“Consumer Choice-Making”

1. Rational consumer choice making:
   1. is DONE ON THE MARGIN – uses marginal (each additional unit) thinking.
   2. Involves MAXIMIZING UTILITY - getting the most satisfaction for what you

pay for.

**Utility Maximizing Rule** :

- if a consumer is considering how much to buy of ONE GOOD, they must ask themselves:

“How much ADDITIONAL UTILITY (Marginal Utility) will the next unit I buy give me?”

“Does this additional happiness (MU) outweigh the ADDITIONAL COST (Marginal Cost) I have to pay for it?”

Therefore.....so long as they gain more additional benefit (MU) from the next unit that they must pay for the next unit (MU>MC) then they should keep on buying more.

Utility is MAXIMIZED where the MU of the next unit purchased equals the MC paid for it

**MU = MC** or another way of stating.....**MU = Price paid**

**What if a consumer wants to find out the COMBINATION OF TWO GOODS that gives then the most utility?**

A **“Consumption Bundle**” = all possible combinations of two goods that is available for a consumer to buy.

A **Budget Constraint –** is the consumption bundles limited to the consumer based on their income level.

**Budget Line Graph** – graph showing the consumption bundles that are affordable and unaffordable to a consumer. Any point on the line indicates the consumer is using ALL their income. Points inside are INEFFICIENT as the consumer is not using all their income. Points outside the line are unaffordable.

If we want to find the combination that gives the most utility, we need to add a step and find where the Marginal Utility Per Dollar Spent on one good EQUALS the Marginal Utility Per Dollar Spent of another good.

**MU/P good A = MU/P good B**

**Marginal Utility Per Dollar Spent =** the MU of a good divided by the Price of the good.

Rules:

1. Calculate MU for each good.
2. Calculate the MU/P for each good by dividing the price into the MU.
3. Find all combos where the MU/P are equal.
4. Add up the total amount spent for the bundles that are equal...the bundle that uses all the consumers income is the most OPTIMAL CONSUMER BUNDLE.