Abstract:
How does the price that other consumers pay, affect consumer demand and firms' pricing decisions? We study the effects of a regulation that required Israeli retailers to post on-the-shelf signs indicating the international (cheap) price of a product alongside the price of that product in the local store. We find that prices of products included in the regulation fell by 8%. The price drop is larger for products that were initially more expensive compared to the international price. Following the price reductions, the quantity sold increased. Yet this increase was significantly smaller than a predicted increase based on pre-regulation demand elasticities and the actual price drops. Moreover, the increase in quantity sold is smaller for products whose prices remained expensive vis-a-vis the international price. We use a theoretical model to explain these findings and to quantify the impact of salient unfair prices. We find that a 10 percentage point salient difference between the local and the international price is equivalent to a 1% increase in the price of the product itself.