

## **APPLIED ECONOMICS FOR MANAGERS SESSION 7—**

### **I. REVIEW: THE MONOPOLY PROBLEM**

#### **A. THE DEADWEIGHT LOSS OF MONOPOLY**

1. MONOPOLY OUTPUT LESS THAN COMPETITIVE OUTPUT
2. INEFFICIENCY: MUTUALLY BENEFICIAL TRADES DON'T TAKE PLACE

#### **B. MARGINAL REVENUE < PRICE WHEN ALL CUSTOMERS CHARGED THE SAME PRICE**

##### **1. THE “TWICE-AS-STEEP” RULE**

2. A NOTE ON THE LERNER INDEX  $LI = \frac{P - MC}{P} = \frac{1}{\epsilon_D}$

#### **C. HARMONIZATION OF SOCIETY'S AND MONOPOLIST'S INTERESTS**

1. DEAD WEIGHT LOSS = LOST SOCIAL SURPLUS
2. PROFIT OPPORTUNITY LOST: TRADES WITH SURPLUS FOR THE MONOPOLIST DON'T TAKE PLACE

### **II. PRICE DISCRIMINATION: SORTING & RESALE PREVENTION**

#### **A. REQUIREMENTS**

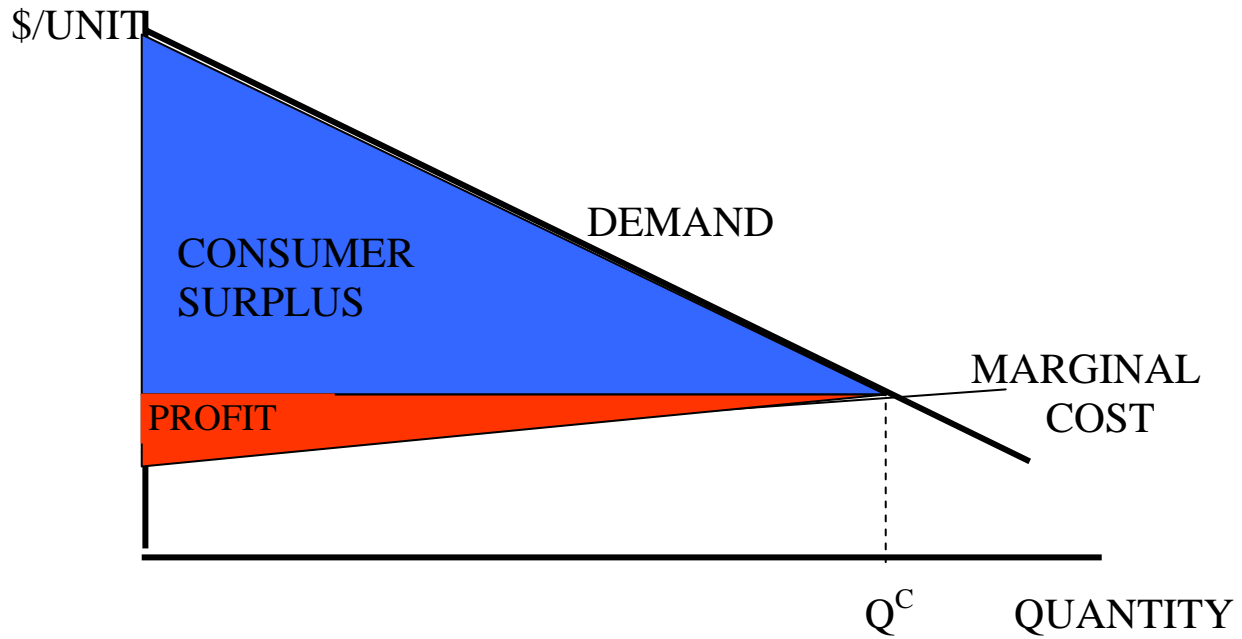
1. IDENTIFICATION: WHO IS WHO ON THE DEMAND CURVE?
2. NO RESALE—NO ARBITRAGE

#### **B. PRICE DISCRIMINATION IN LINEVILLE**

#### **C. OTHER PRICE DISCRIMINATION TACTICS:**

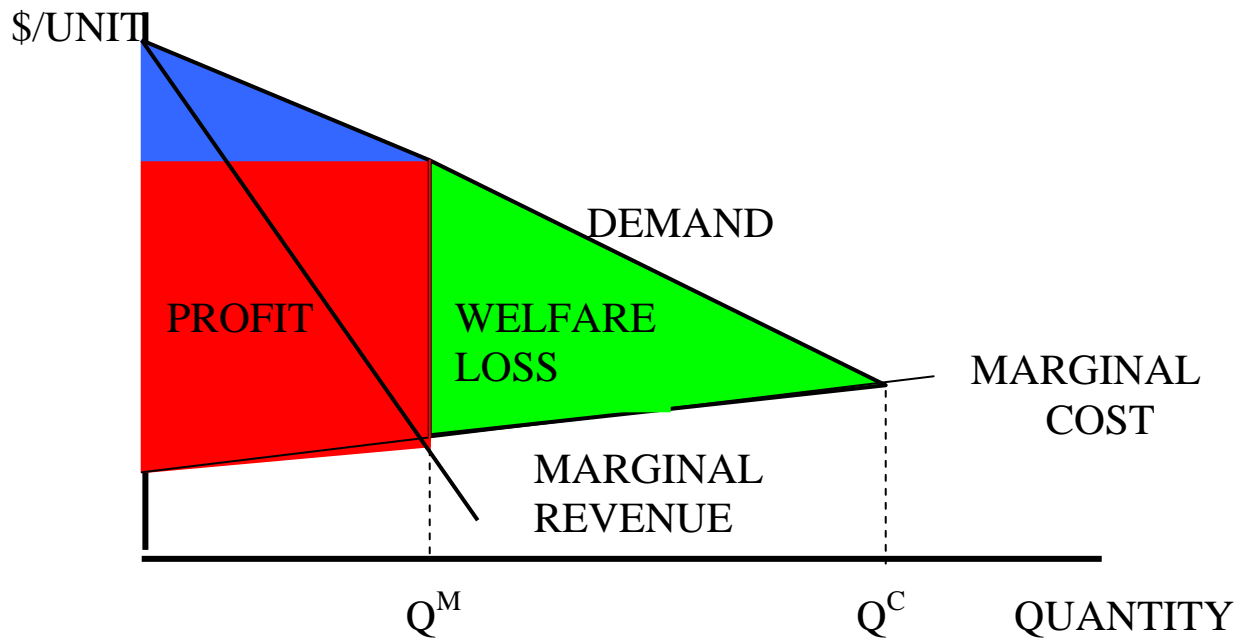
1. TWO-PART TARIFFS
2. QUANTITY DISCOUNTS
3. MARKET SEGMENTATION
4. BUNDLING

## COMPETITIVE VS. MONOPOLY



### B. D. THE DEADWEIGHT LOSS OF MONOPOLY

1. SOCIETY'S PROBLEM
2. THE MONOPOLIST'S PROBLEM



### III. TWO-PART TARIFFS IN DETAIL

CONVENTIONAL MONOPOLY PRICING

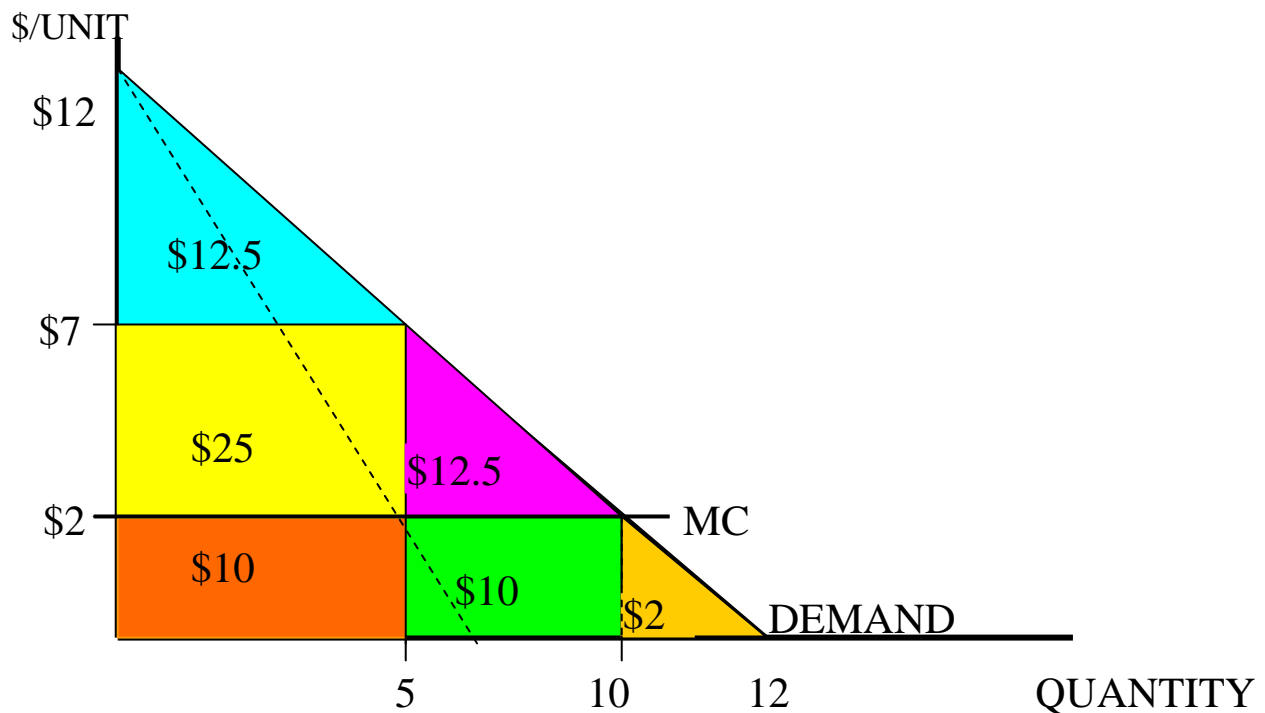
vs

A TWO-PART TARIFF

AT NOSNOWBA VALLEY SKI RESORT

COST OF EACH RIDE UP THE MOUNTAIN IS \$2

TYPICAL SKIER'S DEMAND FOR RIDES:  $P = 12 - Q$   
 $MR = 12 - 2Q$



CONVENTIONAL PRICING: CHARGE FOR INDIVIDUAL RIDES

$P = \$7$ ; #RIDES = 5; AND PROFIT = \$25

STRICT TWO-PART PRICING: PARTICIPATION FEE = \$50

PER RIDE FEE = \$2 = MC

#RIDES = 10; PROFIT = \$50

APPROXIMATE TWO-PART PRICING: LIFT TICKET = \$72

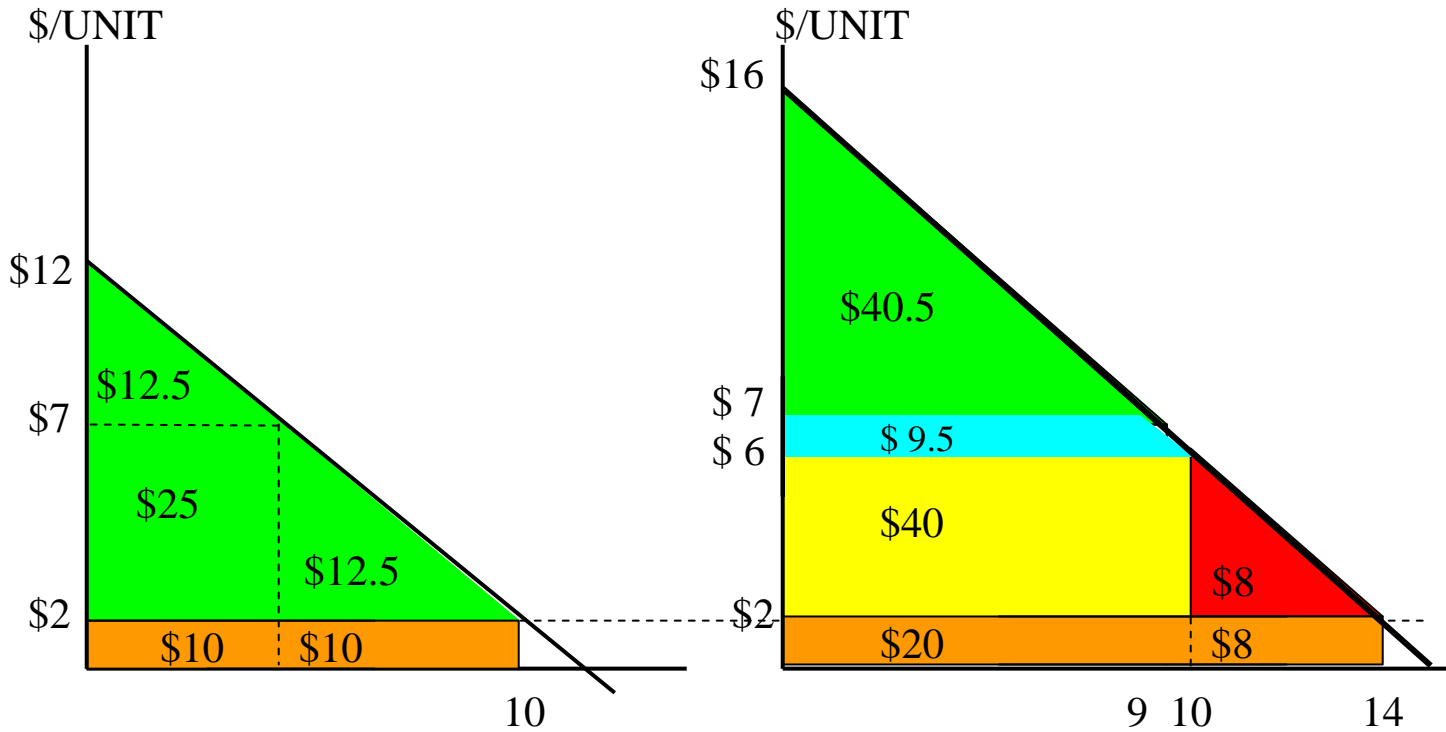
PER RIDE FEE = 0

#RIDES = 12; PROFIT = \$48

**QUANTITY DISCOUNTS  
AT NOSNOWBA VALLEY SKI RESORTS**

**LOW-DEMAND  
CONSUMERS**  
 $P = 12 - Q$

**HIGH-DEMAND  
CONSUMERS**  
 $P = 16 - Q$



**POSSIBLE PRICING SCHEME: OFFER ONLY A 10-RIDE TICKET FOR \$70**

$\Rightarrow$  **LOW DEMAND CONSUMERS WILL BUY THIS PACKAGE AND PAY AN AVERAGE OF \$7 PER RIDE. PROFIT = \$50**

**ALTERNATIVE PRICING SCHEME:**

**NOTE: HIGH DEMAND CUSTOMERS CAN ALWAYS BUY A 10-RIDE TICKET AT  $P = \$70$  AND GET A SURPLUS OF \$40. NASHOBA MUST GIVE THESE SKIERS A SURPLUS OF AT LEAST \$40 ON ANY OTHER DEAL. SO, ...**

$\Rightarrow$  **OFFER A 14 RIDE PACKAGE AT \$86. HIGH-DEMAND CONSUMERS VALUE 14 RIDES AT \$126 AND SO GET A SURPLUS OF \$40 ON THIS DEAL. PROFIT = \$86 - \$28 = \$58. AVERAGE PRICE = \$6.14.**