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Investing in communication: an experimental study of communication in a relational contract setting

Sharon Raszap Skorbiansky

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**Highlights**

- The report studies the effect of introducing cheap talk and truthful talk in a relational contract setting
- Truthful talk improves quality traded when compared to no talk
- Truthful talk also improves total surplus in the market and reduces income inequality
- Cheap talk does not improve quality or social surplus, but reduces the incidence of buyers reneging on the bonus payment
- Traders in cheap talk use the communication channels to send untruthful messages. Sixty-two percent of quality levels shared in cheap talk were reported incorrectly
- Reports have an effect on trading outcomes, even under cheap talk. For example, a buyers offer is less likely to be accepted if they self-report to have defected on payment.

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