"A Simple Model of Price Dispersion and Price Rigidity"

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Abstract

There are two facts about the world that we take as given: First the “law of one price” is false – one can find many different prices for what appears to be, beyond reasonable doubt, the same good. Second, prices are set in nominal terms and appear, beyond reasonable doubt, to be sticky – some sellers keep their prices rigid when the aggregate price level increases. We shown these phenomena emerge naturally together in a search model. In contrast to theories that assume nominal price rigidities, when they are endogenous, they cannot be exploited by monetary policy, even though money is not neutral. The object of this study is to explain the above in a tractable model of money and search.