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 \( LI = \frac{P - MC}{P} = \frac{1}{\varepsilon_d} \)

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
B. D. THE DEADWEIGHT LOSS OF MONOPOLY

1. SOCIETY’S PROBLEM

2. THE MONOPOLIST’S PROBLEM
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

⇒ 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, . . .

⇒ OFFER A 14 RIDE PACKAGE AT $86. HIGH-DEMAND CONSUMERS
VALUE 14 RIDES AT $126 AND SO GET A SURPLUS OF $40 ON THIS