

Principles of economics the theory of consumer choice



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Principles of Economics The Theory of Consumer Choice Martin Sharkey

Western International Question During 2004, the national average gas price rose from \$1.50 a gallon to \$2.25 a gallon. The government has stated that the high price of gas will remain as it is. Discuss how this cost influences your decision to buy a new car. Based on your budget, would you buy the large car that gets 7 miles per gallon or the car that gets 25 miles per gallon Explain.

Answer and Explanation

My purchasing decision about a new car will be based on my expectations about the future prices of gasoline and my budget constraint.

According to the government, the expectations about future gas prices are that they will remain higher in the future. This means that within my budget constraint, I will be spending more on gasoline, by 50% more per gallon, than on other goods and services. Other factors being constant, the higher price for gasoline will limit my buying opportunities for other products and services.

Alternatively, higher gasoline prices will affect the prices of other products and services. Higher prices of other products will further affect my overall consumption, since I will be able to purchase smaller quantities of all products and services within a budget constraint that is this will have an income effect on my consumption, which will take me to a lower indifference curve.

Since gasoline is a supplementary product to cars, my choice of a car will be directly affected by the expectations for changes in gas prices and by the gas consumption of the cars. A car that gets 7 miles per gallon will spend more than 14 gallons per 100 miles. A car that gets 25 miles per gallon is <https://assignbuster.com/principles-of-economics-the-theory-of-consumer-choice/>

thrice more economical, spending 4 gallons per 100 miles. At the higher gas price (\$2.25) the price difference of gasoline expenditure is \$32 compared to \$9 per 100 miles for the more economical car. Provided my budget remains constant, it will be financially justified to prefer the car that gets 25 miles per gallon.