MICROECONOMICS

3. CONSUMER BEHAVIOUR

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Objectives of the Presentation:

- **describe the difference between a consumer and a customer**
- **distinguish between ordinalist and cardinalist ways of measuring utility**
- **define the different types of goods**
- **define the basic characteristics of demand**

Presentation Outline

1. **Theoretical definition of the consumer**
2. **Measuring utility**
3. **Typology of goods**
4. **Characteristics of demand**

3. Typology of Goods

- **The cardinalist and ordinalist approach is applied to the so-called normal type of goods.**
- **The normal type of good (a desirable good) is one that the consumer:**
  - **prefers (by buying and consuming it, he satisfies his need and increases his utility);**
  - **buys more when the price is reduced;**
  - **division into:**
    - **necessary - purchase independently of the amount of income;l**
    - **luxury - purchase only if income is of a certain amount.**

3. Typology of Goods

- **Other goods (in relation to the utility to quantity of the product):**
  - **undesirable:**
    - **consumption reduces consumer utility (sometimes desirable for consumers with low budget constraints);**
    - **example: chemicals, carousels for consumers with weak stomachs, meat for vegetarians (old rolls);**
  - **indifferent:**
    - **consumption does not affect the magnitude of the consumer's utility;**
    - **example: watching football for a woman.**

3. Typology of Goods

- **Other goods (in a goods-to-goods relationship):**
  - **substitutes:**
    - goods that are well substitutable (interchangeable) for each other;
    - consumed separately;
    - a rise in the price of one increases the demand for the other;
    - e.g. TV and radio (imperfect substitutes);
  - **complements:**
    - complementary goods;
    - consumed simultaneously (in some relatively stable proportion);
    - a rise in the price of one causes a fall in demand for the other;
    - e.g. a mobile phone and a charger (imperfect complements have a typical IC shape).

3. Typology of Goods

- **Other goods (in a goods-to-goods relationship):**
  - **independent:**
    - **consumption does not depend on the consumption of another good;**
    - **a change in the price of one good does not affect the demand for another good;**
    - **e.g., rolls and shampoo.**

3. Typology of Goods

- A roll and chocolate ????
  - certainly not a complement.
- Hamburger and Coke????
  - certainly not indifference;
  - close to complement;
  - typical IC shape.

4. Characteristics of Demand

- We know the general characteristics of demand from the last lecture (law of decreasing demand, change in quantity demanded caused by a change in price, change in slope and position of the demand curve caused by other influences, etc.).
- It is necessary to add two other contexts (related to consumer behaviour), which are:
  - elasticity of demand;
  - consumer surplus.

4. Characteristics of Demand

- **Elasticity of demand:**
  - basic premise: the law of decreasing demand;
  - sensitivity of consumer response (change in goods demanded) to changes:
    - prices of that type of good - price elasticity of demand;
    - the nominal income of the consumer (consumer income) - income elasticity of demand;
    - the prices of other goods purchased by the consumer - the cross elasticity of demand.

4. Characteristics of Demand

- **Price elasticity of demand:**
  - **the ratio of the percentage change in the quantity demanded of a good to the percentage change in the price of that good;**
  - **the coefficient (eDP) is used to express the price elasticity of demand;**

$$eDP = \Delta Q / \Delta P;$$

  - **ΔQ: percentage change in quantity demanded (usually opposite direction of positivity as ΔP → eDP usually has a negative value);**
  - **ΔP: percentage change in the price of the good.**

4. Characteristics of Demand

- **Price elasticity of demand:**
  - **types of price elasticity of demand:**
    - **inelastic, eDP > -1: demand is inelastic, a change in price causes a smaller percentage change in the quantity demanded;**
    - **elastic, eDP < -1: demand is elastic, the quantity demanded changes by a larger percentage than the percentage change in price (consumer response is greater);**
    - **unit elastic, eDP = -1: demand is unit elastic, i.e. price and quantity change in the same proportion.**

4. Characteristics of Demand

- **Price elasticity of demand:**
  - **the sensitivity of changes in the demanded good to changes in the price of that good varies for:**
    - **different types of goods - the main problem addressed;**
    - **different consumers (different nations have different sensitivities);**
    - **different income sizes (differently movable consumers have different elasticities - sensitivity to price changes).**

4. Characteristics of Demand

- **Price elasticity of demand:**
  - **Giffen's goods/product (reverse elasticity):**
    - **as the price of a good falls, the quantity demanded falls;**
    - **reason: inferiority of the good – different for different budget constraints (if an inferior good becomes cheaper and cheaper and the consumer's income rises, he stops showing interest in that good):**

      eDP = ΔQ (negative value)/ΔP (negative value) → positive value of eDP;

    - **the opposite extreme for some luxury goods - a rise in price increases the interest in the good (an absolutely exceptional phenomenon occurring only among very wealthy consumers):**

      eDP = ΔQ (positive value)/ΔP (positive value) → positive value of eDP.

4. Characteristics of Demand

- **Income elasticity of demand:**
  - **the dependence of changes in the quantity demanded of a good on changes in the nominal income of the consumer (consumer income);**
  - **the coefficient (eDI) - the coefficient of income elasticity of demand;**

$$eDP = \Delta Q/\Delta I;$$

  - **ΔQ: percentage change in quantity demanded (same direction of positivity as ΔI → eDP usually has a positive value);**
  - **ΔI: percentage change in consumer income (positive value);**

4. Characteristics of Demand

- **Income elasticity of demand:**
  - **types of income elasticity of demand:**
    - **positive (eDI > 0) - applies to normal goods, including luxury goods;**
    - **negative (eDI < 0) - for inferior goods, including Giffen goods (a specific case where income increases and demand for the inferior good decreases).**

4. Characteristics of Demand

- **Cross elasticity of demand:**
  - **the dependence of changes in the quantity demanded on changes in the prices of other goods purchased by the consumer;**
  - **the coefficient (eC) is used to express the cross-elasticity of demand:**

$$eC = \Delta Q / \Delta Py;$$

  - **ΔQ: percentage change in quantity demanded;**
  - **ΔPy: percentage change in the price of good Y.**

4. Characteristics of Demand

- **Cross elasticity of demand:**
  - **types of cross-elasticity of demand:**
    - **positive ($eC > 0$) - valid for substitutes;**
    - **negative ($eC < 0$) - valid for complements.**

4. Characteristics of Demand

- **Consumer surplus:**
  - **basic premise: market equilibrium (the consumer is willing to pay the lowest price asked by the producer and the producer is willing to sell at the highest price the consumer is willing to pay);**
  - **but the consumer surplus is the difference between the price the consumer would be willing to pay at the maximum (market equilibrium) and the price actually paid in the market (this actual price is lower);**
  - **the sum of all the surpluses of the demanding consumers is the consumer surplus of that demand.**

Thank You for Your Attention