

PRINCIPLES OF ECONOMICS

B.Com Hons Part-I

TOPIC -

IMPORTANCE OF LAW OF
EQUI - MARGINAL UTILITY

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Importance of law of equi-marginal utility

① Consumption :-

This is necessary that the person make the best use of resource because the resource are scarce in relation to wants. Every consumer aims at getting the maximum possible satisfaction.

② Production :-

The law is also of great importance in production. The producer has to use several factors of production. He wants maximum net profit. For this purpose, he must substitute one factor for another so as to have the most economical combination. Marginal productivity of the two is equalised in this manner, he will get most economical combination of the 'actors of production' at his disposal to make maximum profit.

③ Exchange :-

The law also applies in exchange because exchange is nothing else but substitution of one thing for another. When we sell a commodity, say sugar we get money. With this money, we buy another commodity, say wheat. We have really substituted sugar for wheat.

④ Distribution :-

It is on the principle of marginal productivity that the share of each factor of production (i.e. labour, land, capital & organisation) is determined. The use of each factor is pushed up to a point where its marginal product is equal to the marginal product of every other factor of course, after allowing for the difference in their respective remunerations. This necessitates substituting one factor for another.

⑤ Price Determination :-

The equi-marginal utility concept has an important influence on price determination. When a product is scarce, the law of substitution comes to our assistance. We are beginning to replace the more scarce and expensive items with less scarce or cheaper products.

⑥ Time allocation :-

The equi-marginal concept refers to the allocation of 24 hours a day to various purposes i.e., between work and recreation. For an hour's more work, he must compare the marginal utility of profits to the marginal utility of leisure, which he must forgo.

⑦ Saving and Investments :-

Profits should be divided between consumption and saving according to this law in such a way

that the last unit of money spent on current consumption should yield the same utility as the last unit of money kept in the form of saving. optimum allocation is called such a distribution.

⑧ Public Finance :-

In the area of public finance, the rule is still applicable. Taxes are levied in such a manner that each taxpayer's marginal sacrifice is equal. The finance minister may substitute one tax for another in order to achieve this objective. Similarly, it is ensured at the time of spending funds that the marginal advantage of each form of public expenditure should be equal.

⑨ International Trade :-

In international trade, a country observes the theory of substitution. It exports a product with a lower marginal utility and imports a product with a greater marginal utility. Until their marginal utilities become equal, this substitution continues. Thus, by the theory of substitution, full benefit from foreign exchange is obtained.