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“The Fallacy of Supply and Demand” by Dan Ariely

1. Anchor prices are prices that set a standard for our future decisions. When we initially buy a good, we use its price as a frame of reference for the acceptable price of future goods in that category. After an anchor price is set in our memory, our willingness to pay for a product is determined relative to that anchor.
2. The “arbitrary” portion of the phrase refers to the fact that initial anchor prices – and our willingness to pay them – are arbitrarily decided and easily influenced. Once we are exposed to an anchor price, our future decisions will be logically built upon that price, hence the “coherence” aspect of the phrase. Essentially, our future decisions are logically based off of anchors.
3. The “annoying sounds” experiment tells us that anchors set by the first suggested prices are persistent and long-lasting in their effects. In the experiment, the group exposed to the lower price was always willing to receive much less compensation than the other group was willing to receive in exchange for listening to the annoying sound again. The experiment tells us that the first impression continues to take precedence over the local one in determining the future decisions of the consumer.
4. Ariely’s statement that we “stand in line behind yourself” means that we make decisions about whether something is worthwhile based on our own past behavior. In other words,

we base our habits on random decisions that were made in the past. Instead of thinking logically about trade-offs, we use our initial impressions and habits to convince ourselves that we are acting out of our own inclination. As such, our first decisions have serious long-term consequences.

5. We are irrational in our decision-making – we make decisions based on our emotions and our herd mentality. Our decision-making is not always founded strictly on the utility we derive from a particular transaction. Rather, it is based on our first impressions and their long-term consequences. Additionally, if we perceive something as required work we will not want to do it, whereas if we perceive something as a coveted privilege we will want to do it.
6. This chapter suggests that the conventional wisdom – giving equal weight to the factors of supply and demand – is incorrect in that it does not account for the dependent relationship between the two factors. As evidenced by the experiments involving anchor prices, consumer memories of anchors have a far greater influence than future price changes have on consumer demand. While short-term reactions are predictable with the conventional wisdom, the long-term reactions are quite different - consumers can readjust to price changes when the new price becomes the new anchor.

Works Cited

Ariely, Dan. "The Fallacy of Supply and Demand." *Predictably Irrational: The Hidden Forces That Shape Our Decisions*. London: Harper & Row, 2008. 23-48. Print.