Consumption

Consumption occupies an important place in Economics. Consumption is use of wealth, for the satisfaction of wants. Whatever the nature of wants, they come up for satisfaction sooner or later. Thus the application of wealth for the direct satisfaction of wants is known as consumption.

Definition:-

A.L. Meyers:- "Consumption is the direct and final use of goods and services in satisfying the wants of free human beings."

In consumption we study wants, their origin and satisfaction, the laws governing their satisfaction, etc. Consumption is the starting point of all economic activities. The production, exchange, distribution of wealth have only this final aim.

Utility

Consumption depends upon utility concept. Utility is the base of consumption. If a consumer feels utility in the commodity he will purchase that commodity. So utility is the want satisfying power of the commodity.

The money which a ~~perp~~ consumer is prepared to offer for a commodity measures directly not the satisfaction he will get from the commodity but the intensity of his desire for it or the utility which he will get from consumption of that unit.

Means, utility is the capacity of a commodity to satisfy some human want. It is the want satisfying power of a commodity. The article which possess this power has utility but if a commodity cannot satisfy want, it cannot be said to possess utility.

Factors —

Consumer's want:-

- Utility depends upon Consumer's want:- If water remains both the places, the desert and the house, its utility is great in one case and less in other case.
- The degree of utility depends upon urgency of want - The utility of a commodity varies and not fixed - A man feels high utility for water when he is very much thirsty but he feels less utility when he is not thirsty.

Utility of all commodities is not same, Some commodities have greater utility than others. How this utility is measured.

Utility cannot be Directly Measured :-

Economists do not possess any accurate means or apparatus for measuring utility such as thermometer for measuring temperature, cloth with yardstick. But no such measure for utility. There is indirect method to measure.

To measure utility there are two approaches.

1. Cardinal Approach :- This approach is given by classical economists who believed that utility can be measured with the measuring rod of money. The amount of money that a person is prepared to pay for a commodity rather than go without it, measures the utility of that commodity. In this way we can say how much utility one, gets from consumption of one unit of commodity. This is called cardinal approach.

2. Ordinal Approach :- Later cardinal approach was not accepted by modern economists. They were of the view that utility cannot be measured in cardinal terms because utility is a psychological concept and we can only compare that between the two commodities which is having more utility and which is having less utility. Exactly we cannot say how much utility one gets - as utility is a feeling of pleasure or happiness which we cannot measure in exact terms.

On the basis of utility there are many laws in consumption. To understand these laws we should know the types of utility.

Types of Utility

There are three types of utility

1. Marginal Utility
2. Total Utility
3. Average Utility -

1. **Marginal Utility** :- Marginal Utility means utility of the last unit of the commodity. When consumer consumes many units of a commodity the utility derived from the last unit of that commodity is known as marginal utility.

According to Boulding :-

"The marginal utility of any quantity of commodity is the increase in total utility which results from a unit increase in consumption."

Marginal utility can be positive, zero, negative.

2. **Total Utility** :- When we consume many units of a commodity, the utility derived from all units of consumption is known as total utility.

According to A.L. Meyers :- "Total Utility is the sum of the marginal utilities associated with the consumption of the successive units."

3. **Average Utility** :- When we divide the total Utility of commodity by its total units of consumption then average utility is derived.

$$AU = \frac{TU}{\text{Number of units}}$$

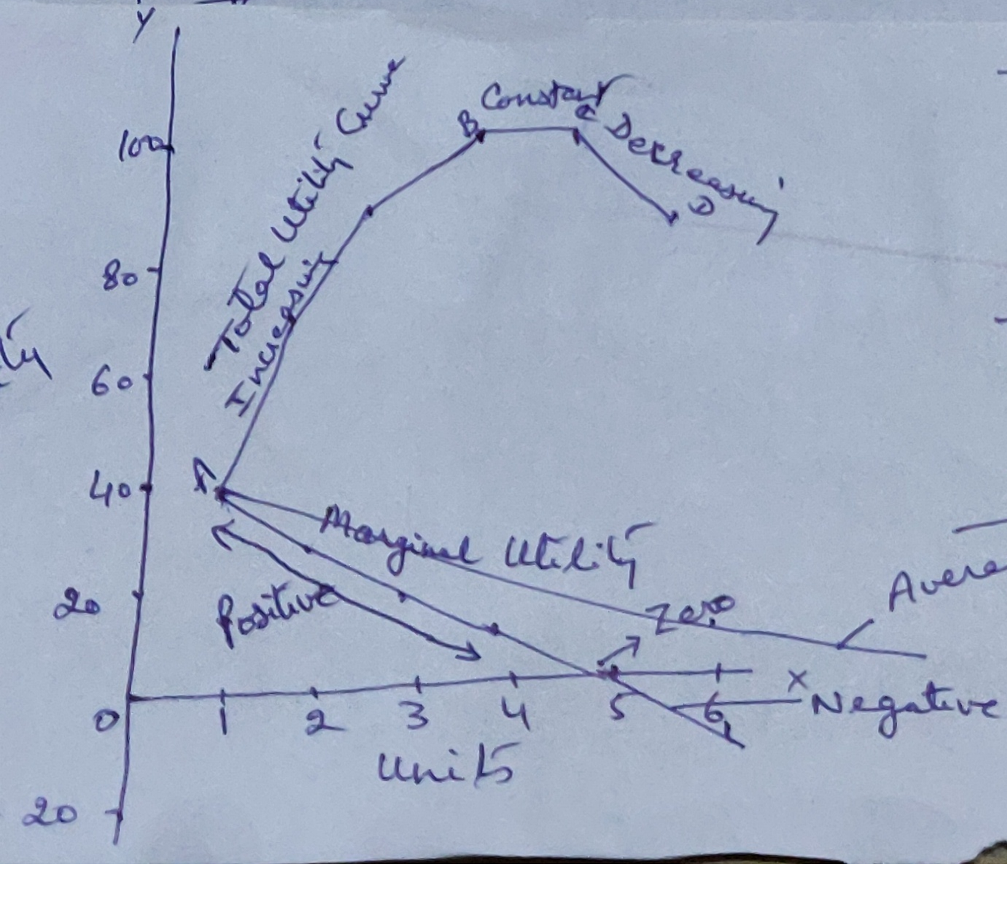
Relationship ~~to~~ in Marginal, Total Average utility

Chart:

Units of Commodity	Marginal utility.	Total Utility	Average utility
Positive MU 1	40	40	40
2	30	70 Increasing	35
3	20	90	30
4	10	100	25
Zero M.U. ← 5	0	100 → Constant	20
Negative M.U. ← 6	-10	90 → Diminishing	15

In the chart
M.U is diminishing with every additional unit
From 1st unit to 4th unit MU is positive as Total utility is increasing.
From 5th unit MU is zero but TU is maximum & constant.
From 6th MU is negative and TU also starts diminishing
Average utility keeps on diminishing but not ~~zero~~ touching zero or negative points.

Diagram:-



Explanation of Diagram:
MUC = sloping left to right downward. It is positive till 4th unit is zero at 5th and negative at 6th unit
T.U.C. is increasing from A to B. From B to C it is constant when MU is zero. TU is decreasing when MU is negative.

Law of Diminishing Marginal Utility

Satisfaction of human wants follows some very important laws and one of them is the law of Diminishing Marginal utility. The law refers to the common experience of every consumer. This law is also known as the First law of Gossen.

The law states that —

The general pattern of consumers behaviour reveals that the satisfaction which we derive from a repeated consumption of a homogenous commodity, diminishes at each stage. In economics, such psychological satisfaction is termed as 'utility' and this trend in consumers' satisfaction in terms of law of diminishing marginal utility.

The attempt taken by Alfred Marshall in his analysis to define the consumers utility in scientific and systematic manner was remarkable.

According to Marshall:- "The additional benefit which a person derives from given increase of a stock of a thing diminishes, other things being equal, with every increase in the stock of that he already has."

This tendency operates universally and visible in the case of all the objects satisfying human wants.

Explanation of the law:- The law states as the person starts consumption of commodity bread, the first unit of commodity bread gives him great pleasure, second bread meeting with less urgent need, yield less satisfaction, the satisfaction of the third will be less than that of the second and so on. The additional satisfaction will go on diminishing with every additional unit of bread till it drops down to zero, and if a consumer is forced to take more the satisfaction may become negative.

In fact consumption basket comprises of some food items like rice, bread, milk vegetables fruits etc which are of perishable in nature and some durable goods like furnitures, TV, automobile etc. In the former group of commodities the rate of diminish in the marginal utility is much faster and greater, whereas in the latter group of commodities it is slow and prolonged. Again, whereas in the case of food items, the marginal utility may reduce to zero or even to negative. In case of durable goods, the marginal utility rarely reduces to zero. The marshallian utility analysis mostly centers around the former group of goods. However in either case, the law of diminishing marginal utility could be invariably applied.

Assumptions :- In the statement of the law, the sentence is always mentioned that "other things remaining the same". So assumptions means, under these conditions this law will be applicable.

1. Homogeneous Commodity and units :- For application of this law it is necessary that all the units of the commodity must be identical. Uniformity of commodity in quality and quantity is necessary.

2. No time interval :- There should not time gap in consumption. It should be continuous.

3. No change in Taste and Fashion :- Consumers taste and preferences should not change.

4. Price of commodity should remain unchanged Price should not change and should remain same for all units.

5. Consumer should be rational :- Mental condition of the consumer should be normal. Then he can be able to measure the utility.

6. Income of the consumer should not change :- Income should remain unchanged. If income increases the demand will increase.

7. Marginal Utility of money should remain constant

8. Unchanged prices of Substitutes :- the prices of the substitutes should remain unchanged unless the law will not applicable.

Illustration :- For example consumer takes many units of commodity A as shown in the chart -

Units of A	MU	Price
1	40	20
2	30	20
3	20	20 - Equilibrium of consumer.
4	10	20
Zero ← 5	0	20
Negative ← 6	-10	20

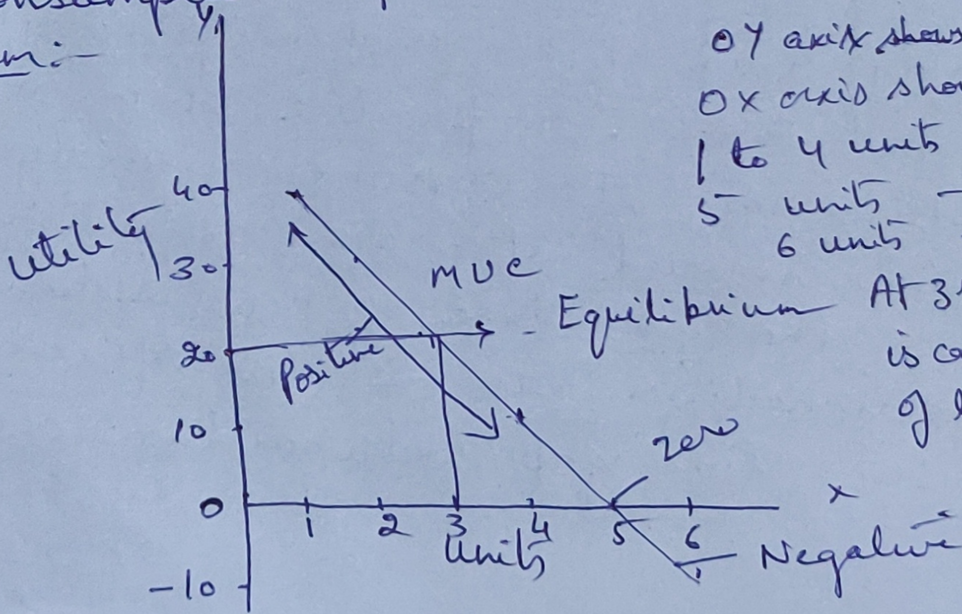
Positive : 1–4

Consumer takes six units of Commodity A.
From 1st units he feels highest utility
From additional units the marginal utility falls.
from 1st to 4th MU is positive
From 5th MU is zero and from 6th MU is negative.

Theoretically the consumer when takes many units of commodity A (food item) the MU is diminishing can reach to zero MU and can be negative.
But practically it is difficult to reach the point of zero or negative.
As in reality the goods may be of two types:-
(1) free goods (2) economic goods.
The free goods are those which are available to the consumer without any payment, whereas in the case of economic goods, the consumer has to pay price.

In the former group of goods (free goods) a consumer may continue his consumption upto zero marginal utility. But in the latter group of goods (economic goods) the consumer never extends his consumption to zero marginal utility because the consumer very often faces the budget limitations. The resources are not unlimited. Thus whenever the consumer purchases goods one after another of same kind, he compares the marginal utility of the goods with its price. When marginal utility of the goods is equal to its price (assuming one unit of money is equal to one unit of marginal utility), the consumer stops his consumption; In chart at unit 3rd consumer would stop & repetition of units because at 3rd unit the MU is equal to its price paid. This point consumer will be in equilibrium position. In other words, consumer could at best extend his consumption upto 3rd unit.

<u>Diagram:-</u>



OY axis shows utility
OX axis shows units
1 to 4 units - Positive
5 units - Zero
6 units - Negative
At 3rd = MU = Price is called Equilibrium of the consumer

The consumer equilibrium takes vital role in guiding the consumers demand for goods in the market with prices.

Criticism of the law:-

There are many weaknesses in Marshall's analysis so it was criticised on various grounds:-

1. Assumptions:- most of the assumptions are rarely fulfilled in our day to day consumption.

A). Perfect homogeneity of goods:- is not seen In rare cases it is found where two dishes of some food items are perfectly homogeneous in respect of its quality, taste, fragarance etc, implies that the law of diminishing Marginal utility would be applicable to only in few cases in which goods are identical.

B) Constant Income:- of the consumer and increase in consumption units are contradictory to each other because increase in consumption units implies a fall in income of the consumer since he has to pay from his stock of income for subsequent units of good consumed.

C.) Many units of the commodity one after another:- is not true. In practice even in the case of food items, the consumer generally takes some desired amount at a time to satisfy his want, unlike the procedure of consumption mentioned in Marshallian law, ie. 'One after another' for many units and no such time gap between two consumption points

If we feel hungry we take some units or if thirsty we take one or two glasses of water and not as explained by Marshall for many units one after another till the point of zero or negative utility.

2. The entire analysis of Marshall centred around the measurability of utility:- Since utility being psychological feeling, it would be purely unscientific arbitrary to assign a cardinal number to utility.

3. More emphasis on Perishable goods :- Marshall's utility analysis stressed much on the food items in which the consumer may reach zero or negative marginal utility. He left much discussion on durable goods. In case of durable consumer goods, the marginal utility declines due to repeated consumption of the goods of same kind, but it rarely display zero or negative values. Consumer purchases durable goods like TV, motorcycle car, building etc. once or twice in his life period. In this case, there is no repeated purchases as Marshall assumed.

4. Constant Marginal Utility of money is not true. Every increase in consumption units implies fall in money income which in turn, indicates an increase in utility of money so marginal utility of money is never constant.

By and large on account of a number of short comings and misleadings in Marshallian utility analysis, the law of diminishing marginal utility has ~~lost~~ lost its ground. In order to overcome the limitations identified in Marshall analysis, later on, Hicks and Allen and Samuelson economists have developed more scientific theories with respect to consumers' behaviour. Inspite of these shortcomings, it is true that the diminishing trend in mental satisfactions from repeated consumption of goods of same kind never be ruled out. It is always seen that if the stock of any commodity increases its utility for the consumer falls. So it has very much importance in consumers' behaviour.