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Prices and Consumer Incomes

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One of the economic factors that consumers must consider carefully in making their purchases of goods and services is their own level of income. A consumer's buying power represents his or her ability to make purchases. The economy affects buying power. For example, if prices decline, consumers have greater buying power. If the value of the dollar increases relative to foreign currency, consumers have greater buying power. When inflation occurs, consumers have less buying power. For example, if a consumer spends one-half of his income on bread alone, a fifty-percent decrease in the price of bread will increase the free money available to him by the same amount which he can spend buying more bread or something else.

Most people earn their income from the work they perform, whether as physicians, carpenters, teachers, plumbers, assembly line workers, or clerks in retail stores. Some people also receive income by renting or selling land and other natural resources they own, as profit from a business or entrepreneurial venture, or from interest paid on their savings accounts or other investments. Here are the important points that determine the prices for those kinds of payments: 1) in a market economy, the basic resources used to make the goods and services that satisfy consumer demands are owned by private consumers and households; and 2) the payments, or incomes, that households receive for these productive resources rise and fall — and that fluctuation has a direct influence on the amount consumers are willing to spend for the goods and services they want, and, in turn, on the output levels of the firms which sell those products.

Consider, for example, a worker who has just retired, and as a result earns only about 60 percent of what she did while she was working. She will cut back on her purchases of many goods and services — especially those that were related to her job, such as transportation to and from work, and work clothes — but may increase spending on a few other kinds of products, such as books and recreational goods that require more leisure time to use, perhaps including travel to see new places and old friends. Income makes consumer choice grow more complex as the type of good changes, as different product and services demonstrate different properties relative to both other products/services and a consumers preferences and utility. If, as in many countries today, there are rapidly growing numbers of people reaching retirement age, those changing spending patterns will affect the overall market prices and output levels for these products, and for many others which retirees tend to use more than most people, such as health care services. In response, some businesses will decide to make more products and services geared toward the particular interests and concerns of retirees – as long as it is profitable for firms to produce them.

To summarize, it should be noted that whether consumers are young or old; male or female; rich, poor, or middle class; every dollar, peso, pound, franc, rupee, mark or yen they spend is a signal — a kind of economic vote telling producers what goods and services they want to see produced. Consumer spending represents the basic source of demand for products sold in the market place, which is half of what determines the market prices for goods and services. The other half is based on decisions businesses make about what to produce and how to produce it.