

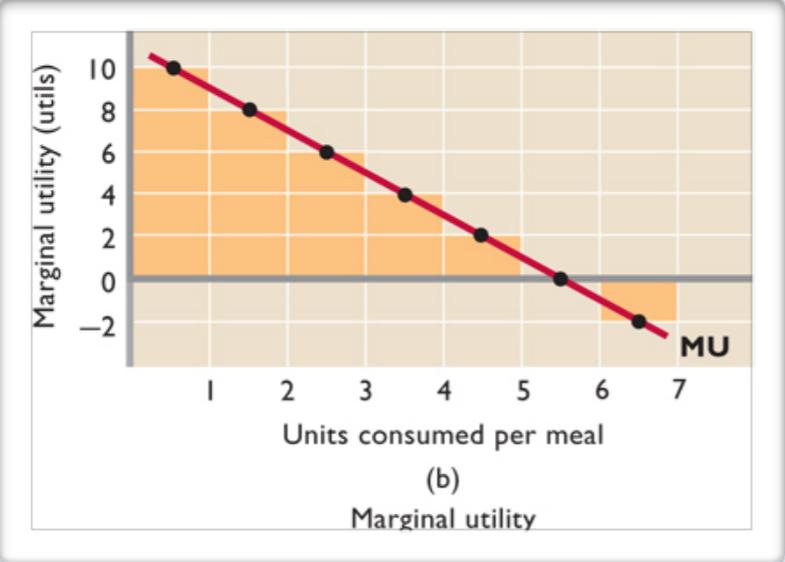
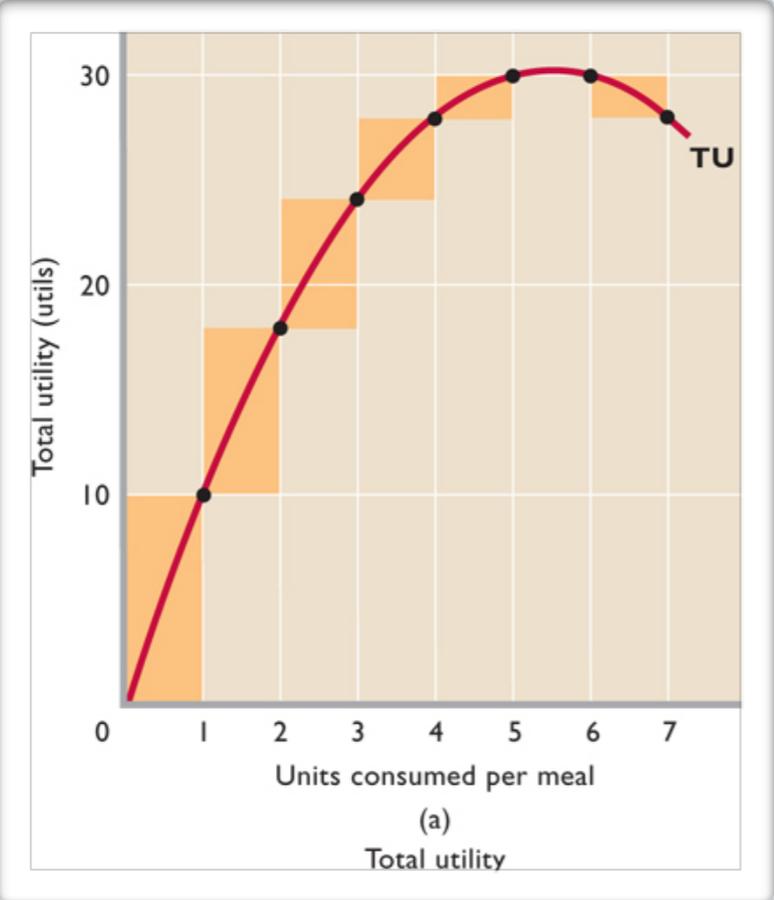
# CHAPTER 7

## CHAPTER 7 - CONSUMER BEHAVIOR

### Law of Diminishing Marginal Utility

- **Law of diminishing marginal utility** - added satisfaction declines as a consumer acquires additional units of a given product
- **Total utility** - the total amount of satisfaction a person derives from consuming some specific quantity of a good or service.
- **Marginal utility** - is the *extra* satisfaction a consumer realizes from an additional unit of the product. So then, marginal utility is the change in total utility that results from the consumption of one more unit of a product.

# Total and Marginal Utility



(1) Tacos Consumed per Meal	(2) Total Utility, Utils	(3) Marginal Utility, Utils
0	0	
1	10	10
2	18	8
3	24	6
4	28	4
5	30	2
6	30	0
7	28	-2

# Theory of Consumer Behavior

- Demand curve is down sloping. There is a negative relationship between P and Q.
- Hence, if successive units of a good yield smaller and smaller amounts of marginal, or extra, utility, then the consumer will buy additional units of a product only if its price falls.
- *How is the consumer going to allocate his/her money income among the many goods and services?*
  1. *Rational behavior* - consumers want to get the most for their money - maximize their utility
  2. *Preferences* - clear cut preferences and a clear idea of marginal utility from each successive unit of the product
  3. *Budget constraint* - consumers have a fixed or limited amount of money
  4. *Prices* - goods are scarce - they have a price tag. Each customer has a limited income, therefore, can only buy a limited amount of goods.

# Theory of Consumer Behavior

- Utility-Maximizing Rule** - to maximize satisfaction, the consumer should allocate his or her money income so that the last dollar spent on each product yields the same amount of extra (marginal) utility.
- $$\frac{MU_A}{P_A} = \frac{MU_B}{P_B}$$

(1) Unit of Product	(2) Apple (Product A): Price = \$1		(3) Orange (Product B): Price = \$2	
	(a) Marginal Utility, Utils	(b) Marginal Utility per Dollar (MU/Price)	(a) Marginal Utility, Utils	(b) Marginal Utility per Dollar (MU/Price)
First	10	10	24	12
Second	8	8	20	10
Third	7	7	18	9
Fourth	6	6	16	8
Fifth	5	5	12	6
Sixth	4	4	6	3
Seventh	3	3	4	2

# Utility Maximization and the Demand Curve

Income = \$10

(1) Unit of Product	(2) Apple (Product A): Price = \$1		(3) Orange (Product B): Price = \$2	
	(a) Marginal Utility, Utils	(b) Marginal Utility per Dollar (MU/Price)	(a) Marginal Utility, Utils	(b) Marginal Utility per Dollar (MU/Price)
First	10	10	24	12
Second	8	8	20	10
Third	7	7	18	9
Fourth	6	6	16	8
Fifth	5	5	12	6
Sixth	4	4	6	3
Seventh	3	3	4	2

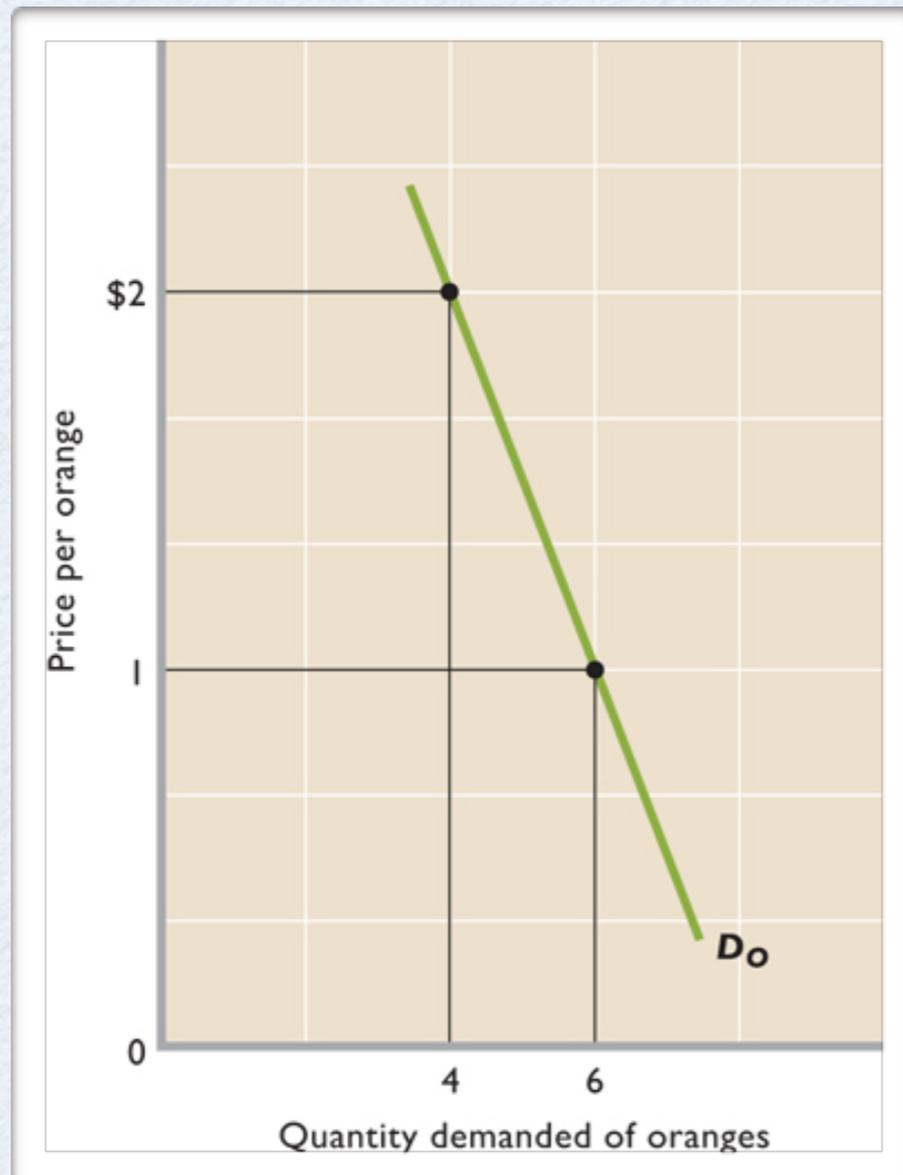
Orange P= \$1  
MU/P

24
20
18
16
12
6
4

4 units of A at \$1/unit = \$4 + 6 units of B at \$1 = \$6,  
total income of \$10 spent

# Utility Maximization and the Demand Curve

Price per Orange	Quantity Demanded
\$2	4
1	6



- If the price of B drops, more will be purchased - **substitution effect**
- If price drops to \$1, real income increases - **income effect**