

## The 'margin'

The margin is an important concept in economic and business analysis. You will come across marginal utility, marginal cost, marginal revenue, marginal product and a host of other marginal terms. But what is the margin?

The margin refers to the difference when one additional or one less unit of something is observed.

One important thing to remember about this concept is the difference between marginal and total values. Let us take a simple example to try to illustrate this.

You are looking forward to a night out with friends. You get to the bar and order your first drink. Give it a rank out of 10 in terms of the pleasure it is going to give you. (This represents, in economic terms the degree of **utility** or satisfaction gained from consumption). Chances are it is going to be quite high - let's say 10/10. The total utility after the first drink is 10 and the **addition** to total utility - the satisfaction gained from that first drink - is also 10.

You finish the first drink and decide to have a second. This next drink is your marginal drink - one additional drink. How much utility does this extra drink give you? Possibly quite a lot but probably not quite as much as the first, if you are totally honest. Let's say 9/10. The total utility gained now stands at  $10+9 = 19$  but the marginal utility - the satisfaction gained from that one extra unit - is 9.

What about the third drink? Again, this extra drink gives you some satisfaction but probably less than the second, and almost certainly less than the first. The utility gained might be scored at 7/10 for this third drink. The total utility is now  $10+9+7 = 26$ , but the marginal utility is 7.

The process could continue - and we are not advocating binge drinking here in the pursuit of economic experimentation! It is possible that you might get to eight drinks - the eighth drink might yield only 1/10 and you might be getting to the stage where you are starting to feel a bit unwell. Someone offers you a ninth drink. You know that if you take this ninth drink, you will be sick - it is perfectly possible, therefore, that the utility gained will be negative in such circumstances.

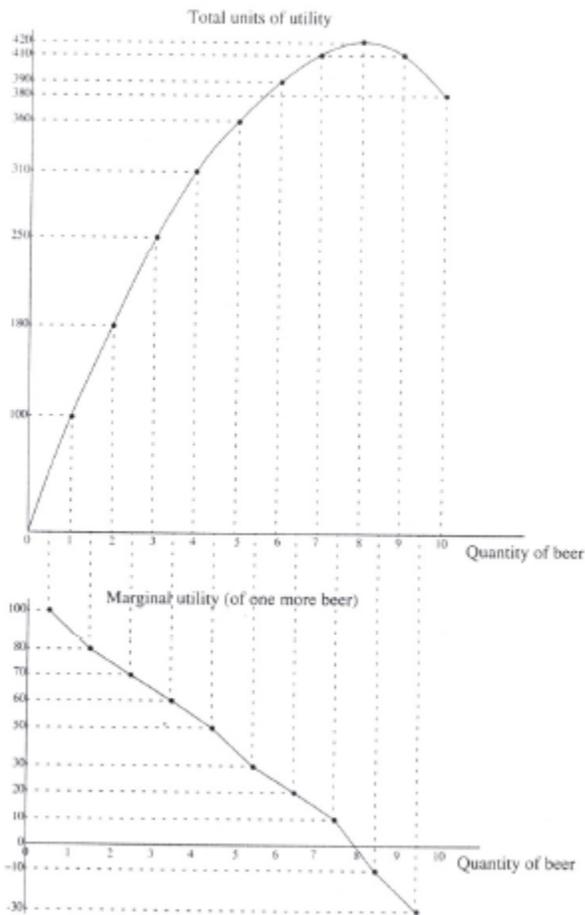


Think about it - is it really worthwhile having that extra drink? Exactly what is the marginal utility gained from it? Copyright: [Kat Callard](#), from stock.xchng.

All the while you are taking these drinks, of course, you have to pay for them. The relationship between what you have to give up in relation to the utility gained is changing. If we assume that all the drinks are the same price (let's say £2.50 for the sake of argument), the relationship between the utility gained and the price you have to pay for the first drink is quite high. Each successive drink, however, sees a reduction in the value relationship. You are paying £2.50 to get 10 units of utility from the first drink but still have to pay the same amount to get only 1 unit of utility from the eighth. If you did take the ninth, then you would effectively be paying £2.50 for the privilege of throwing up!

The concept of the margin, therefore, is important in decision making.

Figure: 1.3 Total and marginal utility of drinking beer in the desert



Questions:

1. Use the diagram above to explain the concepts of total utility and marginal utility
2. As total utility increases at an ever slowing pace, marginal utility will... (finish the sentence)
3. Use the concept of utility to explain and exemplify an individual's choice.
4. What do you think is the connection between a person's marginal utility in the consumption of Good X and the person's willingness to pay for Good X?