

Hi. Welcome to Economics. This is Kate. This tutorial is called "Consumer Choice Theory." As always, my examples are going to be in green and my key terms will be in red. So, in this tutorial, we'll be talking about the different choices that consumers have to make, in the context of what we'll call a two-good economy. So, in this two-good economy, which it will be a simplified model, each consumer will have different preferences. And these preferences are going to make up something we call a utility function. Finally, then, you'll understand the three assumptions that we make about consumer behavior in the context of this two-good economy. And those are completeness, transitivity, and non-satiation.

OK. So we know that consumers make choices every single day. And we are constrained by both our time and our income. Those are, at least, our two biggest constraints. Where we are going with this is, how is it that we maximize our utility in all these decisions that we have to make? Remember, utility is satisfaction, what we get out of something. So we want to maximize it.

OK. So in the context of a two good economy, like I said that's a simplified model, the example I'll use for right now is, let's say, you have to choose between chicken and beef, maybe for dinner, each night of the week. So how much of each of them will you consume? Is it the same for everyone? Obviously not. So the idea here is that different consumers will have different preferences. And our individual preferences affect how much chicken versus beef I choose. And then, my choice might be different if my income changes, or if the price of either chicken or beef changes. So, again, the key idea that we're getting to in this tutorial, is that we each have our own utility functions, which is going to show our preference behavior.

OK. So this is something called an indifference curve. And if you can see right here, I've mapped the two goods in our two-good economy, beef on the x-axis and chicken in on the y-axis. And then I put three dots on this, what is called an indifference curve why. It's called an indifference curve is because, any point along here, the consumer is indifferent to. She would enjoy, or get the same amount of utility, out of a point A, which is consuming eight chicken and only one beef, or point B, which is consuming four chicken and three beef, or point C, consuming two chicken and seven beef. So all of those combinations would give her the same utility. And so she's indifferent to them. Where we're going to go with these indifference curves is, it's going to help show us which ultimate choice is going to maximize our utility. And we'll get there in a different tutorial.

OK. So while we're talking about our preference behavior, we make three assumptions. And they are completeness, transitivity, and non satiation. Let me talk about completeness first. So completeness, one of your key terms, is a condition of rational decision making, where our preferences are defined for all combinations of goods or services. So let's go back to the chicken and beef example to talk about what we mean here with that

definition of completeness. If I am confronted with the choices, different combinations, let's say along that indifference curve I showed you, different points. Point A, point B, point C. I'm always able to choose. I might say, well, I like this combination better than that combination. That would be choosing one over the other. Or I can say, you know what? I'm kind of indifferent between those two combinations. If I'm indifferent, that places them along the same indifference curve.

Where I would be violating this condition of completeness is if someone would say something to me like, oh, you know, well how do you feel about the combination of three chicken and ten beef, let's say. I would not be complete if I said something like, I don't know. I've never thought of that before. I really can't give you an answer. I don't know how I feel about that combination. So in order to be complete, I have to either say I prefer this over that, or I'm indifferent between them.

OK. Transitivity is the next assumption that we make. And this is assuming that we are rational, that we're logical. So if, for example, x is preferred to y, but y is preferred to z, then that means I must prefer x to z. So in the chicken and beef example, I put a little smiley face there. Am I rational? Well, with this hopefully. So I prefer chicken to beef. But I prefer beef to shrimp. So since I like chicken better than beef, and I like beef better than shrimp, I must really not like shrimp that much. I must prefer chicken to shrimp. OK so that's transitivity, that we can't be inconsistent with what we're saying we prefer.

Finally, non-satiation is a fancy term for saying that we'll always, that we always like more. More is always better than less. And this kind of assumes that you can throw it away if you don't want it. It's not going to cost you anything to throw it away. So if two bundles are exactly the same, except one has more chicken, then I take the one with more chicken.

All right. And that is going to leave us here, with one final graph. And this shows indifference curves that cannot ever happen. These would show inconsistent preferences, based on what I was just talking about. OK. So curve here, curve one here, shows that consumer likes-- the consumer likes A and C the same, because they're on the same indifference curve. But at the same time, indifference curve two is suggesting that the consumer likes A and B the same. OK. That would all be fine and well. But, unfortunately, that doesn't make sense, because that would mean C and B should be preferred the same. If A and C are the same, and A and B are the same, then B and C should be preferred the same. But here, that violates both transitivity and non-satiation, because B contains more chicken and more beef. This just cannot be the case. And hopefully that makes sense, if you understand those three assumptions that we make.

OK. So in this tutorial, you learned that every consumer has different preferences, when faced with a choice, in our simplified two-good economy. And when we map our preferences, we're going to be arriving at what we call a

utility function. And there are three assumptions that we make about our preferences. There are the completeness, transitivity, and non-satiation. Thanks so much for listening. Have a wonderful day.