

# Principles of Economics – Lecture 2 (Value) • Study Notes

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## Big Picture

- **Subjective value** is the cornerstone of Austrian economics.
  - **Marginal analysis** (from Carl Menger, 1871) marked the shift from “old economics” to modern economics.
  - Value is **not inherent in goods** – it arises from human judgments about how well something satisfies needs.
  - Scarcity forces us to **economize**, and valuing is the act of ranking goods to maximize satisfaction.
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## Core Claims

1. **Definition of Goods & Utility**
2. A good satisfies a human need.
3. Utility = the capacity of a good to satisfy those needs.
4. An *economic good* exists when demand > supply.
5. A *non-economic good* (like air or abundant river water) exists when supply > demand.
6. **Scarcity Is Permanent**
7. Easier to desire than to produce (Ferrari vs. imagining one).
8. Our wants are limitless and costless, production is costly and difficult.
9. Therefore scarcity never disappears – we always face trade-offs.
10. **Value Is Subjective**
11. Value = a mental construct, not an inherent property.

12. Example: **Oil** was once waste (negative value), became vital with engines, dipped negative again in 2020.
  13. Value exists **only in human consciousness**, not in the good itself.
  14. **Ordinal vs. Cardinal Value**
  15. Austrians: Value is **ordinal** (ranked preferences).
  16. Mainstream: Tries to make it **cardinal** (numerical “utils”), which is meaningless without real units.
  17. Quote (Mises): “A judgment of value does not measure. It arranges in a scale of degrees.”
  18. **Price vs. Value**
  19. Price shows an **upper and lower bound** of value at the moment of exchange.
  20. Buyer values the good more than the price; seller values the money more than the good.
  21. Mutual benefit proves value is subjective.
  22. **Labor Theory of Value Rejected**
  23. Marx: value comes from labor input.
  24. Counterexample: **Mud pie vs. apple pie** — equal labor, radically different value.
  25. Labor contributes to production, but doesn’t create value. Value depends on meeting human wants.
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## **Marginal Analysis**

- Each additional unit of a good is valued **less** than the previous one.
  - **Law of Diminishing Marginal Utility:**
  - First meal after starving = life-saving.
  - Second meal = still vital but less so.
  - 25th meal = no value.
  - Total utility rises, but marginal utility declines.
  - **Least Valuable Use Rule:**
  - Purchases reflect the **least important satisfaction** a good meets at the margin.
  - Explains why water (essential) is cheap, and diamonds (luxury) are expensive.
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## Examples & Paradoxes

- **Water-Diamond Paradox**
  - Water sustains life yet is cheap.
  - Diamonds are non-essential yet expensive.
  - Answer: We don't choose between "all water" vs. "all diamonds."
  - We choose between marginal units. Water is abundant → cheap at the margin. Diamonds are scarce → high marginal value.
  - **Iron vs. Gold**
  - Iron underpins infrastructure but is cheap.
  - Gold serves jewelry/luxury but is expensive.
  - Marginal units explain the difference: extra iron is nearly worthless, extra gold is highly valued.
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## Quotable Ideas

- "Value is not a property of goods. It is a judgment economizing men make." — Carl Menger
  - "Value does not exist outside the consciousness of men." — Menger
  - "A judgment of value does not measure. It arranges in a scale of degrees." — Mises
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## Study Prompts

- Define an **economic good** vs. a **non-economic good**.
  - Why is scarcity permanent?
  - Explain why value is subjective and not inherent in goods.
  - Contrast ordinal and cardinal value.
  - How does marginal utility solve the water-diamond paradox?
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## TL;DR

Value is not in objects — it is in us. Goods are valued according to how they satisfy human needs, and that valuation depends on scarcity and context. Scarcity forces economizing, and **marginal analysis** shows that each additional unit of a good is worth less than the previous one. This explains paradoxes like cheap water and expensive diamonds. Austrian economics stands apart by insisting: **value is subjective, ordinal, and rooted in human choice — not labor, not equations, not imaginary “utils.”**

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