

# FAIR PRICING

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Abstract

This paper explores the consequences of supposing that consumers see a firm as fair if they cannot reject the hypothesis that the firm is somewhat benevolent towards them. When consumers can reject this hypothesis, some become angry, which is costly to the firm. The desire to appear benevolent can lead firms to adopt third-degree price discrimination based on the income of different consumer classes while forswearing third-degree price discrimination based on differences in the elasticity of demand. It can also explain why prices seem to be more responsive to changes in factor costs than to changes in demand that have the same effect on marginal cost. Lastly, if consumers experience regret or disappointment when faced by increased prices, the model can explain why prices can be more rigid in response to disasters that increase demand dramatically than they are when there is a less substantial increase in demand. (JEL: E3, D11, E44)