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Notes – Module 4

Consumer Behavior

I. Why Demand Changes
   a. Income Effect. When a price drops, *real* income rises, so consumers are inclined to buy more of the product.
   b. Substitution Effect. When the price drops, consumers are inclined to substitute more of the good for other goods.

II. Law of Diminishing Marginal Utility
   a. Each unit of a product a consumer buys yields less "utility" (enjoyment) than the previous unit. The second bag of cotton candy isn't as enjoyable as the first.
   b. Eventually, the utility derived from a unit may even be negative, meaning *total* utility declines. ("If I eat one more I'll be sick.")
   c. The demand curve slopes downward because at higher prices consumers cannot obtain an adequate utility per dollar spent on more units – they'll buy fewer.

III. Utility Maximization
   a. To obtain the maximum utility from a bundle of goods (a consumer's "utility bundle"), consumers should purchase goods such that the *last dollar spent on each one yields the same marginal utility.*
   b. Consumers should buy whichever product will yield the greatest MU per dollar until the last dollar of their income is spent.
   c. Given an income of $52, the units highlighted in green should be purchased.

MU / $

	A	B	C
	$1.00	$2.00	$4.00
1	100	400	35
2	140	300	30
3	160	200	25
4	80	100	22.5
5	36	20	20
6	20	**10**	17.5
7	14	8	14
8	**10**	6	**10**
9	10	4	6
10	8	2	3
11	8	1	2