Abstract
We consider a model of firm pricing and consumer choice, where consumers are loss averse and uncertain about their future demand. Possibly, consumers in our model prefer a flat rate to a measured tariff, even though this choice does not minimize their expected billing amount—a behavior in line with ample empirical evidence. We solve for the profit-maximizing two-part tariff, which is a flat rate if (a) marginal costs are not too high, (b) loss aversion is intense, and (c) there are strong variations in demand. Moreover, we analyze the optimal nonlinear tariff. This tariff has a large flat part when a flat rate is optimal among the class of two-part tariffs. (JEL: D11, D43, L11)