

## CONSUMER'S EQUILIBRIUM

Q1) What is equilibrium?

Ans) Consumer's equilibrium refers to the process in which consumer chooses or selects those goods and services from which he can attain maximum satisfaction or utility through his limited income. At the point of consumer's equilibrium, consumer attains maximum possible satisfaction with his limited resources which is the ultimate aim of the consumer.

Q2) Meaning of utility? Types of utility? characteristics of utility?

Ans) Utility means want satisfying power of a commodity or the capacity of a commodity to satisfy a particular want of consumer. Every commodity has some inherent want-satisfying capacity. Utility is a relative word. Although liquor is harmful for health but has utility for the person or consumer using it. Desire to consume commodity gives rise to utility.

There are two types of utility:-

- 1) Marginal utility
- 2) Total utility

1) Marginal utility → The word 'Marginal' means 'additional'. Additional utility derived from consumption of an additional unit of a commodity is called 'Marginal utility'.

$$\text{Marginal Utility} = \text{Total utility}_n - \text{Total utility}_{n-1}$$

or

$$MU_n = TU_n - TU_{n-1}$$

2) Total utility → Utility obtained by the consumer from all units of consumption is called 'Total utility'.

$$TU = \sum MU$$

### Characteristics of utility

- 1) Utility is a psychological phenomenon → It depends upon the mental status of the consumer.
- 2) Utility is subjective & which differs from person to person and the place utility of a particular goods is not same for all consumers.

31 utility is a relative concept  $\rightarrow$  It changes from time and place. woolen clothes have greater utility in winter season and in high altitudes areas but have no utility in summer.

41 utility is not affected by moral duties or principles  $\rightarrow$  If a person derives utility from immoral acts, goods used in such acts will be useful for that person.

5) utility is related to 'expected satisfaction'  $\rightarrow$  actual realised satisfaction because expected satisfaction upon intensity of consumption.

Q4) Give the relationship between marginal utility and total utility.

Ans  $\rightarrow$  Points showing relation between marginal utility and total utility are:

i) Both total utility and marginal utility is positive in the beginning.

ii) As more units of commodity are used, total utility increases with decreasing rate. Total utility increases so long as marginal utility

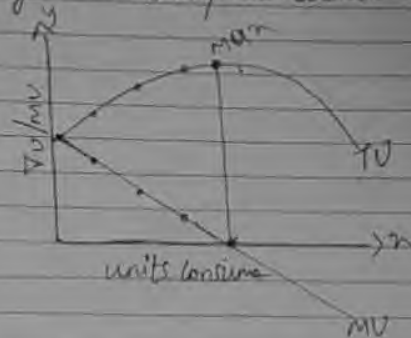
is positive.

iii) Marginal utility decreases continuously, becomes zero at a point and then becomes negative.

iv) Total utility is maximum when marginal utility is zero. This is called point of saturation.

v) Total utility starts decreasing when marginal utility becomes negative.

• Diagrammatic Representation -



\* when TU increases MU decreases (+ve)

\* TU max MU zero

\* TU decrease MU decrease (-ve)

Q5) Explain Gossen's first law. or diminishing marginal utility.

Ans) Law of diminishing marginal utility, also called law of satiety, is an important law of consumption which is universally accepted. It was first described by Austrian economist H. Gossen and is named after him as Gossen's first law.

According to this law, as we go on utilising standard units of a commodity continuously, marginal utility obtained from use of every additional unit decreases. It occurs or happens in all goods and services. Therefore, this law is called fundamental and universal law of satisfaction.

According to this law, as the stock of goods increase with people, marginal utility obtained from additional units of that commodity decreases after a limit.

Q6) Assumption of DMU?

Ans) i) Consumption of goods should be continued. In case of like goods, this law is not applicable.

ii) Size of consumption units should be proper. Small size of unit increases marginal utility.

iii) All units of consumption should be homogeneous. In case of heterogeneity of units, law becomes inapplicable.

iv) Price of available substitutes of goods should be stable.

v) Income and consumption propensity of consumer should remain constant.

vi) No change should take place in fashion, nature and interests of consumer.

Q7) What is equimarginal utility. explain its types?

Ans) The law states that, "Other things being equal, a consumer gets maximum total utility

5) Indifference curves do not intersect at the origin because MRS is diminishing.

6) Indifference curves need not to be parallel. Indifference curves of perfect substitutes are parallel.

Q3. List the assumption of IC.

Ans. The indifference curve approach is based on the following assumptions:

1) Rationality: The consumer is assumed to be rational. He aims at maximizing his benefits from consumption, given his income and price of the goods.

2) Ordinality: Utility is expected satisfaction that a consumer gets from given market basket. In indifference curve analysis, utility is an ordinal concept. Consumer can order or rank the subjective utilities derived from the commodities.

3) Diminishing Marginal Rate of Substitution: Scale of preferences are ranked in terms of indifference curves. Indifference curves are

downward sloping convex to the origin curves. The slope of indifference curve is called marginal rate of substitution (MRS).

4) Weak ordering: Consumer shows weak ordering in his choice. It means that consumer can be indifferent in selection between two combinations of goods but he can not express the superiority of one combination over the other.

Q10. What do you mean by MRS. Explain with help of example.

Ans. The slope of indifference curve shows marginal rate of substitution. Marginal rate of substitution is the rate at which the consumer can be substituted with each other so that total satisfaction of the consumer remains the same.

5 For maintaining the equal level of satisfaction on the various combinations in the indifference curve, consumer has to reduce the quantity of other goods when he increases the quantity of goods. For getting one additional

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of a goods, the quantity of other goods left is called its marginal rate of substitution.

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Q11 what do you mean by budget line. budget set. Indifference map.

Ans -> Budget set: Budget set of a consumer means the collection of all combination of goods which a consumer can buy with his income and given prices of the commodities.

Budget line: A budget line is a line which shows all possible combinations of two goods that a consumer can buy with his given income and prices of commodities.

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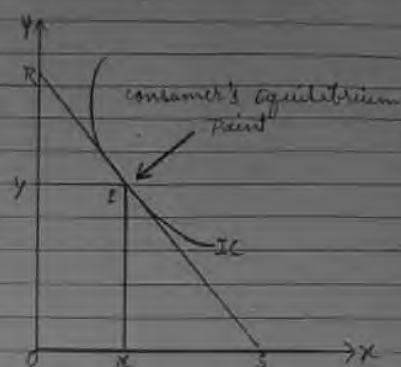
Q3. What do you mean by consumer's equilibrium? Write the conditions of consumer's equilibrium?

Ans. A consumer obtains the state of equilibrium when he becomes successful in maximising his satisfaction by purchasing goods with his limited income and given prices of goods. The price line of the consumer is determined by his income and prices of the goods he consumes. With this given price line, a consumer tries to obtain the maximum possible indifference curve.

In indifference curve analysis, there are two conditions of consumer's equilibrium:

(1) Price line should be tangent to indifference curve. At the point of equilibrium, the marginal rate of substitution  $X$  and  $Y$  ( $MRS_{xy}$ ) should be equal to the ratio of prices of goods  $X$  and goods  $Y$ .

$$MRS_{xy} = \frac{P_x}{P_y} \quad MRS_{yx} = \frac{P_y}{P_x}$$



In fig., at equilibrium point  $E$ , slope of Price line = slope of Indifference curve.

$$\text{or } \frac{P_x}{P_y} = MRS_{xy}$$

(2) For stable equilibrium, indifference curve should be convex to the origin at the point of equilibrium. At  $MRS_{xy}$  should be diminishing at the point of equilibrium.

Q. What do you mean by Cardinal Approach and Ordinal Approach?

⇒ Cardinal Approach → Cardinal utility is the utility wherein the satisfaction derived by the consumers from the consumption of good or service can be expressed numerically. It <sup>has</sup> Quantitative Approach.

It had Less Realistic. It measurement in utils. It is Promoted by classical and Neo-classical Economists. It analysed by marginal utility.

Ordinal Approach → Ordinal utility states that the satisfaction which a consumer derives from the consumption of good or service cannot be expressed numerical units. It has Qualitative Approach.

It had More Realistic. It measured in ranks. It is Promoted by Modern Economists. It analysed by <sup>indifferent</sup> indifferente curve.

