Monopoly Price Discrimination

Chapter 15-4

Laugher Curve
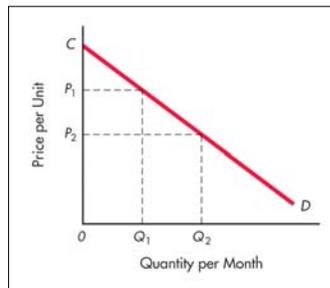
The First Law of Economics:

For every economist, there exists an equal and opposite economist.

The Second Law of Economics:

They're both wrong.

Price Discrimination

Under certain conditions, a firm with market power is able to charge different customers different prices. This is called price discrimination.

The Price-Discriminating Monopolist

- *Price discrimination* is the ability to charge different prices to different individuals or groups of individuals.

The Price-Discriminating Monopolist*

- In order to price discriminate, a monopolist must be able to:

  - Identify groups of customers who have different elasticities of demand;
  - Separate them in some way; and
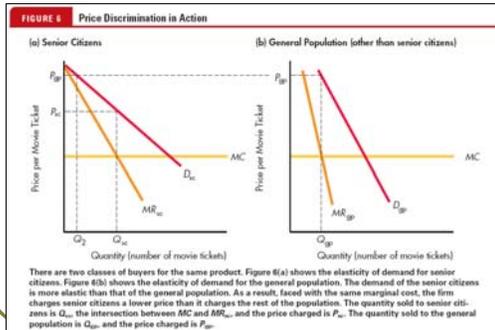 - Limit their ability to resell its product between groups.

The Price-Discriminating Monopolist

- A price-discriminating monopolist can increase both output and profit.

- It can charge customers with more inelastic demands a higher price.
- It can charge customers with more elastic demands a lower price.

Necessary Conditions for Price Discrimination

- For price discrimination to work, the firm must be able to set the price.

- The firm must be able to **"segment the market"** That is, the firm must be able to:
  - Separate the customers
  - Prevent resale of the product

Price Discrimination in Action

FIGURE 6   Price Discrimination in Action

There are two classes of buyers for the same product. Figure 6(a) shows the elasticity of demand for senior citizens. Figure 6(b) shows the elasticity of demand for the general population. The demand of the senior citizens is more elastic than that of the general population. As a result, faced with the same marginal cost, the firm charges senior citizens a lower price than it charges the rest of the population. The quantity sold to senior citizens is Q_{sc}, the intersection between MC and MR_{sc}, and the price charged is P_{sc}. The quantity sold to the general population is Q_{gp}, and the price charged is P_{gp}.

The Early Bird Gets a Lower Price

- Early Bird Specials— Restaurants charge special, lower prices for early diners.
- Matinees—Theaters charge less for earlier shows.
- Air Fares—Airlines charge less for flyers willing to fly "off peak," i.e. early morning and late night.

Perfect Price Discrimination

- By discriminating, a monopoly firm makes greater profits than it would make by charging both groups the same price.

- A firm with market power could collect the entire consumer surplus if it could charge each customer exactly the price that that customer was willing and able to pay. This is called *perfect price discrimination*.