CHAPTER 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
Vilredo Pareto
Concerned

- Efficient, least-cost allocation of scarce resources
- Optimal growth of these resources over time so as to produce and ever-expanding range of G&S.

Assumes

- Economic rationality & a purely materialistic, individualistic, self-interested orientation toward economic decision making.
Framework of NEO-CLASSICAL ECONOMICS

* How is the interaction between buyers and sellers in the market??
Buyers attempt to maximize their gains from getting goods, and they do this by increasing their purchases of a good until what they gain from an extra unit is just balanced by what they have to give up to obtain it. In this way they maximize "utility"—the satisfaction associated with the consumption of goods and services.
Likewise, individuals provide labor to firms that wish to employ them, by balancing the gains from offering the marginal unit of their services (the wage they would receive) with the disutility of labor itself—the loss of leisure.

Individuals make choices at the margin.

This results in a theory of demand for goods, and supply of productive factors.
How about PRODUCERS?

What they do in the economy?
Similarly, producers attempt to produce units of a good so that the cost of producing the incremental or marginal unit is just balanced by the revenue it generates.

In this way they maximize profits.

Firms also hire employees up to the point that the cost of the additional hire is just balanced by the value of output that the additional employee would produce.
The neoclassical vision thus involves economic "agents," be they households or firms, optimizing (doing as well as they can), subject to all relevant constraints.

Value is linked to unlimited desires and wants colliding with constraints, or scarcity. The tensions, the decision problems, are worked out in markets.

Prices are the signals that tell households and firms whether their conflicting desires can be reconciled.
Example...

I want to buy a new car

But manufacturers may not want to produce as many cars as we all want

Our frustration may lead us to "bid up" the price of cars

Then..eliminating some potential buyers encouraging some marginal producers.

As the price changes, the imbalance between buy orders and sell orders is reduced

This is how optimization under constraint and market interdependence lead to an economic equilibrium.
Assumptions

* 1. People have rational preferences among outcomes.
* 2. Individuals maximize utility and firms maximize profits.
* 3. People act independently on the basis of full and relevant information.
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**
  \[ U = u(Q); \quad \sum q_i p_i = Y \]
  \[ U = \text{satisfaction} \]
  \[ Q = \text{a set of G&S purchase in the market} \]
Neoclassical Economics Theories

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

The goal of every economy is to provide consumption

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

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

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

Critiques of Neoclassical Economics Perspective

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.

Unrealistic assumptions

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

- 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.
Who is 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.
Families are both producers and consumers of goods.

In an effort to maximize utility, families attempt to efficiently allocate time, income, and the collection of goods and services they both use and produce.

Household Production Theory is simply the study of household production, consumption and household time allocation.
Household production

* Household production relates to all the output that a household produces including production related to work.
Household consumption

* Household consumption includes all things (quantities or values of the goods and services) that are consumed by a household including things like food, sleep, and leisure.

* Objectives: to satisfy their NEEDS, WANTS or DESIRES.
* Diminishing marginal utility - This idea implies that we will diversify our consumption because increased consumption of the same good will give us less utility after a certain point.

* Time allocation - refers to the exact way we spend each minute of our day. Time allocation also introduces the basic concept of **opportunity cost**, explaining that every minute we allocate to one activity, by definition, can not be allocated to any other activity.
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.
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:
1. prices of basic goods
2. 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.
Discussion

- Draw and explain circular flow of income with relates to your life.