The Geography of Consumer Prices

Preliminary.

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Abstract

We develop a two-country, multi-region dynamic stochastic industry equilibrium model of microeconomic price setting, in which stores set prices in response to idiosyncratic shocks to productivity. Price adjustment involves a fixed cost. Demand is determined by a regionally representative CES-consumer. Due to transaction costs related to distance and the national border, posted prices and prices perceived by consumers may differ. We apply the model to study how geography determines international price deviations in a unique panel of store-level consumer prices in Hungary and Slovakia. We calibrate structural distance and border parameters, and find that distance matters a lot, while the border has virtually no extra effect.

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