

Lecture 16 – March 16, 2006

Efficiency aspects of price discrimination

Ramsey Pricing

- How do you tax several different goods to raise the most money with the least distortion?
- Mark up each good in proportion to $1/\epsilon$
- Intuition:
 - o Inefficiency from $p > mc$ arises from demand shift (too little consumed)
 - o Low elasticity consumers: raising price won't do much
 - o High elasticity consumers: don't mark up prices very much
- Refer to graph drawn in class
- See class notes for derivation of Ramsey prices
- To maximize a weighted combination of profits and welfare, markups should be inversely proportional to elasticity
- If we consider two groups of consumers, rather than two different goods, this is price discrimination
- PD math is similar to math of maximizing welfare with a breakeven constraint
- PD might not be so evil
 - o Helps firms in a way that is less harmful to consumers than no PD
 - o (Positive view) Maybe even a positive impact on consumer surplus

Example

- Two markets (maybe 2 countries in which a drug is sold)
- Big market, inelastic demand (U.S.)
- Small market, elastic demand/low wtp
- PD: High price in U.S., low price in 2nd market
- No PD: 2nd market doesn't get served at all
- Effect on CS? Higher with PD (in this example)
- Positive view of PD: Those willing to pay more do

Dark/Seamy Side of PD

- So far discussed monopoly PD (Ramsey-like prices)
- Oligopoly PD
 - o If group with inelastic demand is better at comparison shopping, may get lower markups
 - o Markups based on exposure to competition
- Potential damage to efficient market organization
 - o IBM punchcard example
 - o PC printers example
 - Hard for smaller competitors to take hold
 - Are printer makers the best people to produce cartridges?

- Problems with PD via Self-Selection
 - Pricing not related to production costs
 - Potential for product to be deliberately damaged in the name of PD
 - Computer chips, broadband market

Read Ch 11, up to p 379