Chapter 05 Appendix: Indifference Curves

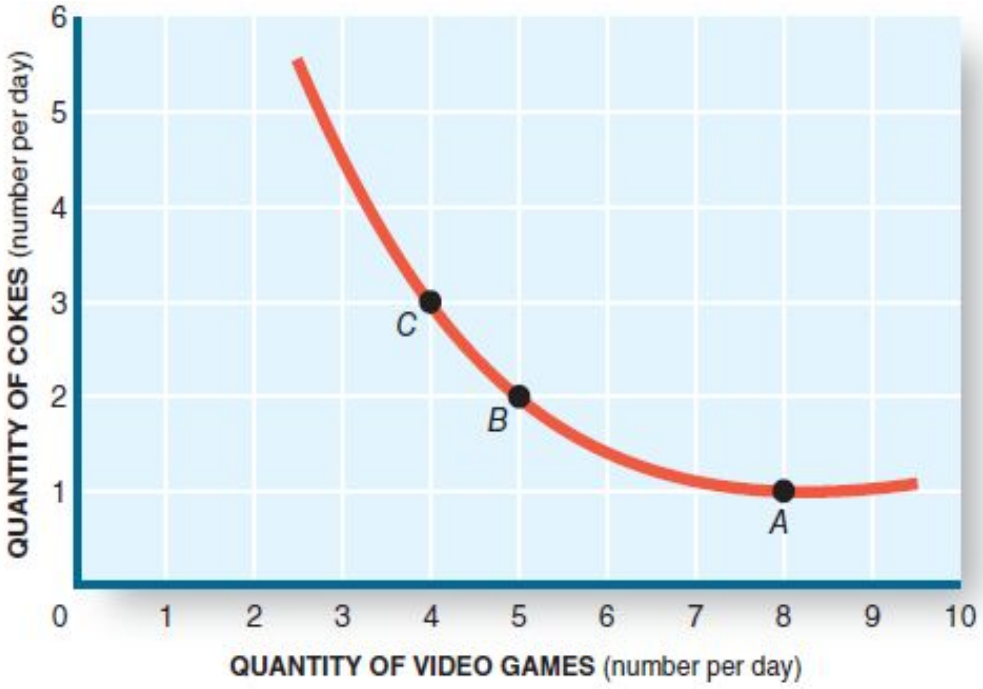
Indifference Curves

Indifference curve: a curve depicting alternative combinations of goods that yield equal satisfaction.

- This is a mechanism for illustrating consumer preferences.
- It can be used as a basis from which to construct a demand curve.

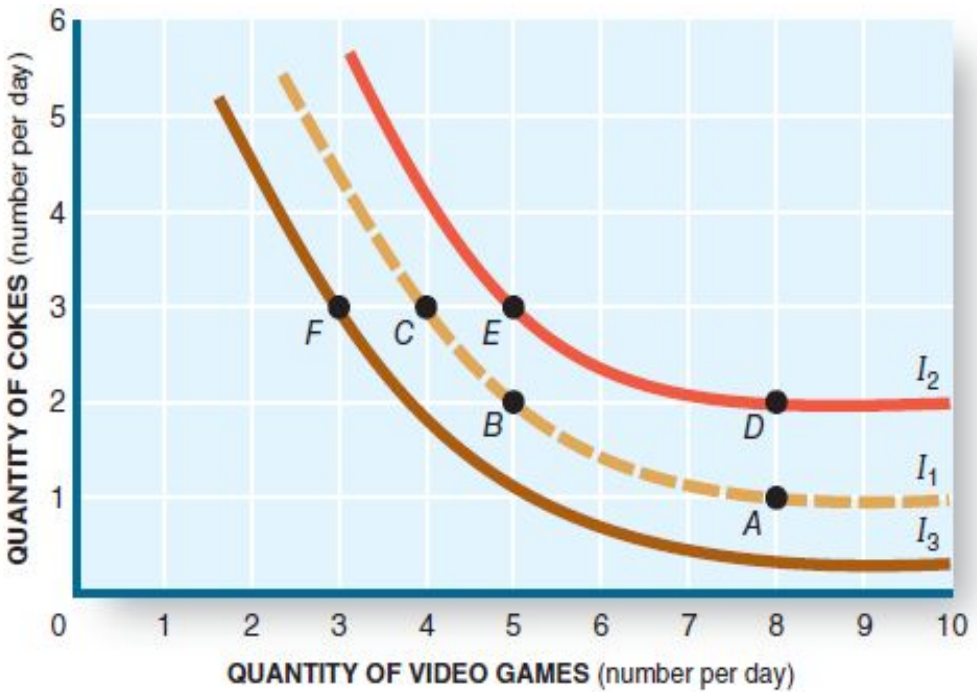
Indifference Curves

- On the graph, you have several choices between Cokes and games. The line indicates a series of combos that yield equal satisfactions.
- Since satisfactions are equal, the consumer would be indifferent as to which choice he or she would make.



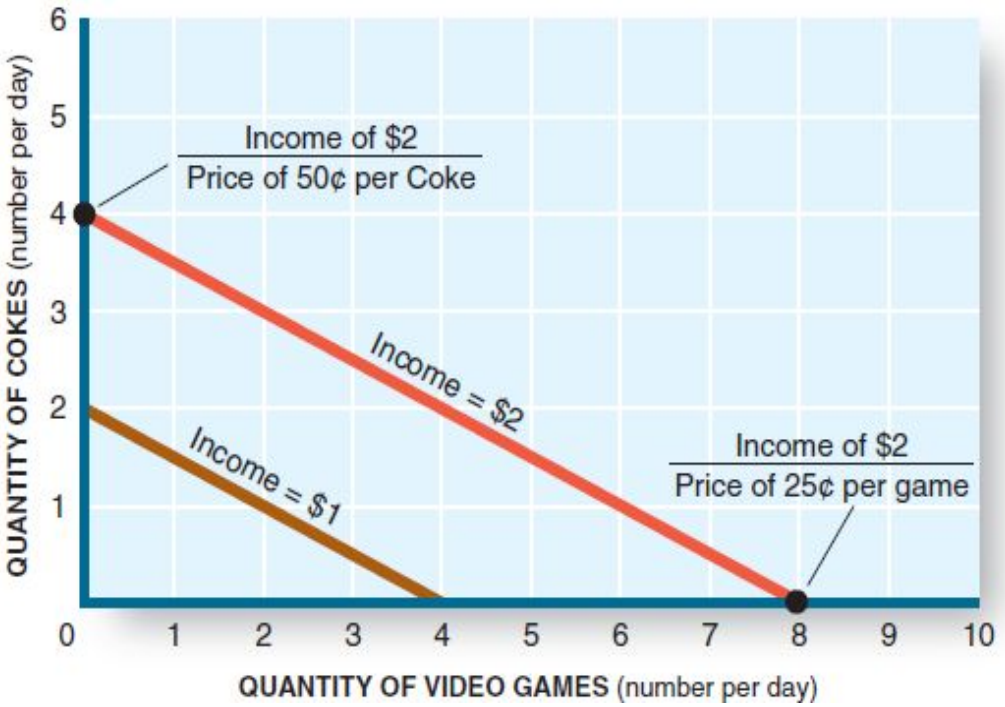
Indifference Curves

- The further away from the origin, the more total utility there is.
- Curve I_2 yields more total utility than curve I_1.
- Curve I_3 yields less total utility than curve I_1.
- This collection of curves is called an indifference map.



The Budget Constraint

- We operate with limited income – that is, on a budget. This limits what we can buy.
- This slide shows two budgets and what they can buy: one with $1 and one with $2.

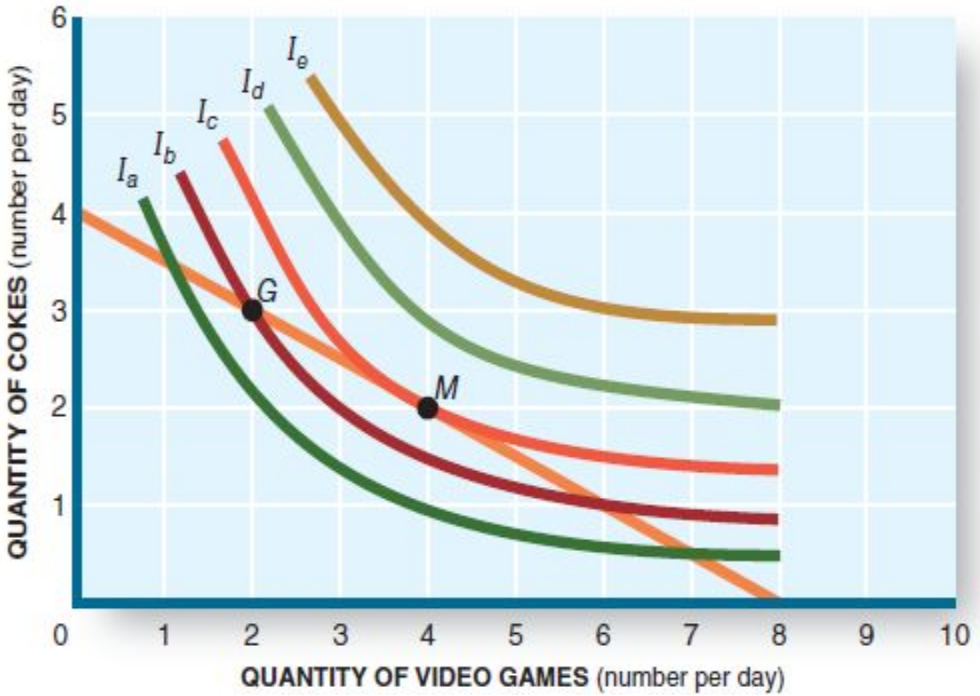


Let's Take a Different Look

Connect the Dots: Consumer Choice & Indifference Curves

Optimal Consumption

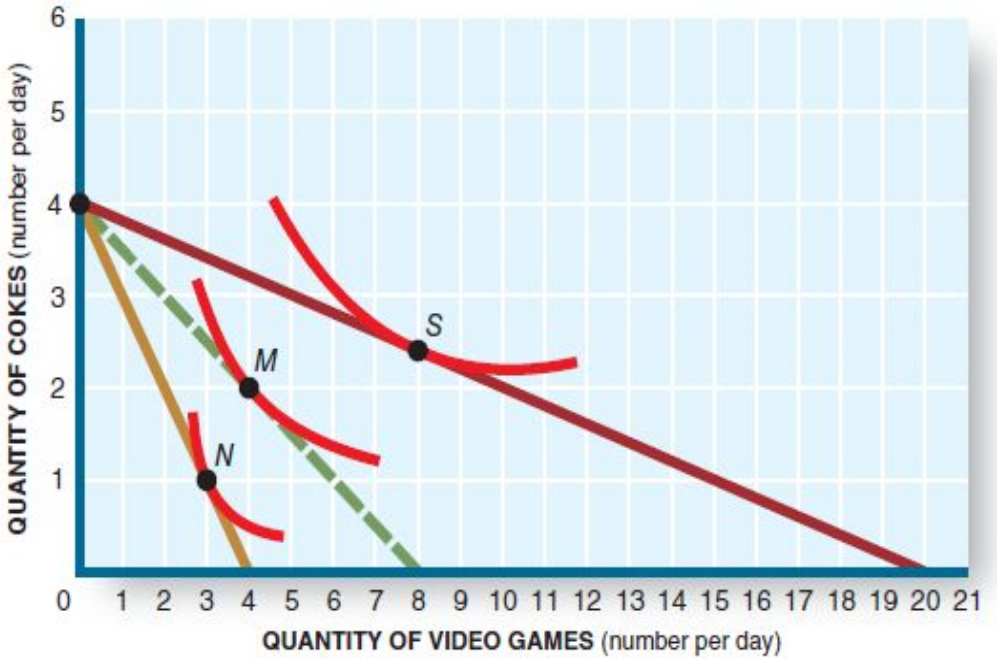
- The objective is to reach the highest indifference curve that is compatible with our budget constraint.
- That occurs at point **M**. No other affordable combination lies on a higher indifference curve than $\mathbf{I_C}$.
- For example, combination **G** lies on a lower indifference curve.



Relation to the Demand Curve

Whenever the price of a good changes, the budget constraint shifts.

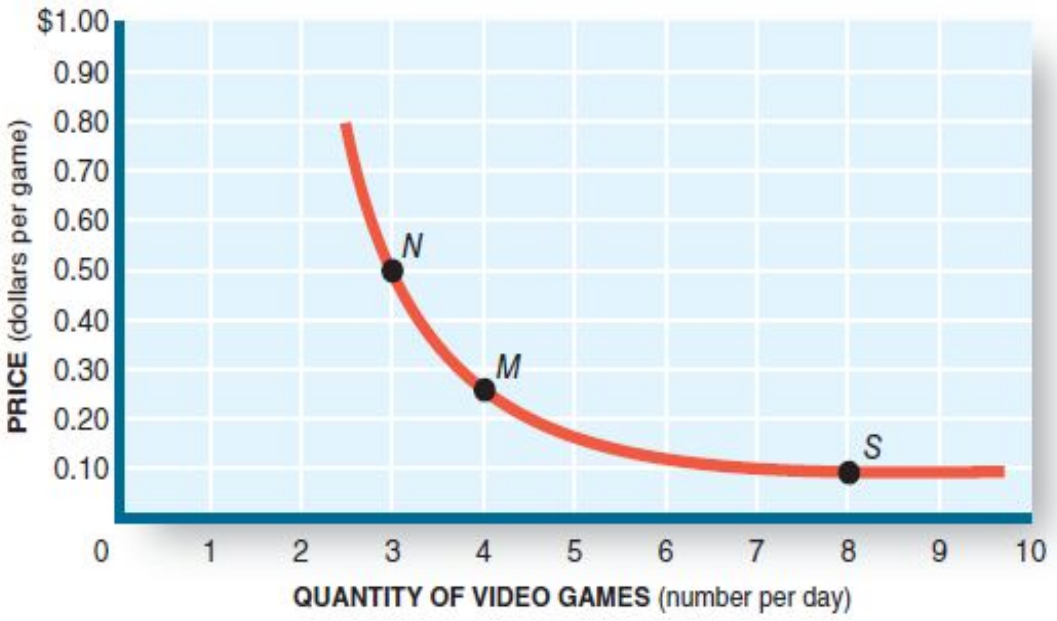
- With $2 to spend, increase the price of a video game from $0.10 to $0.25 to $0.50 reduces the maximum number of games that can be purchased from 20 to 8 to 4.
- The **optimal consumption** of games shifts from **S** to **M** to **N**.



Relation to the Demand Curve

We can construct the demand curve for games, using points **N**, **M**, and **S**.

- As price falls, quantity demanded rises, and vice versa.



Practice Question

Use the indifference curves and the budget lines in Figure 19.3 to answer the indicated question. Assume the price of Y is $1 per unit. If the price per unit of good X is $1, the optimal consumption is found at point

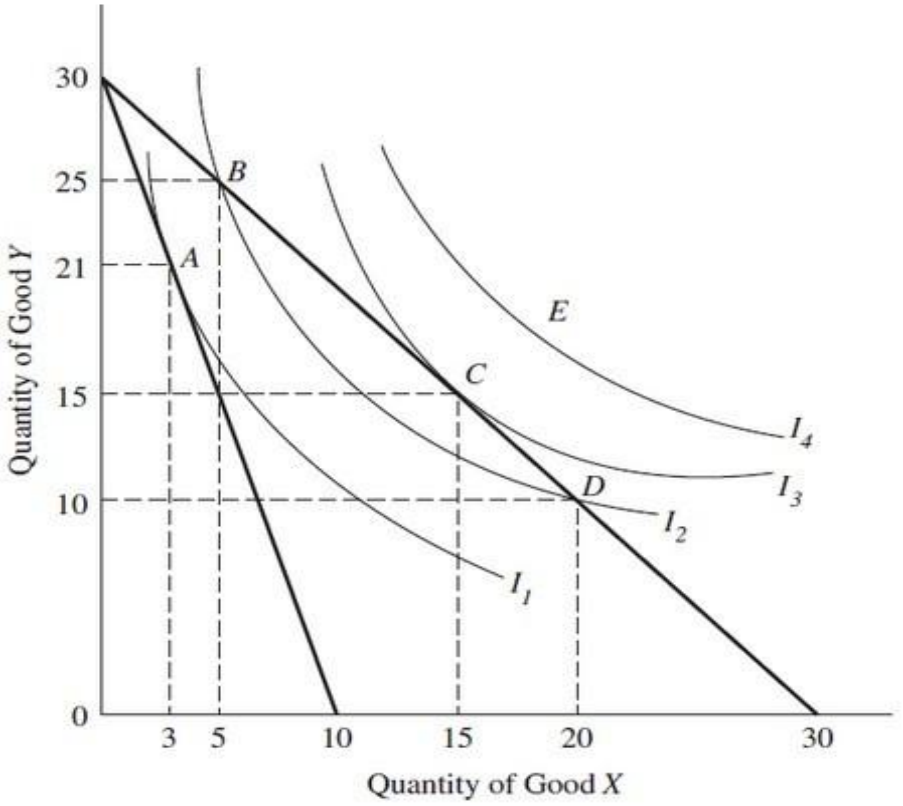


Figure 19.3

a) B b) D c) E d) C

Practice Question - Answer

Use the indifference curves and the budget lines in Figure 19.3 to answer the indicated question. Assume the price of Y is $1 per unit. If the price per unit of good X is $1, the optimal consumption is found at point

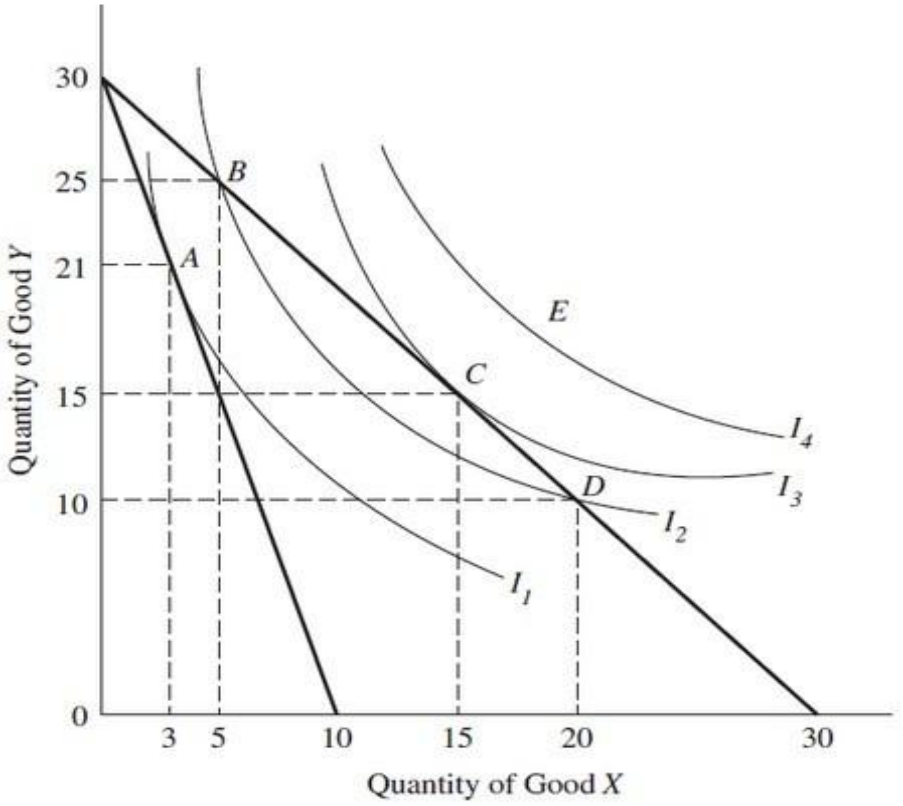


Figure 19.3

a) B b) D c) E **d) C**