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Price Discrimination

GCE A-LEVEL & IB ECONOMICS

Lesson Structure

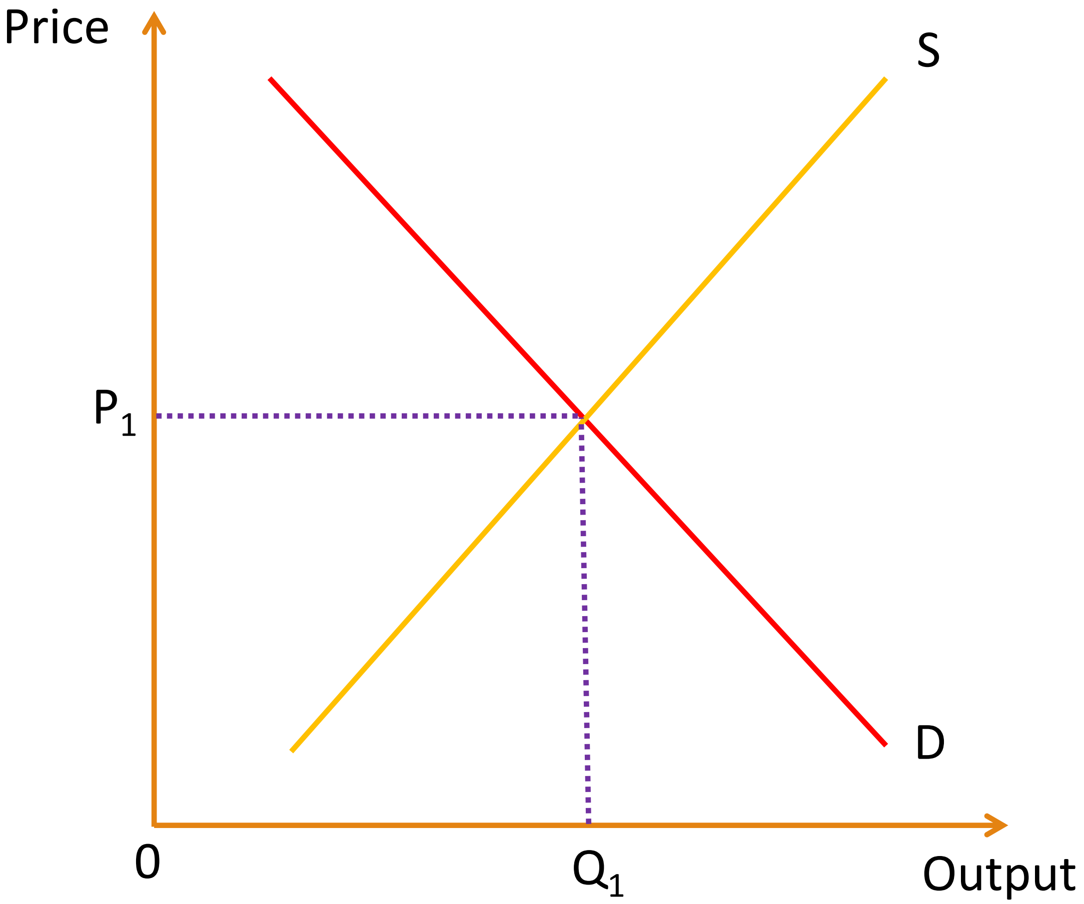
- Price Discrimination
  - Definition & Concept
  - 1^{st} Degree Price Discrimination
  - 2^{nd} Degree Price Discrimination
    - Examples
  - 3^{rd} Degree Price Discrimination
    - Examples & Diagram
  - Summary & Evaluation

Remember Producer & Consumer Surplus?

Where is producer surplus in the diagram?

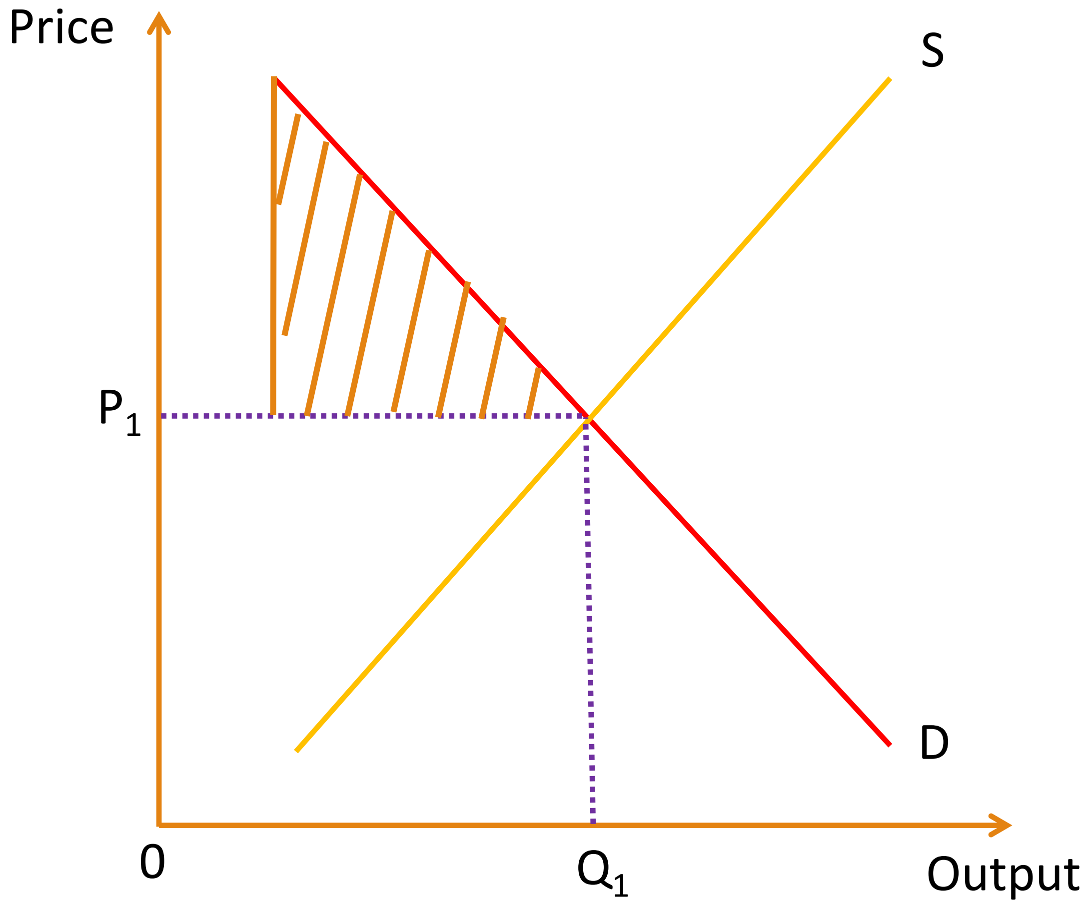
Where is consumer surplus in the diagram?

Why do you think so?



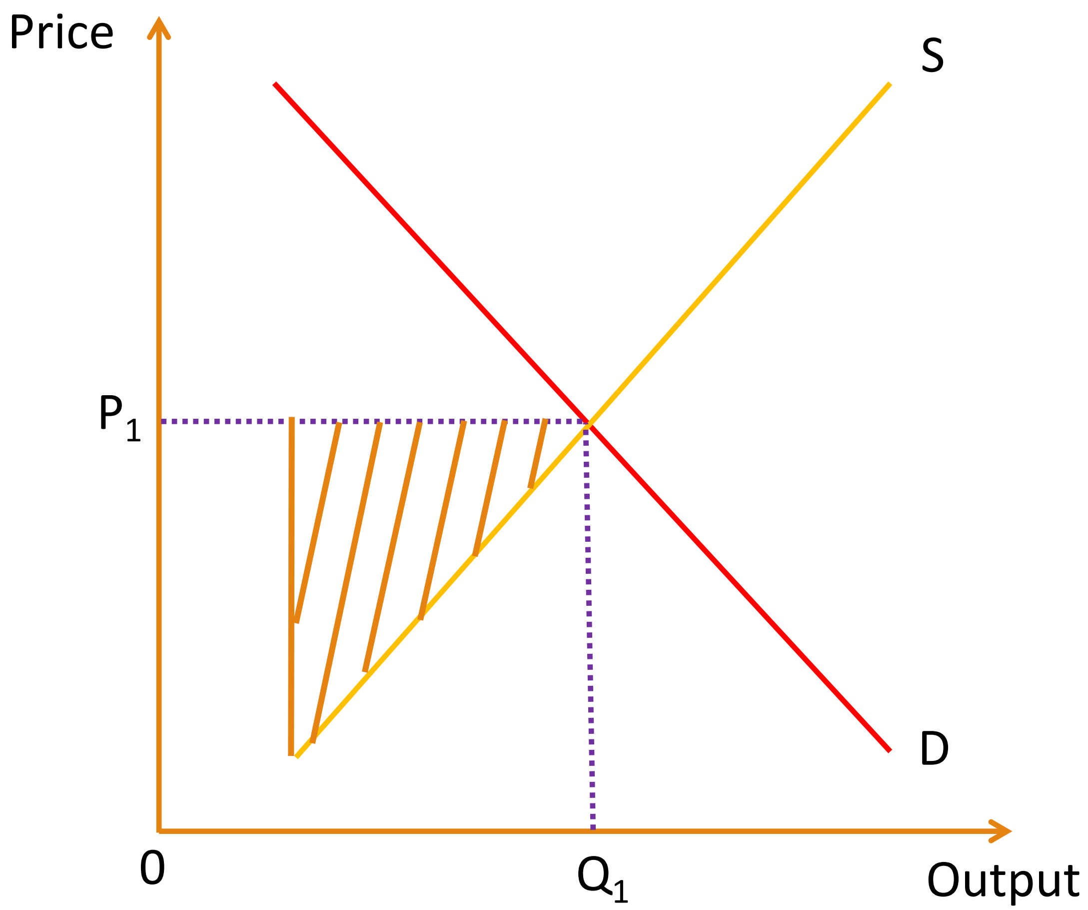
Remember Producer & Consumer Surplus?

Consumer surplus is the triangular area above price, but below the demand curve. It shows the additional value gained by the consumers as they are getting a lower market price than the price they are willing to buy/demand the good at.



Remember Producer & Consumer Surplus?

Producer surplus is the triangular area below price, but above the supply curve. It shows the additional value gained by the producers as they are getting a higher price than the price they are willing to supply the good at.

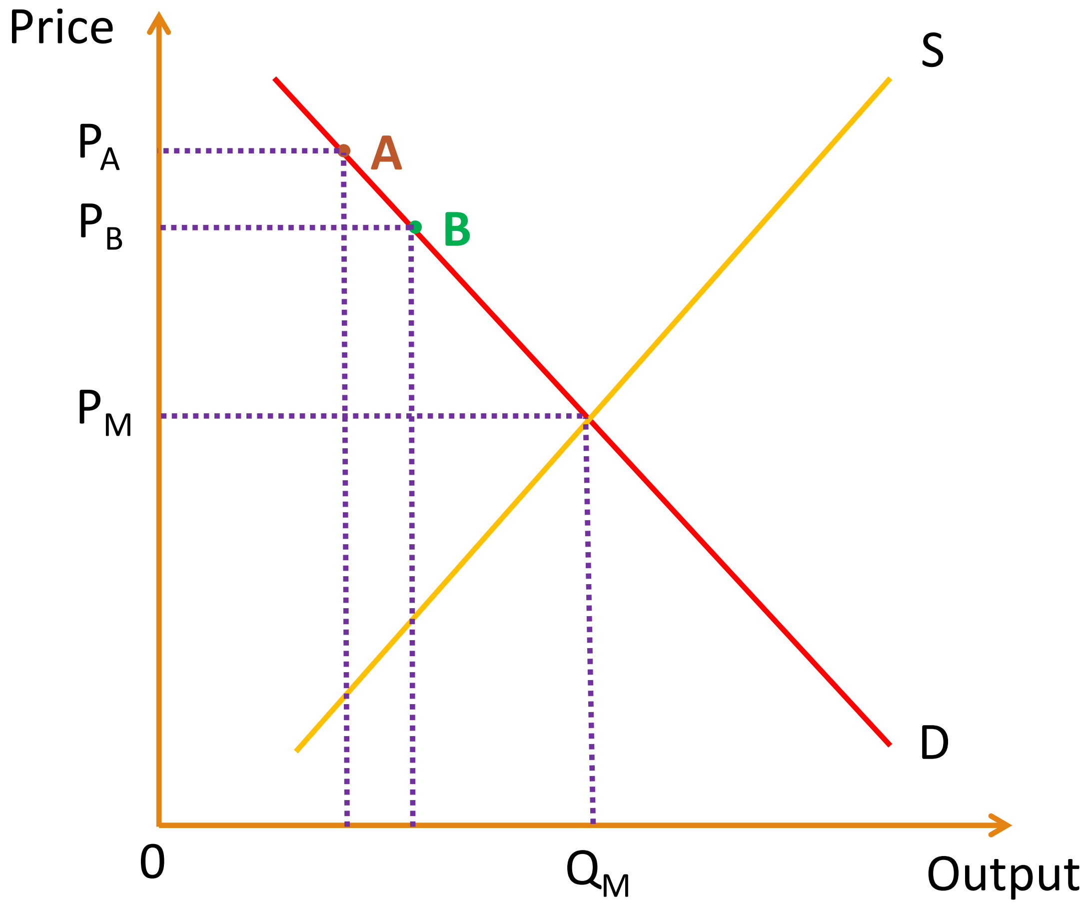


Loss in Consumer Surplus?

What if the firm starts charging consumers differently instead of a single market price?

Charge consumer A at price P_A and consumer B at price P_B etc.

What do you think will happen to consumer/producer surplus?



What is Price Discrimination?

Price discrimination occurs when firms are able to charge consumers different prices for the **same product**.

There are 3 types: 1^{st} degree, 2^{nd} degree and 3^{rd} degree.

3^{rd} Degree is mostly mentioned in the IB specification.

Why do you think firms price discriminate?

Why Price Discrimination?

- Higher profits and revenues
  - Higher producer surplus and revenues
- Improved cash flow
  - More money flowing into the business
- Monetize/utilise spare capacity of the firm
  - E.g. HK cinemas charging less for early movies to monetize existing capital

When do you think firms are able to price discriminate?

Conditions for Price Discrimination

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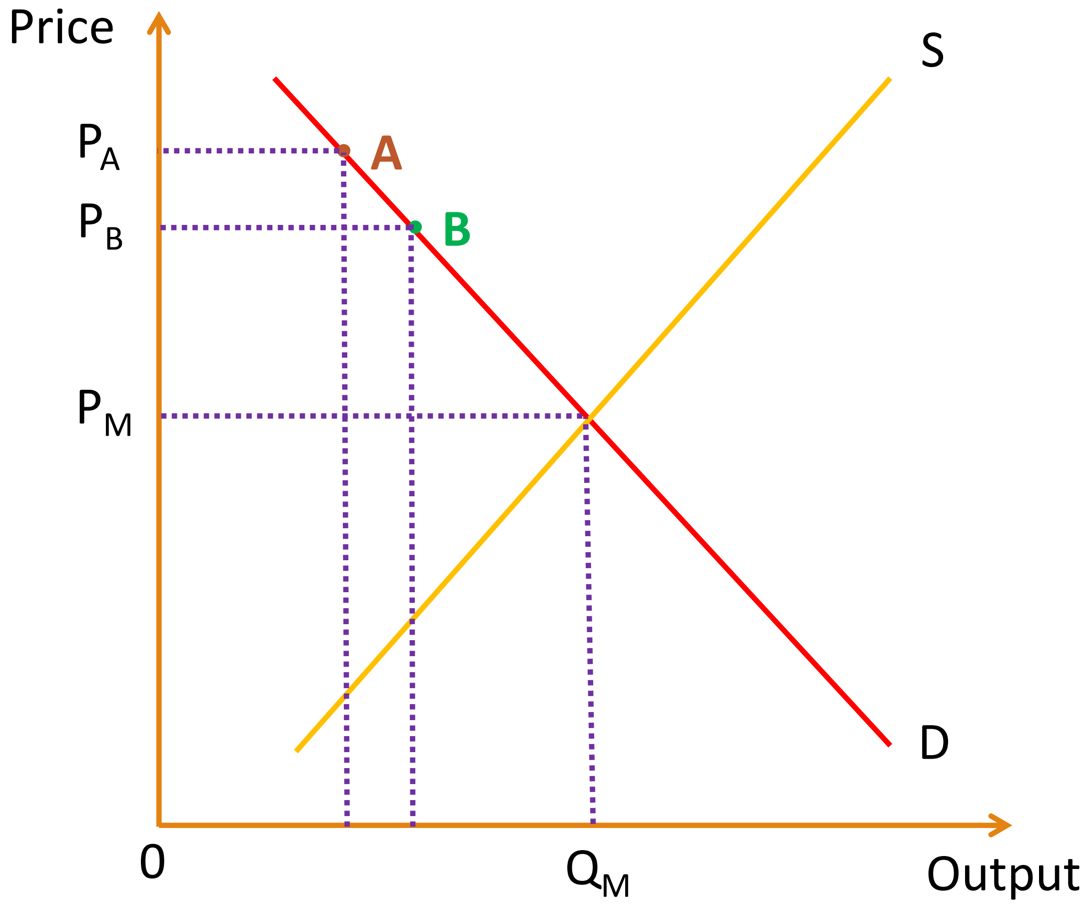
Price discrimination requires the following to work:

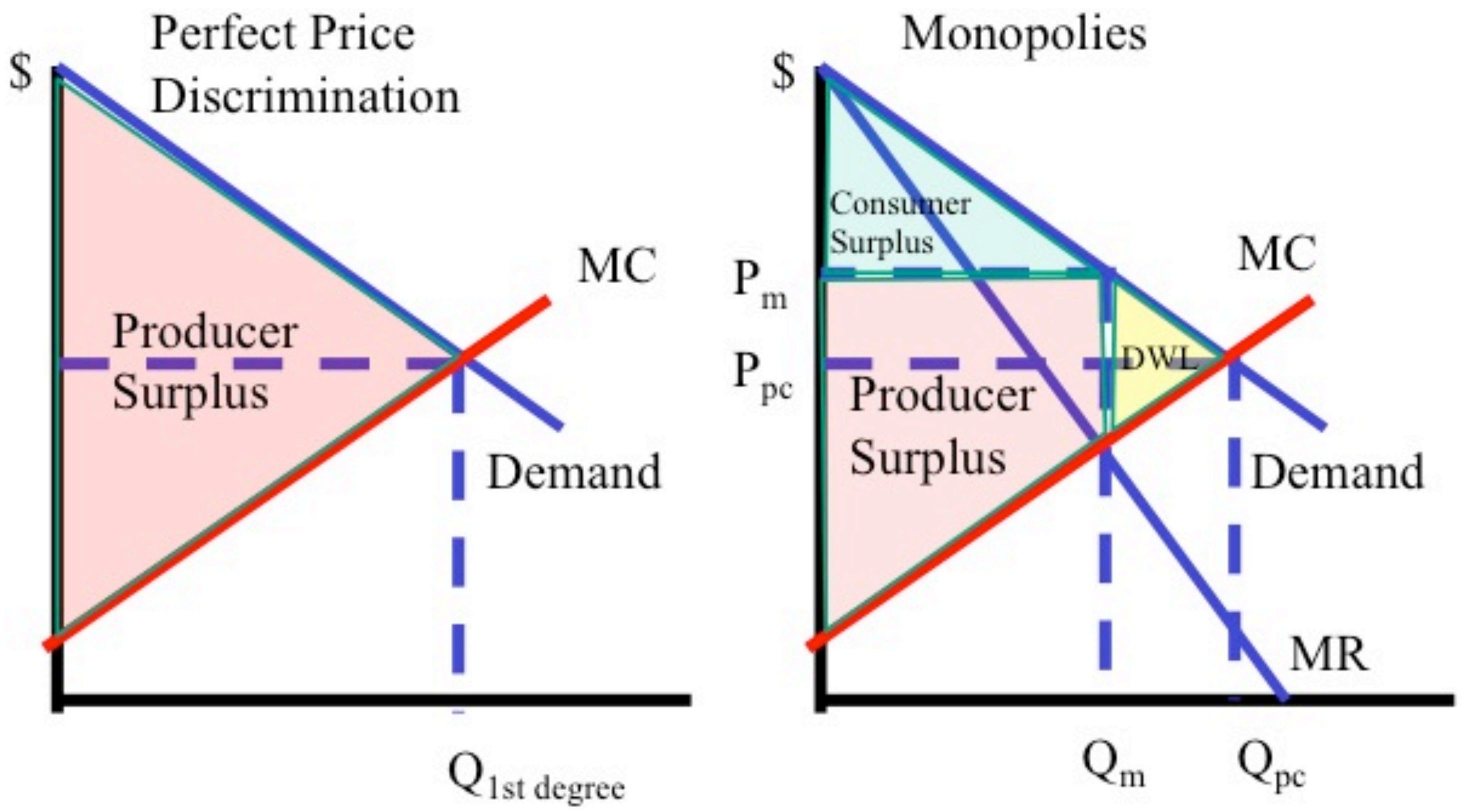
- Firms need to have some degree of market power (allowing them to set prices)
  - Monopoly, monopolistic competition/oligopoly due to differentiated products
- The firm needs to have separable consumer groups and ensure no reselling of the product occurs
  - E.g. By age, income, taste ...
- The consumers need to have different price elasticities (PED) for the same product
  - This means varying degrees of need for the same good, so a higher price can be charged to consumers with less elastic PEDs

First Degree Price Discrimination

If firms are able to charge **each consumer** at the price they are ‘willing-to-pay’, this is called perfect price discrimination, or **1st degree price discrimination**.



First Degree or Perfect Price Discrimination



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Second Degree Price Discrimination

2nd degree price discrimination means to adjust prices according to quantity purchased, or by time of purchase.

i.e. cheaper price when buying in bulk or different prices at different times of year

What do you think are some examples of second degree price discrimination?

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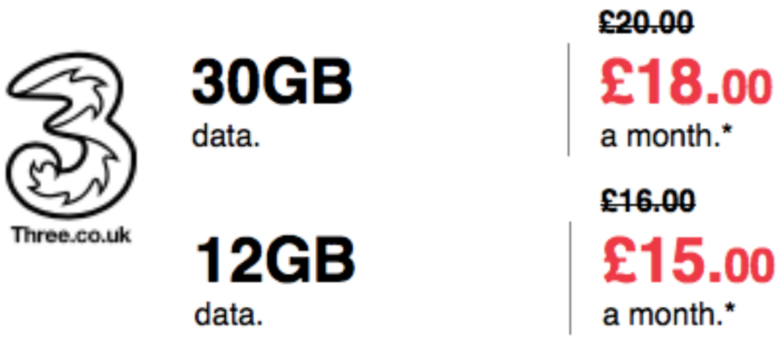
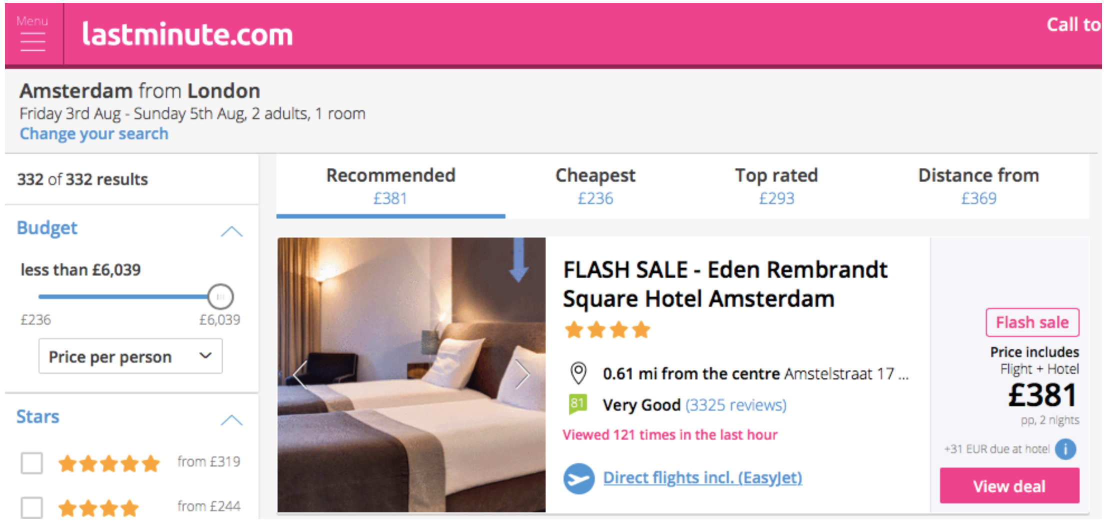
Second Degree Price Discrimination





Third Degree Price Discrimination

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3rd degree price discrimination means to differentiate prices according to different consumer groups/segments.

E.g. by age, income, taste, geography...

What do you think are some examples of third degree price discrimination?

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Price Discrimination Case Study

Nurofen was found guilty in December 2015 by an Australian court of misleading customers by **selling the same painkillers at different prices**. Labels on the packs of its analgesic drugs suggest they target types of pain such as migraines, period pain and sore backs. In fact, they all contain the same ingredient – ibuprofen lysine

https://www.smh.com.au/business/consumer-affairs/accc-sues-voltaren-makers-glaxosmithkline-and-novartis-for-misleading-consumers-20171206-gzzldg.html

Uber and Price Discrimination

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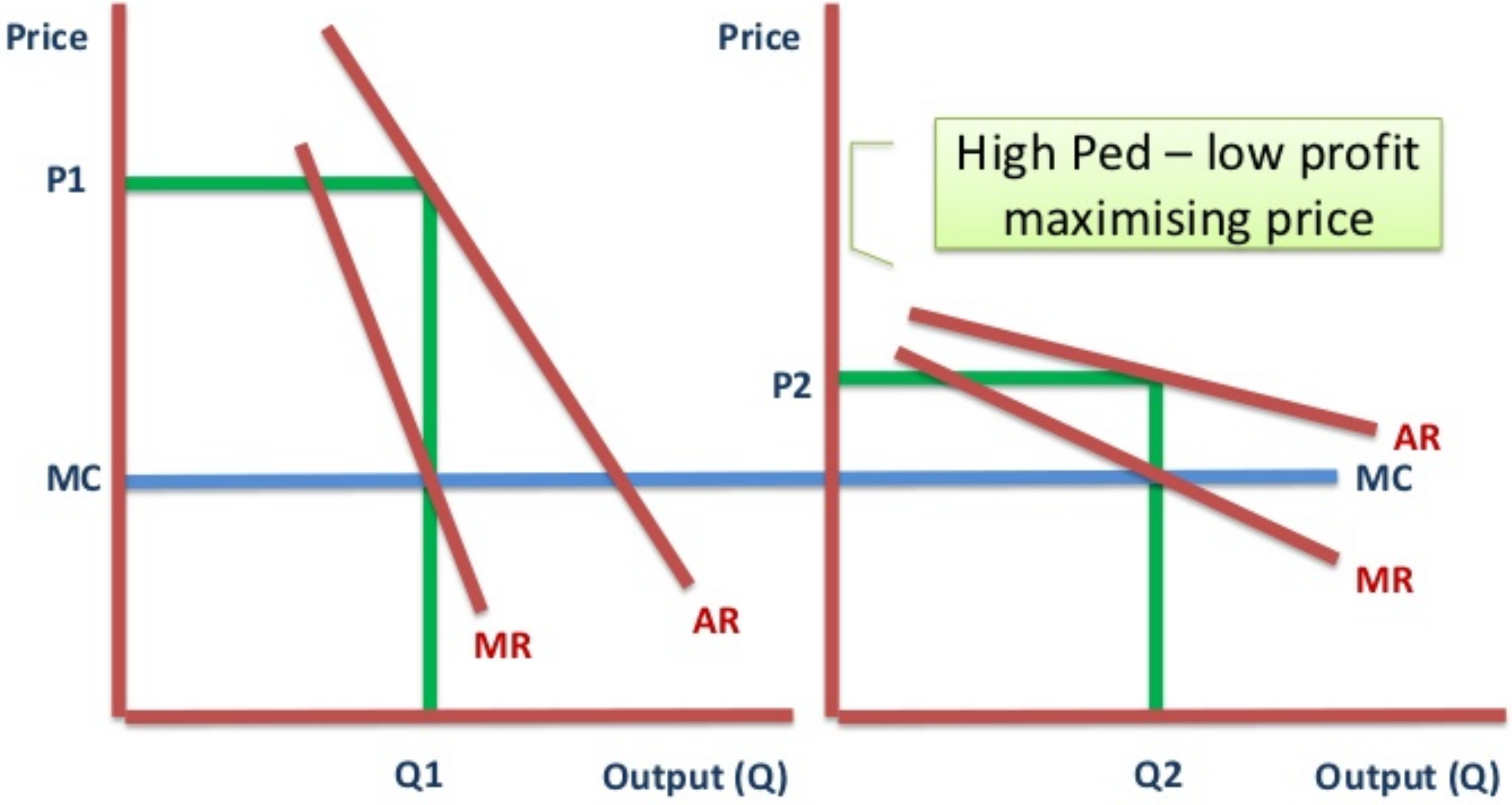
- Uber is a fast-growing taxi service app that now operates in more than 50 countries
- In May 2015, Uber was valued at about 41 billion U.S. dollars by venture-capital firms
- Uber engages in **surge pricing** – also known as **dynamic pricing**
- When market demand out-strips available supply e.g. at peak times, then Uber raises the average fare on their app
- The aim is to encourage more drivers to take to the roads to expand supply
- The business is taking advantage of **low price elasticity of demand** at busy times
- Some economists have criticised this policy especially during emergencies such as freak weather events and terrorist attacks

Surge Pricing

Peak Demand

Third Degree Price Discrimination Diagram



Price Discrimination Evaluation

Advantages for the firm:

- Consumer surplus eliminated – higher revenue from sales

- Producer produces more – economies of scale, lowering average costs and prices

- In the elastic market, competitors may be driven out – the firm undercuts them by using revenue from inelastic market to lower elastic prices.

- Makes use of spare capacity

- May increase research and development

Advantages to the consumers:

- Consumers of the elastic sector find prices more affordable
- Increasing total output makes products more available to more consumers

Disadvantages to the consumers:

- Any previous consumer surplus is lost
- Consumers with inelastic demand may have to pay more – exploitation
- Increase revenue and competitive behaviour may allow a firm to gain monopoly power.