1.6 Rational Decision Making and the Theory of Diminishing Marginal Utility: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Full sentences are required for Q1, Q2, Q6, Q10, Q11 and Q13. Do simple arithmetic without a calculator where asked. Show working for calculations.

1 Equi-marginal principle: Two goods A and B. Explain in full sentences how a consumer with a fixed budget will allocate spending between A and B to maximise total utility, using the equi-marginal principle ($MU_A / P_A = MU_B / P_B$). Include a brief example with numbers: $MU_A = 10$ utils, $P_A = 2$, $MU_B = 6$ utils, $P_B = 1$.

(Total for Question 1 is 4 marks)

2 State the law of diminishing marginal utility as it applies to successive units of a single good consumed by an individual, for example cups of tea consumed during a morning.

(Total for Question 2 is 1 mark)

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Mark scheme · 1.6 Rational Decision Making and the Theory of Diminishing Marginal Utility: 10-minute Pack

Question 1

states the equi-marginal condition: $MU_A / P_A = MU_B / P_B$ for utility maximisation given a budget	**M1**
applies the numbers: $MU_A / P_A = 10/2 = 5$; $MU_B / P_B = 6/1 = 6$	**M1**
concludes that $MU_B / P_B > MU_A / P_A$, so the consumer should buy more of B and less of A to increase total utility per pound spent	**A1**
explains final allocation condition: the consumer reallocates spending until MU_A / P_A rises or MU_B / P_B falls into equality, or until budget is exhausted	**A1**

Answer: Since 10/2 = 5 and 6/1 = 6, B gives more utility per pound, so the consumer should buy more of B and less of A until $MU_A/P_A = MU_B/P_B$ or budget exhausted.

Question 2

as more units of a good are consumed, the marginal utility of each additional unit eventually falls, holding other factors constant	**B1**

Answer: As more units are consumed, the marginal utility of each additional unit eventually decreases, ceteris paribus.

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