The history of inferior and giffen goods economics essay

An inferior good is a good that decreases in demand when consumer 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 opposite of a superior good, one that is often associated with wealth and the wealthy, whereas an inferior good is often associated with lower socio-economic groups.

Inferiority, in this sense, is an observable 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 purpose, but as more costly substitutes that offer more pleasure 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.

There are many examples of inferior goods. Several economists have suggested that shopping at large discount chains such as Walmart vastly 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 costly 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 acceptable, but when money is more abundant than time, more rapid transport is preferred.

Definition of ' Inferior Good'

A type of good for which demand declines as the level of income or real GDP in the economy increases. This occurs when a good has more costly substitutes that see an increase in demand as the society's economy improves. An inferior good is the opposite of a normal good, which experiences an rise in demand along with increases in the income level.

Inferior goods can be viewed as anything a consumer would demand less of if they had a higher level of real income. An example of an inferior good is public transportation. When consumers have less money , they may forgo using their own forms of private transportation in order to cut down costs (car insurance, gas and other car upkeep costs) and instead opt to use a less expensive form of transportation (bus pass).

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INVERSE RELATION BETWEEN INCOME AND DEMAND

Now here is inverse relation between income and demand. Inferior goods can be viewed as anything a consumer would demand less of if they had a higher level of real income. An example of an inferior good we can take public transportation. When consumers have less money wealth they may forgo using their own forms of private transportation in order to cut down costs (car insurance, gas and other car upkeep costs) and instead opt to use a less expensive form of transportation (bus pass). Inexpensive 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 poor people for which richer people have alternatives exemplify inferior goods .

GIFFEN GOODS

Giffen good is one which people paradoxically 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 consumers to purchase less of it and more of substitute goods. In the Giffen good situation, the income effect dominates, leading people to buy more of the good, even as its price rises.

The reason for this is that, even when expensive, rice was still the cheapest source of calories available. Therefore, when the price of rice was cut, households had more money left over after buying rice. Some of this was spent on buying more expensive foods (meat, vegetables and fruit), which reduced their need for rice.

For many years the classic example of a Giffen good were potatoes during the Irish potato famine. One problem with this was partly a lack of data to prove it was a Giffen good. more fundamentally, given that the price rises were caused by lower supply, how could people have been consuming more? This example is mentioned here merely because it still occurs in many text-books – although it is likely to be dropped from future editions now that the Chinese example is known!

Giffen goods may be very rare, but the fact that some exist is important: the complete lack of any examples of a phenomenon that economic theory said was possible, was, to quote the paper on the Hunanese rice, " an embarrassment to economists"

A consumer good for which demand rises when the price increases, and demand falls when the price decreases. basically we can say that there is a positive relation. This phenomenon is noticeable because it shows the law of demand, whereby demand should increase as price falls and decrease as price rises. To be a Giffen good, the item must lack easy subsitutes and it must be an inferior good, or a good for which demand declines as the level of income in the economy increases. sometime the economists disagree on whether Giffen goods exist and how common they are.

As Mr. Giffen has pointed out, a rise in the price of bread makes so large a drain on the resources of the poorer laboring families and raises so much the marginal utility of money to them, that they are forced to curtail 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.

POSITIVE RELATION BETWEEN PRICE AND DEMAND

Positive relation is basically in the giffen goods as income rises their demand for good also rises.

A Giffen good is a good satisfying the following equivalent conditions:

Its price-elasticity of demand is positive even though the value people place on it does not change with changes in price.

ceteris paribus, an increase in the price of the good leads to an increase in the quantity demanded, despite the fact that buyers do not value the good more at a higher price.

ceteris paribus, a decrease in the price of the good leads to a decrease in the quantity demanded, despite the fact that buyers do not value the good less at a lower price.

It is an inferior good for which the demand increases with increase in its price, because buyers shift to high consumption to it from superior, costly substitutes in order to compensate for the extra cost.

In other words, Giffen goods appear to violate the law of demand.

DIFFERENCE BETWEEN INFERIOR GOODS AND GIFFEN GOODS

Define income and substitution effects. The income effect is the urge to buy more items based on a higher income and fewer items based on a lower income. Income can be increased either by lower prices on a particular product or a raise at one's job. The substitution effect is the urge to buy an alternate product when one product's price increases. If apples increase in price and oranges are now cheaper than apples, the substitution effect holds that a consumer will buy oranges rather than apples.

Characterize normal and inferior goods. A normal good is one of the goods which demand increases as price decreases. Examples include your favorite type of soda, soup or tickets to a baseball game. In general, we will basically purchase more of these things if prices decrease. Inferior goods are those that you buy less of as income increases. Noodle soup is an example. As college students earn more money after graduation, they are less likely to subsist on noodle soup.

Identify Giffen goods. A giffen good is a special type of inferior good. Economists at Harvard use the example of rice in China. When Chinese rice decreases in price, so does the demand for it. Economists believe this is because as Chinese have more money and they are good in wealth to spend due to cheaper rice, instead of stocking up on more rice they choose to buy other items such as meat, which is more expensive but also more nutritious.

Draw demand curves for giffen and inferior goods. On each graph, make the X-axis the increasing demand of a product and the Y-axis the increasing income of the individual. For your Giffen graph, plot points at which demand rises with income. Draw a curve through your points on each graph. Use the graphs and definitions of Giffen and inferior goods to note how and why they are different.

Draw the axis for two different graphs. Each graph must have a vertical X-axis and a horizontal Y-axis. Label each X-axis " Demand" and each Y-axis " Income" Write " 0" at the origin of each graph. Choose your own scale for each axis, making sure the numbers increase the further away you get from the origin. Each of your graphs will have increasing demand and increasing income for its axes. Label one graph " Giffen" and the other " Inferior."

Plot your Giffen graph. On the graph labeled " Giffen," put your plot points to show increasing income with increasing demand. Draw a line through your points. It will determine a demand curve that extends upward, left to right from the origin.

Plot your inferior goods graph. Plot points at which demand decreases as income increases. This means you will have a curve that extends downward from left to right from the top of your graph.

" WHILE ALL GIFFIN GOODS ARE INFERIOR GOODS, ALL INFERIOR GOODS ARE NOT GIFFIN GOODS"

Under this we can say that he demand for an inferior good decreases when income rises. Demand increases for normal goods when income rises. The classic example of an inferior good is noodles or grains etc

Examples of inferior goods are consumption of breads or cereals and since the income of the consumer increases he moved towards consumption of more nutritious foods and hence demand for low priced product like bread or cereal decreases. Another example can be of use of public transportation, when income is low people use more of public transportation which is not the case when their income increases.

Hence from the above one can see that other things remaining equal as the income of consumer increases demand for normal goods will increase and demand for inferior goods decrease and vice versa.

A Giffen good is any good where quantity demanded increases when price increases. Most goods have a negative elasticity of demand; that is to say, when price increases, quantity demanded decreases. Giffen goods have a positive elasticity of demand. These goods also lack close substitutes. It is very difficult to find good examples of Giffen goods, but sometimes fine wines are used as an example. A fine wine is often judged by it’s price – high price is indicative of quality. If the price falls, less may be demanded because it is no longer considered a premium product. Additionally, there are not a lot of close subsitutes.

Giffen goods have one unique trait that helps answer your question. The negative income effect is always greater than the positive substitution effect (true for Giffen goods, but not all inferior goods). Since Giffen goods always always have negative income effects, they must always be inferior goods. Thus, a Giffen good is always an inferior good, but an inferior good is not always a Giffen good.

Giffen goods are a special type of inferior good. The quantity demanded for Giffen goods rises as their price rises, which is an exception to the law of demand.

When a demand curve is drawn there are only two variables; the price and the quantity demanded. Nothing else changes or as we like to say in economics, ‘ other things remain equal’. It is important to understand that this means that income is a not fixed that does not change and it is helpful to call this nominal income at this stage of the argument. When the price of a good is high , if our nominal income is fixed this means we can afford less. This is one reason the demand curve slopes downward and it is called the income effect. So if nominal income stays the same and prices rise we are poorer, our real income has fallen. Real income means the amount of goods and services our nominal income can buy.

Changes in income and inferior goods

If we assume that the ‘ other things being equal’ assumption this leads to the whole demand curve moving. When we change nominal income, then sometimes demand will increase (the demand curve moves to the right). A product like cars fits this description because the more we earn the more cars we buy; these we call normal goods.

However when nominal incomes increase sometimes demand decreases (the demand curve moves to the left). When our nominal income increases, the demand for a basic white loaf of bread might actually fall (moves left). This is because when we earn more we will buy other more luxurious types of bread instead, perhaps baguettes or croissants; conversely if incomes fall there is a tendency to buy more of it. This type of good we call an inferior good. It does’nt mean that white bread is poor quality, merely that if our incomes rise we buy less of it. If we return to our original demand curve where nominal income is fixed but price rises, real incomes are reduced and:

for normal goods the quantity demanded is under pressure to fall, i. e., there is a negative (real)incomeeffect, for inferior goods the quantity demanded is under pressure to rise, i. e., there is a positive (real) income effect.

Despite the argument above, if the price of inferior goods rises the quantity demanded still falls – the demand curve is downward sloping and the law of demand is preserved! This is because the income effect is not the only thing influencing demand. When the price of normal or inferior goods rise consumers look to buy alternative products. So if the price of cars or bread rises some people will choose to travel by bus or buy cheap breakfast cereal instead, there is always a negativesubstitution effect.

For normal goods there is a negative income effect and a negative substitution effect. So as price rises, the quantity demanded falls. For inferior goods there is a positive income effect and a negative substitution effect, but the negative substitution effect is more powerful and so as prices rise the still quantity demanded falls.

GiffenGoods For Giffen goods the positive income effect is so strong that it overpowers the negative substitution effect. So when prices rise the quantity demanded rises. Giffen and Marshall are arguing that for ‘ the poor labouring classes’ bread might fall into this category.

This of course breaks the law of demand and results in an upward sloping demand curve. All Giffen goods are therefore inferior goods because there is a positive income effect, but not all inferior goods are Giffen goods.

Giffen Goods Table