

Key Terms

Lecture 4

Theory of consumer's choices

- **Trade-offs**: Any situation in which the quality or quantity of one thing must be decreased for another to be increased.
- **Utility**: The ability of a commodity to satisfy needs or wants; the satisfaction experienced by the consumer of that commodity.
- **Transitivity of indifference curves**: Having the property that if an element A is related to B and B is related to C, then A is necessarily related to C.

❖ **Choices are transitive**: If

A is preferred to B: $A > B$

B is preferred to C: $B > C$

A is preferred to C:

$A > C$

- **Inferior goods:** A good that decreases in demand when consumer income rises; having a negative income elasticity of demand.
- **Income Effect:** The change in consumption choices due to changes in the amount of money available for an individual to spend.
- **Wealth Effect:** The change in an individual's consumption choices due to changes in perception of how rich s/he is.
- **Elasticity:** The sensitivity of changes in a quantity with respect to changes in another quantity.
- **Derivation:** The operation of deducing one function from another according to some fixed law, called the law of derivation, as the of differentiation or of integration.
- **Substitution effect:** The change in demand for one good that is due to the relative prices and availability of substitute goods.

- **Purchasing power:** The amount of goods and services that can be bought with a unit of currency or by consumers.
- **Income Effect:** The change in consumption resulting from a change in real income.