

To Be A Happy Person, Understand Marginal Utility

I'm at dinner and the hostess serves me pie for dessert. I gobble it up. Then the hostess says, "Would you like another piece?"

I politely decline.

In her head, she is thinking "he hates my pie," but this is totally wrong. I love her pie, especially the first piece. But the second piece has slipped from A to B in my preference ranking, and "no pie" has moved from B to A. I'm not making a judgment on the whole stock of goods, I'm choosing based on my perceived value of the incremental unit. This is a gigantic difference.

"So you don't like my pie enough to have a second piece?"

I respond:

"No, I absolutely adore your pie. When I had the first piece, it was the most important thing in the world, and I went wild for it. But when you offered the second piece, I evaluated it as an independent unit of pie. I still love it so much! But eating it is B – not A – on my internal preference ranking. If the option to decline the pie were not present, I would eat it and be overjoyed. It just so happens that what economists call the marginal utility of the second piece is lower than the first, too low to be a point of action for my choosing person."

"I see. You hate my pie!"

What's going on here? The hostess doesn't understand this idea of marginal utility as I do.

A New Theory

I can see why two generations of economists, from the 1870s-1910s, were in a total meltdown frenzy over the concept of marginal utility. This is an idea that can save the world.

I have a theory that if you understand it, you will be more civil. More friendly. More subtle and understanding. You will understand yourself and those around you better. It underscores the sheer complexity of human decision-making and shows why governments are utterly incapable of wise management of the world.

The discovery of marginal utility was to this generation as significant as the discovery of flight, electricity, and the theory of evolution. It was a paradigm shift, an insight that changed everything.

Until that time, economists puzzled about the value of stuff in terms of its total value to society. Water is pretty darn valuable. We have to have it to stay alive. Everyone wants it. Why, then, is it so cheap to buy, even as fripperies like lace and diamonds are so expensive? Does this mean that something is wrong with the world that needs fixing?

No, the prices are determined by the marginal choice given an accessible stock of resources. That may sound like a simple point, but it has profound implications.

What these economists discovered was that value is determined not by the total stock of a good or its perceived value to the whole of society. Value is determined by the incrementally consumed unit, one choice at a time. We rank our preferences from A to infinity, but at any one time, we can only choose one. We go for A, but if that is not possible, we shift B to A, and if that is not possible, we shift C to A. At any one time, we are only choosing one thing. We choose on the margin.

It's Not You

Here is another example of marginal utility in action.

The girl says to the guy, "It's not you; it's me." The guy thinks, I've heard that before; she doesn't like me. But it turns out the girl is right. She does like him. She truly does. But the romance takes time and energy, and she would rather spend her time posting on Pinterest. Pinterest is A on her personal preference ranking. B is the guy. The guy doesn't make the cut.

Or maybe not. Maybe A is Pinterest but B is getting school work done. C is practicing piano. D is watching The Wire. E is making biscuits. F is Snapchatting goofy images to her friends. Finally we get to G, which is "date this guy." She really does like him, and if A-F were not options, she would be all about dating him. But A-F are possible realities. Jumping in the preference ranking from A immediately to G would be an error that would diminish her total happiness from what it otherwise might be.

You see how marginal utility clarifies human decision-making? It means that we don't think and act in black-and-white terms. It is not love or hate, embrace or reject, go for it or spit it out. We make decisions on the margin within the context of a wonderfully complex and infinite array of choices that are ultimately hidden from the view of others.

The Wedding

It is this hidden aspect that feeds the paranoia that leads people not to think about marginal utility.

A friend invites you to his wedding. You say that you would love to go, but you have a work meeting you must attend that very day. You really want to go, but you can only do one thing at a time, and protecting your career at this point seems gigantically important.

Your friend understands. For now. But then the wedding comes,

and you are not there. The picture album comes out, and you are nowhere to be seen. The memories are beautiful and exciting, yet you are not part of them. Over time, your friend begins to think: Hey, I thought he was a friend, but he ditched my wedding with some lame excuse. He must not be the friend I thought he was. I hate him.

This happens all the time. It happens because people do not think about marginal utility. It is not constantly in our minds. That's hardly a surprise, because it took humanity 500,000 years to discover it. In scientific terms, it is a fairly recent discovery. It will probably take another few hundred years before the concept is emblazoned on our hearts. Meanwhile, those who get it are better at navigating life.

The Movies

We begin to understand that just because our friend doesn't go the movie with us doesn't mean he doesn't want to go to the movies. He really does want to go. The problem is that the desire to go to the movie ranks slightly below the top item on the list, and we can only choose one item at a time.

The commercial implications are gigantic.

Let's say you open up a donut shop. You sit there day after day trying to sell them. Over the course of a month, not one donut has sold. You conclude that people don't want your donuts – a conclusion that at first seems entirely reasonable.

But actually, it is wrong. There is a whole community out there, thousands of people, who have preference rankings in their heads. If you had access to them, you would see thousands of people walking around with the idea of donuts, donuts, DONUTS, swirling around in their heads. They live and breathe DONUTS. It's the first thing they think about in the morning and the last thing they think about at night.

So what's the problem? Why aren't people buying your donuts?

The problem is that each one of them has one other thing that they are thinking about more. They want to get to work on time. They worry they are getting fat. They want to save money. They are interested in playing on their smartphones and drive right by your place. Whatever it is, it is preventing them from actually acting on their donut obsession.

What is your job as a donut entrepreneur? You have to figure out a way to crawl into their heads and replace whatever their choice A is with what might be their B choice. You have to switch the top two preferences. If the donut preference is G, you have to do better than bump it up to the B slot. There is only one slot in which donuts win: A. That's when the bell rings. So you struggle and struggle to push and push that lower preference to the higher preference.

Marketing

How do you do this? You can lower your price, increase your quality, offer different flavors, or whatever, but none of this actually accomplishes the task. Why? Because no one knows you are doing this! What you have to do is get into their heads. You have to market. You have to sell. You have to advertise. You have to create buzz through social media. Whatever you do, the goal is clear: Get donuts to the A slot.

That means you have to ramp it up. Maybe a bit of a nudge is all that is necessary for some people. But some people are not enough, and you don't know that for sure anyway. You have to really win this one. So you ramp it up. If you are iPhone, you promise that everyone can be a movie producer. If you are Southwest Airlines, you promise vacation bliss. If you are Nike, you promise a new way of living. And so on.

Is this manipulative? Not in any way. What you are doing is trying to persuade people who want donuts anyway to actually take the step to spend money and make them part of their lives. You are helping people realize and act on their real

desires, leading them to make an exchange to toward mutual betterment. You win. They win. Everyone wins.

Back to the example of the girl who says, "It's not you; it's me." What should the guy do? He should realize that he might only be one tiny preference ranking below number one. He should accept that this could be temporary. He should immediately get to work thinking about how to ascend the ranking from B to A. To be on the safe side, he should be particularly amazing just in case he has to move from G to A.

The Light

In order to understand this process, you need to understand marginal utility. This is the concept that makes sense of how the world works. This is the notion that sheds light on the whole mystery of human decision-making. This is the idea that unlocks the mysteries of human interaction.

Small and great evils in the world have come from absolutism, the belief that there is only one way forward, and that if that way is not what you choose, that makes you the evil enemy. Governments think this way. They don't think on the margin. A world of billions of people acting and thinking based on marginal utility is too complicated a notion for them. So they decide to just ignore it all and divide the world between us and them.

On the other hand, if you think in terms of marginal utility, you realize that the whole world is built in tiny steps as an extension of a complex decision-making process that is ultimately subjective, and that bringing people together can never come through force, but only through small acts of persuasion, one person at a time. Through the lens of marginal utility, we see the beautiful orderliness of anarchy.

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This article was originally published on [FEE.org](#). Read the [original article](#).

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