

Pricing When Customers Care about Fairness but Misinfer Markups

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Thus, elasticity of demand:

$$\varepsilon^D = \varepsilon_P^D + \varepsilon_{F \varepsilon_{K^P} \varepsilon_P}^D \varepsilon_{K^P}^D$$

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Thus, elasticity of demand:

$$\varepsilon^D = \varepsilon_P^D + \varepsilon_F^D \varepsilon_{K^P}^F \varepsilon_P^{K^P}$$

- **Rule of the game:** make ε^D non-constant, imposing ε_P^D and ε_F^D constant:

$$K = \frac{1}{1 - 1/(\varepsilon_P^D + \varepsilon_F^D \varepsilon_{K^P}^F \varepsilon_P^{K^P})}$$

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- ▶ No

2. Fairness + imperfect information on costs → sticky prices?

- ▶ Customers always interpret a price increase as a cost increase: $\varepsilon_P^{K^P} = 0$
- ▶ No

3. Fairness + imperfect information on costs + misinference → sticky prices?

- ▶ Customers partly interpret a price increase as a markup increase: $\varepsilon_P^{K^P} = \chi$
- ▶ Yes

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- When elasticity of fairness increases, elasticity of demand increases

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- **When perceived markup increases, elasticity of fairness to markup increases**
- When elasticity of fairness increases, elasticity of demand increases
- When elasticity of demand increases, **markup decreases**

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1. Elasticity of fairness increases with markup by assumption:

$$F(K^p) = \frac{2}{1 + (K^p/K^f)^\theta}$$
$$\varepsilon_{K^p}^F = \theta \frac{1}{1 + (K^p/K^f)^{-\theta}}$$

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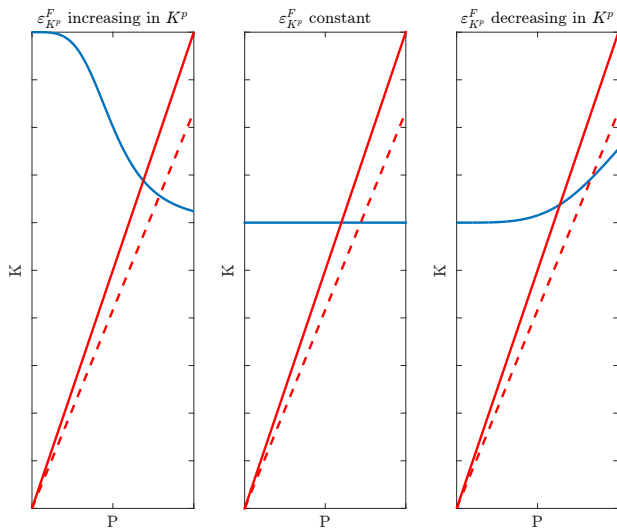
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3. Or decreases with markup?

$$F(K^P) = 1 + (K^P/K^f)^{-\theta}$$
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- Elasticity of fairness **increases** in markup:
 - ▶ Gets even more annoyed at even higher markup
 - ▶ (Extensive margin interpret): more and more customers become angry
- Elasticity of fairness **decreases** in markup:
 - ▶ Gets annoyed at first, then anger plateaus
 - ▶ (Extensive margin interpret): angry ones leave, those who stay don't care

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- Without misinference?
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 - ▶ Ex: I see a price increase; is it at this shop only or at competitors too?

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 - ▶ Ex: I see a price increase; is it at this shop only or at competitors too?
- Without fairness?
 - ▶ Does it matter why customers need to infer costs?
 - ▶ Example: duopoly; Benabou Gertner 1993

Comment 3: What is fairness?

- Fairness or competition: does it matter?
- Competitors' prices define what's acceptable?