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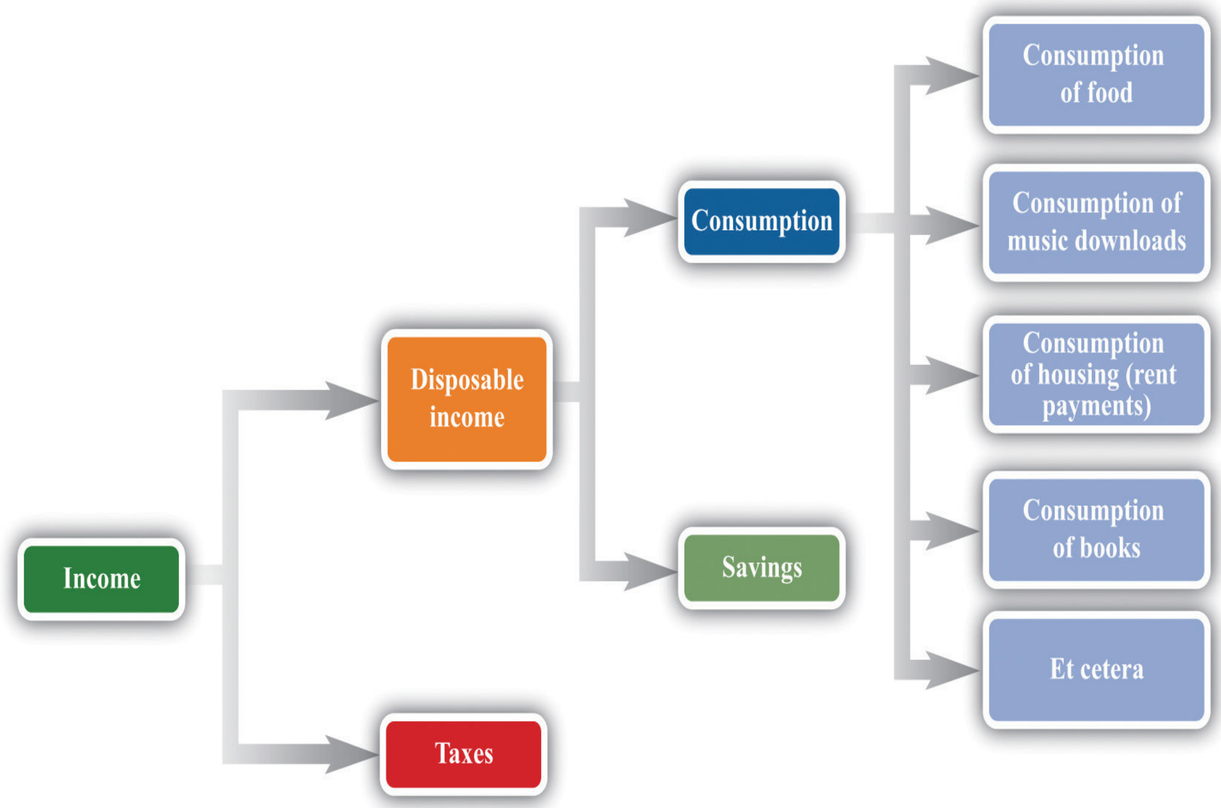
(Paper-1)

Micro theory of consumption



What Is **Consumer Theory**?
Consumer theory is the study of how people decide to spend their money based on their individual preferences and budget constraints. A branch of microeconomics, consumer theory shows how individuals make choices, subject to how much income they have available to spend and the prices of goods and services.

Understanding how consumers operate makes it easier for vendors to predict which of their products will sell more and enables economists to get a better grasp of the shape of the overall economy.

- Consumer theory is the study of how people decide to spend their money based on their individual preferences and budget constraints.

- Building a better understanding of individuals' tastes and incomes is important because these factors impact the shape of the overall economy.
- Consumer theory is not flawless, though, as it based on a number of assumptions about human behavior.

Understanding:-

Individuals have the freedom to choose between different bundles of goods and services. Consumer theory seeks to predict their purchasing patterns by making the following three basic assumptions about human behavior:

- **Utility maximization:** Individuals are said to make calculated decisions when shopping, purchasing products that bring them the greatest benefit, otherwise known as maximum utility in economic terms
- **Nonsatiation:** People are seldom satisfied with one trip to the shops and always want to consume more
- **Decreasing marginal utility:** Consumers lose satisfaction in a product the more they consume it

Working through examples and/or cases, consumer theory usually requires the following inputs:

- A full set of consumption options
- How much utility a consumer derives from each bundle in the set of options
- A set of prices assigned to each bundle
- Any initial bundle the consumer currently holds

Advantages of Consumer Theory:-

Building a better understanding of individuals' tastes and incomes is important because it has a big bearing on the demand curve, the relationship between the price of a good or service and the quantity demanded for a given period of time, and the shape of the overall economy.

Consumer spending drives a significantly large chunk of gross domestic product (GDP) in the U.S. and other nations. If people cut down on purchases, demand for goods and services will fall, squeezing company profits, the labor market, investment, and many other things that make the economy tick.

Consumer choice theory is taken very seriously, influencing everything from government policy to corporate advertising.