NECESSITY AND LUXURY GOODS IN ECONOMICS

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ABSTRACT

In modern economics many well-known and popular categories still remain unclear or even out-of-date. Especially two microeconomics concepts connected with market analysis need to be refreshed and redefined: luxury goods and necessity goods. In the contemporary world the understanding of luxury and necessity is changing because of many reasons, for example: growing income level, processes of democratization of luxury and poverty, globalization of markets, mass-production and wider access to information. Therefore deeper studies seem to be interesting and necessary. In the paper, there are indicated these elements of modern economic theory where these two types of goods are discussed and described and then the evolution in understanding of luxury goods and necessity goods concepts in economics is shown. Also, the backgrounds of concepts creation are briefly described as well as the subsequent changes in their understanding and then the present meaning of luxury and necessity is presented. The main hypothesis states that in economics only the understanding of luxury goods has been changed while the perceiving of necessity goods remains unchanged.

Keywords: *necessity goods, luxury goods, income elasticity od demand*

INTRODUCTION

Goods are the principal elements constituting economic exchange, market economy. Therefore they are analyzed by many scholars and are described and interpreted by economic thoughts. There are many classifications of goods in economics. The most well-known and basic are these which classify goods as free or economic, public or private [1] and common-pool, club, private or public [2]. Other classifications are derived from the concept of elasticities. On the basis of cross-price elasticity of demand goods can be divided into substitutes, complements or not-related goods. Income elasticity of demand allows distinguishing normal, luxury, inferior and necessity goods.

Necessity goods and luxury goods are popular types of goods, but they occur simultaneously only in one well-known classification derived from the concept of income elasticity of demand. In general income elasticity of demand shows the responsiveness of a consumer's choices of a particular commodity to a change in his income. In other words, the income elasticity of demand is calculated as the ratio of percentage change in the quantity demanded to the percentage change in income. If a 1% change in income causes a positive change in the quantity demanded of a good, it is classified as a normal good. If a 1% change in income induces a negative change in the quantity demanded of a good, it is called an inferior good. If a 1% change in income causes a more than 1% change in quantity demanded of the good, it is known as a luxury good. If a 1% change in income causes a less than 1% change in quantity demanded of the good, the product is known as a necessity good. It means that necessity goods and luxury goods are types of normal goods. Luxury goods are these whose income elasticity exceeds unity, necessity goods are those whose income elasticity is less than unity but still positive, it means that its value ranges from 0 to 1 [3].

On the basis of income elasticity of demand luxuries and necessities can also be defined in terms of their share of a the budget of a typical customer. An income elasticity greater higher than 1 means that the share of an individual's budget being allocated to the product is constantly increasing. In contrast, if the elasticity is lower than 1, the budget share is decreasing.

Necessity goods and luxury goods are parts of the canon of modern economic knowledge. Despite this fact, the economic literature dedicated to necessity good is very narrow and limited. This is particularly remarkable considering the fact that luxury goods are the subject of many research and papers. The paper tries to find out and indicate some of these elements of economic theory which are connected with necessity and luxury goods. It also aims to show similarities and differences in understanding of these goods. The main hypothesis states that in economics only the understanding of luxury goods has been changed while the perceiving of necessity goods remains unchanged.

NECESSITY GOODS

In economics, necessity goods are a much less well-known and popular issue than luxury goods. It is difficult to find out any economic theory connected with necessity goods, just except the idea of income elasticity of demand and Engel law (sometimes called Engel relationship) [4]. This economic category is mainly connected with the classification of goods related to the concept of income elasticity of demand, which was discussed earlier.

In common use, necessity good is usually defined as an indispensable thing, something that everyone needs. Therefore necessity goods are treated as necessary to human existence, such as food, water, shelter, and clothing. In other words among them are these goods whose consumption is essential to human survival, or which are considered indispensable for maintaining a certain minimum standard of living. This explanation is right with economic theory. In general, the income elasticity for basic, inferior goods, such as food or rent is less than 1, because as consumer incomes increase, the proportion spent on them declines, even though total expenditures usually increase. Despite the fact that food is a necessary for life, as incomes increase consumers usually spend their higher incomes on items other than food. Also food basket of typical customer changes. Poor quality goods are replaced by better quality goods, which prices are higher. Therefore food with a negative income elasticity of demand, which was replaced by new quality food can be treated as inferior good. It is worth noticing that more expensive food generally has higher income elasticities of demand than staple foods, which is consistent with Bennett's law [5]. In agricultural economics and development economics, Bennett's law describes the situation that as income rises, people eat relatively fewer calorie-dense starchy staple foods and relatively more nutrient-dense meats, oils, sweeteners, fruit, and vegetables [6]. It means the quality of good changes and customers substitute inferior goods by normal goods. Among the three most important staple foods across the world are corn, rice and milk. These goods are usually classified as inferior goods, which means that income elasticity of demand is negative. In poor, less-developed countries these goods can be perceived as necessity good, not inferior goods. This means that the level of development and the level of income are necessary to classify good as inferior or necessity.

Bennett's law is connected with Engel's law. Engel's Law is an economic theory which was introduced in 1857 by Ernst Engel, a German statistician. It states that the percentage of income allocated for food purchases decreases as income rises. As a household's income increases, the percentage of income spent on food decreases while the proportion spent on other goods (such as luxury goods) increases [7]. It means that income elasticity of demand of food is between 0 and 1. Application of this statistic is treating it as a reflection of the living standard of a country. As this proportion increases, the country is by nature poorer, less developed. Conversely a low Engel coefficient indicates a higher standard of living. This approach has advantage over the commonly used prosperity indicator of gross domestic product because the local price level is automatically taken into account. Engel's law is one of the best-proven empirical laws of economics.

The special character of necessity goods causes that people are more likely to buy necessity goods even their prices rises but they are less likely to buy luxury goods when their prices increase (except paradoxes). Additionally, necessity goods very often do not have close substitutes and they are produced by monopolies, especially state-owned. According to the principles of the market economy, the market price of goods depends on quantity demanded and quantity supplied. If the quantity demanded is growing and production possibilities aren't limited, the price level should rise. Therefore some customers can be excluded from the market. In the case of ordinary, basic goods states usually subsidize their production or monopolize the production process. This intervention guarantees low prices and availability of goods to all customers, but often results in lowering the quality of products.

Necessities (understood as a group of goods) are not very often analysed by statistical offices. One of exceptions is Gallup Group. Gallup polls have tracked Americans' access to "basic necessities," such as food, shelter, clean water, and healthcare. Gallup's list of basic necessities includes 13 items, which can be grouped into three broad categories: food, housing and health.

LUXURY GOODS IN ECONOMICS

Luxury and luxury goods are popular issues in economics. In the economic literature, there are many synonyms or expressions closely related to luxury goods as premium goods, status goods, discretionary goods, superior goods or Veblen goods. Despite many synonyms still term "luxury goods" are the most popular and recognizable expression, this is also the term with the broadest meaning. It is mainly because of a long history of usage of "luxury" term in economics. Etymologically, the word luxury derives from the Latin word "lux" which means light, luminosity or luminance, and traditionally luxury has been associated with exclusivity, status, and quality but during history, the connotation of the term „luxury" was changeable and very often also negative.

Before the middle of the 18th century, most commentators believed that working-class aspirations were severely limited and incentives to work weren't widely advocated. The main change in understanding of luxury and its social justification took place between the 17th and the 19th centuries [8]. It was started by discussion between David Hume and his contemporaries which illustrated the level of disagreement in economic discourse during that time [9]. Later on the issue of luxury was considered by many scholars as far back as in the XIX-XX centuries, namely by: K. Marx, T. Veblen, G. Simmel, W. Sombart, M. Weber, J. Locke, A. Smith and others.

Long history, changeable attitude to luxury from total acceptance to total negation of its justification in the economy, and subjective character of the concept have influenced the lack of consensus regarding the widely accepted definition of luxury. Luxury is "constantly on the move" [10] and its meaning changes according to person, place, or time.

As mentioned above luxury goods are a type of normal goods which are characterized by income elasticity of demand higher than 1. It means that customers buy proportionately more of a particular good compared to a percentage change in their income. In other words: an increase in income is accompanied by a proportionally larger increase in quantity demanded. A special example of luxury goods are Veblen goods. Veblen goods are types of luxury goods for which the quantity demanded increases as the price increases which is an apparent contradiction of the law of demand [11]. Therefore this situation is called in economics: “paradox” or “effect”, because in case of Veblen goods law of demand doesn’t work. There are many explanations for this situation. A higher price may make a product more desirable as it becomes the symbol of higher status and social position, it is also explained by the human behaviour called conspicuous consumption and conspicuous leisure [12]. Among luxury goods, there are also positional goods, goods that are available to a few. The founder of this concept was Fred Hirsch who explained that the positional economy is composed of " (…) all aspects of goods, services, work positions and other social relationships that are either scarce in some absolute or socially imposed sense or subject to congestion and crowding through more extensive use" [13]

Luxury is usually defined as something that is desirable and more than necessary and ordinary. It means that it is the opposition to necessity goods. Possessing luxuries satisfies people rather than simply trying to alleviate a state of discomfort, like in the case of necessities. However the decision of what is desirable, more than necessary and ordinary is relative and depends on many factors, such as: level of country’s development, level of income, cultural and social conditions, individual preferences, etc.

Compared with the traditional buyers, new consumers of luxury goods usually have different characteristics, lifestyles, desires, and purchasing behaviour. Therefore, they also have different consumption motives and purchase intentions. Vigneron and Johnson [14] indicate that consumer behaviour regarding luxury goods is the result of multiple motivations, namely three types of interpersonal effects on luxury goods consumption: specifically the Veblen effect (Conspicuous Perception), Snob effect (Uniqueness Perception), and Bandwagon effect (Social Value Perception), and two types of personal effects, namely the Hedonism effect (Emotional Value Perception), and Perfectionism effect (Quality Value Perception) [12].

LUXURIES VERSUS NECESSITIES

Despite the fact that both luxury goods and necessity goods are types of normal goods, these two types of goods are very different.

Luxury goods are produced for a particular type of consumer, who are from the top of the income distribution. While necessities can be possessed by virtually everyone, luxuries are available exclusively to only a few people or at least only on rare occasions.

Unlike necessities, individuals buy luxuries not only for their intrinsic quality but also to confirm and show their social and economic status. Bearden and Etzel [l5] described the necessity-luxury dimension as a continuum ranging from the absolute necessity to absolute luxury. They created the six-point Likert scale ranging from "a necessity for everyone’" to "a luxury for everyone" in order to measure the luxuriousness of many product categories. They defined luxury [l5] as good not needed for ordinary, necessary day-to-day living, so in opposition to necessities.

People purchase necessities to satisfy basic, mainly material needs. The necessity goods are usually standardized, they are produced in big numbers and their buyers are taking into account the relation between quality and price but usually, the price is the main indicator of choice. In opposition individuals buy luxuries not only for their intrinsic quality but also to signal their wealth and confirm social status. Value perception of luxury goods depends on their rarity and uniqueness.

Luxury goods are produced to satisfy individual needs. Their price is the symbol of status but the most important is extraordinary quality, aesthetics and polysensuality. Literature often associates the demand for luxury goods with the desire for distinction, where the individual valuation of a given good decrease as the number of individuals purchasing it increases. The quality is extremely important and this excellent quality can be obtained usually in two ways: by using high-quality raw materials and by detailed workmanship (which made luxuries more rare and unique).

CONCLUSION

The paper tries to find out and indicate some of these elements of economic theory which are connected with necessity and luxury goods. It is impossible to indicate all points in the history of economic thought where necessities and luxuries appeared, so the choice is very subjective. The paper focuses on the description of the nature of analyzed economic categories and tries to indicate their theoretical background. It also indicates the main similarities and differences between necessities and luxuries in economics.

The main hypothesis of the paper states that in economics the understanding of luxury goods has been changed while the perceiving of necessity goods remains unchanged. As it is shown, in the past the understanding of luxury was changing along with the change in attitude to it. Classical economics justified the existence of luxury and the human desire to getting richer. This need is understood as a necessary factor of progress and development. Nowadays scholars argue over the limits of wealth and reducing income inequalities because the distance between the poorest and the riches increases.

The understanding of necessity goods didn’t evaluate over economic history. Even the examples of these goods didn’t change so much. To survive, people still need basic food and clean water. It suggests that the distance between the poor and the rich is still huge and economic policy is not able to reduce it. Poverty remains unchanged, the wealth grows, income inequalities increases.

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