2,000 Baht	A voucher to purchase food worth of 2,000 Baht