ANNOUNCEMENTS

- QUIZ #3 ON THU 7 NOV — SEC01 09.00 – 09.30; SEC02 09.40 – 10.10

NOTE YOU MUST ATTEND THE QUIZ ON THE SECTION YOUR NAME APPEARED

- TUTORIAL SESSION: FRIDAY 8 → APPLICATIONS ON IE & SE *
  FRIDAY 15
  FRIDAY 22
  ALL FROM 11.00 – 12.30

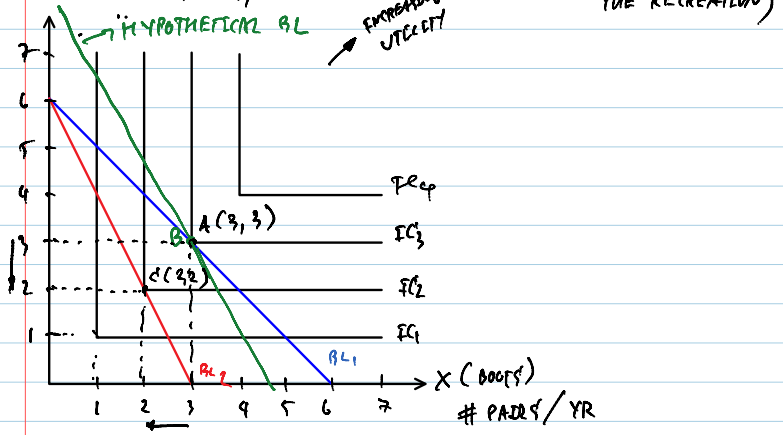
S.E. AND I.E. WHEN THE TWO GOODS ARE PERFECT COMPLEMENTS

CONSIDER TWO GOODS: SKI BOOTS & SKI BINDINGS

SUPPOSE $P_{X(\text{BOOTS})} = 200$ €/PAIR

$P_{Y(\text{BINDINGS})} = 200$ €/PAIR

$M = 1200$ €/YEAR (PREPARED FOR THE RECREATION)



RESULT #1: GIVEN $P_X = P_Y = 200$ & $M = 1200$, A (3,3) IS THE OPTIMAL CHOICE.

RESULT #2: WHEN P_X RISES FROM 200 TO 400 €/PAIR, THE BUDGET LINE ROTATES INWARD FROM BL_1 TO BL_2. NOW, HIS NEW CHOICE IS BASKET C (2,2)

NOTICE ALSO THAT $\left(\frac{P_X}{P_Y}\right)\uparrow$

B/F: $\frac{P_X}{P_Y} = \frac{200}{200} = 1$

A/F: $\frac{P_X}{P_Y} = \frac{400}{200} = 2$

RESULT #3 (S.E. & I.E)

T.E.	=	S.E.	+	I.E
A → C		A → B		B → C
(3,3) (2,2)		(3,3) → (3,3)		(3,3) → (2,2)

- FOR THIS CASE, WHEN X AND Y ARE "PERFECT COMPLEMENTS": THE GOODS MUST BE USED/CONSUMED IN A FIXED PROPORTION, SUBSTITUTION EFFECT = 0 !
- ONLY INCOME EFFECT PLAYS ROLE HERE!

FOR SUBSTITUTION EFFECT: A → B WHAT WE SEE HERE

(3,3) (3,3)

IS THAT AT THE NEW PRICE RATIO THAT HE IS FACING, IF HE "WERE" TO HAVE ENOUGH INCOME TO AFFORD HIS ORIGINAL BASKET

(= IF HE EXPERIENCES NO CHANGE IN REAL INCOME OR NO CHANGE IN PURCHASING POWER) EFFECTIVELY

ONCE HE ARRIVES AT B, IT MEANS THAT

① HE EXPERIENCE NO CHANGE IN REAL INCOME

+

② HE FACES W/ THE NEW RELATIVE PRICE

WE OBSERVE THAT HE WOULD PURCHASE THE SAME BASKET! ⇒ ∴ SE = 0.

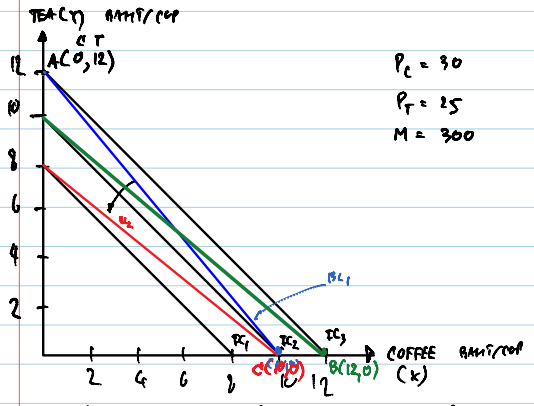
SUBSTITUTION EFFECT AND INCOME EFFECT WHEN THE TWO GOODS ARE "PERFECT SUBSTITUTES"

CONSIDER 2 GOODS : COFFEE (X) & TEA (Y)

P_C = 30 BAHT / CUP

P_T = 25 BAHT / CUP

M = 300 BAHT / WEEK



P_C = 30

P_T = 25

M = 300

RESULT #1 : GIVEN P_C = 30, P_T = 25, M = 300, MIMI'S OPTIMAL CHOICE IS BASKET A (0, 12) (C T).

RESULT #2 GIVEN P_C = 30, P_T = 37.5 (50% INCREASE), M = 300, THE BUDGET LINE ROTATES FROM BL_1 TO BL_2 : TEA HAS BECOME MORE EXPENSIVE RELATIVE TO COFFEE!

NOTICE THAT $\frac{P_C}{P_T}$ ↓

NOW, MIMI'S OPTIMAL CHOICE IS AT C (10, 0) (C T).

THIS WEEK, MIMI RADICALLY SWITCHES TO BUY ONLY COFFEE. (WHY?)

RESULT #3 T.E. = S.E. + I.E.

(CONCEPTUAL)

RESULT #3 (ON S.E & I.E)

T.E. = S.E + I.E.

A → C

(0,12) (10,0)

C T C T

$P_C = 30$ $P_C = 30$

$P_T = 25$ $P_T' = 37.5$

$M = 300$ $M = 300$

S.E.: A → B (0,12) (12,0)

I.E.: B → C' (12,0) (10,0)

IF SHE WERE TO HAVE ENOUGH INCOME TO GET BACK TO ORIGINAL UTILITY, SHE WOULD CHOOSE TO CONSUME ONLY COFFEE (12,0)

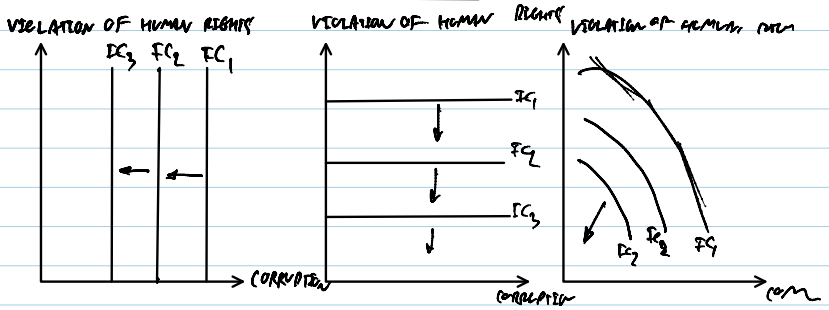
UNFORTUNATELY, HER REAL INCOME FALLS, SO (12,0) IS NOT POSSIBLE), SHE COULD ONLY AFFORD ONLY (10,0)

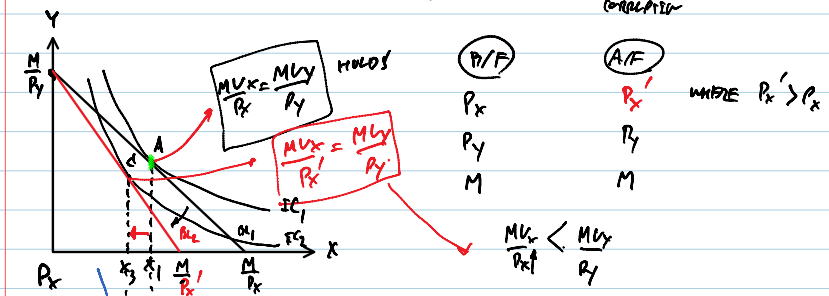
NOTICE THAT S.E. IS RELATIVELY HUGE!

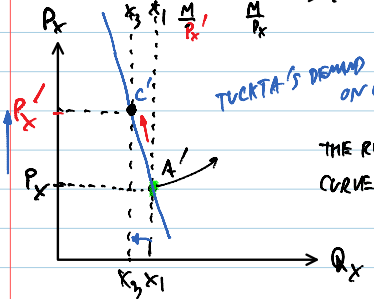
7.11.13

- THEORY OF CONSUMER CHOICE ⇒ DEMAND CURVE
- EFFECT OF A CHANGE IN MONEY INCOME ON A CONSUMER'S CHOICE.
- QUIZ 3 (09.00 - 09.30)

SOME THOUGHTS ABOUT AMNESTY BILL







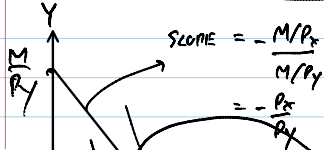
THE REASON WHY SHE MOVES ALONG THE CURVE FROM A' → C' IS BECAUSE SE & IE!

- ALL POINTS ALONG THE DEMAND CURVE ARE CONSUMER'S EQUILIBRIUM (IN ITSELF)

Ex: A' IS AN EQUILIBRIUM GIVEN P_X, P_Y, M.

C' " " P_X', P_Y, M.

4 EFFECT OF A CHANGE IN MONEY INCOME ON A CONSUMER'S CHOICE.



B/F

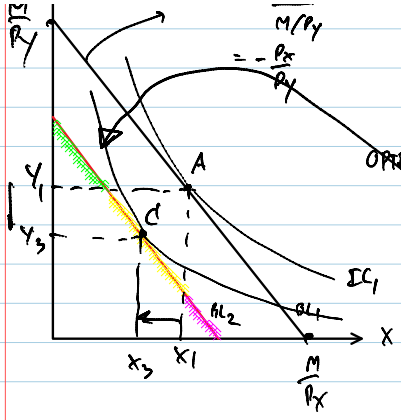
Px

Py

A/F

Px

Py



$\frac{P_x}{P_y}$

M

OPTIMAL CHOICE: $A(X_1, Y_1)$

P_x

P_y

M' WHERE $M' < M$

OPTIMAL CHOICE: $C'(X_2, Y_2)$

RESULT: BUY LESS OF X

" " Y

(IN THIS CASE, X AND Y ARE NORMAL GOODS)

NOTE: IF C' LANDS ON GREEN SEGMENT,

IT WOULD MEAN THAT X IS A NORMAL GOOD.

AND Y IS AN INFERIOR GOOD

(DIY: DRAW A PICTURE TO SHOW THIS CASE)

IF C' LANDS ON PINK SEGMENT,

X → INFERIOR GOOD (∵ SHE BUYS MORE WHEN INCOME FALLS)

Y → NORMAL GOOD (∵ SHE BUYS LESS WHEN INCOME FALLS)

END OF THE TOPIC

REQUIRED READING

① FRANK, ESPECIALLY ON PAGE 101–107

② MANKIW → APPLICATIONS: GIFFEN, WORK/LEISURE, CONSUMPTION/SAVING