

Margin

Within economics, margin is a concept used to describe the current level of consumption or production of a good or service. Margin also encompasses various concepts within economics, denoted as marginal concepts, which are used to explain the specific change in the quantity of goods and services produced and consumed. These concepts are central to the economic theory of marginalism.

This is a theory that states that economic decisions are made in reference to incremental units at the margin, and it further suggests that the decision on whether an individual or entity will obtain additional units of a good or service depending on the marginal utility of the product.

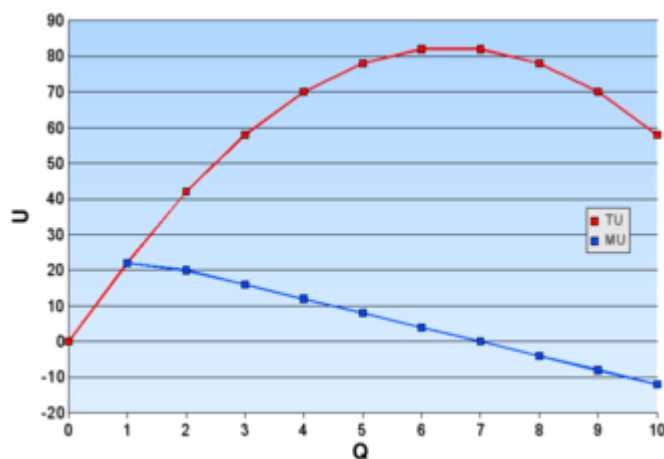
These marginal concepts are used to theorise various market behaviours and form the basis of price theory. It is a central idea within microeconomics and is used to predict the demand and supply of goods and services within an economy.

Marginal Concepts

Marginal utility

Marginal utility describes the added satisfaction or benefits a consumer will obtain by purchasing an additional product or service. The marginal utility can be positive, negative or zero. A negative marginal utility states that the user gains dissatisfaction from an additional unit, whilst a marginal utility of zero states that no satisfaction is gained from the additional unit.

Within marginal utility, the law of diminishing marginal utility describes that the benefit to a consumer of an additional unit is inversely related to the number of current units, demonstrating that the added benefit of each new unit is less than the unit prior.



An example of this could be demonstrated by a family buying dinner. The 1st plate of food would have a greater marginal utility than the 10th plate of food, as the families hunger would be reduced and they would thus obtain less value from it.

Marginal cost

Marginal cost is the change in monetary cost associated with an increase in the quantity of production of a certain good or service. It is measured in dollars per unit, and includes all the variable costs that alter depending on the level of production. Marginal cost differs from average cost as it solely provides the additional cost of one unit, rather than the average cost of each unit.

The marginal cost function is the slope of the total cost function. Thus, given a continuous and differentiable cost function, the marginal cost function is the derivative of the cost function with respect to the quantity produced.

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Marginal rate of substitution

The marginal rate of substitution is the least favourable rate an individual or entity would exchange a good or service for another good or service.^[9] The marginal rate of substitution is associated with the value an individual or entity places on each unit, and would only trade if it provides a positive net value, whereby the value of the good or service obtained is greater than the one given away.

The marginal rate of substitution is calculated between two goods placed on the indifference curve, displaying the utility of each good. The slope of the utility curve represents the quantity of goods one would be satisfied in substituting for one another. There are however difficulties in quantifying the utility of different goods and services in comparison to one another, provide a critique of this framework.

Marginal product

In the theory of marginality, the marginal product of an input is the extra output obtained by adding one unit to a specific input. This assumes all the other factors contributing to the output remain constant. For example, the marginal product of labour would be the added production when increasing a unit of labour, such as hours worked.

Marginality states that theoretically, the wage rate would equal the marginal product of labour. If the wage rate is below the marginal product of labour, profit-maximising businesses would continue to hire more employees until the marginal product reduces to the wage rate according to the law of diminishing return. Moreover, this theory can be applied to working capital, where businesses will employ more capital when the rate of interest on the capital is less than the marginal product. The value of the final product can thus be considered as a contribution of the various inputs and values derived by each.

Criticisms

There are several critiques of the theory of marginal utility. A major critique is that the theory ignores how an individual's valuation of a good or service may be dependent on their reference point and personal circumstances and they may not act as 'rationale'. Psychologists have suggested that people's perceptions and judgements are influenced by their reference position. This is demonstrated by Richard Thaler's endowment effect experiment, whereby individuals were sold small objects and then offered an option for the item to be bought back from them. He found that people would only sell the product at a premium, demonstrating that the value of the good was higher when viewed as something that could be lost compared to something that could be acquired.

Another key limitation of margin is how marginal change is measured. Quantifying the marginal utility of certain products and services such as food may be difficult as utility is a subjective value and thus individuals may struggle to associate a numerical value to it.

References:

Marginalism Definition. Investopedia. (2022). Retrieved 12 April 2022, from <https://www.investopedia.com/terms/m/marginalism.asp#:~:text=Marginalism%20is%20the%20economic%20principle,buying%2C%20selling%2C%20etc.>

^ Jump up to: ^a ^b ^c Reading: Marginal Utility | Microeconomics. Courses.lumenlearning.com. (2022). Retrieved 12 April 2022, from <https://courses.lumenlearning.com/suny-microeconomics/chapter/marginal-utility/>.

^ Jump up to: ^a ^b Stiglitz, J. (2000). The Contributions of the Economics of Information to Twentieth Century Economics. The Quarterly Journal Of Economics, 115(4), 1441-1478.