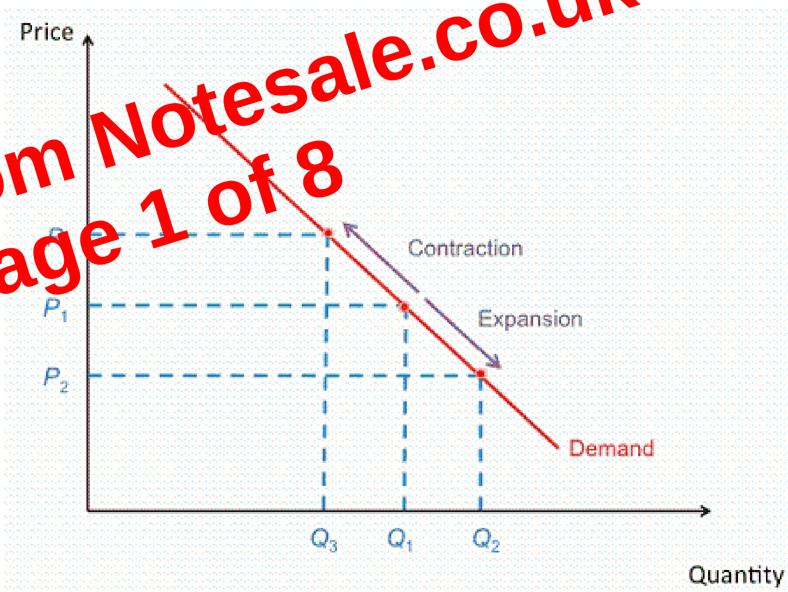
1.2 How markets work

- **Rational decision making** = where consumers allocate their expenditure on goods and services that will maximise utility, whilst producers allocate their resources to maximise profit.
- Reasons why consumers may **not** make rational decisions = the influence of other people's behaviours, addiction, consumer weakness at computation or habitual behaviour.
- Consumer weakness at computation describes how consumers do not think fully about the consequences of their actions and how probable these consequences are.
- **Market** = where consumers and producers come into contact with each other to exchange goods and services.

Demand

- **Demand** = the amount of a good or service that consumers are willing and able to buy at a given price in a given time period (effective demand).
- Individual vs market demand.
- **Utility** = the amount of satisfaction gained from consuming a good or service.



- You can only move **along** the demand curve when there is a change in **price**.
- A fall in price causes an expansion in demand, whilst a rise in price causes a contraction in demand.
- **Marginal utility** = the utility gained from consuming one extra unit of a good or service.
- **Diminishing marginal utility** = as one consumes more of a good, the utility gained from each extra unit will tend to fall.
- As marginal utility falls from each extra good consumed, it means consumers will only buy more of it if the price falls - hence the downwards-sloping demand curve.
- So whilst total utility actually increases, this occurs at a diminishing rate.
- A shift in the demand curve is caused by PASIFICL = Population, Advertising, Substitute's price, Income effect, Fashion/tastes, Interest rates, Complement's price and Legislation.