

CONSUMER DEMAND

The Micro Economy Today, 11th Edition
By Bradley R. Schiller

Consumer Theory: Chapter 5, pages 86 – 91 and 103 – 106
Elasticity: Chapter 5, pages 92 – 103 and 106 – 108

I. How Do Consumers Spend Their Money – And Why?**A. What do we know about the “Average American Household” in year 2008?**

1. It was composed of _____ persons, with _____ persons as income earners.
2. It had a head of household with an average age of _____ years.
3. In _____ of cases, the household head was _____.
4. It had _____ vehicles.
5. _____ of households owned their homes, _____ of households were renters.
6. The average household income before taxes was _____.

B. The 2008 Consumer Expenditure Survey

Item	2008 Dollars Spent	% of Budget
Food	\$6,443	12.8%
At home	\$3,744	
Away from home	\$2,698	
Alcoholic Beverages	\$444	0.9%
Tobacco products and smoking supplies	\$317	0.6%
Housing	\$17,109	33.9%
Shelter	\$10,183	
Utilities	\$3,649	
Operations (baby sitting, elderly care, cleaning, etc)	\$998	
Household Supplies	\$654	
Furnishings	\$1,624	
Apparel and Services	\$1,801	3.6%
Transportation	\$8,604	17.0%
Vehicle	\$2,755	
Gas/oil	\$2,715	
Public Transportation	\$513	
Other (repairs, insurance, etc)	\$2,621	
Healthcare (health insurance, prescription drugs, medical supplies)	\$2,976	5.9%
Entertainment (pets, toys, hobbies, recreational vehicles)	\$2,835	5.6%
Personal Care Products & Services	\$616	1.2%
Reading	\$116	0.2%
Education	\$1,046	2.1%
Cash Contributions (churches, charities, religious organizations, political campaigns, etc)	\$1,737	3.4%
Personal Insurance and Pensions	\$5,605	11.1%
Life and other	\$317	
Pensions	\$5,288	
Miscellaneous	\$840	1.7%
TOTAL	\$50,486	100.00%

Data available online from the Bureau of Labor Statistics at:

<http://www.bls.gov/cex/2008/standard/multiyr.pdf>

C. Gender-based spending differences for young people

	Females under 25		Males under 25	
Food	\$2,769	14.0%	\$2,969	14.8%
Alcoholic Beverages	\$363	1.8%	\$611	3.1%
Tobacco products and smoking supplies	\$83	0.4%	\$174	0.9%
Housing	\$6,721	33.9%	\$6,320	31.6%
Apparel and Services	\$1,059	5.3%	\$611	3.1%
Transportation	\$3,077	15.6%	\$3,537	17.7%
Healthcare (health insurance, prescription drugs, medical supplies)	\$455	2.3%	\$311	1.6%
Entertainment (pets, toys, hobbies, recreational vehicles)	\$1,080	5.5%	\$1,102	5.5%
Personal Care Products & Services	\$440	2.2%	\$136	0.7%
Reading	\$50	0.3%	\$45	0.2%
Education	\$2,367	12.0%	\$2,407	12.0%
Cash Contributions (churches, charities, religious organizations, political campaigns, etc)	\$151	0.8%	\$291	1.5%
Personal Insurance and Pensions	\$976	4.9%	\$1,351	6.6%
Miscellaneous	\$206	1.0%	\$153	0.7%
TOTAL	\$19,798	100%	\$20,019	100%

Data available online from the Bureau of Labor Statistics at:

<http://www.bls.gov/cex/2008/CrossTabs/singlesbyage/malesage.PDF>

<http://www.bls.gov/cex/2008/CrossTabs/singlesbyage/femalage.PDF>

From this table, we can clearly see that:

1. Young females spend more money on:

2. Young males spend more money on:

D. Possible Explanations of Consumer Spending Patterns

1. The Socio-Psychiatric Explanation

a.

b.

c.

2. The Economic Explanation

To actually acquire goods and services, you must be:

3. From this point forward, we will simply take consumer preferences as _____

_____ .

II. Consumer Theory

A. The Basic Concepts

1. Utility:

2. Disutility:

3. How much utility (or disutility) is experienced from a good, service, or activity depends on:

B. Total versus Marginal Utility

1. Total Utility:

2. Marginal Utility:

3. Example – Let's consider a Utility Schedule for an individual (maybe it's you, maybe it's me – you get the idea) who actually likes to consume pizza by the slice.

# of pizza slices	Marginal Utility	Total Utility
0		
1		
2		
3		
4		
5		
6		

C. The Law of Diminishing Marginal Utility:

D. Implication

1. As the Marginal Utility received from consuming a product _____ ,
so does:

2. This Law gives us another reason why:

E. Goal of the Consumer:

1. The consumer faces two constraints:

a.

b.

2. In order to decide how many units of a product to actually consume, you must compare:

=>

F. Application: Should the Government provide life's necessities for free?

Well, health care has been a pretty popular topic as of late.....

Suppose a visit to the doctor costs you _____ .

You visit your doctor so long as:

Maybe that's _____ visits per year.

Now the government makes a doctor's visit FREE.

Now you visit the doctor so long as:

Maybe that's _____ visits per year.

So what's the problem?

III. Basics on Price Elasticity of Demand

A. Price Elasticity of Demand is a concept designed to measure the:

1. A product has _____ demand if there is a _____ quantity response by consumers when its price changes.

a. Consumers buy _____ if the price of this product falls.

b. Consumers buy _____ if the price of this product rises.

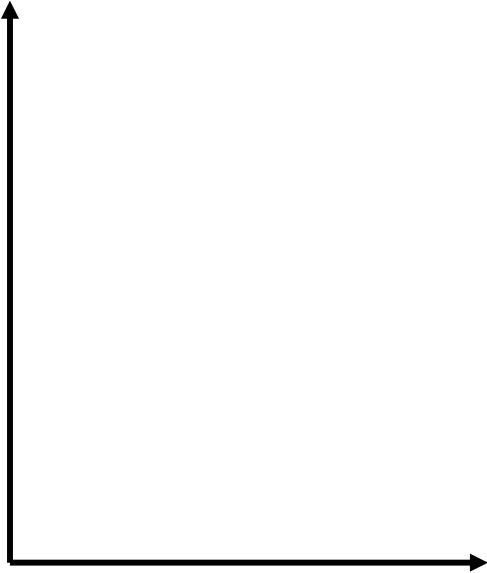
2. A product has _____ demand if there is a _____ quantity response by consumers when price changes.

a. Consumers buy _____ if the price of this product falls.

b. Consumers buy _____ if the price of this product rises.

Graph of the Demand Curve for a Product with:

Graph of the Demand Curve for a Product with:



B. Determinants of a Product's Elasticity

1. A product is more likely to have _____ demand if:

a.

b.

c.

2. A product is more likely to have _____ demand if:

a.

b.

c.

3. The Second Law of Demand

a. The demand for ANY PRODUCT will become _____
_____ over time.

b. Why?

C. Extreme Elasticity Conditions

1. Perfectly Elastic Demand:

2. Perfectly Inelastic Demand:

Graph of the Demand Curve for a Product with:



Graph of the Demand Curve for a Product with:



IV. Computing a Product's Elasticity Coefficient

A. Formula

IMPORTANT: We ARE NOT USING the “midpoint formula” as discussed on pages 92 – 93 of your textbook. MY FORMULA is easier! All questions on practice problems and exams will be written with answers that correspond to using the simple % change formula provided in class. So you'd better use this formula and ONLY THIS FORMULA!

Good Question: How do you compute the % change in a statistic?

B. Evaluating Your Coefficients

1. E_D coefficients will automatically be _____ numbers.

Does that makes sense to you?

It should, based on your knowledge of the Law of Demand!

2. To keep things as simple as possible, we will take the _____
_____ (drop the negative) of our elasticity coefficients.

3. The number line

C. First Hypothetical Example - airfare

When round-trip airfare between Tallahassee and Atlanta is _____ per trip, people fly _____ times per year.

When round-trip airfare increases in price to _____ per trip, people fly only _____ times per year.

1. Computation and classification

2. Graph of the demand curve for air travel

3. When product demand is ELASTIC:

D. Second Hypothetical Example - steak

When steak is priced at _____ per pound, people purchase _____ pounds of steak per month.

When steak prices fall to _____ per pound, people purchase _____ pounds of steak per month.

1. Computation and classification

2. Graph of the demand curve for steak

3. When product demand is INELASTIC:

V. Price Elasticity and Sales Revenue for Business Owners

A. Sometimes we as consumers operate under the FALSE BELIEF that business owners will:

1. The goal of the business owner is to:

2. Formulas

a.

b.

B. Example: Joe's Gourmet Burger Stand

Joe is an entrepreneur who currently lives in the Tallahassee area. He has a pick-up truck and an attached trailer. In this trailer is all of the kitchen equipment necessary to produce hamburgers. Joe exemplifies the true meaning of “meals on wheels”, since he can place his business in the precise geographic location of his customers. This week, that location might be at Southwood. Next week, it might be on the FSU campus. In the springtime, it might be downtown near the capitol building while legislators and lobbyists are in town. You get the idea!

1. Suppose Joe currently sells _____ hamburgers per day at a price of _____ per burger.

2. Compute Joe's Total Sales Revenue

3. What would happen to Joe's Total Sales Revenue if he raised the price of the gourmet burger to _____ each?

C. Scenario #1: Suppose when Joe raises price to _____ per burger, he sells only _____ burgers per day.

1. In this example, we have:

2. Compute Joe's New Total Sales Revenue

3. When demand for a product is _____:

D. Scenario #2: Suppose when Joe raises price to _____ per burger, he sells only _____ burgers per day.

1. In this example, we have:

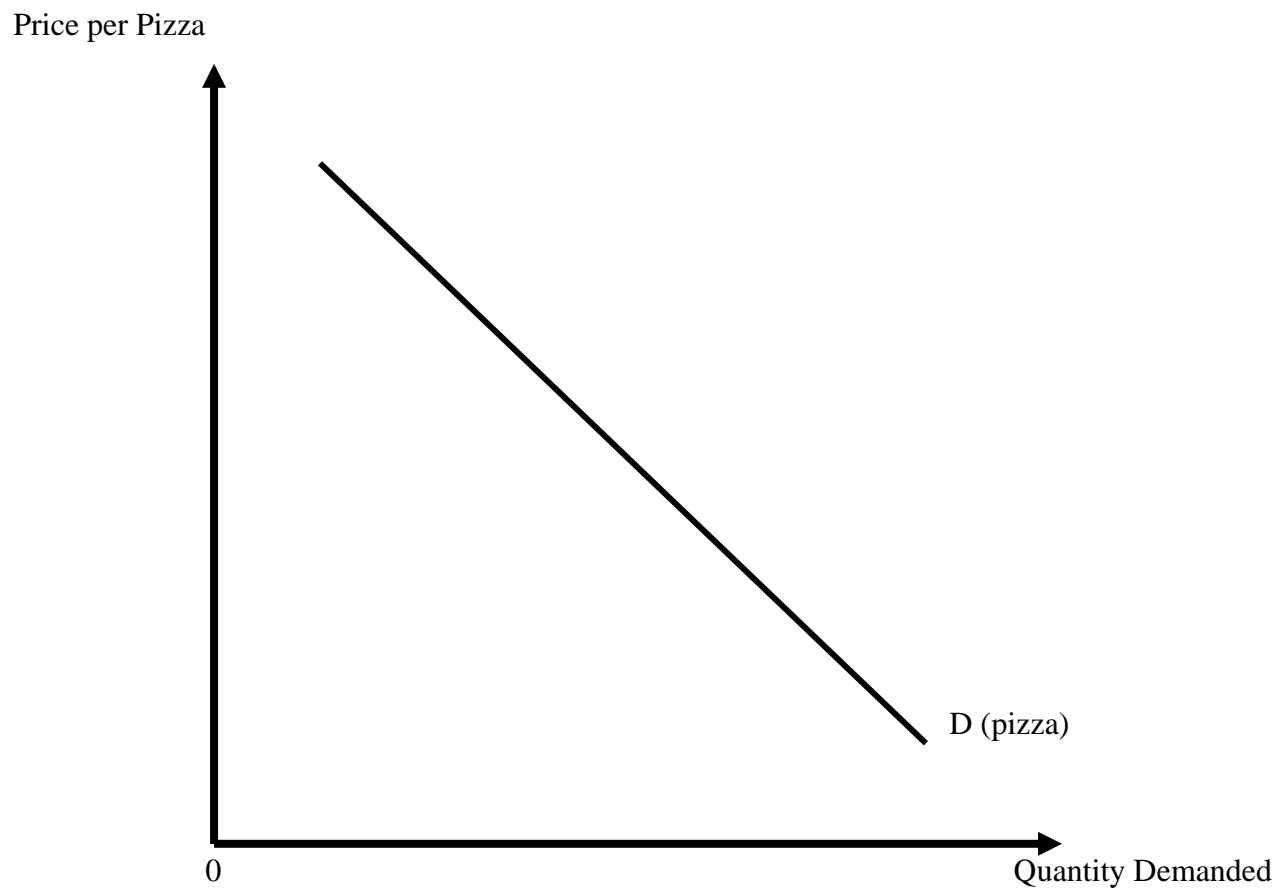
2. Compute Joe's New Total Sales Revenue

3. When demand for a product is _____:

E. Real-World Complication

1. Price elasticity of demand:

2. Graph



3. Implication

a. At a relatively high price, the demand for pizza (or in general, any product)

tends to be _____ .

=>

b. At a relatively low price, the demand for pizza (or in general, any product)

tends to be _____ .

=>

VI. Applications with Price Elasticity of Demand

A. Government Taxation of Goods and Services

1. Sometimes the government chooses to tax a product:

In this case, it will need to tax a product with _____ demand.

2. Sometimes the government chooses to tax a product:

In this case, it better hope the product has _____ demand.

3. What happened with the luxury boat tax in the 1990s?

B. Advertising

1. From the ECONOMIC PERSPECTIVE, why do companies spend billions of dollars each year on advertising?

a.

b.

2. Graph

3. As this shift takes place: