# What is a Price?

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Voice 800.634.4941 Fax 800.998.0854
E-mail learnseed@aol.com
www.learningseed.com

## Contents

**What is a Price?** is a XX minute program available in either VHS or DVD formats. The program is close captioned. Catalog number 28806.

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## Summary

Anybody can read a price tag. Price is so much a part of modern living that even four year olds know the words "it costs too much." But who sets all these prices? What hides behind a price tag? How does price control your life?

Viewers learn that a price is information disguised as a number. They realize how it influences consumer behavior, sends a message from the producer, allows the consumer to talk back, and plays a vital role in our market economy.

- What is a price and who sets it?
- How does price influence behavior?
- What can "free food for all" teach about prices?
- Why can't you afford an oceanfront house? Hint: It's not high prices.
- Why individuals, not governments or corporations, "pay the price."
- Who has the final word in pricing – the buyer or the seller?
- How prices help insure free choice.
- What is price discrimination and why is it so common?
- Why "Its costs to much" is not really a statement about prices.

## Key Points From Script

***Key Idea #1: A price is information.***

A price is not an arbitrary number someone "puts" on something. A price is a part of the conversation between producer and consumer.

A price is the point at which both producer and seller agree to trade -- product for the money. A price communicates; it is a mutual "yes."

Price is a simple but powerful idea. Producers profit only if they produce what consumers want. Consumers use prices to tell producers what they want and what they don't want.

***Key Idea #2: There is one basic price – what the market will bear.***

A seller wants the price to be as high as possible, a buyer wants to spend as little as possible. The selling price is where these two wishes meet.

In one sense, the statement "prices are too high" is a contradiction. A price is the point at which seller and buyer agree. If it's "too high" there is no sale. An asking price with no sale might be a wish or a dream, but it's not a real price.

***Key Idea #3: Prices influences how MUCH of something people buy.***

A lower price often means people will buy more of something. A lower price by itself does not "create" demand.

Prices change to balance supply (how much of something there is to sell) with demand (how much people want to buy).

***Key Idea #4: The buyer often has the final word in setting the price***

A price is not a price until someone pays it. Just try to sell your fifteen year old rust bucket for $20,000 and you'll see who has the final word in pricing.

***Key Idea #5: Pricing serves as a kind of voluntary rationing.***

We use prices to ration the limited supply of oceanfront housing. Without prices, some other system would be needed to decide who gets the oceanfront houses. Prices help ration limited supplies.

***Key Idea #6: In the absence of pricing, other methods are needed to share goods***

Pricing is a system of rationing scarce goods. In the absence of pricing, some other system is needed. One alternative is to have government officials distribute the goods. A lottery is an alternative system.

***Key Idea #7: People pay prices***

Both governments and corporations collect money from people and distribute it to other people. But it is the individual who buys goods and pays taxes.

***Key Idea #8: Prices help share scarce resources, balance supply and demand***

Parking meters are simple devices designed to use the power of price to help shoppers share a limited number of parking spaces. The low price for parking at a meter is a strategy to allocate parking spaces.

***Key Idea #9: Part of almost every price is hidden***

What something costs is usually more than the number on the price tag. The real price for anything is the effort required to acquire it.

***Key Idea #10: Prices influence behavior.***

High prices cause people to buy less of the high priced goods or to seek alternatives. Low prices usually lead to increased consumption.

***Key Idea #11: Prices change often and price discrimination is common.***

The same item is often sold at different prices to different sellers. Economists call this price discrimination. Price discrimination can help create markets.

***Key Idea #12: To make sense of our consumer world, you need to understand the concept of a price.***

A strength of pricing as a way to distribute resources is that it relies on human nature instead of laws or police powers.

The major weakness of a pricing system is that some, through no fault of their own, do not have the means to pay the price for what they need.

A pricing system provides what people WANT, not necessarily what they NEED. It might provide plenty of options for plastic surgery in Hollywood, but relatively few choices for basic health care for the needy.

## Questions for Discussion

The video points out that “a price is information.” What kind of information does a price contain? What happens to prices if one party to a transaction has a lot of information and the other very little?

Since “a price is information,” what might the effect of the Internet be on pricing for some goods?

You hear someone say “prices are too high.” The statement could be about the price of a latte at Starbuck’s, a gallon of gas, or the selling price for a house on the other side of town. In what way is such a statement wrong?

The video points out there is really only one price for anything — what the market will bear. What does that mean?

How does pricing serve as a kind of voluntary rationing system?

The video tells of the fictional “Freeland” in which the government announces it will provide “free food” for everyone. What does the story illustrate about prices?

What do parking meters illustrate about pricing?

Give some everyday examples of how prices influence behavior.

Producers make money by selling goods or services for more than they cost to make. It would seem to make sense that they could be most successful by selling goods at increasingly high prices. Why is “the road to riches” not paved with high prices?

The government passes a law requiring all cars made improve gas mileage by 20%. Somehow the car makers comply and the more efficient cars cost only a little more. Would this move “save” gasoline and reduce our dependence on foreign oil? Remember that prices influence consumer behavior.

Would raising the minimum wage to $15 or even $20 an hour help eliminate poverty?

Why does a pricing system that allows for frequent changes in price work better than a system with more fixed prices? So why not barter with the store clerk for a better price on the tube of toothpaste?

Using a system in which a free market sets the prices is one way to ration limited resources. What weaknesses does pricing have when used to ration resources people need to survive?

When you buy meat or fruit or vegetables you pay by the pound. When you buy lumber or wire you pay by the foot. But when you buy shoes or clothing you pay the same price for the smallest size as for the largest. Is this “one price fits all” a fair pricing system? Why does it exist?

## Quiz on “What Is a Price?”

According to the video, a price is: (A) A number on the price tag, (B) information that is part of communication between maker and buyer, (C) a high number set by the seller to make the most profit on that item, or (D) a number showing the true value of the item.

The video says that there is really only one price for anything: (A) Whatever the maker wants to charge, (B) Whatever the buyer can afford to pay, (C) Whatever the market will bear, or (D) Whatever the value of the item is to society.

A price (A) determines if people want something or not, (B) determines when people want something, (C) determines how much of something people will buy, or (D) creates demand for something.

Prices change in order to balance demand with (A) supply, (B) desire, (C) value, or (D) available money.

Name three things people buy in which the prices change almost daily.

The video states that most people cannot afford the high price of oceanfront property. It also says that a high price is not the real reason everyone cannot buy oceanfront property. What is the basic reason?

Let’s say you remove prices from some item that lots of people want or need. What effect might this have on the availability of the item?

Supposedly, the U.S. government once paid $10,000 for a toilet seat on a manned spaceship. The video explains this high price by noting (A) No consumer group acts as a “watchdog” over government pricing, (B) The price was high because the government does not have competition to hold prices down, (C ) The price reflected the time and labor needed to solve the “weightless toilet” problem, or (D) Who wouldn’t spend $10,000 for a toilet seat?

The video notes that In Denmark, the sales tax on an auto is over 200%. That means a $30,000 car comes with a $60,000 tax bill. This example illustrates (A) How high taxes can ruin an industry, (B) that if taxes are too high people do not pay them, (C) that prices act to influence consumer behavior, or (D) that high taxes do not produce the intended effects.

Selling the same product to different people at different prices is (A) economic injustice, (B) fair only to people with lots of money, C price discrimination, (D) price control.

## Answers to Quiz

B. A price is information that is part of communication between maker and buyer. The idea that a price is information is perhaps the most basic idea in this program.

C. A price is typically set at whatever the market will bear. A price does NOT measure the value of something to society. Water is more valuable than diamonds yet this value is not reflected in pricing.

C. A price determines how much of something people will buy. A price does not CREATE demand. People either want something or they don't want it. The price influences how much of that item they buy.

A. Prices help balance supply with demand.

Things that change price daily or more often: items sold at auctions, stocks and bonds, gasoline prices, airline tickets, hotel rooms, the prices for commodities such as minerals and crops, money, seasonal foods.

The high price for oceanfront property is the result of its lack of supply and high demand. If few people wanted to live on the ocean, such property would be readily available for a low price.

Removing prices (or making them invisible) is the same as making the price zero (think "free"). Remember that prices influence how much of something consumers demand. If a product is desirable and the price is zero, demand will skyrocket. But since the price is zero there is no obvious incentive for anyone to make such a product. So the effect is to increase demand dramatically while cutting supply. This combination will typically create shortages and the need for some system to replace pricing as a way to ration the desired goods.

C. The price reflected the time and labor needed to solve the "weightless toilet" problem. The video observes that "once we all travel in spaceships, you will certainly be able to buy one at Spaceship Depot for $29.95."

C. Prices act to influence consumer behavior. A 200% tax means a $30,000 car comes with a $60,000 tax bill. The result? People live close to where they work, use public transportation, and ride bicycles. Fewer people own cars.

C. Price discrimination. Selling the same product at different prices allows sellers and buyers to communicate more precisely. A "one price fits all" policy is less efficient. Note that "to discriminate" means to exercise careful judgment, to make fine distinctions. The word "discrimination" today is often used as a synonym for racial prejudice.

## Resources

**The Business of America**
John Steele Gordon (Walker & Co., NY, 2001).

Gordon is an historian, not an economist. He tells the stories of famous industrialists from Henry Ford to Samuel Slater as he teaches about the market economy. His chapter on "*The Tragedy of the Commons"* would make an excellent discussion starter. "What if a supermarket that served 1,000 families tried a new system. Instead of every customer paying for groceries as they are purchased, each family gets a bill of 1/1,000th of the total. What would happen under these circumstances?"

**The Economics of Life**
Gary S. Becker and Guity Nashat Becker (McGraw-Hill, NY, 1997).

Gary Becker is the 1992 Nobel Laureate for his theory of "economic reasoning." The book is a collection of short essays written for *Business Week.* You might find a lot to disagree with here, but you will be challenged to think in terms of economics.

**Naked Economics: Undressing the Dismal Science**
Charles Wheelan (W.W. Norton and Company, NY, 2002).

Wheelan "undresses" economics by stripping away diagrams, equations, and jargon for a fun and breezy tour of the economic world all around us.