

Chapter 8: Budget Lines and Indifference Curves

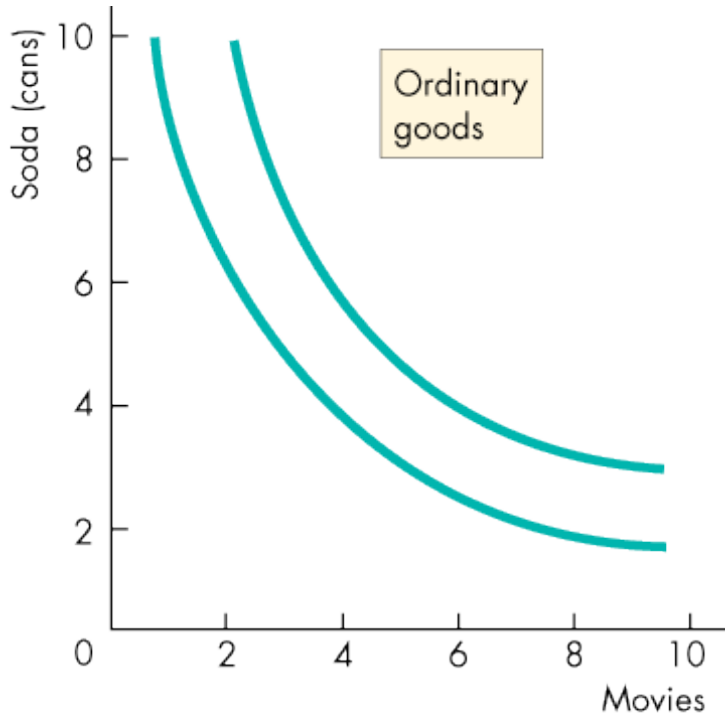
What is a budget line?

How do we get the equation of a budget line? What does each term mean?

Changes in the Budget Line

What is an indifference curve?

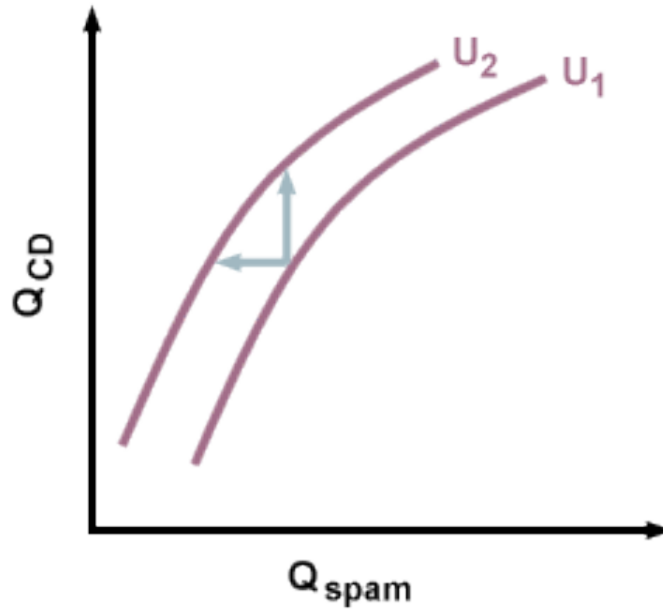
Standard Indifference Curve and Its Characteristics



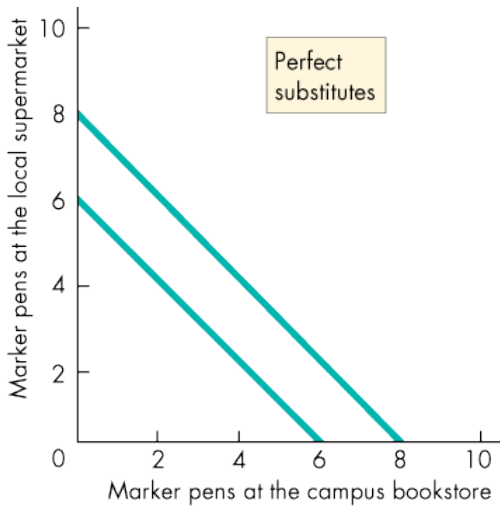
(a) Ordinary goods

Special Types of Indifference Curves

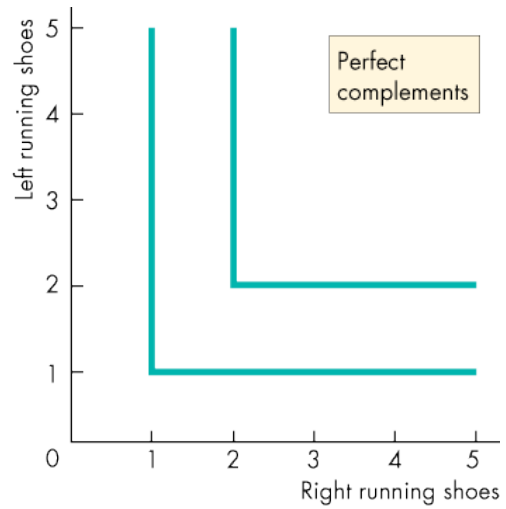
Normal and Undesirable Goods



Perfect Substitutes and Perfect Complements



(b) Perfect substitutes



(c) Perfect complements

Marginal Rate of Substitution

Important Statement: People have unlimited wants since indifference curves go to infinity but a budget creates a limit on consumption since you can't reach an indifference curve outside the amount of money you have.

From this, we end up at the notion of Consumer Equilibrium...again.

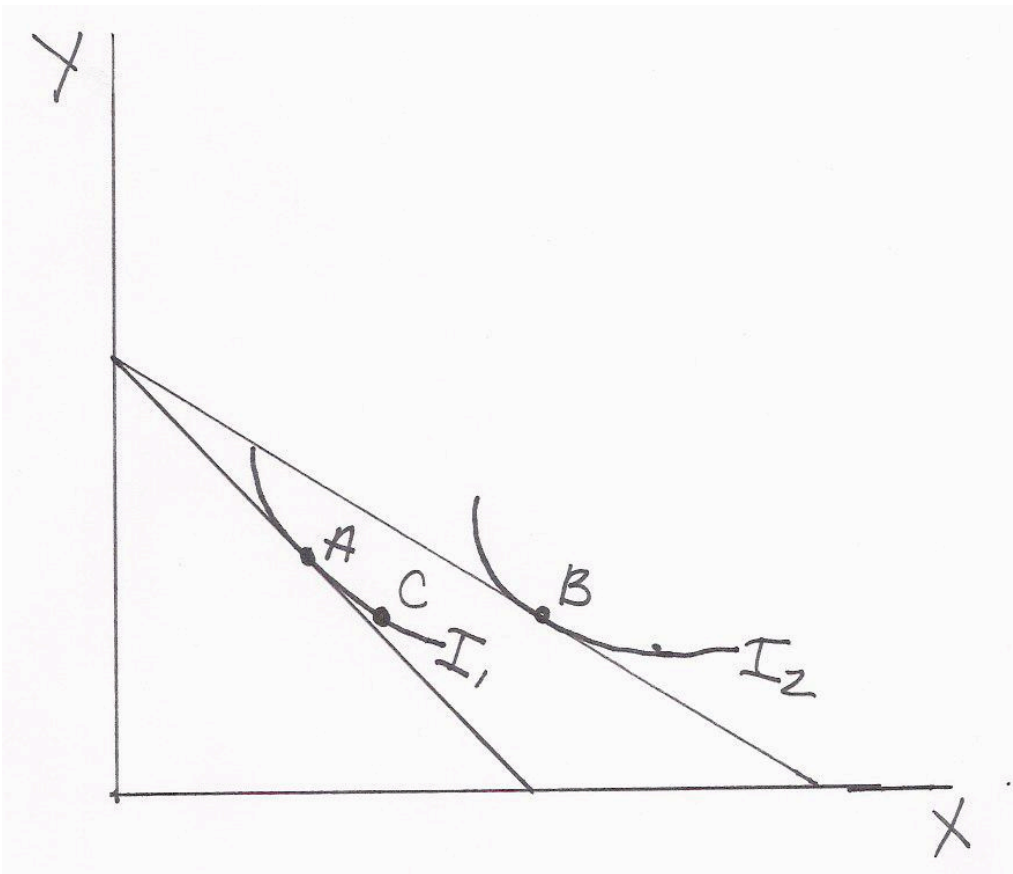
The Price Effect: Determining our Consumption of Two Goods

The price effect, which is the total effect from a change in the price of good X, is broken into two separate effects,

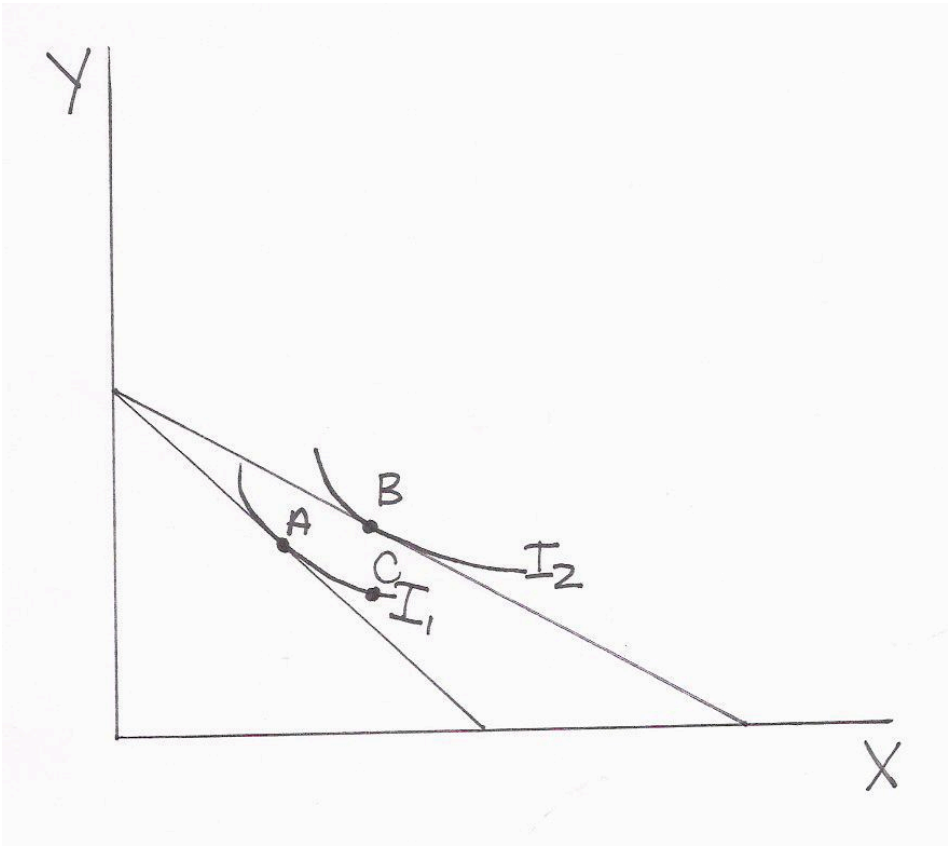
Substitution Effect

Income Effect

Case 1: _____



Case 2: _____



Case 3: _____

