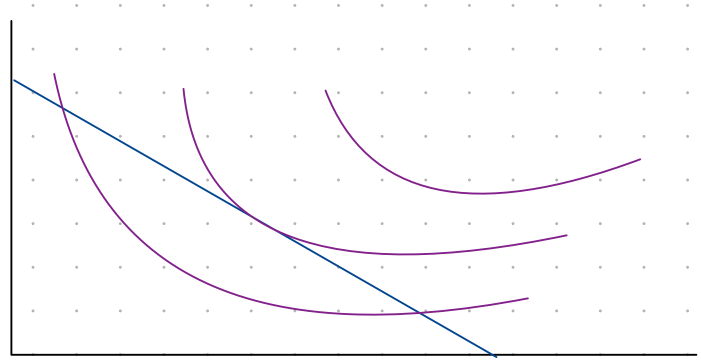
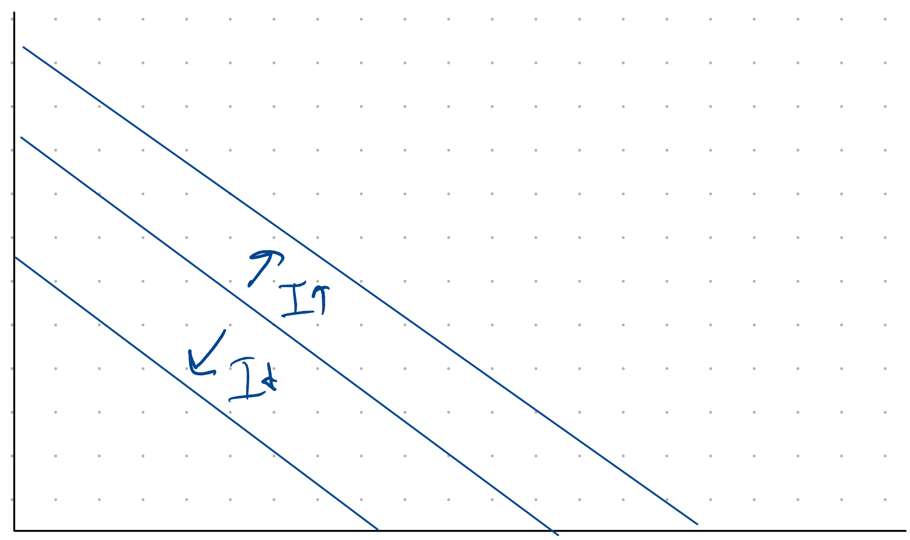
Ch. 5 Individual and Market demand

5.1: How Income Changes Affect an Individual's Consumption Choices

recall: Consumption choices are determined by consumers maximizing their utility s.t. their budget constraint



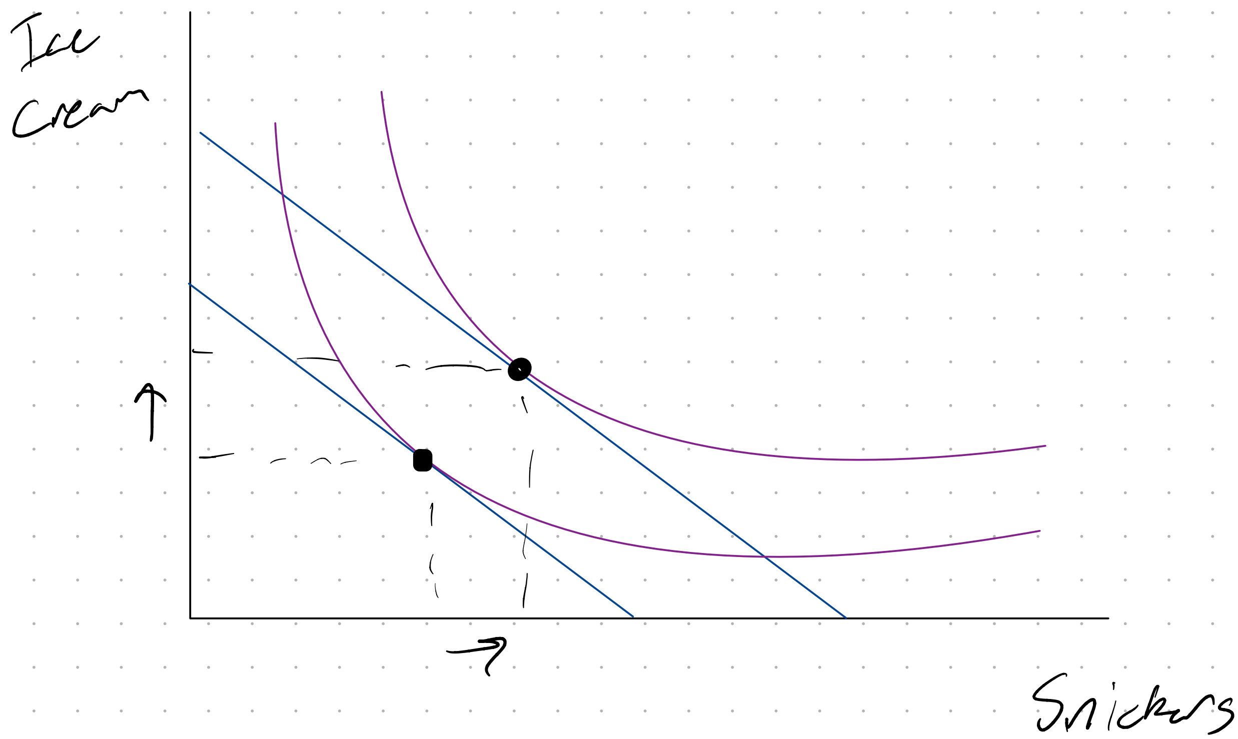
So, what changes to our consumption when our income changes?



Let's say income ↑

We could end up:

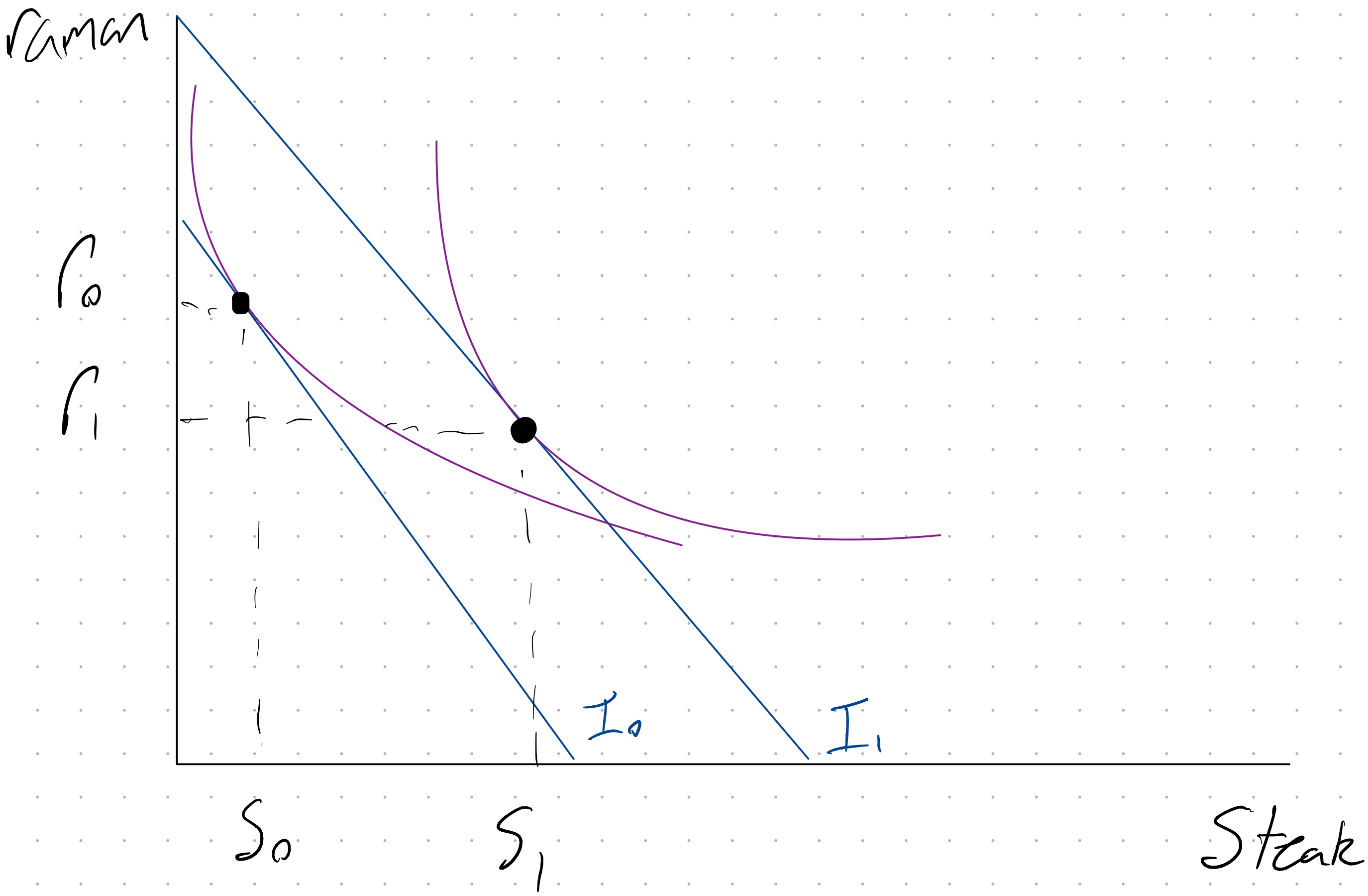
Increasing consumption of both goods



This will occur when both goods are normal.

recall: normal good → consumption↑ when income↑

Increase consumption of only 1 good, decrease consumption of another good



This will occur when:

one good is inferior

recall: inferior good → consumption ↓
when income ↑

Q: Is it possible for consumption of all goods to ↓ when income ↑?

A: no. Because we assume "more is better" so, a bundle with less of every good ≺ previous bundle.

Since the previous bundle is still affordable, new bundle doesn't max. our utility s.t. budget constraint.

Recall from Ch 2.5:

Income elasticity: measures the % change in the quantity consumed of a good in response to a given % change in income

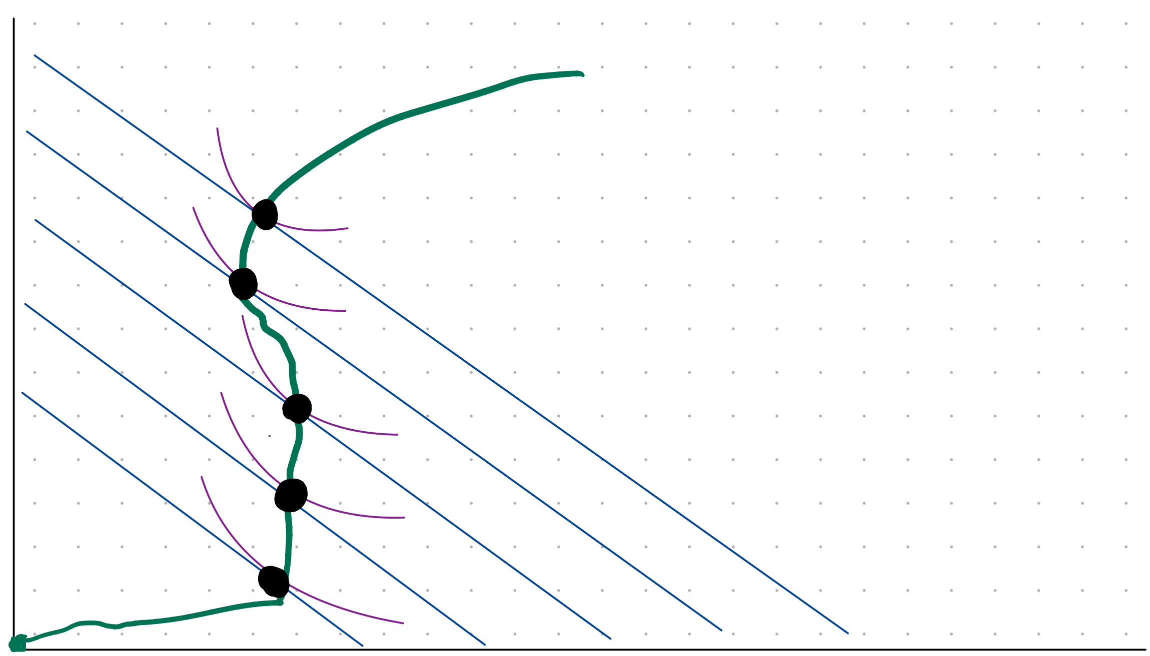
$$E_I^D = \frac{\%\Delta Q}{\%\Delta I} = \frac{\Delta Q/Q}{\Delta I/I}$$

$E_I^D < 0 \rightarrow$ Inferior good

$E > 0 \rightarrow$ Normal good

normal goods $\begin{cases} \text{necessity } E_I^D \in (0,1) \\ \text{Luxury } E_I^D > 1 \end{cases}$

The Income Expansion Path is a curve that connects a consumer's optimal bundles at each income level.



Note:

- Income expansion paths always start at the origin.

- Some goods may be normal goods at certain levels of income, but then became inferior goods later on.