History and introduction: the giffen goods

In economics and consumer theory, a Giffen good is one which people ironically consume more of as the price rises, violating the law of demand. In normal situations, as the price of a good rises, the substitution effect causes customers to purchase less of it and more of substitute goods. In the Giffen good situation, the income effect dominates, leading public to buy more of the good, even as its price rises.

facts for the existence of Giffen goods is limited, but microeconomic mathematical models explain how such a thing could be present. Giffen goods are named after Scottish economist Sir Robert Giffen, who was attributed as the author of this idea by Alfred Marshall in his book Principles of Economics. Giffen first proposed the paradox from his observations of the purchasing habits of the Victorian era poor.

For most goods, price elasticity of demand is negative (note that, even though they are negative, price elasticities of demand are often reported as positive numbers; see the mathematical definition for more). In other words, price and quantity demanded pull in opposite directions; if price goes up, then quantity demanded goes down, or vice versa. Giffen goods are an exception to this. Their price elasticity of demand is positive. When price goes up, the quantity demanded also goes up, and vice versa. In order to be a true Giffen good, price must be the only thing that changes to get a change in quantity demand, and a Giffen good should not be confused with products bought as status symbols or for conspicuous consumption (such a situation would indicate a Veblen good).

The typical example given by Marshall is of inferior quality staple foods, whose demand is driven by poverty that makes their purchasers unable to afford better-quality foodstuffs. As the price of the cheap staple rises, they can no longer afford to supplement their diet with better foods, and must consume more of the staple food.

As Mr. Giffen has pointed out, a rise in the price of bread makes so large a exhaust on the resources of the poorer labouring families and raises so much the marginal utility of money to them, that they are enforced to restrain their consumption of meat and the more expensive farinaceous foods: and, bread being still the cheapest food which they can get and will take, they consume more, and not less of it.

â€” Alfred Marshall

Giffen goods are also related to experience goods and credence goods in that the two often show increases in demand with price, yet are different in that close substitutes are available for the later types.

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Types of goods in economics

Analysis

There are three essential preconditions for this situation to arise:

the good in question must be an inferior good,

there must be a lack of close substitute goods, and

the good must constitute a considerable percentage of the buyer's income, but not such a considerable percentage of the buyer's income that none of the related normal goods are consumed.

If precondition #1 is changed to " The good in question must be so inferior that the income effect is greater than the substitution effect" then this list defines compulsory and adequate conditions. As the last condition is a condition on the buyer rather than the good itself, the occurrence can also be labeled as " Giffen behavior".

This can be illustrated with a diagram. Initially the consumer has the choice between spending their income on either commodity Y or commodity X as defined by line segment MN (where M = total accessible income divided by the price of commodity Y, and N = total available income divided by the price of commodity X). The line MN is known as the consumer's budget restraint. Given the consumer's preferences, as expressed in the indifference curve I0, the most favorable mix of purchases for this individual is point A.

If there is a fall in the price of commodity X, there will be two effects. The abridged price will alter relative prices in favour of commodity X, known as the substitution effect. This is illustrated by a association down the indifference curve from point A to point B (a turn of the budget constraint about the original indifference curve). At the same time, the price reduction causes the consumers' purchasing power to increase, known as the income effect (an external shift of the budget constraint). This is illustrated by the shifting out of the dotted line to MP (where P = income divided by the new price of commodity X). The substitution effect (point A to point B) raises the quantity demanded of commodity X from Xa to Xb while the income effect lowers the quantity demanded from Xb to Xc. The net effect is a decrease in quantity demanded from Xa to Xc making commodity X a Giffen good by definition. Any good where the income effect more than compensates for the substitution effect is a giffen good.

Empirical evidence

Evidence for the survival of Giffen goods has generally been limited. A 2002 beginning working paper by Robert Jensen and Nolan Miller of Harvard University made the claim that rice and wheat/noodles are Giffen goods in parts of China by tracking prices of goods. A further 2007 working paper by the similar authors (now published in the September 2008 issue of American Economic Review) experimentally confirmed the existence of Giffen goods among humans at the household level by directly subsidizing purchases of rice and wheat flour for extremely poor families. It is easier to find Giffen effects where the number of goods available is inadequate, as in an experimental economy: DeGrandpre et al. (1993) provide such an experimental demonstration. In 1991, Battalio, Kagel, and Kogut proved that quinine water is a Giffen good for a few lab rats. However, they were only able to show the existence of a Giffen good at an individual level and not the market level.

Great Famine in Ireland

Potatoes throughout the Irish Great Famine were long believed to be the only case of a Giffen good. But this theory was debunked by Gerald P. Dwyer and Cotton M. Lindsey in their 1984 article Robert Giffen and the Irish Potato, where they showed the contradicting character of the Giffen “ legend” with respect to historical evidence.

The Giffen nature of the Irish potato was also later discredited by Sherwin Rosen of the University of Chicago in his 1999 paper Potato Paradoxes. Rosen showed that the occurrence could be explained by a normal demand model.

Other proposed examples

It has been recommended that a number of other goods might be Giffen. While the arguments are supposedly sound (i. e., they accord with Marshall’s basic intuition), in each case the supporting empirical evidence has been found to be unimpressive.

Anthony Bopp (1983) proposed that kerosene, a low-quality fuel used in home heating, was a Giffen good. Schmuel Baruch and Yakar Kanai (2001) suggested that shochu, a Japanese distilled beverage, “ might” be a Giffen good. In both cases, the authors offered supporting econometric confirmation. However, the empirical evidence has been usually considered to be incomplete. In a 2005 article, Sasha Abramsky of The Nation conjectured that gasoline, in certain conditions, may act as a Giffen good. However, no supporting evidence was offered, and evidence from the large increases in oil prices in 2008 would propose that quantity demanded for gasoline did really fall as a result of increased prices. Of course, the lack of evidence at the aggregate level does not rule out that the planned goods may have been Giffen for certain groups of consumersâ€" in particular for poor consumers.

The great depression has raised the possibility that very safe financial assets (Treasuries, cash, gold) become Giffen goods in liquidity trap scenario or during bad economic times. As investors fear lower returns in equities and other funds they minimize risk by purchasing more of a low return, higher price asset that is considered safer.

INFERIOR GOODS

In Economics, an inferior good is a good that decreases in demand when customer income rises, unlike normal goods, for which the opposite is observed. Normal goods are those for which consumers' demand increases when their income increases. This would be the conflicting of a superior good, one that is often linked with wealth and the wealthy, whereas an inferior good is often connected with lower socio-economic groups.

Inferiority, in this sense, is an evident fact relating to affordability rather than a statement about the quality of the good. As a rule, these goods are affordable and adequately fulfill their point, but as more costly substitutes that offer more delight (or at least variety) become available, the use of the inferior goods diminishes.

Depending on consumer or market indifference curves, the amount of a good bought can either increase, decrease, or stay the same when income increases.

Examples

There are many examples of inferior goods. Several economists have recommended that shopping at large discount chains such as Walmart greatly represent a large percentage of goods referred to as “ inferior”. Cheaper cars are examples of the inferior goods. Consumers will generally prefer cheaper cars when their income is constricted. As a consumer’s income increases the demand of the cheap cars will decrease, while demand of expensive cars will increase, so cheap cars are inferior goods. Inter-city bus service is also an example of an inferior good. This form of transportation is cheaper than air or rail travel, but is more time-consuming. When money is constricted, traveling by bus becomes more suitable, but when money is more abundant than time, more rapid transport is preferred.

reasonably priced foods like bologna, hamburger, mass-market beer, frozen dinners, and canned goods are additional examples of inferior goods. As incomes rise, one tends to purchase more expensive, appealing and nutritious foods. Likewise, goods and services used by deprived people for which richer people have alternatives exemplify inferior goods. As a rule, used and out of date goods (but not antiques) marketed to persons of low income as closeouts are inferior goods at the time even if they had earlier been normal goods or even luxury goods.

Others are very not in agreement across geographic regions or cultures. The potato, for example, generally conforms to the demand function of an inferior good in the Andean region where the crop originated. People of higher incomes and/or those who have migrated to coastal areas are more likely to prefer other staples such as rice or wheat products as they can pay for them. However, in several countries of Asia, such as Bangladesh, potato is not an inferior good, but rather a comparatively expensive source of calories and a high-prestige food, especially when eaten in the form of " French fries" by urban elites.

Some inferior goods are so consistent that they can be seen as economic indicators. One such is instant noodles, where an early 2005 increase in the Thai " Mama Noodles Index" (the number of the accepted Mama-brand instant noodles sold in that country) was seen as a sign of weakness after about ten years of stability.

ALL GIFFEN GOODS ARE INFERIOR GOODS BUT NOT ALL INFERIOR GOODS ARE GIFFEN GOODS.

Giffen goods are hard to find because a number of circumstances must be satisfied for the associated behavior to be observed. One reason for the difficulty in finding Giffen goods is Giffen originally envisioned a exact situation faced by individuals in a state of poverty. current consumer behaviour research methods often deal in aggregates that average out income levels and are too blunt an instrument to capture these specific situations. In addition, complicating the matter are the requirements for limited availability of substitutes, as well as that the consumers are not so poor that they can only afford the inferior good. It is for this reason that a lot of text books use the term Giffen paradox rather than Giffen good.

A few types of premium goods (such as expensive French wines, or celebrity-endorsed perfumes) are sometimes claimed to be Giffen goods. It is claimed that lowering the price of these high rank goods can decrease demand because they are no longer perceived as exclusive or high status products. However, the apparent nature of such high status goods changes significantly with a substantial price drop. This disqualifies them from being considered as Giffen goods, because the Giffen goods analysis assumes that only the consumer's income or the relative price level changes, not the character of the good itself. If a price change modifies consumers' perception of the good, they should be analysed as Veblen goods. Some economists question the experimental validity of the distinction between Giffen and Veblen goods, arguing that whenever there is a substantial change in the price of a good its perceived nature also changes, since price is a large part of what constitutes a product. However the hypothetical distinction between the two types of analysis remains clear; which one of them should be applied to any actual case is an empirical matter.