

Microeconomics

Segment 29

Price Discrimination

S. Shang

Monopoly

- Over the past few segments, we have done a lot:
 - Defined the term monopoly
 - Introduced a workhorse model of monopoly pricing
 - Noted that the model was really quite a bit more widely applicable than just to the traditional, only-one-supplier-of-a-good, kind of situation
 - Noted deadweight loss resulting from monopoly pricing
 - Noted division of surplus skewed toward supplier under monopoly pricing
 - Defined the Lerner index
 - Noted that monopolists will price on the elastic part of the demand curve
 - Saw an example of how we could infer markups and/or marginal costs from demand elasticities
 - Talked about situations where we might want a monopoly
 - Talked about situations where we would not want a monopoly

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 - Talked about situations where we might want a monopoly
 - Talked about situations where we would not want a monopoly
 - Whew, that's a lot.

Monopoly

- Today we're going to go beyond our standard, workhorse model of monopoly pricing, and see something else that monopolists can and do do.
- In particular, we are going to relax our assumption that the monopolist has to charge the same price to all consumers.
- There are many situations where such an assumption makes perfect sense: many suppliers operate in a market where a single price has to be posted and honored, and that price will be common to all potential consumers.
- There are many situations, though, where a supplier may have an opportunity to charge different consumers different prices.

Monopoly

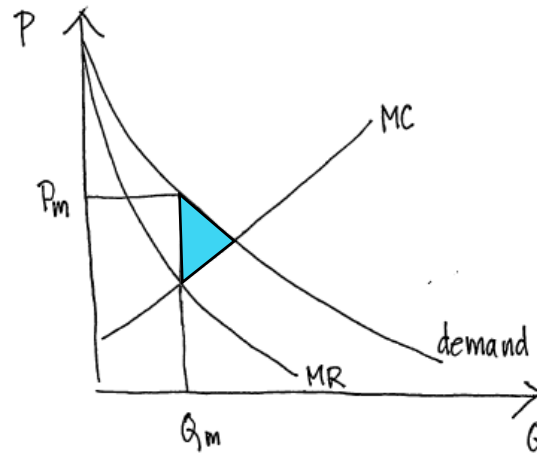
Disney World's donut shop

manufacturer of Hydro Flask se

at the wholesale level to retailers

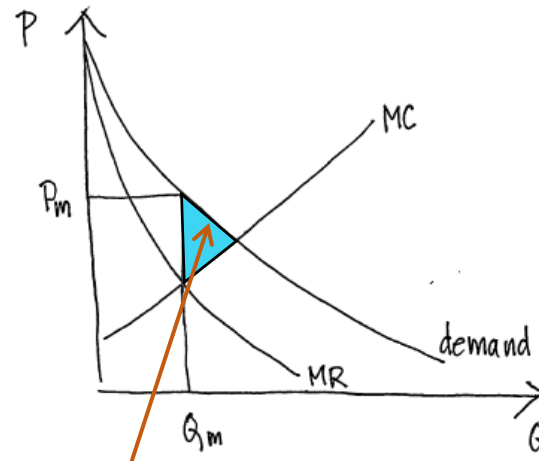
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- In fact, you might have thought about the possibility when you saw the monopoly pricing graph and thought about the problem of deadweight loss.
- As economists, we worry about the deadweight loss because it represents just pure gains from trade in the economy that are not being realized. We want to get rid of it.

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- As economists, we worry about the deadweight loss because it represents just pure gains from trade in the economy that are not being realized. We want to get rid of it.
- How could you get rid of it? Maybe just relax the assumption that the monopolist has to charge everyone the same price, and let him charge the people who are down here less.

Monopoly

- An economist worries about the deadweight loss because it represents an inefficiency. A monopolist may also worry about deadweight loss (but perhaps not in the same social-good sort of way).
- He may see it as an opportunity to increase profits further. There are potential consumers out there who are willing to pay more than it costs me to produce a marginal unit of the good---how can I exploit that opportunity?

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- He may see it as an opportunity to increase profits further. There are potential consumers out there who are willing to pay more than it costs me to produce a marginal unit of the good---how can I exploit that opportunity?
- In fact, one answer (to both the economist and the monopolist) is price discrimination.

Price discrimination

- Let's start with a definition: a common (but too restrictive) definition of price discrimination is charging different customers different prices for identical products with the goal of increasing profits.
- Once you start looking, you can see examples of price discrimination everywhere.
- Although it's easiest to see analytically in the case of a monopolist, competitive firms can and do also price discriminate.

Price discrimination

In fact, this definition works pretty well for two different types of price discrimination, but we will see a third type where products need not be identical.

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Lots of examples

Bargaining power



Gunnar Rathbun/AP Images for Walmart

As the world's largest retailer, Walmart has huge bargaining power when it comes to its suppliers. Many brands depend on Walmart sales to stay in business, while even larger, established companies can little afford to be removed from Walmart's aisles or webpages.

Walmart can demand lower wholesale rates than just about any other retailer on earth, and it passes these savings on to customers.

How Online Shopping Makes Suckers of Us All

Will you pay more for those shoes before 7 p.m.? Would the price tag be different if you lived in the suburbs? Standard prices and simple discounts are giving way to far more exotic strategies, designed to extract every last dollar from the consumer.



almohada francesa
French Flag Pillow
15,99 EUR



almohada holandesa
Dutch Flag Pillow
9,99 EUR

Boston Opera House Student Discount

Discounted Rush Tickets For 1 Or 2 Guests (Depending On Availability). Purchase From Opera House Box Office, 2 Hours Prior To Curtain W/ Student ID. Check Facebook For Details

×60 and over ?◀▶

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SENIOR WEDNESDAYS

10% DISCOUNT ON REGULAR PRICED ITEMS

5% RECEIVE AN ADDITIONAL DISCOUNT ON IN-STORE SPECIALS

POKE & DELI PRODUCTS INCLUDED
(AVAILABLE ALL DAY WEDNESDAY)

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OFFERED AT
TAMURA SUPER MARKET
Waianae



MUST PRESENT VALID ID AT REGISTER TO RECEIVE DISCOUNT
*EXCLUDES ADVERTISED SALE ITEMS, ALCOHOLIC BEVERAGES & TOBACCO PRODUCTS
DISCOUNTS ARE ACTIVE WEDNESDAY ONLY. OTHER RESTRICTIONS MAY APPLY

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Here is part of an article talking about the phenomenon of manufacturers charging different prices for the same product to different retailers, and, in particular, charging less to Walmart.

This practice can actually be illegal in the US, under the Robinson-Patman Act, but that act makes exceptions for firms charging different prices “to meet the competition,” so it is quite hard for retailers paying higher prices to bring a successful legal action.

From the FTC website:

Price Discrimination: Robinson-Patman Violations

A seller charging competing buyers different prices for the same "commodity" or discriminating in the provision of "allowances" — compensation for advertising and other services — may be violating the Robinson-Patman Act. This kind of price discrimination may give favored customers an edge in the market that has nothing to do with their superior efficiency. Price discriminations are generally lawful, particularly if they reflect the different costs of dealing with different buyers or are the result of a seller's attempts to meet a competitor's offering.

Here are two descriptions of discounts, one given to students and the other to seniors. Such discounts are very common and typically treated as legal. In any case, they are never challenged, either legally or in the court of public opinion, as far as I know.

They are, to be clear, price discrimination, though.

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Here is a headline from an article talking about price discrimination in another setting, online shopping.

This type of price discrimination is deeply unpopular, as Amazon executives found out when they embarked on a “pricing experiment” in 2002 and were discovered by some savvy customers.

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Consumer Outrage

Amazon shoppers were outraged when they first discovered that they were quoted different prices for the same DVD.

Savvy shoppers began experimenting to see exactly how much variance there was in Amazon's pricing. What they found, and what Amazon later confirmed, was that customers were given random discounts of between 20 and 40 percent on 68 DVDs.

Although the difference in pricing mostly amounted to only a few dollars (US\$), the disparities on some DVD purchases were significant. Buyers of "The X-Files: The Complete Second Season" paid prices ranging from \$89.99 to \$104.99 for the DVD collection that has a list price of \$149.98.

Price tests conducted by the E-Commerce Times during Amazon's pricing experiment resulted in discounts of 30 to 40 percent. During one online session, the price for the DVD "Mission Impossible" was \$17.99, a 40 percent discount. Several hours later, the price had risen to \$20.99, a 30 percent discount.

And here was the result:

E-tail giant Amazon.com (Nasdaq: AMZN) issued a formal apology Wednesday for price testing it conducted earlier in the month that caused customers to be quoted different prices for the same DVD.



Although several news reports indicated that Amazon was altering the prices based on demographics, the Seattle, Washington-based e-tailer denied those claims, saying, "These reports were incorrect and were not based on the facts." The company added that it was simply trying to determine how much sales are affected

by lower prices.

"We've never tested and we never will test prices based on customer demographics," said Amazon founder and CEO Jeff Bezos. "What we did was a random price test, and even that was a mistake because it created uncertainty for customers rather than simplifying their lives."

And this one is just
funny:



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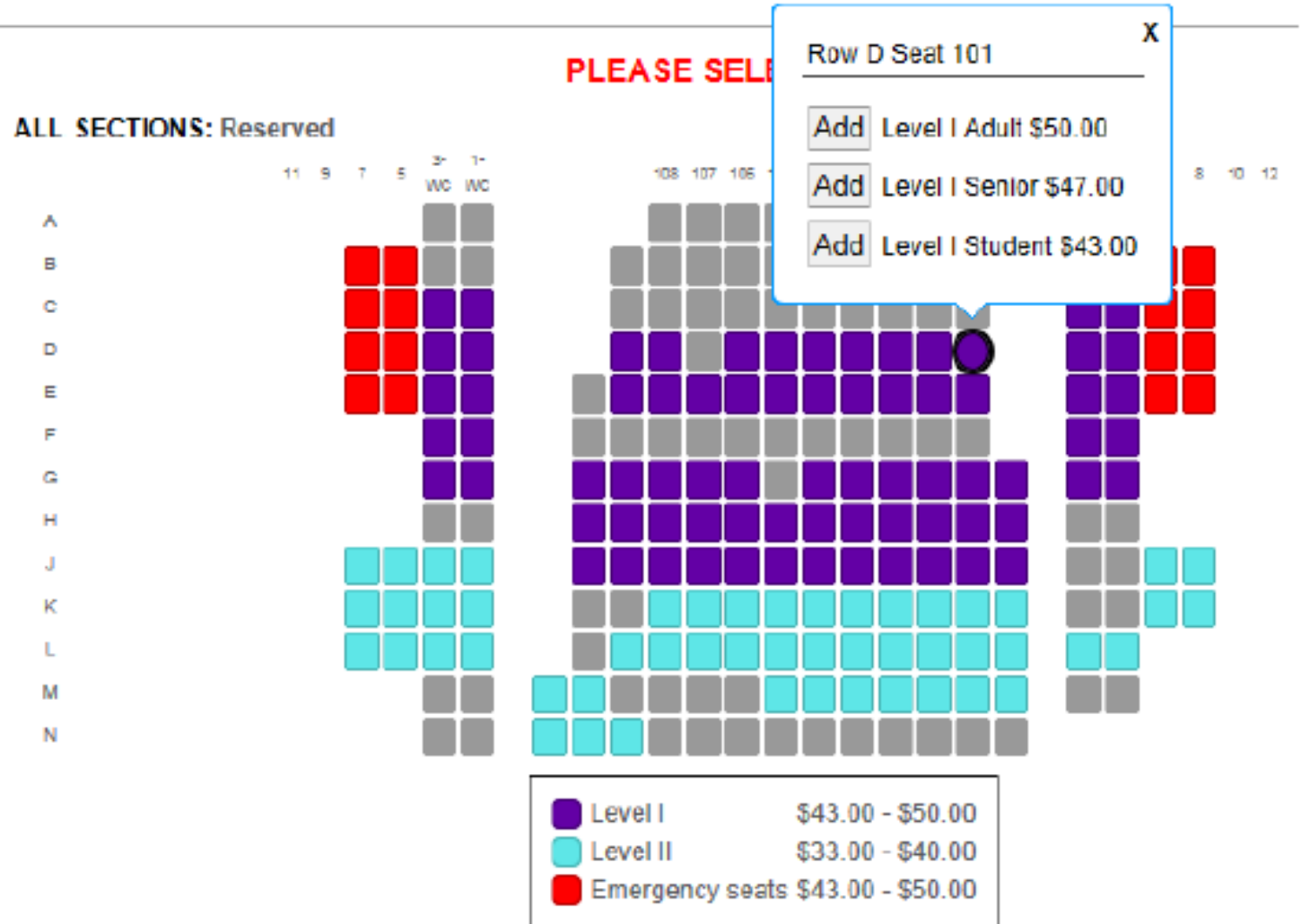
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Here, the “no arbitrage condition” only holds if people don’t realize that pillows can be rotated.

Macbeth
Thursday, October 25 at 7:30PM

Price-discrimination is easier on products where no arbitrage can be enforced, like theater tickets. Also, discriminating between well-identified groups and requiring ID can help.



This one is also pretty funny ...

FROM RICHARD OWEN (London Times)
IN ROME

AN ITALIAN supermarket that offered 20 per cent discounts to the over-60s has discovered the flaw in the scheme: resourceful and unscrupulous grandmothers have been hiring themselves out to shoppers who are under 60 but still like the idea of a discount on their grocery bill.

The management of the supermarket in Udine, near Venice, was surprised and delighted by the "unimaginable success" of its scheme. The "senior citizens discount" produced a 40 per cent surge in takings, making Udine, a medieval town hitherto best known for its Tiepolo frescoes, a mecca for elderly shoppers.

It took a year for the penny to drop. "We seem to have been providing a social service," the manager said ruefully yesterday. "The ordinary shoppers made a saving, and the old people made a fortune in tips."

He knew there had been cases of middle-aged people pretending to be older, but he had no idea that teams of grandmothers had been operating a systematic scam, loading up trolleys of groceries and unloading them into the cars of strangers. The more enterprising had hovered near the entrance, whispering "Need any help with your shopping?" as customers arrived.

The reaction of many Italians was to applaud a display of enterprise. "This was no racket," said la Repubblica. "It was yet another example of our native Mediterranean genius, a brilliant scheme for saving money all round."

One defiant grandmother said at the checkout: "It helped to supplement my pension. I've never seen so much of my children and grandchildren before in my life." The scheme has now been dropped.

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