WEEK 2
Consumption Concept and Model
Conceptualization of Consumption

- Neoclassical microeconomics
- Consumption and Household Production
- Sustainable Consumption
- Consumption from religious perspectives
Neoclassical Economics

Whose who?
Stanley Jevons, Leon Walras, Maria Edgeworth and Vilfredo Pareto

Concerned

Efficient, least-cost allocation of scarce productive resources
Optimal growth of these resources over time so as to produce and ever-expanding range of goods and services

Assumes

Economic rationality & a purely materialistic, individualistic, self-interested orientation toward economic decision making.
Neoclassical Economics

- **Utility functions**
  \[ U = u(A) \]
  \[ U = \text{satisfaction} \]
  \[ A = \text{a set of alternative from which he/she can choose from} \]

- **Demand theory**
  \[ U = u(Q); \quad \sum q_i p_i = Y \]
  \[ U = \text{satisfaction} \]
  \[ Q = \text{a set of G&S purchase in the market} \]
**Utility & Production Maximization**

**Utility** = measure of the happiness/satisfaction gained from a G&S

Utility was originally viewed as a measurable quantity with respect to each good, add these together to yield the total utility.

The goal of every economy is to provide consumption.

Moral foundation, which views human happiness as the main unit of value, expressed as utility.

Aim to maximize the total utility.

Consumption is defined as the act of buying goods and services, and it is assumed that consumption yields utility.

Aim to maximize the total utility.

Human beings are assumed to live for happiness, and happiness is understood as a product of consumption.
Critiques of Neoclassical Economics Perspective

1. The method to achieve progress is the overall maximization of individual human utility.

2. Utilitarianism is problematic for the environment because it “perpetuates a false view of humanity’s place in the world” and does not explain why all the millions of nonhuman species in the world should be in service to man.

3. Because utilitarianism is at the center of our economic decision-making, we make decisions where progress is defined as increasing human consumption.

4. Even though we know that our ever-increasing appetite for consuming is causing environmental degradation, this economic model assumes that increasing consumption is good, and bias us towards actions that encourage us to continue to consume with little regard for its effect on the environment.

Criticisms of neoclassical economics: unrealistic assumptions

- The focus on individuals in the economy may obscure analysis of wider long term issues, such as whether the economic system is desirable and stable on a finite planet of limited natural capital.

- The ideal of profit maximization, but this is not necessarily viewed as desirable if this comes at the expense of a "locust-like" neglect of wider social issues.

- The assumption that individuals act rationally may be viewed as ignoring important aspects of human behavior. Many see "economic man" as being demonstrably different to a real man on the real earth.
Household Production Theory: Development


- Uses microeconomics analysis to aspects of human behavior – human capital/competence, household and family, crime and punishment and economic discrimination.

- Main assumption is that individual, household, firms and organizations behave rationally i.e., purposefully, and that their behavior can be described as if they maximized a specific objective function, such as utility or wealth.
Definition of Household

A household is defined as a small group of persons who
• share the same living accommodation,
• who pool some, or all, of their income and wealth, and
• who consume certain types of **GOODS** and **SERVICES** collectively, mainly housing and food.

Many of the goods acquired by HH for purposes of consumption are subjected to a significant amount of further processing within the HH before they are consumed.

Many of the services consumed by HH are not purchased at all but produced largely within the HH.
Consumption Expenditure

- It is difficult to estimate prices and quantities of G&S consumed.
- Consumption expenditures are defined as expenditures incurred by households to acquire goods and services that they intend to use for purposes of consumption. Expenditures are not uses.
Definition of household consumption

- Household consumption refers to the quantities or values of the goods and services consumed by households.

- Household final consumption is defined as an activity in which members of households use goods or services to satisfy their needs, wants or desires.
Household production theory

- $U = u(Z_i)$

$Z_i = f(Q_i, S_i, T_{hi}, O)$

- $Q_i$: a set of non durable G&S purchased and used in the production of $Z_i$
- $S_i$: a set of owned durables used to produce the commodity
- $T_{hi}$: time spent by HH members in producing $Z_i$
- $O$: environmental factors that affect the production process.
Premise of Household Production Theory

- Household can be regarded as a factory which produces basic goods (meals, entertainment etc.) using time and input of ordinary market goods which are purchased in the market.

- Price of goods have 2 components:
  - prices of basic goods
  - the time expenditure for production and consumption of the good. This is equivalent to wages multiplied by the time spent per unit of the good produced in the household.
The Circular-Flow Diagram
The household production model postulates that households combine time and market goods to produce commodities that directly enter their utility functions (Becker, 1965).

An increase in the wage of one member of the HH gives rise not only to changed incentives for work in the market, but also a shift from more to less time intensive product on consumption of goods produced by the household. Some of the household function (eg. child care) are shifted to other institutions, firms, schools or agencies.

This leads to Theory of the Allocation of Time by Becker in 1965.