

7.2 Indifference curves and budget lines

Name: _____ Class: _____ Date: _____ Total: 22 marks

KEY WORDS indifference curve • budget line • substitution effect
• consumer equilibrium • income effect

Objective

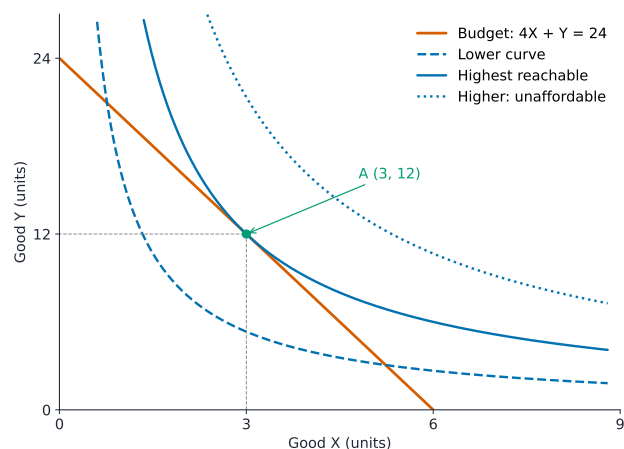
Build the skills to answer exam questions on **indifference curves and budget lines** – **consumer equilibrium**, and the **income and substitution effects**.

You must be able to:

- draw an indifference curve and a budget line
- find consumer equilibrium (tangency)
- explain the income and substitution effects (normal, inferior, Giffen goods)

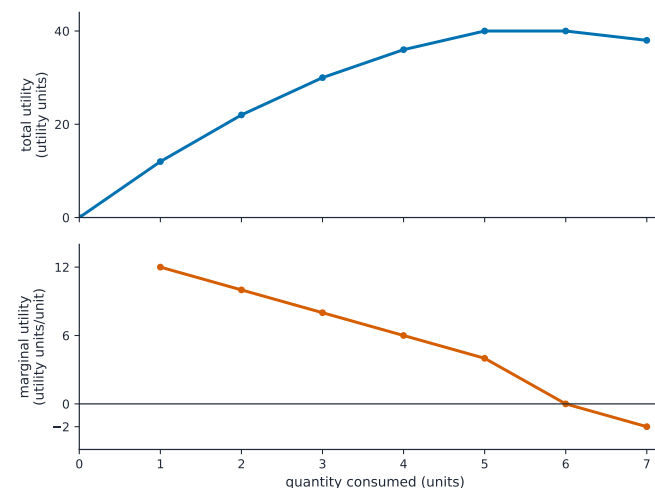
1 Key knowledge and worked examples

■ Consumer equilibrium



Indifference curve = equal utility; budget line = what is affordable

- **Indifference curve** : combinations giving the **same** utility (slopes down, bows in).
- **Budget line** : combinations just affordable; **equilibrium** at the tangency point.
- A price fall raises quantity via two effects: **substitution effect** (switch to the cheaper good) + **income effect** (real income rises).
- **Giffen good** : a strong negative income effect → demand rises as price rises.



Behind the indifference map: diminishing marginal utility is why the curves bow inward

Answer shapes: an **Explain** [up to 8] answer may use an indifference diagram (AO3); **Discuss** [12] adds a judgement (AO4).

2 Practice

2.1 Define the term *indifference curve*. [2]

2.2 State where **consumer equilibrium** occurs on an indifference diagram. [1]

2.3 State the difference between the income effect and the substitution effect. [2]

3 Exam-style questions

3.1 Consumer equilibrium occurs where the budget line is: [1]

- ☐
- A above the highest indifference curve

B tangent to the highest reachable indifference curve

C parallel to the indifference curve

D at the origin

3.2 Using an indifference-curve diagram, explain how a consumer reaches equilibrium.[8]

3.3 Explain, using income and substitution effects, why the demand for a Giffen good slopes upward. [8]
