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Econ 304—Bethany College

**Lecture 23: Price Discrimination I**

1. Why do we have coupons? Why not just have sales?
   1. Do a particular type of person use coupons?
   2. Coupons are an example of *price discrimination*—when a seller charges different prices of the same good or service
2. Price discrimination requirements
   1. *Distinguishable units*: there must have a way to determine which person or amount should be charged which price.
   2. *Prevention of resale*: the product cannot be easily resold; otherwise the discounted customers will turn around and sell it to others at a profit.
      1. *Arbitrage*—buying low and then selling high—prevents price discrimination from working.
   3. *Uniform cost*: the cost to bring the item to market cannot change; otherwise it’s just two different prices for two different products.
3. Efficiency and price discrimination
   1. Part of price discrimination is a transfer payment (from consumer to producer surplus). This sounds bad, but a transfer payment is neutral. From an efficiency standpoint, everyone is treated equally.
   2. But if price discrimination reduces output, then you get some deadweight loss.
   3. *However*, if it increases output (assuming no deadweight loss as a result), then it is good for economic efficiency. Price discrimination increases firm revenue which is sometimes needed to induce entry into product.
      1. Is it better to have a rare disease or a common one?
      2. The role of market size. PD allows an increase in market size, and thus of revenue. PD helps cover fixed costs.
4. Bundling (aka commodity bundling)
   1. This is kind of the opposite of tying. Instead of two goods being separately (one good and many goods), *bundling* is selling a good which can only be bought in a bundle of other goods (one-to-one).
      1. You only need to buy one Nintendo Wii to play many games. But you want more copies of Microsoft Excel, you’ll have to buy more copies of Word along with the Excel copies.
      2. Bundling examples: cable channels, Office software, buffets, traditional newspapers, politicians
   2. Companies bundle when groups of people value parts of the bundle differently. If the bundle is assembled correctly, lots of people should value the result the same even if they vastly disagree on how they value the parts of the bundle.
      1. Wilf and David both use Microsoft Office. Wilf tends to use Excel, using other software for word processing. David prefers Word, using Excel only in rare cases. Suppose each is willing to pay $90 for what they use often and $10 for what they use rarely.
      2. Even though they disagree on how much each component is worth, they agree on the bundle.
      3. Unbundled, Microsoft could charge $90 for each or $10 for each part (getting $180 or $40 in total revenue, respectively). With bundling, they charge $100 for each bundle, getting $200 in revenue.
   3. Bundling is price discrimination. In practice, David is being charged $90 for Word and $10 for Excel while Wilf is being charged $10 for Word and $90 for Excel. The same good, examined as separate for the bundle, is being charged different prices.
   4. In other words, the different prices functionally occur in the consumer’s own head.