

# STUDENT NOTES: CONSUMERS AND CHOICE

- A consumer refers to any person who buys goods and services.
- A choice is a decision between alternatives, e.g., to go on a fishing trip or a weekend away at the ski fields. Choices have to be made by consumers because of their limited means (income or money, time, skill or knowledge and whanau or family) relative to their unlimited wants. Individuals can not have everything because of their limited means, for example, \$100 spent on a bungy jump can not be used for a sky dive. An individual who spends time playing golf can not at the same time go on a fishing trip. Therefore, individuals will choose the option they desire the most.
- Every choice results in an opportunity cost. The opportunity cost of a decision is the next best alternative foregone, i.e., it is the second-ranked alternative missed out on. For example, Frank's ranking of choices of summer sports:

1st Surf lifesaving

2nd Orienteering ✓ opportunity cost

3rd Tennis

Individuals can not have everything they want, so choose the option they want the most.

- A good is an object with a physical presence, tangible items, e.g., compass, cellphone.
- A service is what someone does for you, e.g., giving defensive driving lessons.



# REVIEW (EXAM) QUESTIONS

Michael is twenty and works part time. He earns \$100 per week. Michael is saving for a car and intends to buy either a DVD player or a computer. His sporting commitments, assignments and studies mean he is too busy to earn more. His birthday is coming up, and he asks his family to contribute towards a better computer instead of buying him presents.

1 Fully explain scarcity in relation to choices and opportunity cost for Michael. In your answer you should:

- Refer to the resource material and link the following: limited means, choice, opportunity cost.
- Explain how Michael's means have increased because of his family.

Michael faces the problem of scarcity, that is, he has limited means (time and money) in relation to his unlimited wants.

Michael's income is limited. He does not earn enough to buy everything he wants; he only earns \$100 per week, so he has to choose the cheapest option/the one he wants the most. He must make a decision between alternatives (a choice) between a DVD player or a computer. Because there are only 24 hours in a day, Michael faces the problem of limited time. Michael is too busy with assignments, study and sporting commitments to earn enough to buy everything he wants so he has to choose the cheapest option/one that he wants the most. Time spent on his sporting commitments can not be used to do his assignments or study.

When Michael makes a decision he will give up a next best alternative – this will be his opportunity cost. If Michael ranks buying a computer as the most important thing he wants to buy, followed by a DVD player, then the DVD player missed out on is his opportunity cost.

Michael's means have increased because of his family, more individuals allow for greater means. Michael can afford a better computer because his whole family is contributing.

Links concepts of limited means (time and money), choice and opportunity cost in context of Michael's options.



**7** Read the resource and answer the questions that follow.

Caitlin has just finished High School and is looking forward to the summer break. She intends to play touch with her friends and work picking strawberries to save money for her course fees. Caitlin is a consumer of books, DVDs and Playstation games, going to the movies and eating takeaways.

**a** Describe what is meant by a consumer.

*A consumer is a person who buys/uses goods and/or services.*

Caitlin was able to get work at the local library answering inquiries.

**b** Explain how this situation will affect Caitlin's demand for takeaways.

*Her demand for takeaways is likely to increase. A shift of Caitlin's demand curve to the right because she is willing and able to buy more at each price (or can afford more).*

Consideration of others is a value Caitlin holds.

**c** Explain how this value may influence how Caitlin spends her income.

*Caitlin may buy gifts for her family/friends or donate money to charity, i.e., link a spending decision to consideration for another individual or group.*

**d** Identify the value in the table. Select from: Integrity, Travel/adventure, Fair trading/Honesty, Consideration of others, Financial security.

Situation	Value
(i) Marty tells the buyer of his car that it will not pass a warrant because of the rust.	Fair trading/Honesty
(ii) An individual goes to church and holds fast to a set of moral principles for how they live their life.	Integrity
(iii) Greg, who donates money to charity.	Consideration of others
(iv) Bill, who decides to go on a holiday overseas.	Travel/adventure/have a break
(v) Mel, who puts money aside in a bank account.	Financial security/ belief that it is important to save money in case of an emergency



# REVIEW (EXAM) QUESTIONS

Ray lives in a flat. He works part time at the local pool. The main activities he chooses to spend his time on are: working at a local gym (least preferred option), attending university (main priority) and spending time reading a book.

1 Explain how scarcity and values affect consumer choice. Explain how time is a limited resource for Ray. In your answer you should refer to the resource material above and discuss:

- scarcity
- choice
- opportunity cost.



Scarcity describes the condition of limited means (in this case, time) relative to an individual's (Ray's) unlimited wants. There are only 24 hours in a day, therefore Ray does not have enough time to do all the things he would like to do, such as working at the gym or attending university. Time spent on one option means he cannot spend this time on other choices, thus, Ray must choose the option he desires the most, in his case it is attending university.

By choosing to attend university Ray gives up his next best alternative, which is defined as his opportunity cost. In this instance, it is missing out on reading a book.

Links the concepts of scarcity (time), choice and opportunity cost in the context of Ray's options.



Fully explain the way values might influence how Ray chooses to spend his time. In your answer you should refer to the main activities on the previous page that Ray chooses to spend his time on, and discuss:

- the most likely activity Ray will spend his time doing if he values his education
- the most likely activity Ray will spend his time doing if he values financial stability
- conflict that might arise over the two decisions above
- one way in which Ray may resolve this conflict.

If Ray values his education, he is likely to choose going to university.

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If Ray values financial stability, he is likely to spend his time working at the local gym.

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A conflict could arise over the decisions Ray makes because if Ray spends more time at the local gym to earn an income for financial security he cannot use this time to attend university to get an education (and vice versa).

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To resolve this conflict, Ray could work at the gym early in the morning or at the weekends and spend the week days going to university. This choice will allow Ray to earn an income for financial security, as well as getting an education.

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Links values and the decisions or activities in the context of Ray's options. Explains how a compromise may be reached in the context of Ray's options and justifies it in relation to his values.

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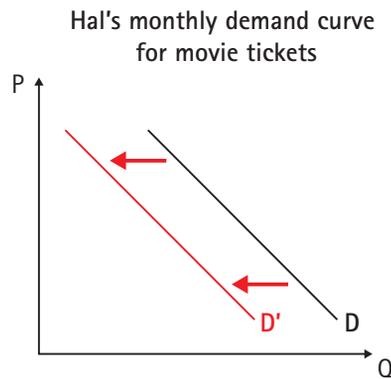
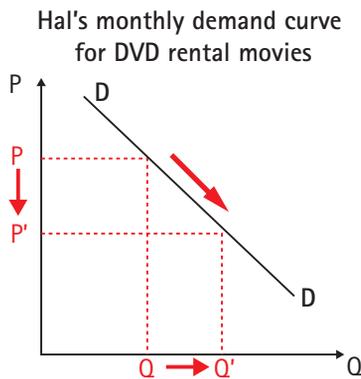
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The DVD rental industry is putting pressure on movies because they are lowering the price of DVDs.

2 Fully explain the effect of falling prices for DVD rental movies on Hal's demand for tickets to the movies. In your answer you should:

- explain the term that describes the relationship between movie tickets and DVD rentals
- fully label the graphs provided to show the changes and refer to them in your explanation
- explain several flow-on effects this change in demand may have for Hal.



Movie tickets and DVD rentals are substitutes because they can be used in place of each other.

As the price of DVD rentals falls, shown as the change in price from  $P$  to  $P'$ , the quantity demanded by Hal increases, shown as the change from  $Q$  to  $Q'$ . Hal will buy more DVD rentals because he can afford more OR he is more willing and able to buy DVD rentals. Hal's demand for tickets to the movies will decrease, this is shown by the demand curve shifting inwards (to the left) because at each and every price there will be a decrease in quantity demanded. Hal's demand for movie tickets will decrease (as shown by the change from  $D$  to  $D'$ ) because they are now relatively more expensive when compared to DVD movie rentals (or DVD movie rentals are relatively cheaper).

Several flow-on effects for Hal are that he might decide to buy a bigger TV screen (a complement) to watch the movies on or install a better sound system. Hal might also decide to buy more takeaway food to enjoy while he watches DVD movie rentals at home.

Explains the concept of substitutes in the context of using the graphs and correctly uses the terms 'quantity demanded' and 'demand'. Refers to the graphs drawn. Flow-on effects are explained.



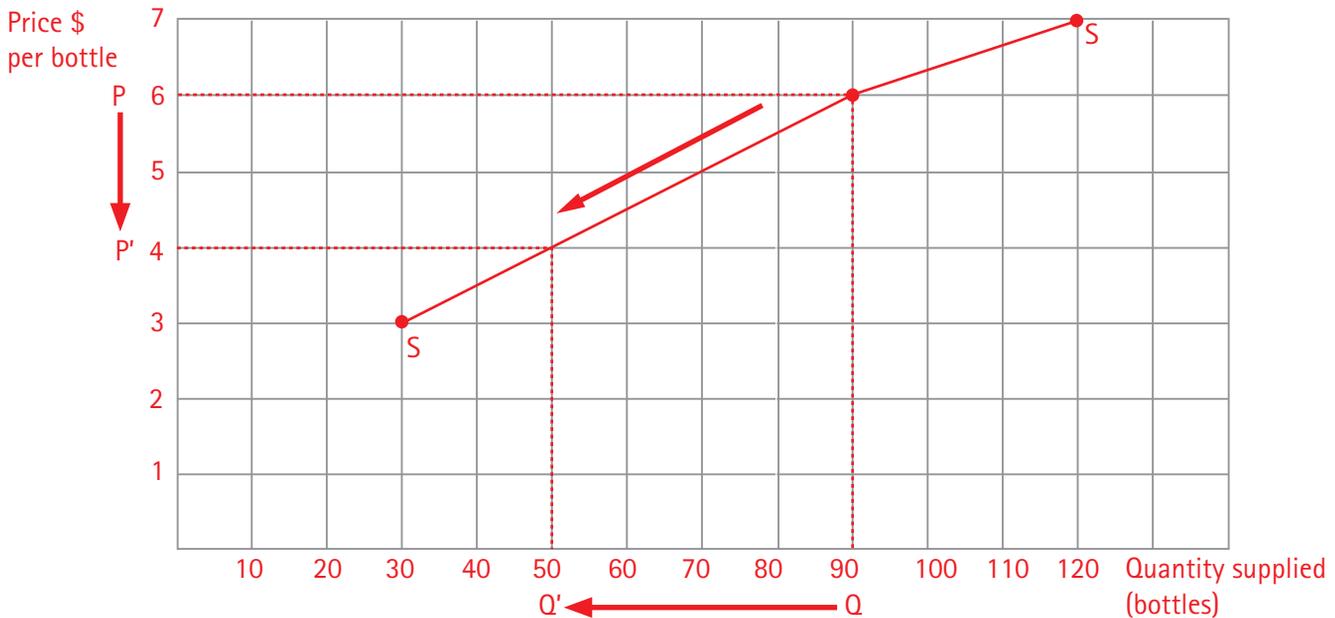
Chole sells strawberry jam at the local market each month. If the price is \$3 a bottle she produces 30 bottles. If the price increases by 100% she will produce 90 bottles. At \$7 a bottle she produces 120 bottles.



3 Use the information above to draw a supply curve in the grid below. Show the effect of a price decrease of 33.3% from \$6.00 per bottle for Chole's strawberry jam. Fully label the changes. Discuss the law of supply as it relates to a decrease in price. In your answer you should:

- describe the law of supply by referring to relevant data from your graph
- fully explain the effect of a price decrease
- fully explain what Chole might do if the price for her strawberry jam falls below \$3 a bottle.

Chole's supply curve for strawberry jam each month

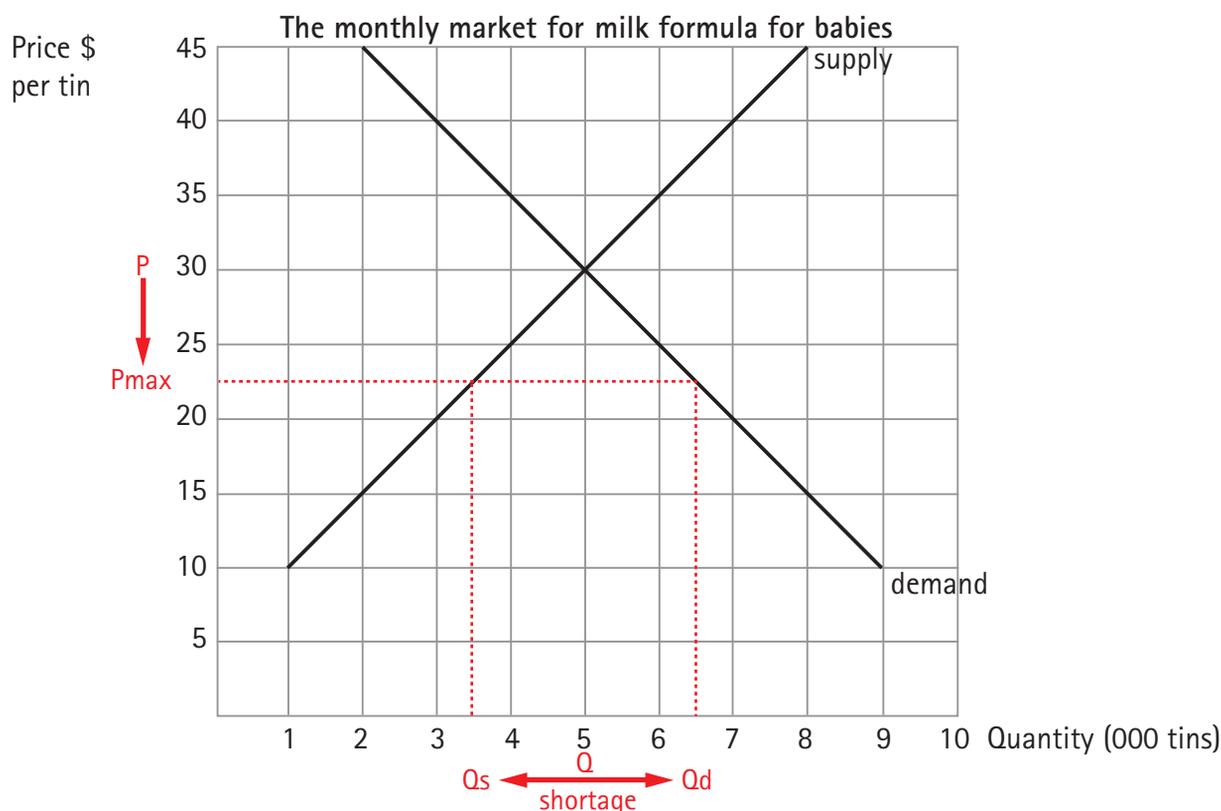


The law of supply states that as price decreases quantity supplied decreases, *ceteris paribus*. As the price of Chole's strawberry jam falls from \$6 to \$4 per bottle the quantity supplied falls from 90 bottles to 60 bottles, *ceteris paribus*.

As the price of strawberry jam falls, selling strawberry jam becomes less profitable for Chole since revenue is lowered and she is less able to cover costs. Chole, who is wanting to maximise profit, will decrease the quantity supplied of strawberry jam.

If the price of strawberry jam falls below \$3 per bottle, Chole is less likely to be able to cover her costs of production, the revenue she generates will be lower and producing strawberry jam will be less profitable. Chole is likely to divert her resources into producing a related good (other types of jam) which may be relatively more profitable.





**6 a** On the monthly market for milk formula for babies graph above, show the effect of a maximum price control that reduces the price by 25%. You must label the maximum price ( $P_{max}$ ), the quantity demanded ( $Q_D$ ) and quantity supplied ( $Q_S$ ).

- b** Referring to the graph in a, fully explain the consequences of a maximum price control on this market. Include the following in your explanation:
- quantity demanded before and after the maximum price control
  - quantity supplied before and after the maximum price control
  - a problem the maximum price control might create
  - a possible solution for the above problem.

Quantity demanded increases from 5 000 tins to 6 500 tins ( $Q$  to  $Q_D$ ).

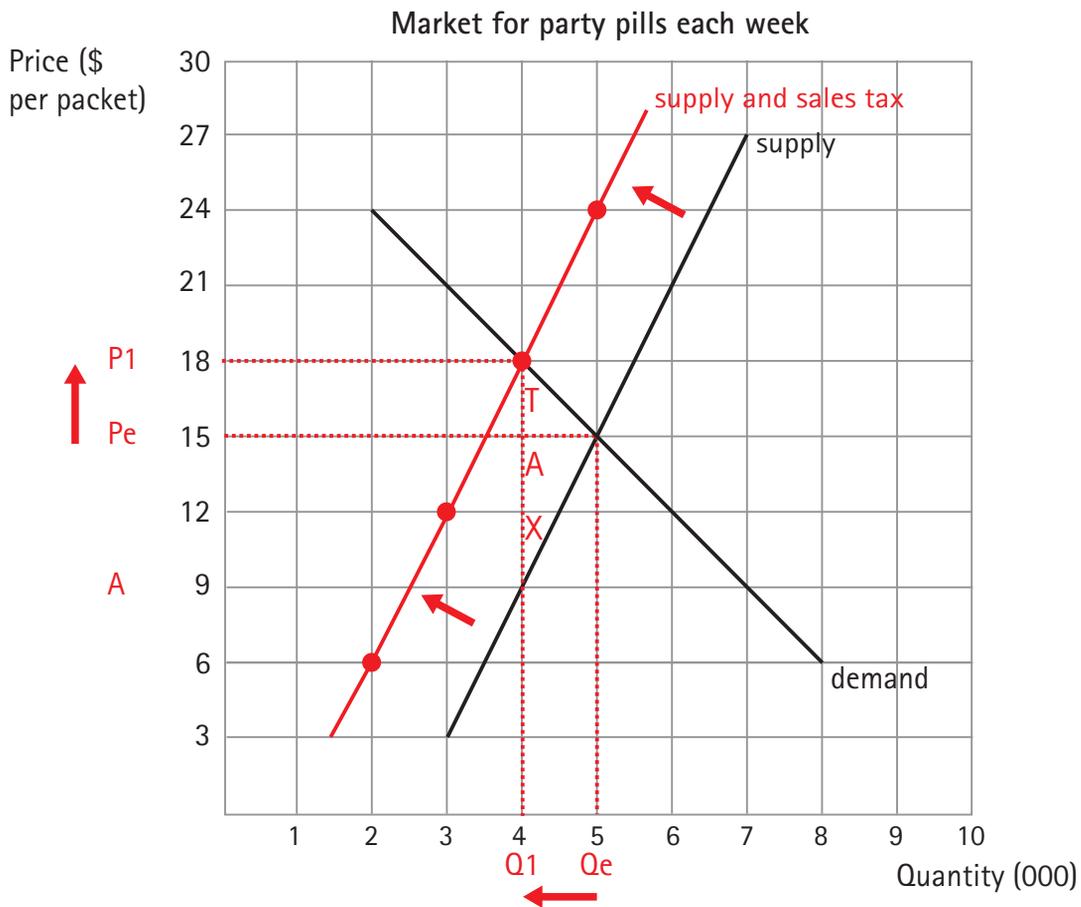
Quantity supplied decreases from 5 000 tins to 3 500 tins ( $Q$  to  $Q_S$ ).

There will be a shortage of 3 000 tins of milk formula for babies, which is a problem. Some consumers will be willing to pay more than the \$22.50 per tin which is illegal and creates a black market.

Solutions to the shortage problem could include rationing, first-in-first-served or providing producers with a subsidy in order to increase supply.



Concerns are being raised about the increased use of party pills. Government is set to review tax on party pills.



- 2 a (i) On the graph above, show the original equilibrium price and quantity (label as  $P_e$  and  $Q_e$ ).
- (ii) Show the effect of a \$9 per unit subsidy on party pills.
- (iii) Show the new equilibrium price and quantity (label as  $P_1$  and  $Q_1$ ).
- b Refer to the graph and identify:
- the number of party pills consumers buy before and after the sales tax  
before: 5 000 ( $Q_e$ ) after: 4 000 ( $Q_1$ )
  - the price per packet of party pills consumers pay before and after the sales tax  
before: \$15 ( $P_e$ ) after: \$18 ( $P_1$ )
  - the price per packet of party pills firms receive before and after the sales tax  
before: \$15 ( $P_e$ ) after: \$9 ( $A$ )

