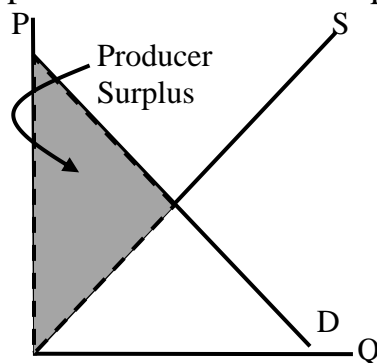


## LECTURE 18: PRICE DISCRIMINATION II

- I. 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.
- II. 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.
- III. Why does popcorn cost so much at the movies?
  - a. No, it's not because they are the only ones who provide popcorn. They are also the only ones who provide bathrooms but they don't charge for those, either. Napkins are free, too.
  - b. When answering questions like these, it is often help to rethink what the vendor is selling into the broadest sense possible. The movie

theater isn't merely selling movies; it's selling a movie-going experience.

- i. For some people to enjoy the experience, they just want to see the movie.
  - ii. For others to enjoy the experience, they need a snack. Often this is popcorn but other food works just as well; note all snacks are expensive at movie theaters.
  - iii. Movie tickets are relatively cheap (they barely the cost the theater has to pay for the right to show the movie). Tickets are cheap because theaters want as many people as possible to show up. The first group has an elastic demand for snacks; they walk away from such high prices.
  - iv. But the rest of those people will want popcorn and such people will have a very inelastic demand curve for it (remember: to have an enjoyable experience, popcorn is *necessary*).
  - v. By charging a lot for popcorn but a little for the ticket, the theater has two prices for "the movie-going experience," one for the elastic group and a higher one for the inelastic group.
- c. If your economic naturalist question involves an industry's strange pricing, it is often useful to rethink what the firm is actually selling. Selling an "experience" rather than simply a product is quite common.