

## Budget Constraint

- I. What is the point of Indifference Curves (IC) and Budget Constraint (BC)?
- (1) IC tells us what the individual *prefers to* consume
  - (2) BC tells us what the individual *can* consume
  - (1) + (2) = what the individual would consume

Note we made no distinction between purchases and consumption here—they are the same thing for all we concern.

### Derivation of IC and BC

Preferences → Utility function → IC

Prices + Income (Wealth) → BC

## II. Step-by-Step

### A. Graphing the Standard Budget Constraint

*Ann has \$100 which she could spend only on gym sections (\$10) or pizzas (\$2); assume perfect divisibility graph her budget constraint.*

### B. Non-standard Budget Constraint

#### i. Membership required

*\$20 must be paid before you can attend any gym section*

#### ii. “Buy two get one free”

*1 free gym section for every 2 gym section purchased*

#### iii. Volume discount

*Each additional gym section after the first five costs only \$5*

*-what is the inverse of volume discount?*

The above situations can be mixed.