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The Common Sense of Consumer Choice

LEARNING OBJECTIVES

After completing the material in this chapter you should be able to

- define, understand, and use correctly the terms and concepts listed below.
- distinguish between total and marginal utility.
- explain the role of marginal utility as a guide to the maximization of total utility.
- explain how the law of diminishing marginal utility can be used to derive an optimal purchase rule.
- explain how the optimal purchase rule can be used to derive a demand curve.
- explain what assumptions mean by inferior goods and why inferior goods may have demand curves that slope upward.
- distinguish between the income and substitution effects of a price change.

IMPORTANT TERMS AND CONCEPTS

Diamond-water paradox
Marginal analysis
Total utility
Marginal utility
Diminishing marginal utility
Optimal purchase rule (P = MU)
Scarcity and marginal utility
Inferior goods
Income effect
Substitution effect