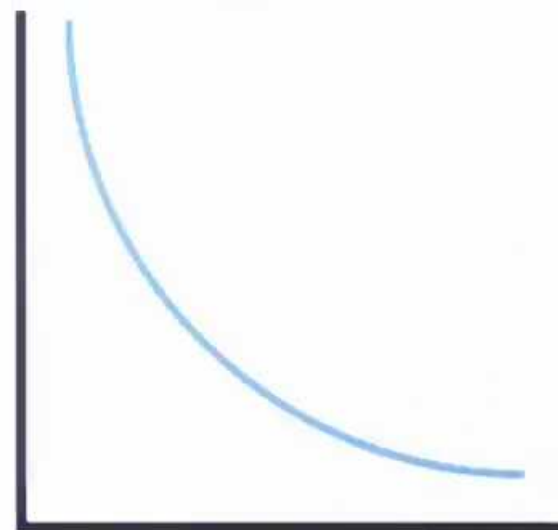


# Theory of Choice

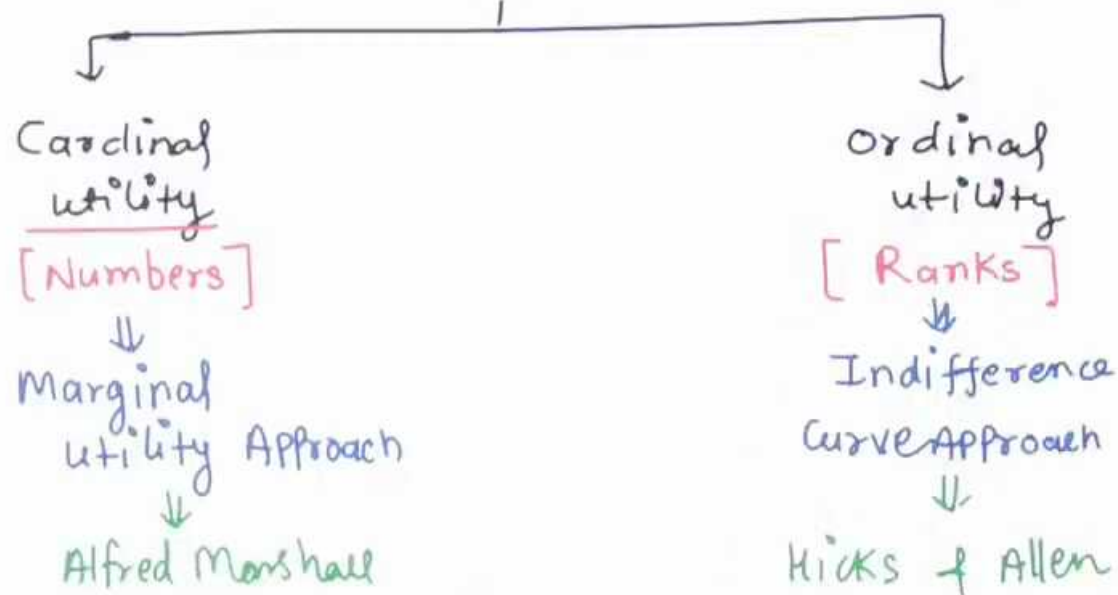
## Meaning of Indifference Curve

An indifference curve shows the various bundles (Combinations) of two goods that make the consumer equally happy i.e., consumer is equally satisfied.

comb	Apple	Orange	MRS
A	1	10	-
B	2	7	
C	3	5	
D	4	4	



utility  
(Satisfaction)





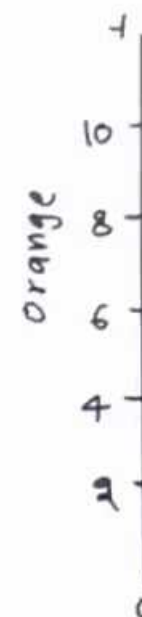
Equally Satisfy ←

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Equally Satisfy ←

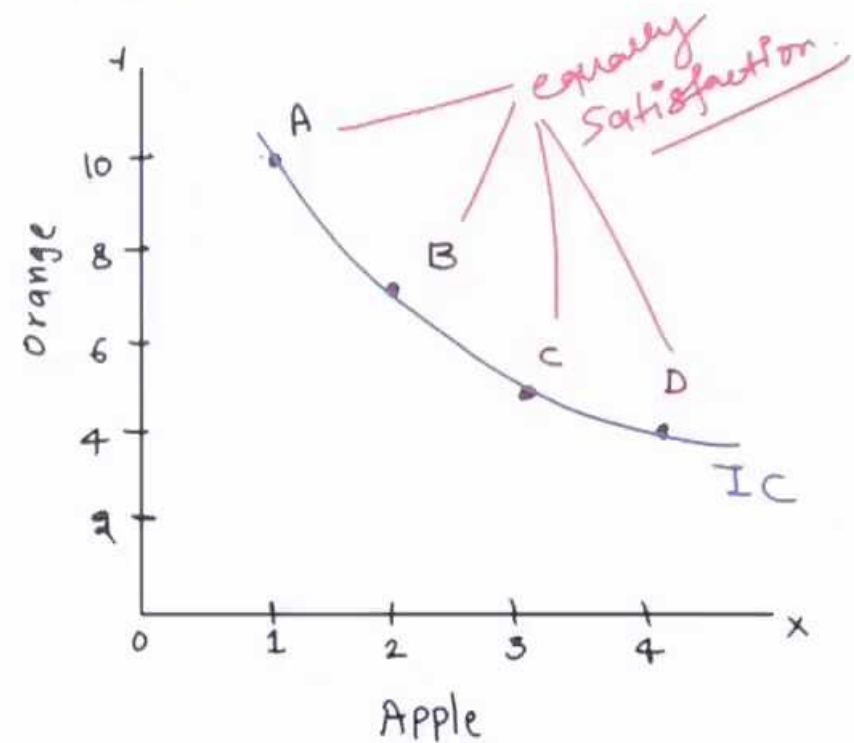
Equally Satisfy ←

Comb.	Apple	orange	MRS
A	1	10	
B	2	7	
C	3	5	
D	4	4	



→ Convex

Comb.	Apple	Orange	MRS
A	1	10	
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→ convex

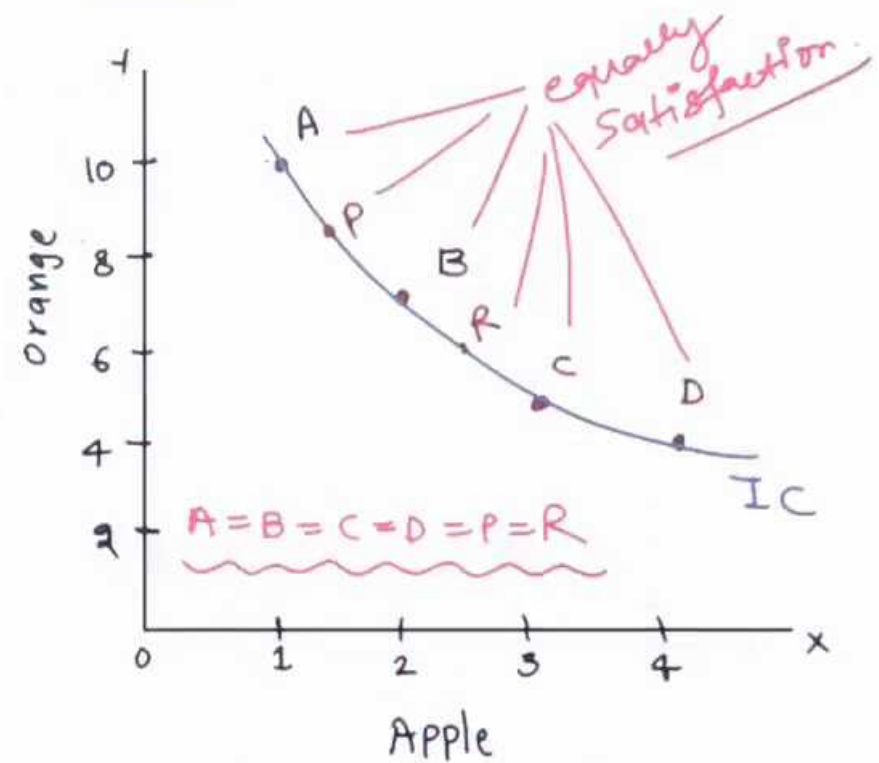




Figure shows different combinations of consumer on indifference curves. The consumer is indifferent among combinations A, B, C and D because they are all on the same curve.

Not surprisingly, if the consumer's consumption of orange is reduced, say, from point A to point B, consumption of apple must increase to keep him equally happy.

If consumption of orange is reduced again, from point B to point C, the amount of apple consumed must increase yet again.

## Meaning of Marginal Rate of Substitution

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It is the rate at which a consumer is willing to trade one good for another. In other words, MRS shows sacrificing amount of one good in order to achieve one unit of another good.

It is also called the Slope of Indifference Curve.

$$\text{MRS} = \text{Sacrificing Unit of Good-X} / \text{Gaining unit of Good-Y}$$

=



97%



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MRS = Sacrificing Unit of Good-X / Gaining unit of Good-Y

$$= \frac{\text{Sac.}}{\text{gain}} \quad \underline{\text{OR}} \quad \frac{\Delta X}{\Delta Y}$$



## Meaning of Marginal Rate of Substitution

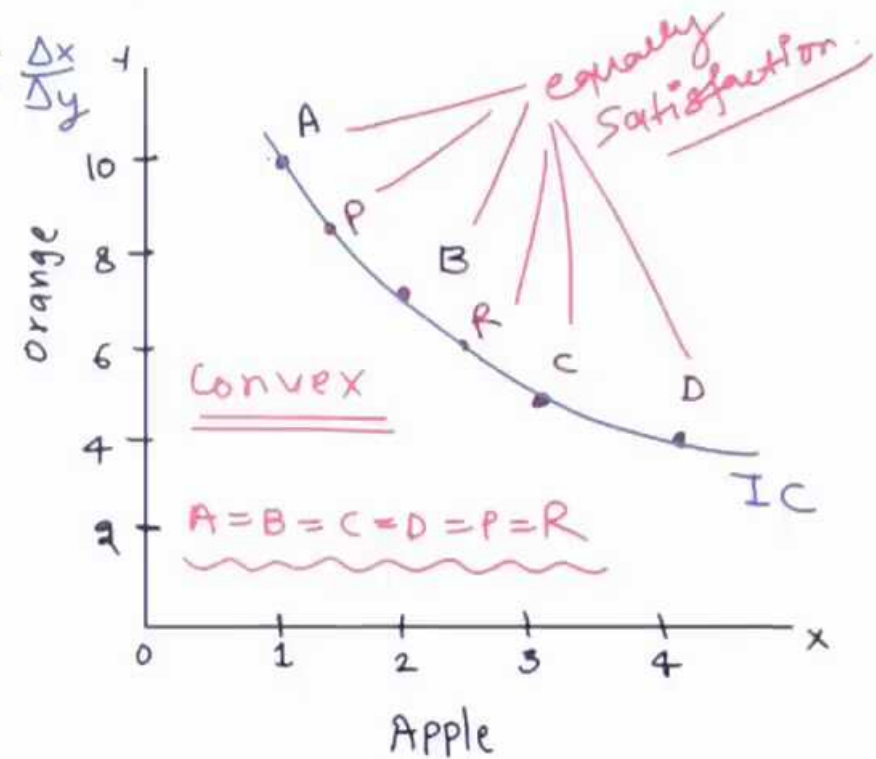
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$$\frac{\text{Sac.}}{\text{gain}} \quad \underline{\text{OR}} \quad \frac{\Delta X}{\Delta Y}$$

	Good-y	Good-x	
Comb.	Apple	Orange	MRS = $\frac{\text{Sac. gain}}{\text{or } \frac{\Delta x}{\Delta y}}$
1	10	-	
2	7		$\frac{3}{1} = 3$
3	5		$\frac{2}{1} = 2$
4	4		$\frac{1}{1} = 1$



## Meaning of Marginal Rate of Substitution

It is the rate at which a consumer is willing to trade one good for another. In other words, MRS shows the amount of one good in order to achieve one unit of other good.

It is also called Indifference Curve.

→ slope / shape → MRS

Unit of Good-X / Gaining unit of Good-Y

OR  $\frac{\Delta X}{\Delta Y}$

## Meaning of Marginal Rate of Substitution

It is the rate at which a consumer is willing to trade one good for another. In other words, MRS shows sacrificing amount of one good in order to achieve one unit of other good.

also called the Slope of Indifference Curve.

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## Meaning of Marginal Rate of Substitution

It is the rate at which a consumer is willing to trade one good for another. In other words, MRS shows sacrificing amount of one good in order to achieve one unit of other good.

It is also called the Slope of Indifference Curve.  $\rightarrow$  slope / shape  $\rightarrow$  MRS

MRS = Sacrificing Unit of Good-X / Gaining unit of Good-Y

$$= \frac{\text{Sac.}}{\text{gain}} \quad \underline{\text{OR}} \quad \frac{\Delta x}{\Delta y}$$

$$\text{Slope of I.C} = \text{MRS} = \frac{\Delta x}{\Delta y}$$



## Assumptions of Indifference Curve

- 1) The consumer acts rationally so as to maximize satisfaction.
- 2) There are two goods X and Y
- 3) The consumer's tastes, habits and income remain the same throughout the analysis.
- 4) Monotonic Preference : A consumer always prefer that good which provide him greater satisfaction.
- 5) More is better : More of commodity is preferred as compared to less of it. It is noted that there are some things which less of them is preferred to more. They are called 'bads' in economics. Like Pollution, germs, smog etc.