

Applications of Utility Maximization Problem

- Giffen good
- Subsidy
- Vouchers
- Work & leisure
- Intertemporal consumption

Application 1: Giffen Good

- Giffen good is a special case of *inferior good*.
- It is a good at which **quantity demanded decreases when its price is lower**, which is not consistent with the law of demand.
- This is possible when income effect (negative) is greater than substitution effect (positive).
- Example: Suppose there are two goods – potatoes (X) and meat (Y).
Let $P_X=3$, $P_Y=4$, and $B = 120$. If P_X decreases to 2, X^* will decrease.

Application 2: Per-Unit Subsidy

Ex: Suppose the gov't gives a \$2 per-unit subsidy for good X. Everything else constant.

Application 3: Voucher

Ex: Suppose you receive a ฿500 starbucks coupon. Everything else constant.

