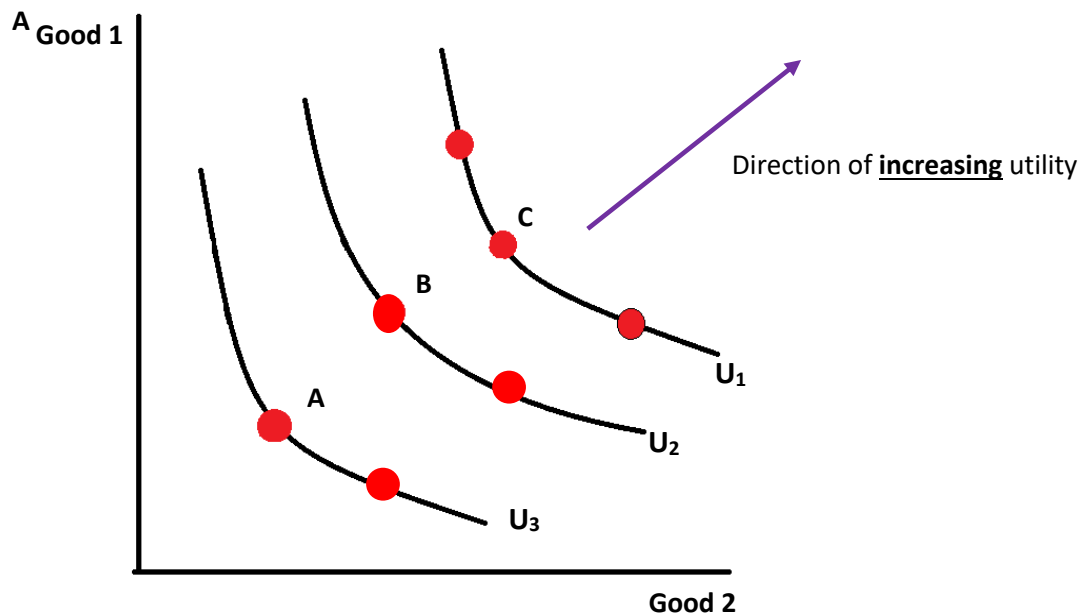




## Activity 5 – Answer Sheet

As detailed in Resource 1, we know that **higher** indifference curves represent **higher** levels of utility. In the illustration below,  $U_1$  therefore represents the highest level of available utility. Specifically, the level of utility represented by an indifference curve increases as we move **away from the origin**, in the direction signalled by the **purple** arrow below. Think about bundles A, B, and C. The proportion of goods 1 and 2 in each of these bundles is constant, however the absolute amount of each good increases as we move in the direction of the arrow. A common assumption in economics is to assume that marginal utility of consumption is positive, which is to say that individuals prefer more consumption to less. Bundles that include a larger number of each goods are assumed to also provide a higher level of utility!



**Answers to Exercises (2/2)**

- Sam is **incorrect**. It is true that by choosing bundle A, Sam is exhausting his available budget on a particular combination of goods 1 and 2. However, consider the indifference curve that would depict the level of utility provided by bundle A. This is the dashed indifference curve shown below. Clearly, Sam can reach a higher indifference curve – and therefore a higher level of utility – by switching to bundle B. This bundle also exhausts his budget; however bundle B provides a higher level of utility to Sam. Remember from Resource 3 that the unique utility-maximising bundle is given at the point of tangency between the budget line and the highest achievable indifference curve.

