Perverse demand curves

This links back to irrationality, but is mainly a bit of fun (it's not on the specification directly).

The exercise really is just a five minute one. Ask the students to think of any products for which as the price rises, they think quantity demanded might also rise.

Generally the two that they come up with are:
1. Veblen goods (ones where the high price is part of the attraction, so Rolex watches etc., where people want to flaunt their wealth).
2. Quality signalling goods, where consumers use price as a proxy for quality – hence thinking that a higher price must mean a higher quality and therefore buying more, even if it isn't true.

If they get stuck, give them a scenario – imagine you are going around to your girl/boy friend's house or other person you are keen to impress and you've got to take a bottle of wine. You wander into the supermarket / off licence – which one do you pick….?

Then ask them to draw what they think the demand curve looks like. If they are lazy, they will just draw a function with a positive gradient coming out of the origin, but this isn't going to be right – free wine and Rolex watches would have lots of takers…

It should probably look something like this:
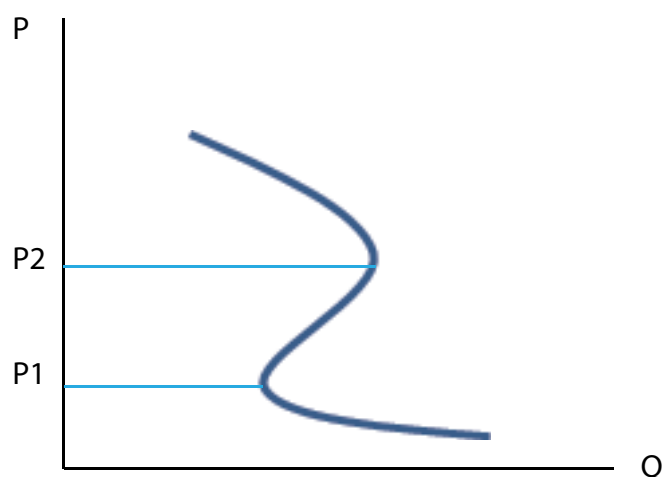
Between 0 and P1 the demand curve is normal, it is perverse between P1 and P2 for the reason identified above and then once price rises too high, it becomes normal again.

An interesting video, again by Dan Ariely, that suggests that price actual does affect how much we want a product (ie we actually get more satisfaction from higher priced products) is here:

Price signalling: http://youtu.be/nm5GB7Wu26Q