

2016 Prelim – H2 Economics EQ2 SAMS

- 2 Cheapticket and Orbitz are online firms which give 'Members Only' deals on hotels to users who are logged-in.

Adapted from www.dailymail.co.uk

- (a) Explain the conditions for price discrimination and the possible motivations for the above firms to do so. [10]
- (b) With price discrimination, society tends to suffer. To what extent do you agree? [15]

(a)

INTRODUCTION

Define price discrimination – a firm selling of the same good at different prices not due to differences in cost of production.

BODY

Three conditions must be present:

- (i) Firm must possess market power (to set prices);
- (ii) Firm must be able to separate consumers into different sub-groups and ensure no seepage across sub-groups;
- (iii) The price elasticities of demand of the good are different across the different sub-markets.

Students to use an example to illustrate the necessary conditions above for a firm to practise PD.

Possible motivations:

- To increase revenue and, hence, increase profits (due to same cost incurred)
- Higher market share due to higher quantity demanded (3rd degree PD)

CONCLUSION

The above conditions are necessary for successful PD to be practised in order to achieve the desired goals of a firm.

Level	Knowledge, Application, Understanding and Analysis
L3 (7 – 10)	<ul style="list-style-type: none">- 3 well-explained conditions.- Use of real-life example is needed to obtain full credit.- At least one objective of firm is required.
L2 (5 – 6)	<ul style="list-style-type: none">- 2 well-explained conditions OR 3 conditions but only briefly explained.- At least one objective of a firm.
L1 (1 – 4)	<ul style="list-style-type: none">- 1 well-explained condition OR 2 conditions but only briefly explained.- At least one objective of a firm.

(b)

With price discrimination, society tends to suffer.

To what extent do you agree?

[15]

INTRODUCTION

- State the economic agents of the society – consumers, firms, government
- Goals of economic agents:
 - o Consumers: utility maximisation (consumer surplus)
 - o Firms: Profit-maximisation
 - o Government: maximise societal welfare

BODY

Thesis (consumers, other firms and the government suffer)

- Consumers who face higher prices (2nd degree and 3rd degree) enjoy lower CS than before. Lower utility.
- Increased profitability may encourage/allow firms to grow larger – increasing market dominance. Smaller/weaker firms may not survive should the dominant firm gain greater market power. Start to earn lower/negative profits → shut down leading to possible retrenchment.
- More market power → more market dominance → more severe case of market failure

Anti-thesis (consumers, other firms and the government gain)

- Increased profitability may encourage/allow firms to embark on R&D → DE → more choices for the consumers.
- Govt could gain more corporate income tax → more funds to finance social programmes (equity)
- Other benefits
 - o 3rd degree PD:
 - Richer/more able consumers pay higher price
 - Lower ability consumers pay lower price
 - → helps bridge income gap (cross subsidisation)
 - o 1st degree PD
 - Allow loss-making firms to continue to survive. Hence, consumers continue to enjoy the goods and services.
 - Achieves AE

Level	Knowledge, Application, Understanding and Analysis
L3 (9 – 11)	For a comprehensive and detailed answer that provides a balanced explanation of the benefits and costs of PD to society's stakeholders.
L2 (6 – 8)	For an answer that briefly attempted to explain both the benefits and costs of PD.
L1 (1 – 5)	For an answer that is mostly descriptive and with some inaccuracies or one-sided answer focusing on either the benefits or costs of PD.
E2 (3 – 4)	For a judgement based on economic analysis/adequately substantiated.
E1 (1 – 2)	For an unexplained judgement, or one that is not supported by economic analysis.