

## CHAPTER 10

# CONSUMPTION AND THE CONSUMER SOCIETY

*Microeconomics in Context* (Goodwin, et al.), 1<sup>st</sup> Edition (Study Guide 2008)

### Chapter Summary

In this chapter, we explore the traditional microeconomic model of consumer behavior, in which consumers are assumed to maximize utility using marginal thinking. You will learn how changes in prices and income influence a consumer's budget line.

Also in this chapter you will learn about the psychological models of consumer behavior that are used in marketing research and in other areas of the social sciences. The text raises questions about what it means to pursue well-being, and looks at the ways in which the traditional model can fall short in accounting fully for this process. If your instructor chooses to include the appendix to this chapter, you will learn about the concept of indifference curves in the traditional model.

### Objectives

After reading and reviewing this chapter, you should be able to:

1. Describe the marketing view of consumer behavior.
2. Describe the utility theory view of consumer behavior.
3. Discuss the history and institutions of consumer society.
4. Discuss the relationship between consumption and well-being.
5. Comment on the benefits of and problems with consumer society.

### Key Terms

consumer sovereignty  
attributes (characteristics)  
reference group  
aspirational group  
real income  
utility function  
diminishing marginal utility  
wants  
capability approach  
relative deprivation

living standard (lifestyle) goals  
reference point  
membership group  
budget line  
utility  
utils  
consumerist values  
needs  
absolute deprivation

### Active Review Questions

*Fill in the blank*

1. The idea of consumer sovereignty holds that \_\_\_\_\_ is the ultimate economic goal.

2. A group to which a consumer wishes he or she could belong to is a(n) \_\_\_\_\_ group.
3. One frequently used categorization of human perceived needs breaks these needs down into five categories: physiological needs, safety needs, social needs, esteem needs, and \_\_\_\_\_ needs.
4. Goods and services are said to have \_\_\_\_\_ that are the real items of interest to the consumer.
5. The economic approach that assesses institutions and policies in terms of the opportunities they create for people to live valuable lives is known as the \_\_\_\_\_ approach.
6. There is about 1 passenger car for every 2 people in the US, about 1 for every \_\_\_\_\_ people in Europe, and about 1 for every \_\_\_\_\_ people in developing countries.
7. The purchasing power of income, with prices taken into account, is referred to as \_\_\_\_\_ income.
8. A \_\_\_\_\_ line shows all the combinations of two goods that a consumer can purchase, given his or her monetary resources and the prices of the two goods.

*True or False*

9. About one fifth of the world's population suffers from absolute deprivation.
10. One's relative income level, at a given point in time, has no effect on one's happiness.
11. If China were to increase its car ownership rates to the current level in the US, it would need to pave over an area equivalent to more than 1/10 of its current rice-producing land.
12. Renee allocates her income between soup and nuts. If the price of soup increases while the price of nuts remains constant, Renee's budget line will shift inward to a new, parallel budget line.
13. John allocates his income between bows and arrows. Suppose that a graph of his budget line shows quantity of bows on the horizontal axis and quantity of arrows on the vertical axis. If the price of bows decreases, John's budget line pivots outward to a new line with a shallower slope.

14. According to the traditional model, consumers maximize utility by purchasing goods up to the point where the marginal return on utils is equal to marginal cost.
15. In the standard model of consumer maximization of utility, some goods – such as voting and eating chocolate cake – are considered to be incommensurable, meaning that we cannot meaningfully model decisions between them in the same graph.

*Short Answer*

16. Name the five steps in the consumption decision making process, according to the marketing view.

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17. “Marginal thinking about consumption breaks down if the underlying assumptions are violated.” Explain, and suggest one example that illustrates this point.

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18. Briefly explain the difference between old utility theory and new utility theory.

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Questions #19 and #20 are based on material covered in the Appendix to Chapter 10.

19. Briefly define the concept of an “indifference curve,” and illustrate it with an example.

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20. Explain why indifference curves are generally drawn as a curve that is bowed in toward the origin.

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**Problems**

1. Joel has \$10 to spend on some combination of roses and daisies. Roses cost \$1 each, and daisies cost \$2 each.
  - a. Draw Joel's budget line, putting daisies on the vertical axis.
  
  
  
  
  
  
  
  
  
  
  - b. If Joel buys four daisies, how many roses can he buy?
  
2. Continuing the example from above, now suppose that Joel's income increases from \$10 to \$12. Sketch the budget line from problem #1 and then show the change to the new budget line.



- b. The price of both beans and corn decreases by 50%, to \$5 and \$10 respectively. Draw the change in Jenny's budget line on the graph in part (a).
- c. What other event could have produced the change you diagrammed in your answer to part b?

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5. Tabitha has \$6 to spend. She has the option to buy two goods: sandwiches and peppermints. Sandwiches cost \$3 each, and peppermints cost \$1 per bag. The table below shows the utility Tabitha derives from consuming sandwiches or peppermints at various levels of consumption.

- a. In the table below, fill in the marginal utility per dollar for each level of consumption.

Units purchased	Sandwiches		Peppermints	
	Marginal utility	Marginal utility/\$	Marginal utility	Marginal utility/\$
1	9		15	
2	6		9	
3	3		4	
4	n/a		2	
5	n/a		1	

- b. How should Tabitha spend her first \$ 3? Explain why.

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- c. How should Tabitha spend her remaining \$ 3? Explain why.

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### Self Test

1. The other consumers whose consumption choices help you decide what to buy are
  - a. your reference group
  - b. your support group
  - c. your self-actualization group
  - d. your budget reference
  - e. your reference point

Questions # 2 and # 3 refer to the budget line graph below:

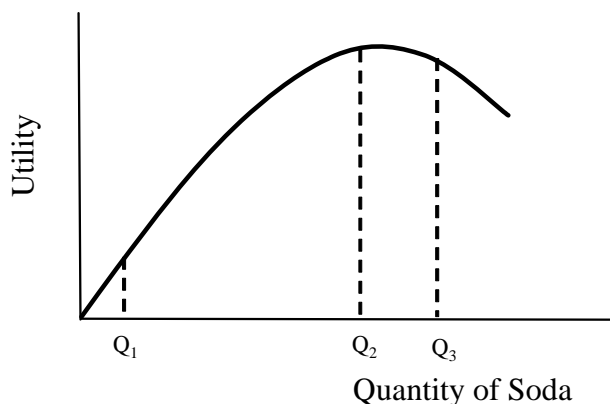


2. Dorothea has to allocate her budget between groceries and rent. Which of the following combinations can Dorothea afford?
  - a. 6 weeks of rent and 20 bags of groceries
  - b. 6 weeks of rent and 10 bags of groceries
  - c. 1 week of rent and 25 bags of groceries
  - d. 5 weeks of rent and 18 bags of groceries
  - e. 6 weeks of rent and no groceries
3. Dorothea has to pay for a trip to the emergency room when her niece has an asthma attack. Now she has less money for groceries and rent. What happens to her budget line?
  - a. The slope increases.
  - b. The slope decreases.
  - c. The budget line does not change.
  - d. The budget line shifts toward the origin while the slope does not change.

- e. The budget line pivots to the right.
4. Which of the following is an example of relative deprivation?
- a. Three teenagers spend their allowances on new clothes.
  - b. Sam can't afford to get trendy clothes like his 9<sup>th</sup> grade classmates.
  - c. A child gets sick because he doesn't have enough to eat.
  - d. A wealthy donor withdraws support from the local school system.
  - e. A community cannot afford to obtain vaccines against yellow fever.
5. Jane allocates her income between candy and soda. Something happens that causes her budget line to shift toward the origin without a change in slope. What could have caused this change?
- a. Jane's income decreased.
  - b. The price of both candy and soda increased by the same percentage.
  - c. The price of candy increased.
  - d. Jane decided to buy more of both goods.
  - e. Both a and b are true.
6. Consumer sovereignty is the idea that
- a. Businesses should be consumer-oriented.
  - b. Consumers should be independent of the government.
  - c. Consumer satisfaction is the ultimate economic goal.
  - d. It's important to the economy for consumers to be employed independently.
  - e. Both a and c.
7. George buys a fashionable new outfit, hoping to impress his colleagues. In Maslow's hierarchy of needs, George can be said to be fulfilling a(n)
- a. physiological need
  - b. safety need
  - c. esteem need
  - d. self-actualization need
  - e. basic need
8. Psychologists have found that the degree to which we perceive a need is related to
- a. reference points
  - b. reference groups
  - c. our past experience
  - d. the experience of groups to which we compare ourselves
  - e. all of the above

9. The assumption of rational consumer behavior is characteristic of
- the marketing view
  - the utility theory view
  - the traditional microeconomic view
  - both a and c
  - both b and c
10. John divides his income between chips and salsa. If the prices of both chips and salsa decrease by the same proportion, which of the following statements is true?
- The effect on John's budget line is the same as if his income had increased with no change in price.
  - The effect on John's budget line is the same as if his income had decreased with no change in price.
  - John's real income decreases.
  - John's utility decreases.
  - John's budget line pivots outward.
11. Which of the following is *not* an element of a consumer's decision-making process from a marketing perspective?
- problem recognition
  - information search
  - evaluation of alternatives
  - production decision
  - post-purchase behavior
12. According to the theory of consumer maximization of utility,
- People's numeric assessments of utility are obtained from survey data.
  - People trade goods for utility.
  - People are assumed to act as if they were maximizing a quantifiable entity called utility.
  - Marginal utility is always positive.
  - Marginal utility increases as consumption of a good increases.

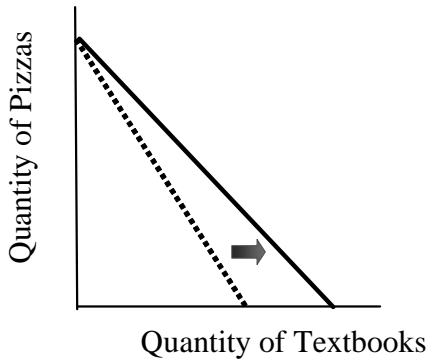
Question #13 refers to the following graph:



13. The graph above shows the utility function of a student consuming bottles of soda. Which of the following statements is *false*, based on the information in this graph?
- The marginal utility of an additional can of soda in the region from  $Q_1$  to  $Q_2$  is positive.
  - Diminishing marginal utility first occurs at  $Q_3$ .
  - Soda consumption is characterized by diminishing marginal utility.
  - Marginal utility is greater at  $Q_1$  than at  $Q_2$ .
  - At  $Q_3$ , an additional bottle of soda makes the student feel worse, not better.
14. At the utility-maximizing level of consumption,
- The last dollar spent on each good produces the same marginal utility.
  - Total expenditure equals total utility.
  - Marginal expenditure is the same for both goods in question.
  - Consumption is at competitive equilibrium.
  - Marginal expenditure is equal to total utility.
15. Which of the following statements is true regarding the relationship between income and feeling happy, according to the information presented in the textbook?
- At a given point in time, people with higher incomes tend to be happier than people with lower incomes.
  - At a given point in time, income has no effect on happiness.
  - Rising incomes throughout the 20th century have been accompanied by rising levels of reported happiness.
  - Average levels of happiness increase as an economy grows.
  - Aggregate happiness increases with rising income inequality.
16. About what proportion of the world's population experiences *absolute deprivation*?
- 1%
  - 5%
  - 10%

- d. 20%
- e. 30%

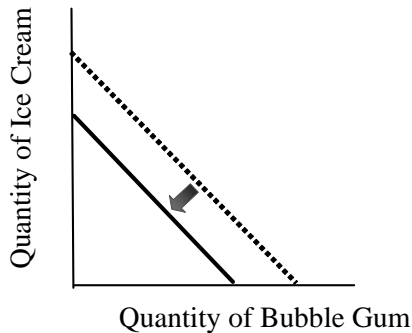
Question #17 refers to the following graph:



17. Marnie allocates her income between pizzas and textbooks. The graph above shows Marnie's budget line. Which of the following events could produce the shift from the dotted line to the solid line?

- a. A decrease in the price of textbooks
- b. An increase in the price of textbooks
- c. An increase in the price of pizzas
- d. A decrease in the price of pizzas
- e. Marnie signing up for a class that requires her to buy more textbooks

Question #18 refers to the following graph:



18. James allocates his income between bubble gum and ice cream. The graph above shows James' budget line. Which of the following events could cause James' budget line to shift inward, from the dotted line to the solid line?

- a. A decrease in James' income.
- b. An increase in James' income.
- c. An increase in the price of bubble gum relative to ice cream.
- d. An increase in the price of one good and a decrease in the price of the other.
- e. None of the above.

19. All of the following scholars are known for their work on the conceptual or practical problems associated with an economic model of ever-increasing consumption except

- a. Milton Friedman
- b. John Kenneth Galbraith
- c. Tibor Scitovsky
- d. Juliet Schor
- e. Robert Frank

20. According to the textbook, which of the following changes has tended to accompany and facilitate increased consumption?

- a. Increase in consumer credit.
- b. Decrease in advertising revenues.
- c. Increase in labor union power.
- d. Increase in political freedom.
- e. Reduction in government spending.

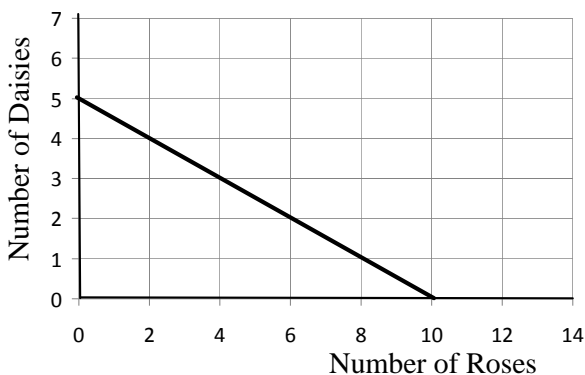
### Answers to Active Review Questions

- 1. consumer satisfaction
- 2. aspirational
- 3. self-actualization
- 4. attributes (or characteristics)
- 5. capability
- 6. 3.5; 68
- 7. real
- 8. budget
- 9. True.
- 10. False.
- 11. False. The estimate is that China would need to pave over the equivalent of more than *half* its rice-producing land.
- 12. False.
- 13. True.
- 14. False.
- 15. False. The standard model assumes that all goods can be compared.
- 16. Problem recognition, information search, evaluation of alternatives, purchase decision, post-purchase behavior.
- 17. Assumptions underlying the traditional model of utility maximization include the assumption that all benefits from consumption can be compared and summed up, so that only one measure, utility, needs to be considered. The model also assumes that consumers' preferences can be taken as given, that consumers have perfect information, and that there are no externalities or multiple equilibria in consumption. One example of a situation the model does not account for is a case in which aggressive or misleading advertising convinces people to start buying a

18. In old utility theory, there is an assumption that utility can be measured, and that it can be compared across individuals (i.e., it is possible to say that a rich person may value an extra dollar less than a poor person). The tenets of old utility theory allow economists to justify redistributive policies and efforts to alleviate poverty from the perspective of utility. New utility theory, in contrast, assumes that utility cannot be measured, and that interpersonal comparisons of utility are impossible. In new utility theory, there is also an assumption that consumer behavior reveals people's true preferences (such that, for example, a person who eats unhealthy food must have made a conscious decision to do so).
19. An indifference curve shows the combination of two goods with which a consumer would be equally satisfied. For example, a consumer might theoretically be equally satisfied with one ice cream cone and seven cookies, or with three cookies and two ice cream cones.
20. The shape of the indifference curve reflects the assumption that the consumer experiences diminishing marginal utility for both goods in question.

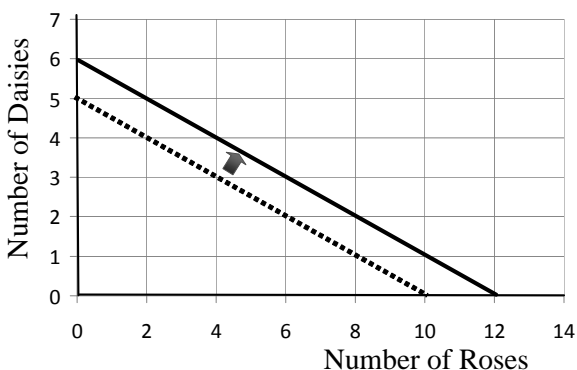
### Answers to Problems

1. a.

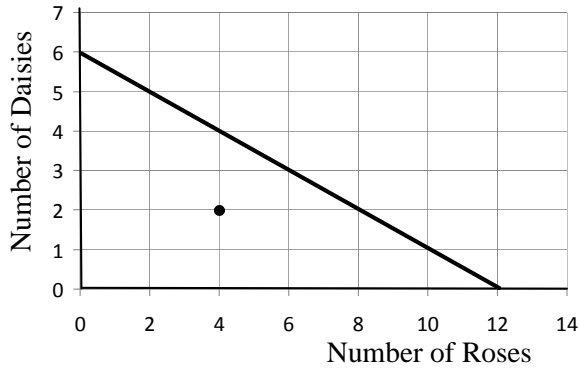


1. b. After spending \$8 (= 4 × \$2) on daisies, Joel has enough left to buy 2 roses.

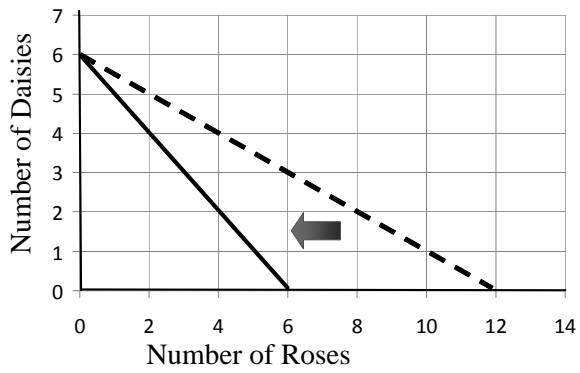
2.



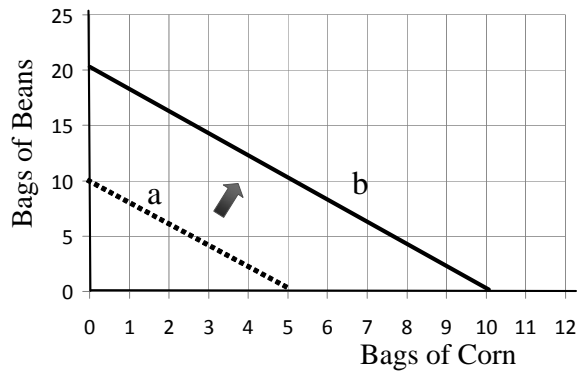
3. a. This consumption combination, shown as a point, falls well to the left of the budget line.



3. b.



4. a and b



4. c. An increase in Jenny's income from \$100 to \$200 would have produced the same change.

5. a.

Units purchased	Sandwiches		Peppermints	
	Marginal utility	Marginal utility/\$	Marginal utility	Marginal utility/\$
1	9	3	15	15
2	6	2	9	9
3	3	1	4	4
4	n/a	n/a	2	2
5	n/a	n/a	1	1

b. Tabitha would spend her first dollar on peppermints, gaining 15 utils; her second dollar on peppermints gaining an additional 9 utils; and her third dollar on peppermints, gaining an additional 4 utils. (Her marginal utility from peppermints is higher in this range than her marginal utility from sandwiches. Spending the initial \$3 on sandwiches would only have gotten her 3 utils per dollar, or 9 utils total.)

c. She would spend her remaining \$ 3 on a sandwich, which gives her a marginal utility per dollar of 3 utils. (If she had spent her fourth dollar on peppermints, her gain in utility would only be 2 utils, and after that even lower for additional dollars.)

### Answers to Self Test Questions

1. a
2. e
3. d
4. b
5. e
6. c
7. c
8. e
9. e
10. a
11. d
12. c
13. b
14. a
15. a
16. d
17. a
18. a
19. a
20. a