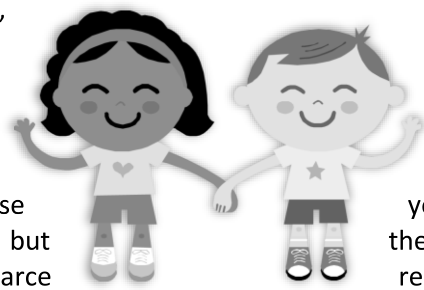
Maximizing Utility

Individuals act to make themselves as well off as possible ... they seek to maximize their own utility.

Economics starts with one very important assumption: Individuals act to make themselves as well off as possible. To use the jargon of the profession, individuals seek to maximize their own utility. The concept of utility is used in economics to represent the advantage or enjoyment a person gets from consuming a good or service (it's a similar concept to happiness, only broader). For instance, you might derive utility from eating a cookie or drinking a soda – especially if you are hungry or thirsty. The tricky part is that utility is an abstract concept rather than a concrete, observable quantity. The units that we assign to an "amount" of utility, therefore, are arbitrary, representing a relative value that varies from person to person based on their personal preferences. For instance, eating a cookie right now might give me a utility of 3, on a 5-point scale. Alternatively, you might say that eating a cookie gives you a utility of 5 because you are really hungry, or 1 if you just ate. The amounts are arbitrary, but they do make it easier to compare the relative value we place on a scarce resource (in this case cookies). Remember that the focus of economics is to understand how people deal with the problem of scarcity. Because resources are scarce, people need to allocate their resources efficiently. We try to do this by weighing the costs and benefits of everything we do. An economist would say that we attempt to maximize utility given the resources at our disposal; others would say that we try to get the most bang for our buck.



Bear in mind that maximizing utility is no simple proposition. Life is complex and uncertain. There are an infinite number of things that we could be doing at any time. Indeed, every decision that we make involves some kind of tradeoff. Many of our important decisions involve balancing the value of consumption now against consumption in the future. Should I spend all my money today, or save it up to buy something big? The answer really depends on your personal preferences and on what will give you the most satisfaction (or the most utility). We all try to make ourselves as well off as possible by maximizing our utility. We may not always make perfect – or even good – decisions. But each of us does try to make the best possible decisions given whatever information is available at the time.

Now, let's define a couple more "utility" terms. The utility that we may receive from consuming a certain amount of a particular good or service is referred to as our total utility. For example, eating a bowl of Starbucks coffee almond fudge ice cream gives me a total utility of 45. The marginal utility of a good or service is the addition to total utility that you may receive from consuming one more unit of that good or service. Returning to the ice cream example, one additional scoop of ice cream beyond the first bowl gives me some additional amount of utility, say a marginal utility of 20. One final concept related to utility is the Law of Diminishing Marginal Utility. This economic law predicts that marginal utility will decrease as additional units of a good or service are consumed. Put another way, in a given time period, consumers generally receive less satisfaction from additional units of a good consumed; the more you consume of something, the less you value one additional unit of it. That third or fourth scoop of ice cream starts looking less and less appealing, and so I would get less marginal utility from each additional scoop.