

KEY TERMS

Chapter 4

Indifference Curve: A consumer will be just as happy with any combination of Good X and Y on indifference curve I_1 , though s/he will prefer any bundle on indifference curve I_2 or I_3 .

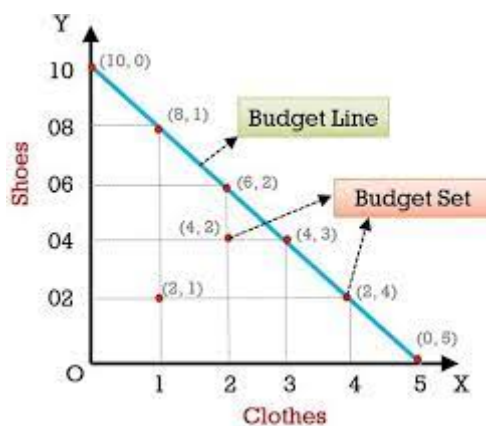


. Budget Curves and Indifference Curves

Budget constraint: In economics, a budget constraint represents all the combinations of goods and services that a consumer may purchase given current prices within his or her given income. Consumer theory uses the concepts of a budget constraint and a preference

map as tools to examine the parameters of consumer choices.

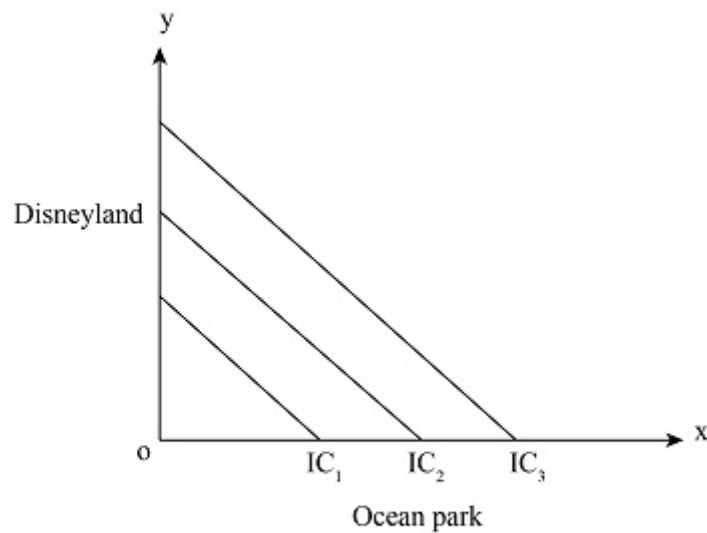
Budget line: The budget line is a **graphical delineation of all possible combinations of the two commodities** that can be bought with provided income and cost so that the price of each of these combinations is equivalent to the monetary earnings of the customer.



Indifference Curves: Indifference curves are designed to represent an equal perception of overall value in a given basket of goods relative to a specific consumer. That is to say that each point along the curve is considered by the consumer of equivalent value despite alterations in the quantity of each good, as these trade-offs are considered of equal value and thus indifferent.

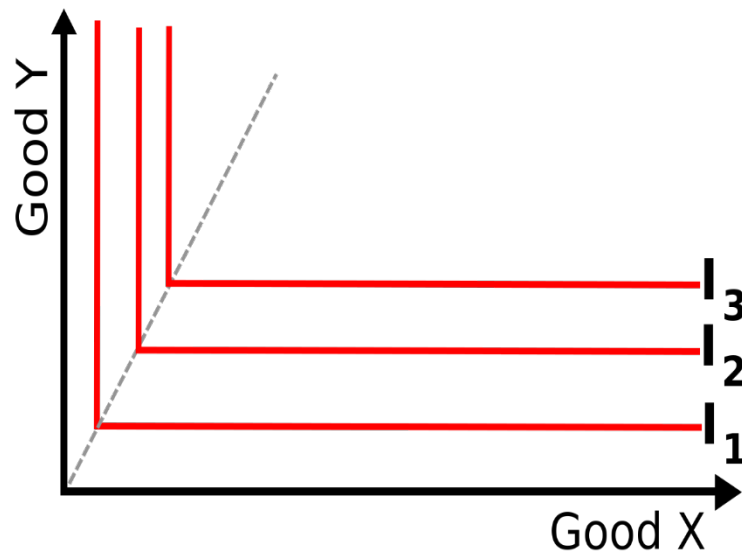
- **substitute:** A good with a positive cross elasticity of demand, meaning the good's

demand is increased when the price of another is increased.

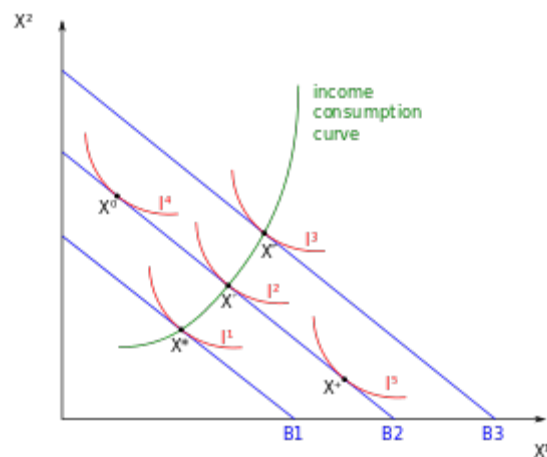


The above graph shows ocean park and disneyland two common are perfect substitute

- **Complement:** A good with a negative cross elasticity of demand, meaning the good's demand is increased when the price of another good is decreased.



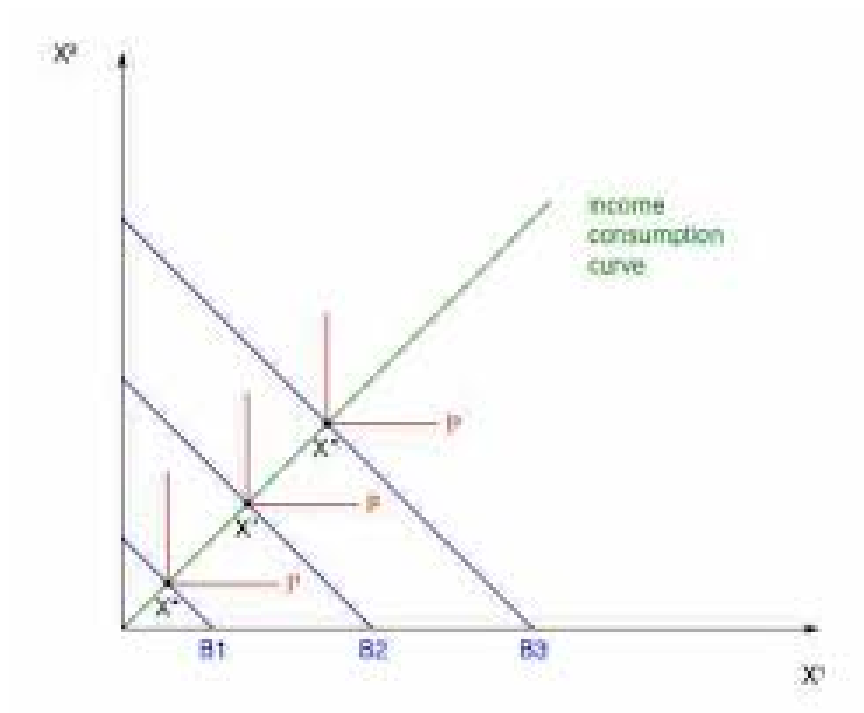
Income-Consumption Curve: Simply put, increases or decreases in income will alter the optimal quantity (and thus relative utility) of a given basket of goods for a specific consumer.



Income Levels and Inferior Goods: This graph demonstrates the inverse relationship between income and the consumption of inferior goods. As income rises,

the quantity consumed of 'X1' decreases. This illustrates increased variance in consumer choice as income rises.

Income Effect on Complementary Goods: In this graphical depiction of income increases, the consumption of these two goods are complementary and thus interdependent.



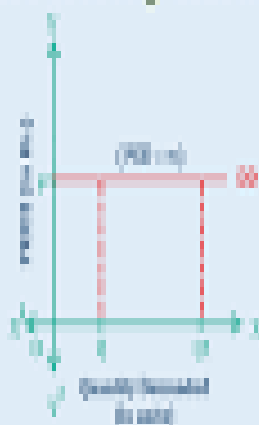
Demand Shifts: This graph demonstrates a shift in overall demand in the market, where the generation of

a new parallel demand curve is required to accurately represent consumer choices.

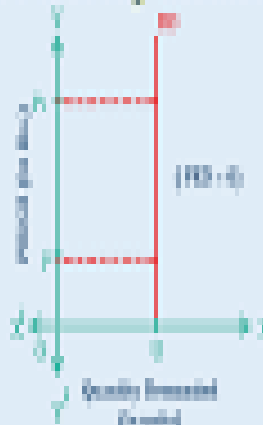
Price Elasticity: As this graph demonstrates, the slope of the demand curve will vary as a direct result of how elastic consumer purchasing behaviors will be compared to price changes.

Price Elasticity of Demand

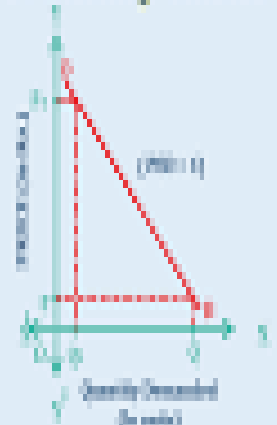
1. Perfectly elastic



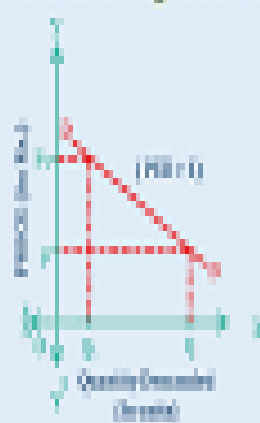
2. Perfectly inelastic



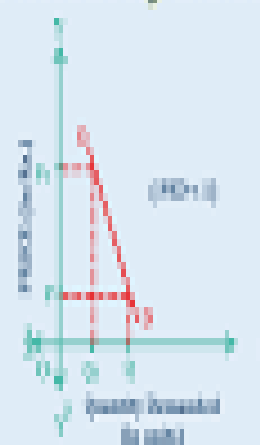
3. Unitary elastic



4. Relatively elastic



5. Relatively inelastic

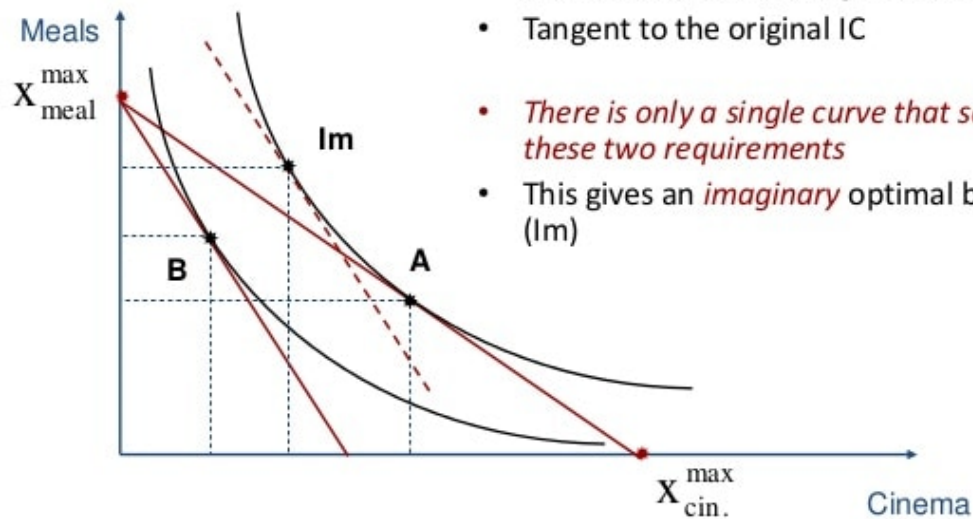


Deriving the Demand Curve (Normal Goods): This illustration demonstrates the way in which economists can identify a series of prices and quantities for goods demanded, which ultimately represents the overall demand curve for a given product/service.

Income Effects on Consumption and Budget Constraints: This graphical representation of a consumer's income (I) and budget constraints (BC) underlines the variance in quantity of 'Good X' and 'Good Y' that will be demanded dependent upon income circumstance. Naturally, a higher income will result in a shift towards increase in quantity for many consumable goods/services.

Income and substitution effects

In order to separate the 2 effects, we add an *imaginary* budget constraint



- Parallel to the new budget constraint
- Tangent to the original IC
- *There is only a single curve that satisfies these two requirements*
- This gives an *imaginary* optimal bundle (Im)