## Short Notes on Theory of Consumer Behavior

# Theory of Consumer Behavior

Key Concepts

- Consumer Behavior Theory: Explains how price changes influence demand.
- Utility: Psychological satisfaction from consuming goods or services.
  - Subjective and cannot be measured, only compared.

Measurement of Utility

1. Cardinal Utility Approach:
   - Proposed by Alfred Marshall.
   - Utility is measurable in 'utils.'
   - Assumes independence of utility derived from different products.
   - Concepts:
     - Law of Diminishing Marginal Utility.
     - Law of Equi-Marginal Utility.

2. Ordinal Utility Approach:
   - Proposed by Hicks and Allen.
   - Utility is ranked based on preferences.
   - Assumes rational choice between alternatives.

Key Theories and Laws

1. Law of Diminishing Marginal Utility:
   - As consumption increases, additional satisfaction decreases.
   - Total utility increases at a diminishing rate.

2. Law of Equi-Marginal Utility:
   - Consumers allocate resources so that the marginal utility per unit of money is equal across all products.

3. Indifference Curve Analysis:
   - Represents combinations of goods providing equal satisfaction.
   - Properties:
     - Downward sloping, convex to origin.
     - Higher curves indicate greater satisfaction.
     - Curves never intersect.

- Budget Line: Represents combinations of goods affordable within income constraints.

Consumer Equilibrium

- Achieved when maximum satisfaction is derived within budget constraints.
- Occurs where the budget line is tangent to the highest indifference curve.

Additional Concepts

1. Value Paradox: Explains differences in value of products (e.g., water vs. diamond).
2. Marginal Rate of Substitution (MRS): Rate at which one product can replace another while maintaining the same utility.

Example of Consumer Equilibrium:

If a consumer has a fixed income, they distribute it between two goods, X and Y, such that $MUx/Px = MUy/Py$, maximizing overall utility.