

UNIT - II

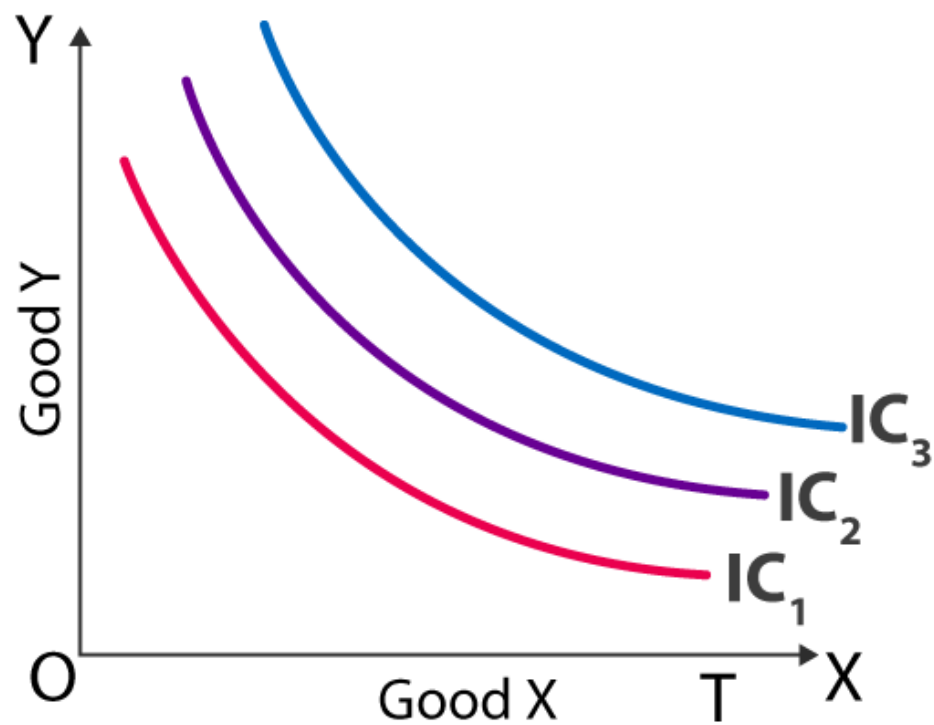
CONSUMER BEHAVIOUR

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INDIFFERENCE CURVE ANALYSIS

- ▣ **An indifference curve** is a graphical representation of a combined products that gives similar kind of satisfaction to a consumer.
- ▣ It shows that a consumer is indifferent between the two products as it gives him the same kind of utility.
- ▣ **The Indifference Map** refers to a set of Indifference Curves that reflects an entire view of a consumer's choices.

IC curve Map



Indifference Map

Indifference Curve Schedule

Combination	Food	Clothing
A	1	12
B	2	6
C	3	4
D	4	3

Properties of IC curve

- ▣ **(A) indifference curve always slopes downwards from left to right**
- ▣ **(B) indifference curve is always convex to the origin**
- ▣ **(C) higher indifference curve represents higher level of satisfaction**
- ▣ **(d) It never touches neither X axis nor Y axis**

Budget line and consumer equilibrium

- ▣ The budget line is essential for understanding the theory of consumer's equilibrium.
- ▣ A higher indifference curve shows a higher level of satisfaction than a lower one.
- ▣ Therefore, a consumer to maximize his satisfaction will try to reach the highest possible indifference curve.
- ▣ the budget line which represents the prices of the goods and consumer's money income.

- Suppose a consumer has got income of Rs. 50 to spend on goods X and Y. Let the price of the good X in market be Rs. 10 per unit and that of Y Rs. 5 per unit.
- If the consumer spends his whole income of Rs. 50 on good X, he would buy 5 units of X; if he spends his whole income of Rs. 50 on good Y he would buy 10 units of Y.
- If a straight line joining 5X and 10Y is drawn, we will get **the price line or the budget line.**
- This budget line shows **all those combinations of two goods which the consumer can buy spending his given money income on those two goods** at given prices.

INCOME – EFFECT

- The income effect describes how an increase in income can change the quantity of goods that consumers will demand.
- The consumer's choice of how much to consume of various goods depends on the prices of those goods.
- If prices change, the consumer's equilibrium choice will also change.
- The **income effect** takes account of how price changes affect consumption choices by changing the real purchasing power or **real income of the consumer**.

SUBSTITUTION EFFECT

- When the price of a good changes, the price of that good relative to the price of other goods also changes.
- *Relative* price changes cause consumers to substitute from one good to another—this is known as the **substitution effect**.
- *Shows how a change in the prices of goods or a change in income affects the number of goods demanded by consumers*

Price Effect

- Price Effect refers to the change in the consumption of the commodities when the price of one of the commodity changes while the price of other commodity and income of consumer being the same.
- Ex: When the price of Coca Cola rises from Rs.40 to Rs.60, *It means a rise in the price of a commodity will decrease the satisfaction of the consumer.*
- On the contrary, if the price of Coca Cola falls from Rs.40 to Rs.30, *It means a fall in the price of a commodity will increase the satisfaction of the consumer.*

The budget line

- ▣ The budget line is a graphical representation 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.
- ▣ The two basic elements of a budget line are as follows:
 - ▣ The consumer's purchasing power (his/her income)
 - ▣ The market value of both the products

- ▣ The equation of the budget line equation can be represented as follows:
- ▣ $M = P_x \times Q_x + P_y \times Q_y$

Where, P_x is the cost of product X.

Q_x is the quantity of product X.

P_y is the cost of product Y.

Q_y is the quantity of product Y.

M is the consumer's income.

Budget line Schedule

Combination	Cream biscuit @10 per pack	Salt biscuit @5 per pack	Budget allocation
A	0	10	$0 \times 10 + 5 \times 10 = 50$
B	1	8	$1 \times 10 + 8 \times 5 = 50$
C	2	6	$2 \times 10 + 6 \times 5 = 50$

Revealed preference theory

- ▣ Revealed preference, a theory offered by American economist **Paul Samuelson** in **1938**
- ▣ Prof. Samuelson's theory of demand is based on the revealed preference hypothesis which states that **choice reveals preference.**
- ▣ Theory states that the **consumer's product or service choice under different income and price levels** according to their preferences

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- ▣ There are three axioms of revealed preference which are listed as follows:
 - Weak axiom of revealed preference;
 - Strong axiom of revealed preference;
 - Generalized axiom of revealed preference

Cont...

- ▣ Revealed preference theory works on the assumption that **consumers are rational**.
- ▣ The theory states that given a consumer's budget, they will prefer the same bundle of goods as long as that bundle remains affordable.
- ▣ Suppose a consumer buys a combination of two goods (A and B) either because he likes this combination in relation to others or this is cheaper than others.

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- ▣ Suppose the consumer buys combination A rather than combination B, C or D. It means that he reveals his preference for combination A.
- ▣ He can do this for two reasons. **First**, combination A may be cheaper than the other combinations B, C, D.
- ▣ **Seconds** combination A may be dearer than others
- ▣ In such a situation, it can be said that A is revealed preferred to B, C, D or B, C, D are revealed inferior to A