Dear referee #1,

Thank you for the helpful contributions to fit the paper. Here, I will offer a short answer for each of the points addressed by you. I do intend to send a reviewed redaction within about two or three weeks.

1) Driscoll and Holden (2004) have found that reciprocity could generate inflation inertia within a range of unemployment rate from 4.7 to 6.5%. Therefore, it would not generate a large unemployment rate such as those often found in disinflation. In contrast, using the job finding rate as the measure of workers' opportunities outside the firm, instead of the unemployment rate, reciprocity generates a cumulative effect in the latter. In the example I use, the unemployment rate peaks at 9,41%.

2) I am upgrading the language inaccuracies mentioned by you, and a native professional proofreader will prepare the final form of the text after I make all the improvements in content that are necessary.

3) Regarding the reflections on retribution versus imperfect monitoring, the desire to reciprocate a kind treatment is generally seem as weaker than the desire to retaliate an unfair treatment. This asymmetry is usually assumed in behavioral labor economics, and this is the case in Driscoll and Holden (2004) – Citations will be made to justify it.

4) Literature – I will do this. I will also justify the reasons for which I have used the data chosen in section 2.2 (you incorrectly mentioned section 1.2). According to my knowledge, the literature does not discuss reciprocity versus sticky information. I will check these particular again and state something about this, and I will explain why I do think the Michigan survey is relevant to this discussion. A profound empirical analysis on this subject would, nevertheless, deserve a specific paper.

5) I will explain and make the suggested changes regarding the figures and equations.
Equation (1): the statement right before the equation indicates that v_t stands for utility, but this will be explicitly said. ϕ and inequality are parameters related to the disutility of not retaliating an unfair treatment – I thought this was clear, but this will also be highlighted.
Equation (2): dw is a first difference of a variable in natural log.
Equation (5) is standard in literature, and, for this reason, it was considered beside the point to deduce it. Of course it would come from a term related with consumption in the utility function, and this can be included in the model.
Equation (6): there should be an "imply" arrow on it, instead of a simple arrow.
Equation (7): $E_{t-1}[P_t]$ should be also on it, instead of simply P_t.

6) Expectations in the model are rational. I have mentioned this on sections 4.3, 5.3 and in the conclusion (in these two latter cases I used the term "consistent expectations"), but I agree I should have mentioned and explained this point in the beginning. This will be done.

7) The utility of consumption is not explicit in the model, but the utility and disutility of effort, of retaliating and of leisure, plus of compensation when the worker is unemployed, are all normalized in relation with the utility of consumption obtained with the real wage. These are the variables/parameters that lead the workers to decide in which conditions the effort shall be zero or one, which is the relevant decision in the model.
This normalization was originally used in Shapiro and Stglitz (1984) model and in the dynamic version of Kimball (1994).
I could have explained this. But I can, instead, include the consumption function explicitly.

8) Explaining how to obtain equation (11) is basically duplicating what was done in Kymball (1994), and this is what I wrote just before the equation was presented. Anyway, here is the demonstration, which I shall add to the paper:

Obtaining equation (11):

Equating $E_{t-1}[V^S_t]$ ad $E_{t-1}[V^N_t]$, and the equations that define them, gives:

(A1) $E_{t-1}[V^U_{t+1}] = E_{t-1}[V^N_{t+1}] - ((1+r)/q)\beta_t E_{t-1}[A_t]$.

leading to the result that β_t influences the difference between $E_{t-1}[V^N_{t+1}]$ and

$E_{t1}[V^U_{t+1}]$. Substituting (A1) and (6) in (8):

(8') $E_{t-1}[V^N_t] = ((\eta - 1)/\eta)E_{t-1}[A_t] - \beta_t E_{t-1}[A_t]$

$$+ b(1 + r)^{-1}\{E_{t-1}[V^N_{t+1}] - ((1 + r)/q)\beta_t E_{t-1}[A_t]\}$$

$$+ (1 - b)(1 + r)^{-1}E_{t-1}[V^N_{t+1}]$$

$$= ((\eta - 1)/\eta)E_{t-1}[A_t] - (1 + b/q)\beta_t E_{t-1}[A_t] + (1 + r)^{-1}E1_{t-1}[V^N_{t+1}].$$

Given (9), $E_{t-1}[V^U_t]$ is
(A2) $E_{t-1}[V^U_t] = \theta E_{t-1}[A_t] + (1 + r)^{-1}E_{t-1}[a_t(V^N_{t+1}) + (1 - a_t)(V^U_{t+1})]$.

Substituting (A1) and (8') in (A2):
(A2') $E_{t-1}[V^N_t] = ((1 + r)/q)\beta_{t-1}E_{t-2}[A_{t-1}]$

$$+ \theta E_{t-1}[A_t] + (1 + r)^{-1}E_{t-1}[a_t(V^N_{t+1})]$$

$$+ (1 - E_{t-1}[a_t])(1 + r)^{-1}\{E_{t-1}[V^N_{t+1}] - ((1+r)/q)\beta_t E_{t-1}[A_t]\}$$

$$= ((1 + r)/q)\beta_{t-1}E_{t-2}[A_{t-1}] + \theta E_{t-1}[A_t] + (1 + r)^{-1}E_{t-1}[V^N_{t+1}] - (1 - E_{t-1}[a_t])/q)\beta_t E_{t-1}[A_t]$$

Equating (8') and (A2'):

$((\eta - 1)/\eta)E_{t-1}[A_t] - (1 + b/q)\beta_t E_{t-1}[A_t] + (1 + r)^{-1}E_{t-1}[V^N_{t+1}]$

$= ((1+ r)/q)\beta_{t-1}E_{t-2}[A_{t-1}] + \theta E_{t-1}[A_t] + (1 + r)^{-1}E_{t-1}[V^N_{t+1}] - (1- E_{t-1}[a_t])/q)\beta_t E_{t-1}[A_t]$

$== > ((\eta - 1)/\eta) = \theta + (1 + b/q)\beta_t + ((1+ r)/q)\beta_{t-1}(E_{t-2}[A_{t-1}]/E_{t-1}[A_t]) - (1- E_{t-1}[a_t])/q)\beta_t$

$== >$ (A3) $((\eta - 1)/\eta) = \theta + \{(1+(b+E_{t-1}[a_t]-1)/q)\beta_t + ((1+r)/q)\beta_{t-1}(E_{t-2}[A_{t-1}]/E_{t-1}[A_t])$

Multiplying both sides of (A3) by $E_{t-1}[A_t]$ and using (6):

(11) $(W_t/E_{t-1}[P_t]) = E_{t-1}[A_t]\{\theta + (1 + (b + E_{t-1}[a_t] - 1)/q)\beta_t\} + E_{t-2}[A_{t-1}]((1+ r)/q)\beta_{t-1}$