Dynamic Price Competition Theory and Evidence from Airline Markets

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We introduce a model of oligopoly dynamic pricing where firms with limited capacity face a sales deadline. We establish conditions under which the equilibrium is unique and converges to a system of differential equations. Using unique and comprehensive pricing and bookings data for competing U.S. airlines, we estimate our model and find that dynamic pricing results in higher output but lower welfare than under uniform pricing. Our theoretical and empirical findings run counter to standard results in single-firm settings due to the strategic role of competitor scarcity. Pricing heuristics commonly used by airlines increase welfare relative to estimated equilibrium predictions.