EXAM #1: Chapters 1, 2, and 21

Don’t forget to review chapters 1 and 2 for the first exam.

CONSUMER THEORY (Chapter 21)

How do consumers decide what to buy in the market? They maximize their utility (happiness) subject to their budget constraint.

A. Budget Constraint

Income, Price of good X, Price of good Y
Calculate slope of budget constraint (negative)
What happens to budget constraint when we change Income? $P_X$, $P_Y$?

B. Utility

Preferences—what people like
Indifference curve—graphical representation of utility
    Slope of indifference curve
Properties of indifference curves
    Higher curves are preferred to lower curves
    Downward sloping
    Do not cross
    Bowed inward
Marginal Utility
Law of Diminishing Marginal Utility
Marginal Rate of Substitution

C. Consumer Optimization

At tangency point, slope of indifference curve = slope of budget constraint
Bang per buck – make sure you can do the math!
How do changes in income affect consumer choices?
    Normal vs. inferior goods
How do changes in prices affect consumer choices?
    Deriving a demand curve—all points on demand curve are optimal consumption points

[Remember to skip the sections discussing 1) indifference curves for goods that are perfect substitutes and perfect complements and 2) the income and substitution effects of a change in price.]