

Chapter 16: Consumer Choice



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Diminishing Marginal Utility in The Rolling Stones' "I Can't Get No Satisfaction"

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Answers to the following questions

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Values are Subjective

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Utility

- **Utility:** is the satisfaction or well-being that a consumer receives from consuming a good or service.
- Utility varies from individual to individual.
- Economists measure this in
- Goal of the consumer is to his/her utility

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How do rational consumers choose what to spend their money on?

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1. Consumers always choose the highest valued alternative (transitivity)

Domino's breakfast pizza >

grasshoppers
and noodles >

pork brains in milk gravy

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2. One good can be substituted for another

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3. More of a good thing isn't always better

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Utility Theory

- Marginal Utility
 - The additional satisfaction obtained by a consumer from consuming more unit of a good.

$$\text{Marginal utility} = \frac{\text{change in total utility}}{\text{change in number of units consumed}}$$

- Contentment is hard to measure. Happiness is a balance between economic and personal factors.

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Diminishing Marginal Utility

- **Diminishing Marginal Utility:** more we have of something, the less marginal utility each unit of that good brings us.
- Think of your favorite food, why don't you just consume that all of the time?

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A Food Eating Contest

- Three ways to win:
 - \$400 per Swiss Roll eaten
 - \$2,000 bonus for 1st place, \$1,000 bonus for 2nd place, \$500 for 3rd place.
 - \$2,000 bonus for finishing all the rolls.
- One way to NOT win.....
- This applies to the consumption of *every* product.

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S#%^

- People who occasionally swear experience greater pain reduction when swearing than pain sufferers who swear on a regular basis in everyday conversation.

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Total and Marginal Utility

Utils per
brownie

(a) Total Utility

Number of
brownies
eaten

Utils per
brownie

(b) Marginal Utility

Number of
brownies
eaten

Number of brownies eaten	TU (per brownie)	MU (utils per brownie)
0	0	0
1	25	25
2	45	20
3	60	15
4	70	10
5	75	5
6	75	0
7	70	-5
8	60	-10
9	45	-15
10	25	-20

Optimising Consumption Choices

- We don't focus on total utility but the
- The way we maximise utility is by solving the 2 following conditions:
- 1. MU/P is
- 2. The total purchase must fall within our

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Maximising Utility

- Two goods, pizza and pepsi
 - Pizza is \$ per slice
 - Pepsi is \$ per can
 - You have \$ to spend
- Consumption of pizza and Pepsi both exhibit
 - If I consume pizza, MU_{pizza}
 - If I consume Pepsi, MU_{Pepsi}

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The Consumer Optimum with Pepsi & Pizza

(1)	(2)	(3)	(4)	(5)	(6)
Pepsi (cans)	MU Pepsi	MU Pepsi/Price (\$1/can)	Pizza (slices)	MU Pizza	MU Pizza/Price (\$2/slice)
1	9	$9/1 = 9$	1	20	$20/2 = 10$
2	8	$8/1 = 8$	2	16	$16/2 = 8$
3	7	$7/1 = 7$	3	12	$12/2 = 6$
4	6	$6/1 = 6$	4	8	$8/2 = 4$
5	5	$5/1 = 5$	5	4	$4/2 = 2$
6	4	$4/1 = 4$	6	0	$0/2 = 0$
7	3	$3/1 = 3$	7	-4	$-4/2 = -2$
8	2	$2/1 = 2$	8	-8	$-8/2 = -4$
9	1	$1/1 = 1$	9	-12	$-12/2 = -6$
10	0	$0/1 = 0$	10	-16	$-16/2 = -8$

- Rank each purchase from highest MU/\$ to lowest MU/\$ (use info in columns 3 & 6)
- Assume: you spend \$10

• Purchase :	Cost \$	Total \$
• Purchase :	Cost \$	Total \$
• Purchase :	Cost \$	Total \$
• Purchase :	Cost \$	Total \$
• Purchase :	Cost \$	Total \$

Maximising Utility Depends on Rationality

<u>PIZZA</u>	<u>BEER</u>
20	9
16	12
12	24
8	76
4	390
0	2,309
-4	12,908
-8	232,089
-16	-500
Where: pizza costs \$2/slice and Beer costs \$1/can, values represent MU.	

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How a Price Change Affects Consumer Optimum

- **Substitution Effect:**
 - Consumers and producers shift from goods and resources that become relatively priced in favor of goods and resources that are now priced.
- **Real-Income Effect:**
 - The in people's purchasing power that occurs when, other things being constant, the price of one good that they purchase changes.

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Diamond-Water Paradox

- *Nothing is more useful than water, but it will purchase scarcely anything; scarcely anything can be had in exchange for it. A diamond, on the contrary, has scarcely any use-value, but a very great quantity of other goods may frequently be had in exchange for it.*
– Adam Smith, 1776

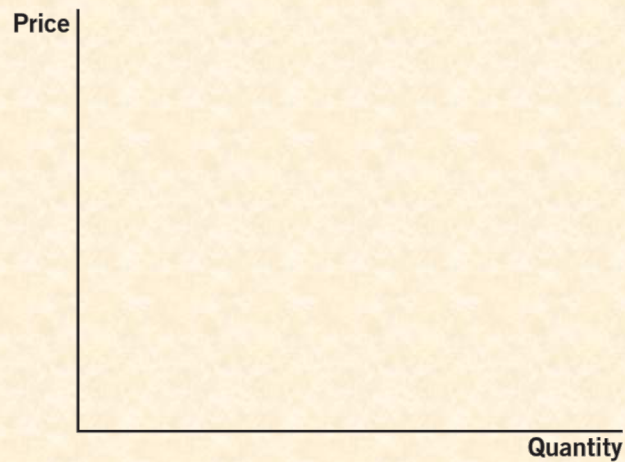
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Diamond-Water Paradox

- What's the confusion?
 - Mixes up the with the
 - Compares the of a very
good (diamond) with the marginal
utility of an good (water)

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The Diamond-Water Paradox



Fast Food

You've got a deal!

- Why do fast food restaurants provide “value sizes”?
- Why do we order so much food?
- What they lack in quality they make up for in quantity!
- These restaurants are passing along low marginal costs.

Fancy Restaurants

- But not nice restaurants! They serve small amounts.
- At nice restaurants they attempt to create (every bite tastes great) and they do not want to diminish that marginal value through over-eating.
- Translation: More is NOT always better!

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Economics in *Super Size Me*

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