<u>PRICE DISCRIMINATION</u> (Sub-topic of the chapter 'Monopoly')

Meaning of price discrimination: Price discrimination is the important feature under monopoly form of market. Under price discrimination, the seller charges different price for the same commodity from different group of buyers. It can be defined as ***the practice of the seller, specifically of the monopolist, by which different price can be charged for the same commodity from different group of buyers depending on the market condition.*** For example; the Calcutta Electric Supply Corporation supplies electricity to different categories of consumers (domestic, commercial, industrial etc.) at the different rates. Here the concerned monopolist is termed as the ***discriminating monopolist***.

Different types of price discrimination: Price discrimination can be classified into different categories depending on its nature. In this context important classifications are: (a) personal price discrimination (b) price discrimination according to use and (c) regional or local price discrimination.

(a) Personal price discrimination: When the monopolist charges different price for the same commodity from different persons then it is called personal price discrimination. For example; doctor charges relatively higher fees from the rich patients than the poor one for the same surgery.

(b) Price discrimination according to use: When monopolist charges different price for the same commodity from different group of buyers based on the nature of use of the commodity then it is called price discrimination according to use. For example; the CESC charges higher price or rate of electricity for industrial use than the domestic use.

(c) Regional or local price discrimination: When the monopolist charges different price for the same commodity from different consumers residing in different locality or region then it is called regional or local price discrimination. For example; the multinational giant firm sells the commodity at a cheaper rate in the international market than the domestic market to capture the foreign markets.

Such price discrimination in international level is called ***dumping***.

Degrees of price discrimination: Depending on the nature of price discrimination economist A.C.Pigou classified it into three different categories: (a) Price discrimination of first degree (b) price discrimination of second degree and (c) price discrimination of third degree.

Under ***first degree price discrimination***, the monopolist has the perfect idea of nature of the demand curve of the consumer. Here, the monopolist charges the maximum price that a consumer is ready and willing to pay for it. It implies that, the monopolist squeezes entire consumers' surplus. As the consumers' surplus is entirely taken away by the monopolist while selling the product, it is termed as the ***perfect price discrimination***.

In ***second degree price discrimination***, monopolist charges different rates for the product according to the quantity demanded. In case of electricity, the company is charging different rates for the different blocks of electricity consumption. Here block implies the quantum of units of electricity upto a certain range. For example rate of electricity upto 50 units of consumption differs from the rate within the block 51 to 100 units and so on. Such a discriminating pricing policy is termed as the block pricing.

Third degree price discrimination is very common phenomenon under price discrimination policy by the monopolist. Here, the monopolist charges different prices for the commodity from different categories of buyers due to difference in their response towards change in demand for change in price i.e., price elasticity. For example; CESC, the Calcutta Electric Supply Corporation, charges higher electricity rate from the industrial users than the domestic users.

Conditions for successful price discrimination: Price discrimination is an essential feature under monopoly. To conduct price discrimination successfully certain conditions are essential to exist even if it is monopoly. Few of such conditions are as follows:

1. Consumers' ignorance: Consumers' ignorance regarding price fluctuation in different markets helps the monopolist in conducting price discrimination successfully.

2. Nature of the commodity: If the commodity is characterized by service in nature, then it is not possible to resale it. Hence, price discrimination is conducted successfully.

3. Tariff barrier: If cost of transportation (tariff) of the commodity is very high from one market to another then none of the buyers of the costly market are induced to buy it from the cheaper market. Hence, the monopolist easily conducts price discrimination.

4. Government intervention: Legal sanction of the Government empowers the monopolist to conduct price discrimination successfully. For example, transfer of electricity from the cheaper domestic use to the costly commercial or industrial use is a criminal offence by law.

5. Price elasticity in two different markets must be different: A monopolist conducts price discrimination successfully only when price elasticity of demand for the commodity is different in two separated markets.

Profitable condition for price discrimination: Price discrimination generally means charging different price for the same product from different group of buyers. But it is essential to judge the market where price is relatively higher compared to other. Otherwise, the buyers supposed to enjoy the commodity at a higher price will be offered at the lower price. Hence, objective of the discriminating monopolist to maximize net profit could not be materialized. In this context essential profitable condition is:

The price is relatively higher in that market where demand price elasticity for the commodity is relatively lower.

More specifically, we separate the markets into 'Market A' and 'Market B' with their respective demand price elasticity as E_A and E_B respectively. Now to conduct price discrimination successfully and in a profitable way, price in market 'A' (say P_A) is greater than price in market 'B' (say P_B) when E_A is less than E_B. Therefore, the profitable condition is; *if* $E_A < E_B \Rightarrow P_A > P_B$.

Equilibrium condition under price discrimination: Discriminating monopolist is guided by the objective of profit maximization. Hence, it is necessary to achieve equilibrium with price discrimination. To determine equilibrium condition under price discrimination, we separate the monopoly market into 'market A' and 'market B'. We assume that, in these two markets marginal revenue is MR_A and MR_B respectively. Now we have three different situations with respect to MR_A and MR_B:

1. If $MR_A > MR_B$, it implies that for the discriminating monopolist it will be more beneficial to sell the entire commodity units in market A instead of market B so as to enjoy more additional revenue from market A. Therefore, price discrimination is not feasible.
2. If $MR_A < MR_B$, it implies that discriminating monopolist will sell the entire commodity units in market B instead of market A, so as to earn more additional revenue from market B. Hence, price discrimination cannot be conducted further.
3. If $MR_A = MR_B$, it implies that for the discriminating monopolist it is equally beneficial to sell the commodity in both the two markets A and B. Hence, under this condition discriminating monopolist distribute the whole commodity units in two different markets charging different price. So, the equilibrium condition to conduct price discrimination is $\mathbf{MR_A = MR_B}$.
Moreover, for the monopoly itself, essential condition to determine equilibrium output is **MR = MC**. If we combine the monopolist with its discriminating nature then we find equilibrium in general as,

$$\boxed{\mathbf{MR_A = MR_B = MR = MC}}$$

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