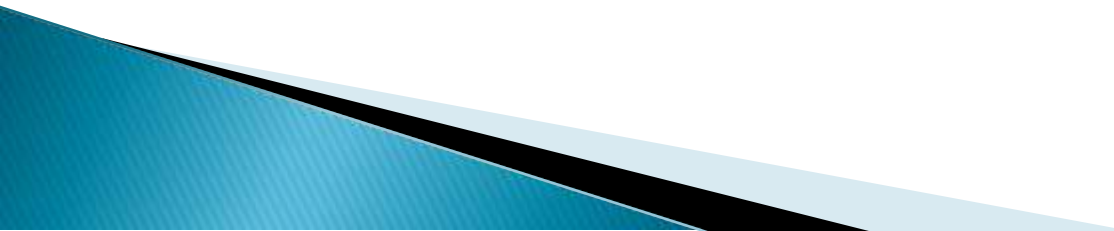



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ECONOMIC ANALYSIS



What is utility ?

- ▶ Utility is the want satisfying power of commodity.
 - ▶ It is a subjective entity and varies from person to person.
 - ▶ It should be noted that utility is a not the some thing as usefulness.
- 

Meaning of utility

Utility may not be confused with usefulness as it is purely subjective satisfaction derived from the consumption of a commodity.

Example:

- water has the ability to slake thirst, pen has ability to write.

UTILITY

- ▶ **Definition:**

In objective terms, utility may be defined as the “amount of satisfaction derived from a commodity or service at a particular time”.

UTILITY APPROACH

▶ Two Types of Approach


➤ Cardinal Approach

- The cardinal utility theory says that utility is **measurable** and by placing a number of alternatives so that the utility can be added.
- The index used to measure utility is called **utils**.

➤ Ordinal Approach

- The ordinal utility theory says that utility is **not measurable** but it can be compared.
- Ordinal approach uses the **ranking of alternatives** as first, second, third and so on.


Characteristics of utility

- ▶ Dependent upon human wants.
 - ▶ Immeasurable.
 - ▶ Utility depend upon use.
 - ▶ Utility is subjective.
 - ▶ Utility depends upon shape.
 - ▶ Utility depends upon on knowledge.
 - ▶ Utility depends upon ownership.
- 

Concepts of Utility

- ▶ **Initial Utility**- Satisfaction Derived from very first unit consumed of any object.
- ▶ **Total Utility** – Total Satisfaction derived from the product.
- ▶ **Marginal Utility**- The word Marginal means “Border” or “Edge”.


It is the addition made to the total utility by consuming one more unit of a commodity.



Utility is of two types:

- ▶ Total Utility
- ▶ Marginal Utility

TOTAL UTILITY(TU)

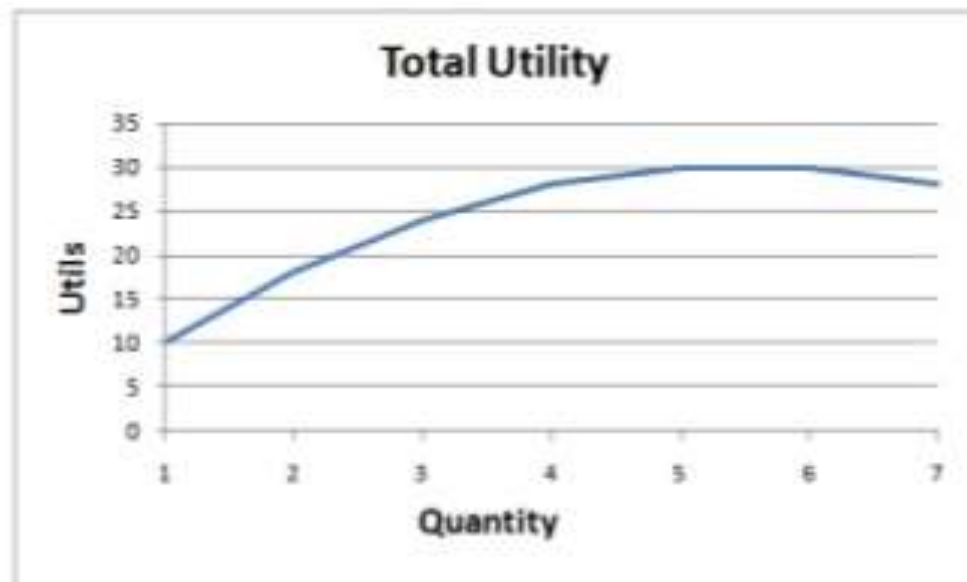
- ▶ The sum total of satisfaction which a consumer receives by consuming the various unity of the commodity.
 - ▶ (The more unit of a commodity he consumes, the greater will be his total utility)
- 

Total Utility

- ▶ The total satisfaction of wants & needs obtained from the consumption of goods & services
- ▶ Based on the presumption that the amount of utility generated from the consumption of a good can be explicitly measures
- ▶ Hypothetical measure is util

Curve of Total Utility

Quantity	Total Utility
1	10
2	18
3	24
4	28
5	30
6	30
7	28



MARGINAL

- ▶ **The term marginal refers to the effects of a small change in consumption.**

'Marginal considerations are considerations which concern a slight increase or reduction of the stock of anything which we possess.'

Marginal

- ▶ Marginal utility can be defined as a measure of relative satisfaction gained or lost from an increase or decrease in the consumption of that good or service.

Examples:

- ▶ A motor vehicle or A haircut
- 

MARGINAL UTILITY (MU)

The additional to total utility as a result of consuming one more units of the same good or services.

$$\text{Marginal Utility (MU)} = \frac{\text{Change in Total Utility}}{\text{Change in Total Quantity}}$$

$$\text{MU} = \Delta \text{TU} / \Delta \text{Q}$$

Curve of Marginal Utility

Quantity	Marginal Utility
1	10
2	8
3	6
4	4
5	2
6	0
7	-2



Marginal Utility

The additional satisfaction gained by the consumption of one more unit of something

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

OR

The change in total utility (ΔTU) resulting from a one unit change in consumption (ΔX).

$$MU = \Delta TU / \Delta X$$


Marginal utility

- Positive Marginal Utility
 - Zero Marginal Utility
 - Negative Marginal Utility
- 

Positive Marginal Utility

If, by consuming additional units of a commodity, total utility increases then the marginal utilities of these units will be Positive

Negative Marginal Utility

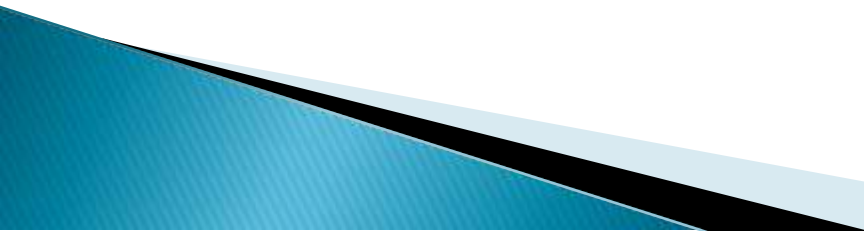
If the consumption of an additional unit of a commodity causes a fall in total utility, it means the marginal utility of that unit is negative



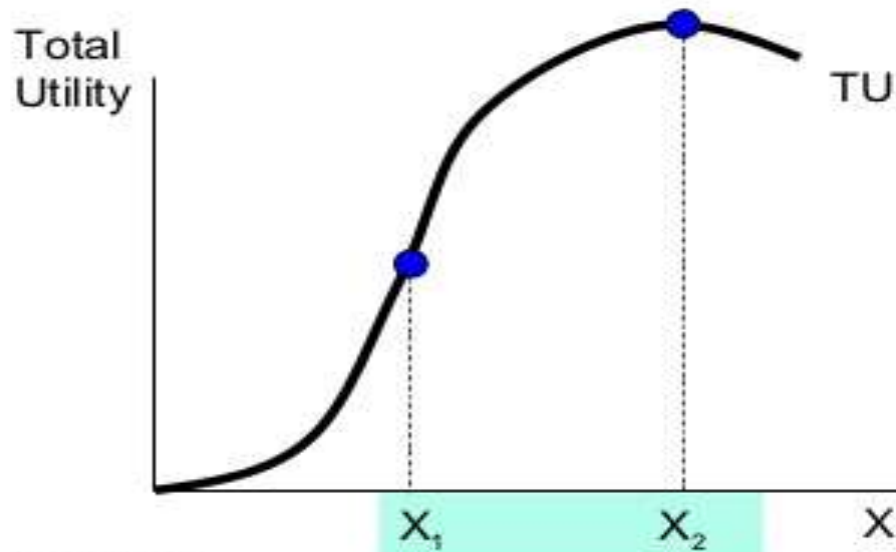
Zero Marginal Utility

If the consumption of an additional unit of a commodity Causes no change in the total utility, it means the marginal utility of that unit is negative

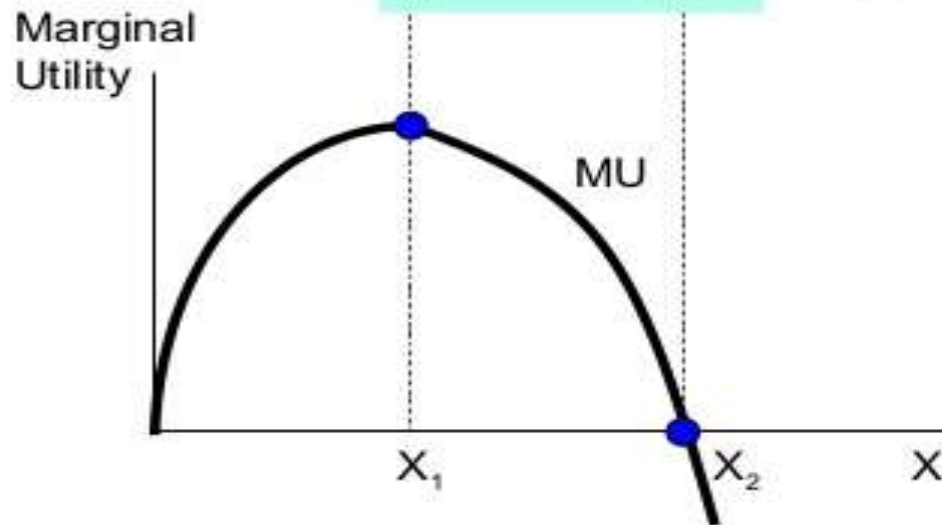
Relationship between Total Utility and Marginal Utility

- When marginal utility is positive total utility increases
 - When marginal utility zero total utility is at maximum. It is also known as 'point of maximum satisfaction'
 - When marginal utility is negative total utility diminishes.
- 

Graphs of Total Utility & Marginal Utility



X_1 is where marginal utility reaches its maximum. This is where we encounter diminishing marginal utility. The slope of TU has reached its maximum; TU has an inflection point here.



X_2 is where total utility reaches its maximum. MU is zero. This is the saturation point or satiation point. After that point, TU falls and MU is negative.