

**Syllabus Reference 1.5 : HL Extension - *Price Discrimination***

---

**(A) Reasons for P.D.**

- Price discrimination exists when a good is sold at different prices to different consumers although the costs of production are the same: note that sometimes the consumer benefits if costs are higher and the price charges is the same e.g. postal services, bus services
- Existence of consumer surplus- see diagram in section 2.3 of syllabus RE Consumer /Producer surplus. Monopolist will try and use up the available “consumer surplus” .e.g P1 reduces CS as compared with P3 in Diagram A
- Price differentiation is where goods with different costs of production are charged at different prices e.g. cup of tea in a luxury hotel in London
- PD is easier to accomplish in service industries but have you ever bought anything in a “no price shop”?

**Methods of PD:**

1. **Time:** taxis have different rates at different times of day
2. **Geographical:** different rates by firm in different regions
3. **Branding:** own brand vs supermarket brand
4. **Age:** older + students pay less

**Exam Questions:**

M10/3/ECONO/HP2/ENG/TZ1/XX

2. **Explain why an airline would want to practice price discrimination. Under what conditions would the airline be able to do so?**

**(B) 3 Conditions necessary for PD:**

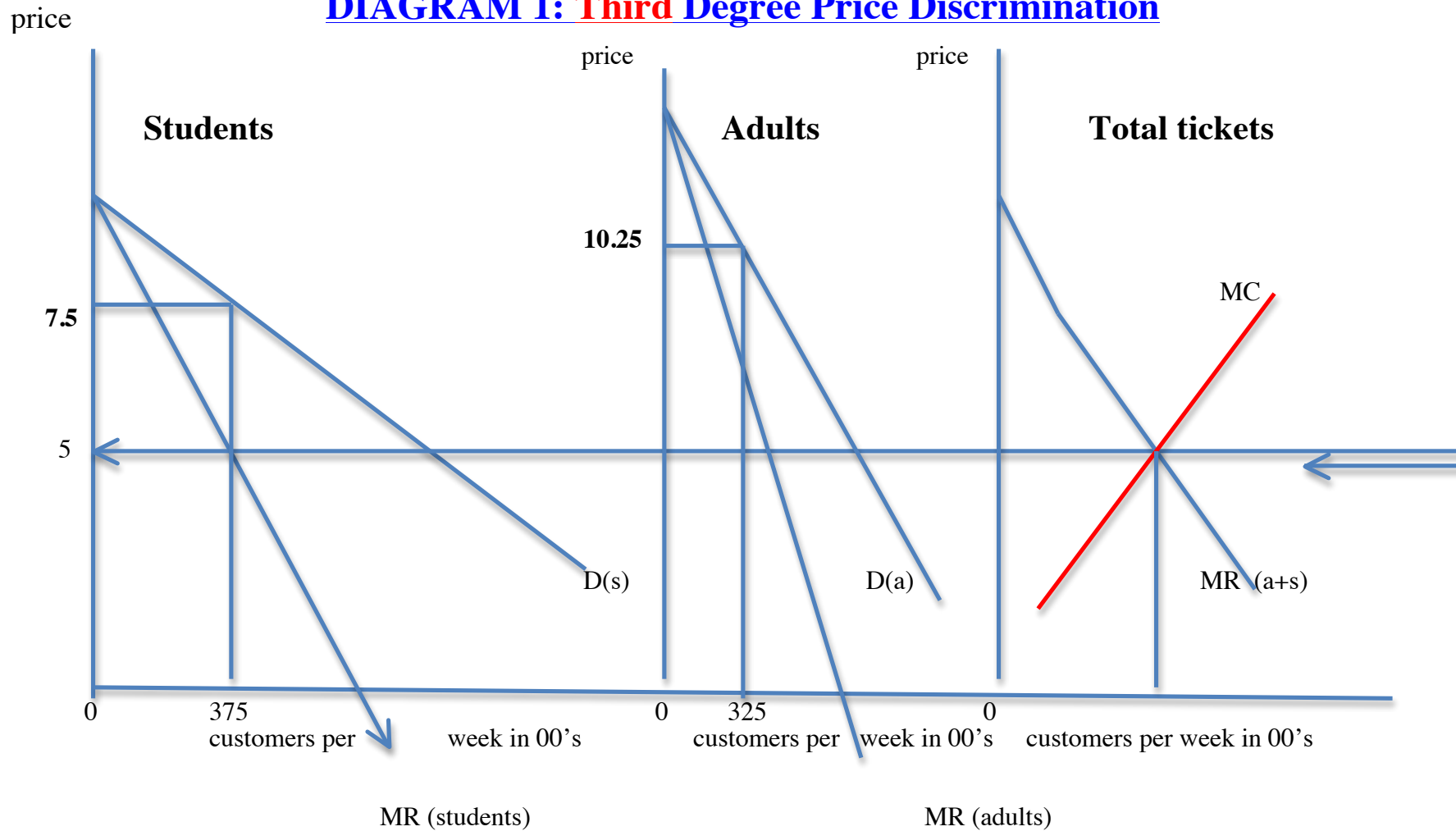
1. **Price Power:** Firm must have price power. Therefore it is possible in M, M-istic and O.
2. **Elasticity:** Household must have different elasticities of demand:  $P_{ed} = -3$  (lower price will increase total revenue).
  - Hairdressing for women e.g.  $p_{ed} = -3$  for men  $p_{ed} = -1$
  - Flying economy class for businessmen
  - Pay TV for sport
  - 'no price shop'
  - Note for assessment: for evaluation be aware of benefits to consumers of price discrimination and the different categories of price discrimination i.e. 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup>
3. **No Resell ability:** Household must not be able to resell. Firm must be able to identify and keep separate the groups paying different prices
  - Consumer indifference (low priced items)
  - Lack of knowledge about cheaper prices

Focus on 3<sup>rd</sup> Degree Price Discrimination: syllabus item **77**

**Webnote 158: syllabus ref 77**

See Blink textbook pages 134 + 135 for an explanation of 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> degree price

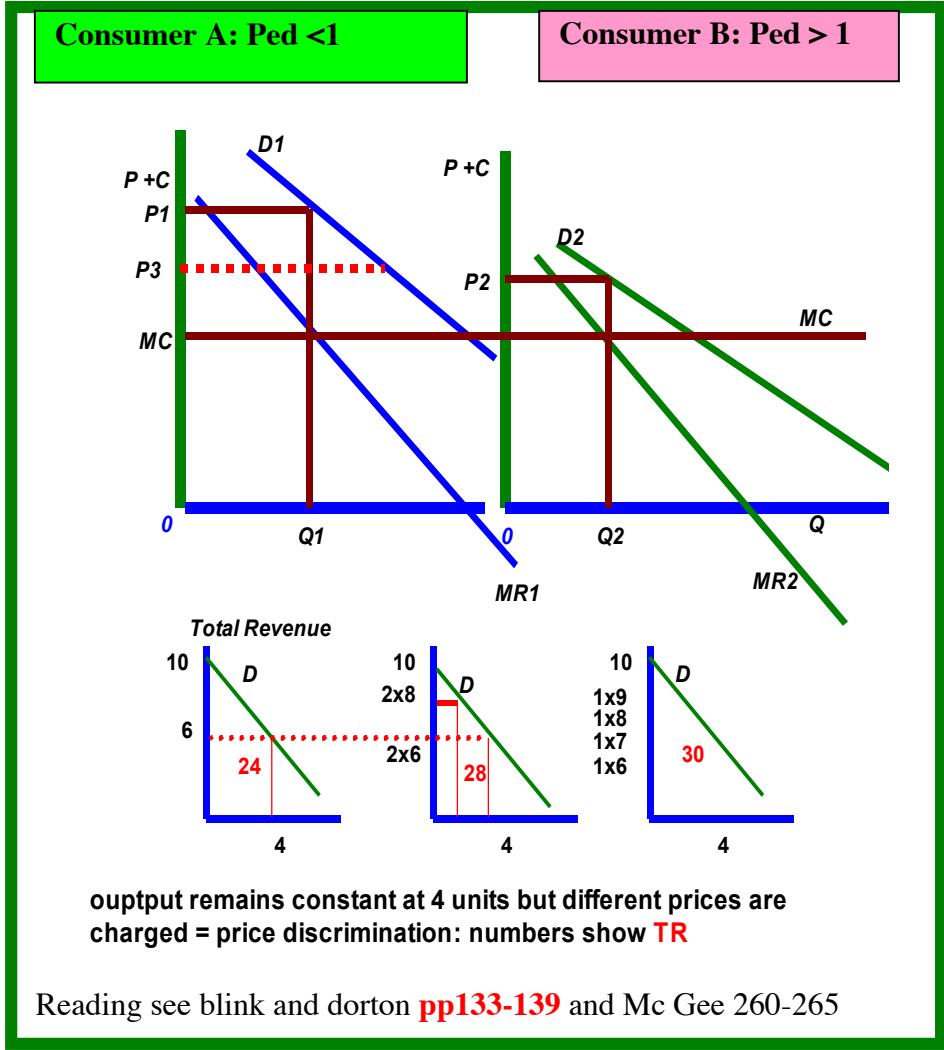
**DIAGRAM 1: Third Degree Price Discrimination**



Firm increases TR by charging 2 different prices (7.5 and 10.25 based on different price elasticity of demand).

Note: see Blink edition 2 page 135-136

**DIAGRAM 2: Price Discriminating Monopolist**  
**Third (3<sup>rd</sup>) Degree Price Discrimination**



**TR** increase as a result of Price Discrimination: Firm can earn a TR of **24** or **28** or **30**

Ped is decreasing: i.e. more inelastic as price increases the total revenue increases to 30 simply because some consumers are willing to pay higher prices for the same good!

➔