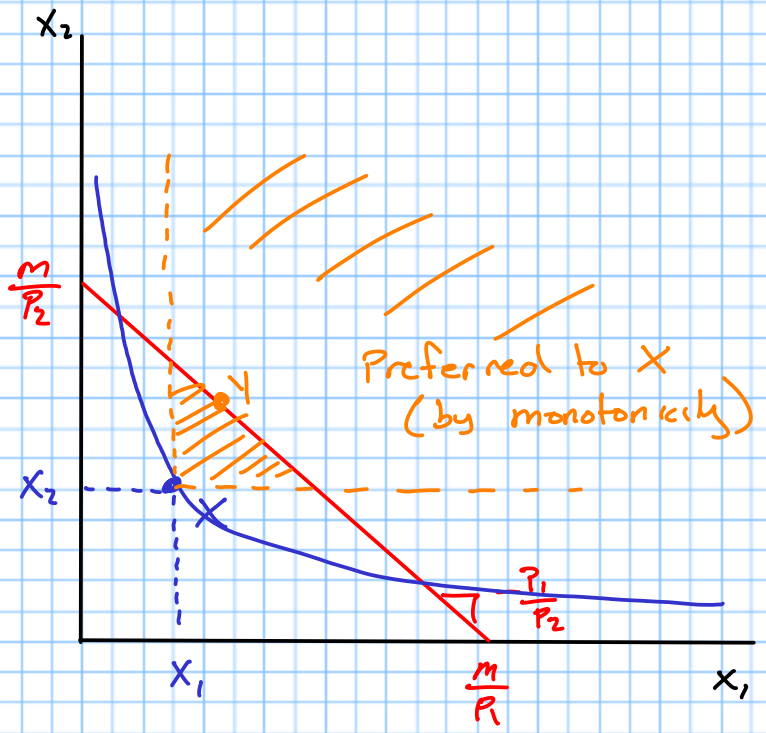
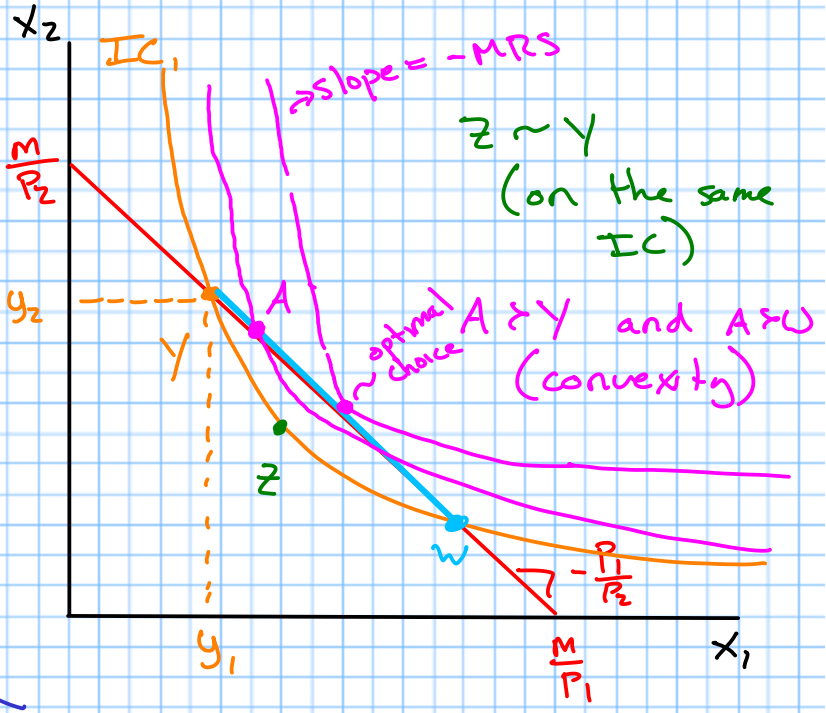
Choice

- We know what the consumer can buy (budget constraint)
- We know how consumers choose between alternatives (preferences)
- How do consumers choose their most preferred bundle that is in their choice set?

Note: unless otherwise noted, we will assume preferences are rational and well-behaved



- Suppose consumer is consuming $X = (x_1, x_2)$
- Is there another bundle they can consume that they would prefer to consume?
- Result 1: Consumer will choose a bundle on the budget line



Same question

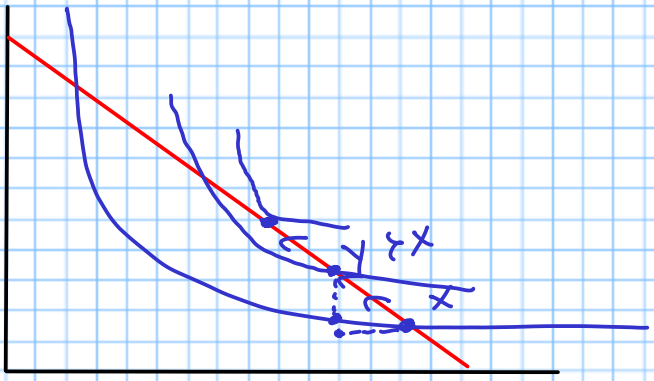
Result 2: At the optimum,

$-MRS = -\frac{P_1}{P_2}$

$MRS = P_1/P_2$

Slope of IC = slope of BL

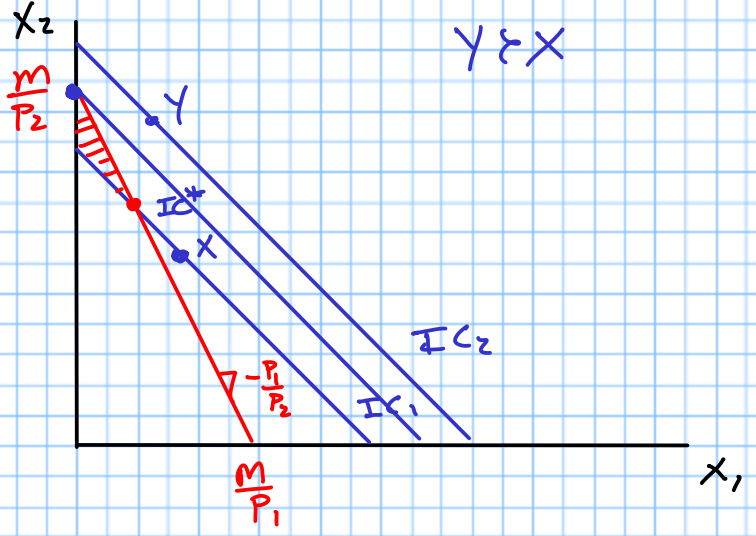
MRS = opportunity cost



What happens if preferences are not well-behaved?

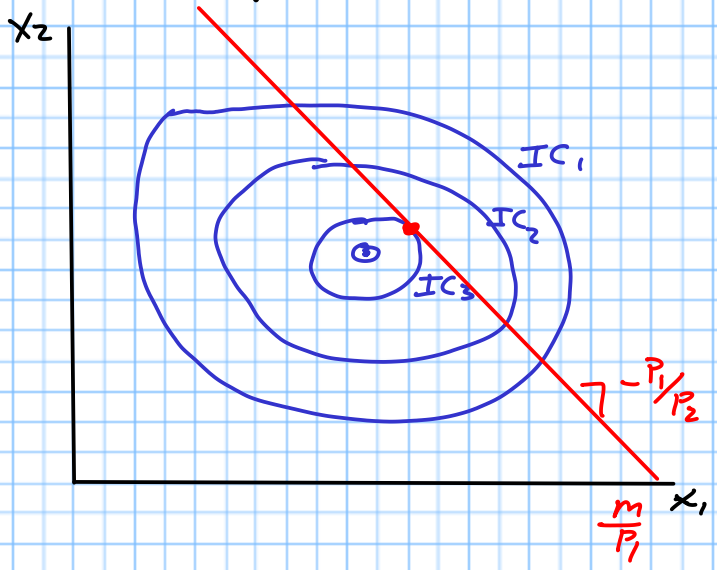
Example: Non-convex preferences

- Perfect substitutes



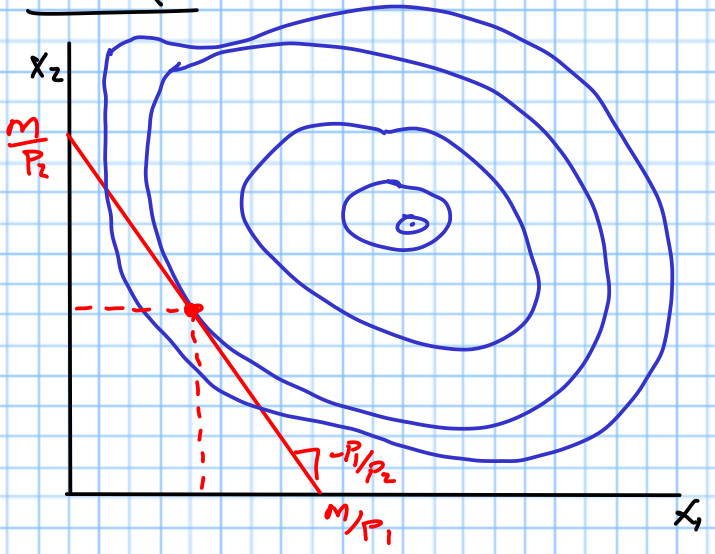
→ "Corner solution"
MRS ≠ P_1/P_2

Example: non-monotonic preferences



→ neither condition holds when preferences are non-monotonic

Example



We don't need preferences to be well-behaved everywhere, just for bundles in the choice set (under the budget line)