

# Example of critical thinking on diamond - water paradox

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The idea behind the diamond-water paradox starts with the concept of value. According to Adam Smith, value can be defined to mean the “value in use” or “value in exchange”. Those that have the greatest value in use will have the smallest value in exchange. In the same way, those that have the greatest value in exchange will have the smallest value in use. As such, we possess things of high value in use to acquire those things with high value in exchange and vice versa. For example, water has a very high value in use while diamond has a very high value in exchange. No matter how valuable a diamond is because it can be used to buy everything else, a person owning a diamond will still be willing to trade it for water because it is essential to one’s life. In the same way, the person with a source of water will have an enormous incentive of exchanging the same because it will pave the way for purchasing huge quantities of other goods.

Adam Smith was the first to recognize the existence of this paradox.

However, it was William Stanley Jevons that explained why it worked – the reason as to why a diamond is expensive in the market in comparison to water. Instead of looking at the total utility a particular good can offer, Jevons emphasized to focus our understanding of marginal utility. Therefore, we should look at how much utility or satisfaction we will get from the last piece of a diamond or the last glass of water. If a thirsty person were to choose between water and diamond, he should choose the water because it will give him the most utility. Water is essential for his survival and any man in his rightful mind will disregard owning a diamond in this first decision. As a person drinks more and more water, there will come a time when he will no longer be thirsty and will use the water for other purposes of little

significance to him such as, say watering his garden, because he could just buy it from anywhere.

In this example, we learn that as more and more water is consumed, the utility we get from the last glass of water will significantly be lower than our very first. On the other hand, since diamonds are in limited supply, we will choose to own a diamond after several decided choices between the two because it will give us more utility for the last unit. In other words, we would rather have a diamond in the end because purchasing clothes, phones, house, etc. from the sale of this diamond will make us happier than merely watering our gardens. This sums up the logic of why water is cheaper and diamond is more expensive.

### **Reference:**

Arnold, Roger. Economics 9th ed. Ohio: South-Western Cengage learning, 2008. Web. 30 Jan. 2013.