Price Discrimination

- Question – Does price discrimination raise or lower profit?
- Price discrimination – selling the same good or service at a number of different prices.

  Basically an illegal activity under the Clayton Act
  unless there is a cost justification for the price
  discrimination

- Answer – Price discrimination is a marketing means to increase economic profit

Price Discrimination

- Methods of price discrimination

  -- Discriminate among groups of buyers

  works when different buying groups are willing
  to pay different prices (on the average) for the same good or service

  Example: Airline travel – prices target business travelers vs leisure time travelers

  -- discriminator is advance notice, shorter the notice, the higher the price

Some Examples of Price Discrimination

- Doctors often charge rich patients more than poor patients
  - They may have one price for those with insurance and another price for those without insurance
- Movies in the evening cost more than those in the early afternoon
- Senior citizen, youth, and student discounts
- New and used cars
- Youth fairs on airlines
- Evening meals in restaurants often cost more than the same meal at lunch

Practicing Price Discrimination

- The firm that practices price discrimination must be able to distinguish between two or more separate groups of buyers
- Price discriminators must also be able to prevent buyers from reselling the product or service
  - For example, if a fifteen-year-old could resell his youth fare seat to an adult who could then use it, the price discrimination effort would fail

Motives for Price Discrimination

- In most cases, price discrimination is basically a mechanism for rationing goods and services
- The main motivation for price discrimination is to raise profits
  - The greater the price discrimination, the greater the profits because buyers lose some of their "*consumer surplus*"
  - If price discrimination were carried to its logical conclusion, we would have perfect price discrimination
    - The buyers would lose all of their "*consumer surplus*"

Price Discrimination

- Methods of discrimination

  -- Discriminate among units – firm charges the same price to all customers but there are volume discounts

- The key idea is to figure a way to charge those incremental buyers who are willing to pay more a higher price
- Result – Consumer Surplus is converted to Producer Surplus

Price Discrimination

- Perfect Price discrimination occurs when a firm figures out how to extract the entire consumer surplus
- Once the firm has the entire consumer surplus, the MR curve becomes the Demand Curve
- At that point, the firm extracts even more economic profit by increasing production to the point where
  MR(D) = MC

Price Discrimination

- Efficiency – When the firm increases output to the point where MC = D, the efficient quantity is produced, but
- The producer has taken all the consumer surplus, and
- Since there is ample economic profit, the firm may be induced to spend money (increase costs) to protect its economic profit (rent seeking and is usually political in nature)