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**Lecture 24: Price Discrimination II**

1. Some additional types of price discrimination.
2. Tying (aka Two-Part Pricing)
   1. What is the most expensive liquid commercially available (as in, no liquid gold)? (It costs about $7,400 a gallon.)
   2. Why does it cost so much?
   3. *Tying*—when the seller charges one price for a good that can only be used with another good charged at a lower price
      1. Crucially, the seller must be the only seller of the higher-priced good. The two goods must be tied together.
      2. This is why video game consoles are so cheap compared to video games themselves. You can’t use an X-Box game on a Nintendo Wii.
   4. It’s easy to see how this is price discrimination if you imagine the two goods—console and games, for example—as one good: ability to play video games.
      1. Those with a high willingness to pay are probably video game nerds and will buy many different games.
      2. Those with a low willingness to pay will only buy a few games and thus pay a much lower price for the ability to play.
3. Block Pricing
   1. When items are sold only as a set of the same item that is block pricing.
      1. You can, at minimum, buy only 4 rolls of toilet paper
4. Peak-load pricing
   1. Sometimes demand shifts in a predictable cycle, such as electricity throughout the day or airline travel throughout the week. This can cause the demand to exceed capacity, something that cannot be expanded in the short run. And since this spike in demand is short-lived, it may not be worth expanding capacity to meet these predictable cycles.
   2. *Peak-load pricing*—charging higher prices during peak times compared to off-peak times
   3. In a lot of ways, this is no different than normal shifts in demand. But because it is a regular expansion and contraction—without a movement along the supply curve—it becomes a form of price discrimination.
5. Cross-subsidies
   1. Sometimes, two goods influence one another even if they are consumed separately.
      1. For example, some online games are free to play but if you want more content, you have to pay. Since games where lots of people play are more fun, and thus you are willing to pay more to get the full experience.
   2. A *cross-subsidy* is a pricing strategy where profits from the sale of one product are used to subsidize sales of a related product
   3. Note this is different from tying, where consumers have to buy both products to get the price discrimination to work. Here, some consumers buy one product and other consumers buy the other.
      1. What makes this unique is that the more the cheaper product is bought, the more valuable the original product is.
   4. Note also that while these products are different, usually the subsidized product is just a slim-downed version of the more expensive product. In other words, the marginal costs of production are identical.
6. Price matching[[1]](#footnote-1)
   1. Often companies will declare they will not be undersold and give discounts to anyone who proves otherwise. Why? Is it just a credibility thing?
   2. Maybe, but also bear in mind that if you are showing one store that another sells Pepsi for less, you are demonstrating that you are the type of consumer that shops around.
   3. *Price matching* is when a firm advertising that it will match any lower price offered by a competitor. Only those sensitive enough to bother seeking out a lower price will get the discount.

1. Some textbooks address price matching in a different way than I do, focusing on how it can lock firms together at an artificially high price since one firm lowering its price automatically triggers a price war. For various reasons, I find this claim dubious and instead focus on the price discrimination aspect of price matching. [↑](#footnote-ref-1)