# Price Discrimination

Price discrimination refers to the practise of selling same product to different buyers at different prices. A seller does price discrimination when it is profitable and possible for him to do so. If the manufacturer is able to sell a refrigerator at Rs. 10,000 to one customer and Rs. 10,500 to another customer (all condition of cost and delivery being the same) then he is practising price discrimination.

Prof. Stigler defines price discrimination as “ the sales of technically similar products at prices which are not proportional to marginal cost”.

## Conditions for Price Discrimination

1) The market must be divided into sub-markets with different price elasticities.

2) There must be effective separation of the sub-markets so that no reselling can take place from a low price market to a high price market.

## Degrees of Price Discrimination

1) 3rd Degree price discrimination is said to occur when the seller divides his buyers into two or more than two sub-markets or groups depending on the price elasticity of demand.

2) 2nd Degree price discrimination occur when a monopolist is able to charge separate prices for different blocks or quantities of a commodity from buyers and in this way he takes away a part but not all consumer surplus from them.

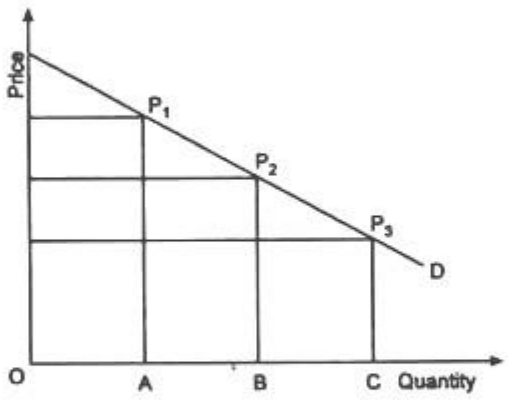


Fig. 9 : Public utility pricing

In this figure the public utility pricing is done in such a way that A block gets sold at $P_1$ price and B block at $P_2$ price and the C block at $P_3$ price. Here discrimination is done on the different blocks of goods that is being sold.

3) 1st Degree price discrimination involves maximum possible exploitation of each buyer in the interest of a seller's profits. It is also called perfect price discrimination. It is said to occur when the monopolist is able to sell each separate unit of the output at a different price. The seller leaves no consumer surplus to any buyer.

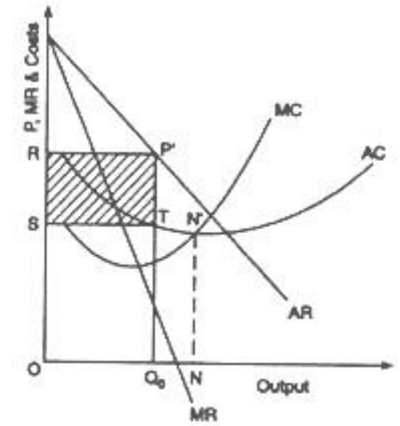

Fig. 1 : The equilibrium position of a monopolist in the short run

The 1st degree price discrimination is the worst price discrimination. In this the monopolist takes away the whole consumer surplus of the consumer. As we can see in the figure that ON is the optimum output that can be sold by the monopolist but he prefers to produce less than that so that he sell it at a higher price. He sells OQ output at OR price and thus makes supernormal profit of RSP'T.

## When is Price Discrimination Possible

1) The nature of the commodity: The nature of services of lawyers and doctors are such that they are able to charge different prices from different customers. They usually charge higher fee from rich patients and lower fee from poor patients.

2) Long distances or tariff barriers: If the two markets are separated by long distance or tariff barriers the cost multiplies. There are transportation cost involved which leads to price discrimination.

3) Legal sanction: There is sometimes legal backing to charge different prices from different customers. Electricity department charges different prices from industry and agriculture.

4) Preference or prejudices of the buyers: Buyers might have their brand preference and they are ready to pay any price for that product. So in the face of it the seller can induce them to pay more for some exclusive product.

5) Ignorance and laziness of buyers: The buyer might be ignorant or lazy and has not found out the different prices prevailing in the market. This might prompt the sellers to take advantage of the situation.

6) When different groups require same service for differentiated product: Railways charge different price for carrying cotton and coal. Same service but the nature of product is different prompting the seller to charge different.

## Equilibrium Condition of a discriminating monopolist

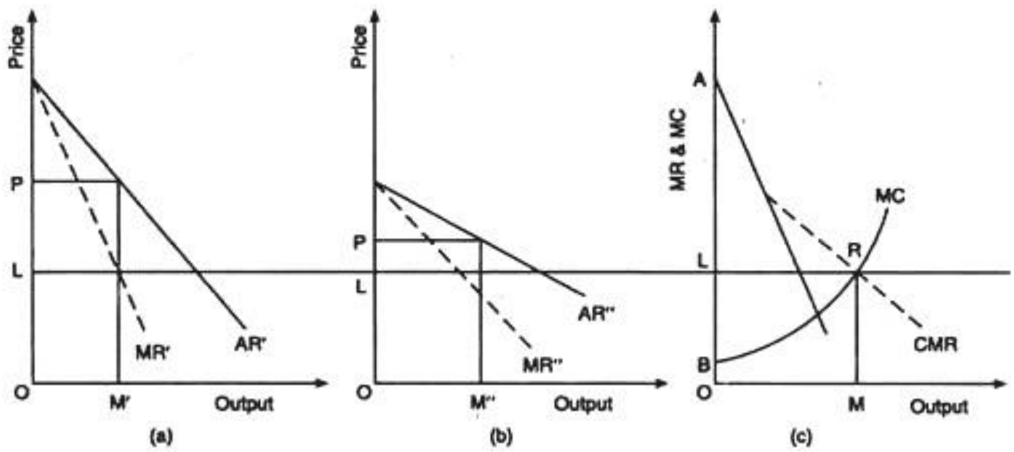


Fig. 10 : Equilibrium of a Discriminating Monopolist

In Panel A we have a market where demand is inelastic and in Panel B we have a market where the demand is elastic. There is a barrier between the two markets so that no reselling can take place. The overall market demand is shown in panel C .Price is determined at point R where the MC curve cuts MR from below. This price is taken up by the two markets in Panel A and B. In panel A where demand is inelastic a lower quantity OM’ is sold at higher price OP and in panel B where demand is elastic a higher quantity OM” is sold at a lower price OP. Total quantity OM of panel C is in this way distributed between the two markets.