Essential conditions for Price Discrimination

Price discrimination would not be possible unless three essential conditions were fulfilled.

Firstly, the price discriminating firm should be a monopolist. Price discrimination is not possible under perfect competition. Price discrimination is possible under other forms of imperfect competition only if there is some tacit or explicit understanding on the part of all the firms with regard to the price of the product.

Secondly, there should be two or more than two markets for the monopoly product. Further, the elasticity of demand for the product should be different in the different markets at single monopoly price. The monopoly firm shall then be in a position to fix a higher price in the market for inelastic demand and a lower price for elastic demand. It should be remembered that the monopoly firm would not be able to resort to price discrimination if the elasticities of demand in the various markets at single monopoly price are equal because it cannot be expected to increase total profit by transferring output from one market to the other.

Thirdly, there should not be any possibility of resale of the monopoly product from the customer in the low-price market to the consumer in the high-price market. The two types of markets should be segregated from each other. There should be watertight compartments. The markets for services can be segregated more easily than the markets for physical commodities. The reason is obvious. Services cannot be resold. The services rendered by the medical practitioner to the poor patients cannot be resold to the rich patients. Hence the medical practitioner can practise price discrimination.

Price-output determination in Discriminating Monopoly

Now we will discuss price output determination in discriminating monopoly. How does the discriminating monopolist achieve equilibrium? How does he maximize his profits? We will solve these questions by applying the ordinary theory of the simple monopoly firm where there are two or more markets. By applying simple monopoly firm to more than one market, our analysis will, no doubt, become a little complicated but it will not affect the fundamental of the theory. We shall assume that the discriminating monopolist also seeks to maximise his profit and to ensure this, he fixes his out in such a manner as to equat his marginal revenue with marginal cost. He will equalise his marginal revenue and marginal cost in both the markets if he is to maximise his profit (let us assume Market A + B). we further assume that there are many customers in both the markets. we also assume that the monopolists is a monopolist in both the market. Now the question is: How he fix prices and outputs in both these markets so as to earn maximum profit? It is that of a discriminating monopolist is to earn maximum profit then two separate conditions must be fulfilled - Firstly marginal revenue in all the market (two) must be the same. Secondly, the marginal revenue in both markets must also be equal to the marginal cost of the monopolist whole output. It should be remembered that unless these two conditions are fulfilled simultaneously, the discriminating monopolist cannot achieve equilibrium. Now let us analyse these conditions in detail.

The first condition is that as we saw above, the marginal revenue in short MR in all the markets must be the same. we will see this by applying elasticity of demand into our discussion because MR with AR is influenced by elasticity of demand. while we were discussing the condition for the success we saw that monopolist could practice price discrimination only if the elasticity of demand in A + B market were different. If the elasticities are the same in A + B market at single monopoly, the monopolists will not be able to practice price discrimination. ~~Because~~ if elasticities at the single monopoly price are the same in both the markets MR are bound to be equal in two market. This is derived from the formula $MR = AR \times \frac{e-1}{e}$