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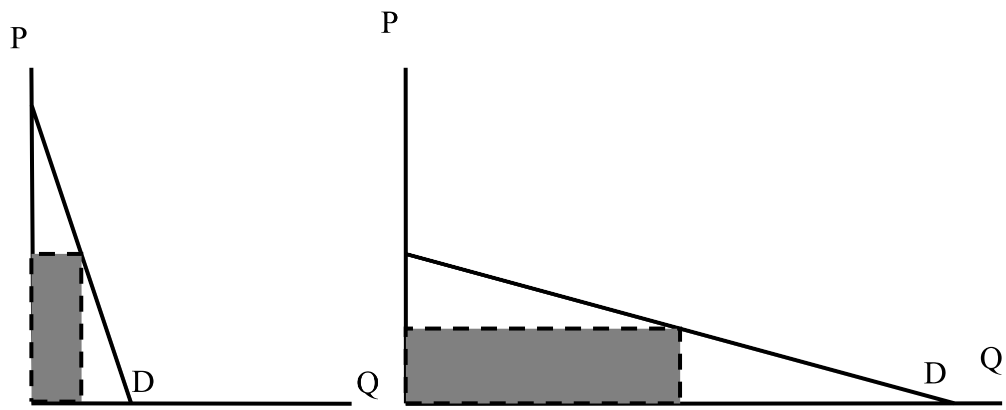
TOPIC 11: PRICE DISCRIMINATION I

I. Why do we have coupons? Why not just have sales?
   a. Do a particular type of person use coupons?
   b. Coupons are an example of *price discrimination*—when a seller charges different prices of the same good or service

II. Elasticity
   a. The most intuitive type of price discrimination is when two different types of customers get charged a different price for the same good.
      i. The firm "segments" the market into two markets: one elastic demand curve and one inelastic demand curve
   b. For example, buying a plane ticket today for a flight today versus buying today for a flight next month.



III. Price discrimination requirements
   a. *Distinguishableness*: there must have a way to determine who should be charged which price.
   b. *Prevention of resale*: the product cannot be easily resold; otherwise the discounted customers will turn around and sell it to others at a profit.
      i. *Arbitrage*—buying low and then selling high—prevents price discrimination from working.
   c. *Uniform cost*: the cost to bring the item to market cannot change; otherwise it's just two different prices for two different products.
   d. Other Examples
      i. Five dollar foot-longs, airplane tickets, and AIDs medication

IV. Efficiency and price discrimination

a. Part of price discrimination is a transfer payment (from consumer to producer surplus). This sounds bad, but a transfer payment is neutral. From an efficiency standpoint, everyone is treated equally.

b. If price discrimination reduces output, then society becomes less wealthy.

c. *However*, if it increases output, then society (probably) becomes wealthier. Price discrimination increases firm revenue which is needed to induce entry.

   i. Is it better to have a rare disease or a common one?

   ii. PD allows an increase in market size, and thus of revenue. PD helps cover upfront costs.

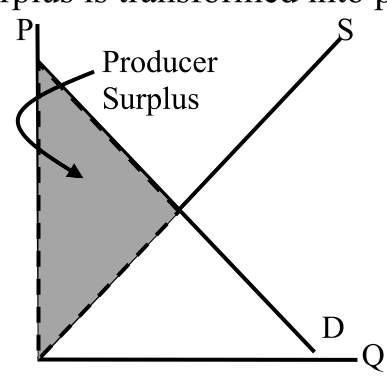
   iii. Remember, AIDs medication. Without PD, there might be fewer medications invented.

V. Perfect price discrimination

a. *Perfect price discrimination*—when each customer is charged maximum willingness to pay

   i. *Examples*: mechanics, bank loans

b. In PPD, consumer surplus is transformed into producer surplus.



c. Note this is *as efficient* as if there was no price discrimination at all.