AQA Economics A-level

Microeconomics

Topic 5: Perfect Competition, Imperfectly Competitive Markets and Monopoly

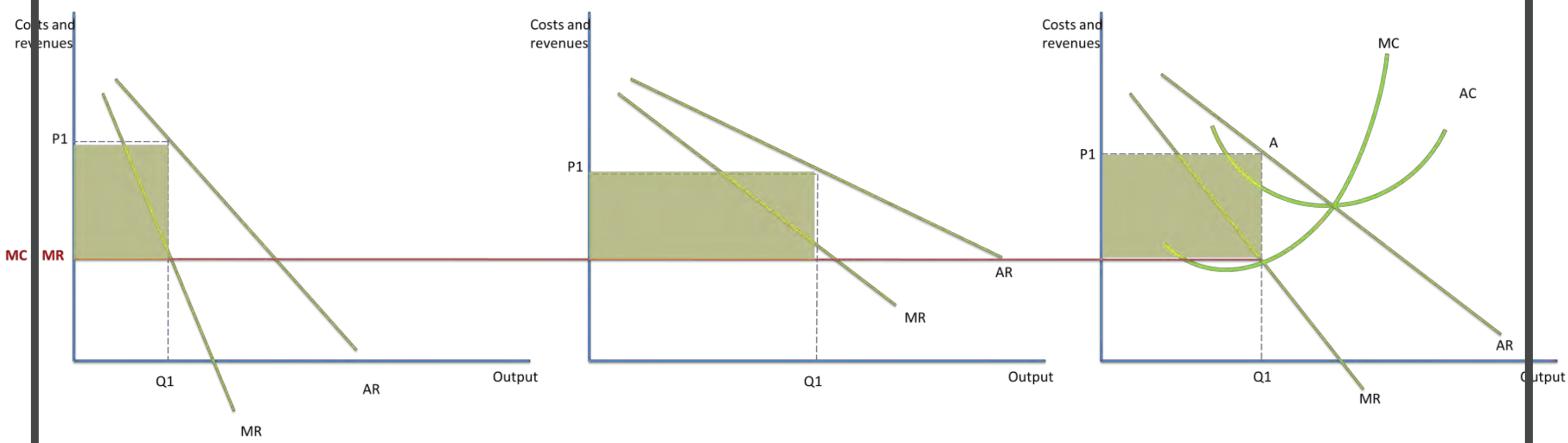
5.7 Price discrimination

Notes

- Price discrimination occurs in a monopoly, when the monopolist decides to charge different groups of consumers different prices, **for the same good or service.** This is not for cost reasons.

- Usually, demand curves of different elasticities exist with each group of consumers. This allows the market to be split and different prices to be charged. It must not cost the monopolist much to split the market; otherwise, it will not be financially worthwhile.

- The diagram shows the different price elasticities in a market, which might mean the monopolist charges different prices. A market with an elastic demand curve (the second graph) will have a lower price, while a market with an inelastic demand curve will have a higher price (first graph). The third graph shows the firm's costs and revenues. The area of supernormal profit is represented by the yellow shaded rectangle.



- By charging different prices, the monopolist can maximise their overall profits.

- First degree price discrimination is when each consumer is charged a different price. For example, a lawyer might charge a high income family more than a low income family.
- Second degree price discrimination is when prices are different according to the volume purchased. For example, with gas.
- Third degree price discrimination is when different groups of consumers are charged a different price for the same good or service. For example, the higher price at peak times on trains is a form of third degree price discrimination, because generally, a different group of consumers (usually commuters) use trains at peak times, than off-peak times. Similarly, adults, students and children pay different prices to see the same film at a cinema. It costs the cinema the same to show the film, but the consumers have been divided into groups based on age.

	Costs	**Benefits**
Consumers	Usually, price discrimination results in a loss of consumer surplus. Since P > MC, there is a loss of allocative efficiency. It strengthens the monopoly power of firms, which could result in higher prices in the long run for consumers.	Consumers could benefit from a net welfare gain as a result of cross subsidisation, if they receive a lower price. Some consumers, who were previously excluded by high prices, might now be able to benefit from the good or service. For example, drug companies might charge consumers with higher incomes more for the same drugs, so that the less well-off can also access the drugs at a lower price. This can yield positive externalities.
Producers	If it is used as a predatory pricing method, the firm could face investigation by the Competition and Markets Authority. It might cost the firm to divide the market, which	Producers make better use of spare capacity. The higher supernormal profits, which result from price discrimination, could help stimulate investment.

	limits the benefits they could gain.	If more profits are made in one market, a different market which makes losses could be cross subsidised, especially if it yields social benefits. This will limit or prevent job losses, which might result from the closure of the loss-making market.