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## **Free Enterprise: The fees that break the traveler's back**

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Cloud nine just got even harder to reach - and one should pack sparingly while trying to get there. Last week's announcements by United Airlines and US Airways to follow American Airline's decision of charging \$15 for the first piece of checked luggage made sure of that.

As depicted in a cleverly directed TV ad by a competitor, more additional fees are on the horizon and some are already approaching with Mach speed. In August, US Airways will begin charging the majority of passengers \$2 for nonalcoholic drinks.

According to news reports, the airlines expect to collect hundreds of millions of dollars through the additional charges. This newly implemented (for large airlines) system is frequently referred to as a la carte pricing. Customers faced with these types of menus often ask whether this represents price discrimination and why the airlines do not simply increase airfares, which - with 14 such attempts since the beginning of the year - they have not been shy about.

Economics can provide answers.

Although airlines are a textbook example of how successful (and legal) price discrimination is implemented, the baggage surcharge does not have to be an instance of such pricing. Discrimination in this context refers to the ability of a seller to charge various customers different prices for basically the same product.

A just-released edition of a popular economics textbook vividly illustrates this by showing a picture of an aircraft with large differences in prices paid for various seats in the same section of the airplane. However, by definition price discrimination is not present when differences in prices can be explained by differences in cost.

The airlines are going to great lengths to emphasize this point. The president of American Airlines, J. Scott Kirby, was quoted as saying that, now, only those who actually check bags and cause additional cost will have to pay for this service.

The question of why the airlines do not simply add those charges to their ticket prices at the time of the booking has several explanations, one of which is that travelers may be unsure of how many bags they want to take.

However, there may be a more significant scenario at work. The Alchian and Allen Theorem, often referred to as the "third law of demand," provides another explanation. Simply stated, it suggests that consumers may rationally be inclined to purchase a more expensive good when large, fixed expenditures are part of the transaction, since that makes it "relatively" cheaper. Examples include choosing French cuisine rather than the fast-food option when one is already paying a baby sitter to have a night out or buying more pricey goods while on an expensive holiday trip.

Airlines, then, are well advised to - in the customer's mind - separate the initial ticket purchase and whether to check luggage into two discrete decisions. It ensures both, that prospective customers with a tight budget for tickets will not be driven out of the market and that - once they start packing - they will consider the \$15 for the first bag in the context of having already paid hundreds of dollars for the journey.

In the meantime, one should make sure to have the wallet at the ready when taking a trip over the rainbow and to forget that pot of gold at the other end.

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