

LECTURE 15: PRICE DISCRIMINATION III

- I. Tying
 - a. What is the most expensive liquid that many of you own?
 - i. Hint: It costs about \$2,700 a gallon.¹
 - b. *Tying*—when the seller charges one price for a good that can only be used with another good charged at a lower price
 - i. Crucially, the seller must be the only seller of the higher-priced good. The two goods must be tied together.
 - ii. 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.
 - c. 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.
 - i. Those with an inelastic demand curve are probably video game nerds and will buy many different games.
 - ii. Those with an elastic demand curve will only buy a few games and thus pay a much lower price for that ability.
 - d. Note the popcorn question from last class is also referencing tying.
- II. Bundling
 - a. This is kind of the opposite of tying. Instead of two goods being separately (one good and many goods), *bundling* is selling a good which can only be bought in a bundle of other goods (one-to-one).
 - i. You only need to buy one Nintendo Wii to play many games. But you want more copies of Microsoft Excel, you'll have to buy more copies of Word along with the Excel copies.
 - ii. Bundling examples: cable channels, Office software, buffets, traditional newspapers, politicians
 - b. Companies bundle when groups of people value parts of the bundle differently. If the bundle is assembled correctly, lots of people should value the result the same even if they vastly disagree on how they value the parts of the bundle.
 - i. Wilf and David both use Microsoft Office. Wilf tends to use Excel, using other software for word processing. David prefers Word, using Excel only in rare cases. Suppose each is willing to

¹ <https://beyondtype1.org/the-10-most-expensive-liquids-in-the-world/>

pay \$90 for what they use often and \$10 for what they use rarely.

- ii. Even though they disagree on how much each component is worth, they agree on the bundle.
 - iii. Unbundled, Microsoft could charge \$90 for each or \$10 for each part (getting \$180 or \$40 in total revenue, respectively). With bundling, they charge \$100 for each bundle, getting \$200 in revenue.
- c. Bundling is price discrimination. In practice, David is being charged \$90 for Word and \$10 for Excel while Wilf is being charged \$10 for Word and \$90 for Excel. The same good, examined as separate for the bundle, is being charged different prices.
- i. In other words, the different prices functionally occur in the consumer's own head.