LECTURE 4.4

THIRD DEGREE

PRICE DISCRIMINATION

THIRD DEGREE PRICE DISCRIMINATION

It is difficult to learn each individual consumer's willingness to pay. It is more practical to divide consumers into a few groups according to observable characteristics.

- e.g. age or gender
- e.g. timing or location of purchase

Third degree price discrimination is the charging of a different price to different groups.

- Separate the market into the appropriate number of groups. Then maximise profit as a single price monopolist in each of the separate sub-markets.

THIRD DEGREE PRICE DISCRIMINATION

How does a single price monopolist maximise profit in each of the separate sub-markets.

- Recall, set MR = MC in each of the separate markets
- I.e. Elasticity rule implies higher prices for groups with less elastic demand.

$$\frac{p - MC}{p} = \frac{1}{\eta}$$

Examples

- student/senior/child discounts
- different price online vs. in store
- coupons mailed to some ZIP codes but not others

THIRD DEGREE PRICE DISCRIMINATION

Effects of third degree price discrimination based on market segmentation:

- Profit must go up
- Ambiguous effects on consumer surplus and total welfare.

Practical difficulties:

- Identification of each consumer group's demand
- Arbitrage
- Possible legal/PR issues (though price discrimination is not per se illegal)