

# Theory of the Consumer

- Work with 2-good consumption bundle
  - Good 1 is  $x$ , good 2 is  $y$ ,  $(x,y)$
- Consumer has utility function  $U(x,y)$  describing preferences with respect to  $x$  and  $y$ 
  - Theory for axiomatizing behavior

## Properties of Preferences

- completeness
  - Consumers can rank all market baskets
  
- transitivity
  - If A is preferred to B, and B is preferred to C, the A is preferred to C
  
- monotonicity (“more is better”)

## Diagramming Assumptions

## Indifference Curves

- Locus of consumption bundles  $(x,y)$  yielding equal satisfaction for consumer
  - Slopes downward
  - Direction of increasing utility
  - Indifference curves do not cross
  - Ordinal, not cardinal

## Shape of Curve, Reason

- Banana experiment

## MRS, with Math

## Examples of Utility Functions and their Indifference Curves

- “usual case”
  - $u=x^a y^b$  (Cobb Douglas)
- Perfect substitutes
  - $U=ax+by$
- Perfect complements
  - $U=\min(ax,by)$