

Price Rigidities

An attempt at a new angle

December 21, 2021

David L. Osten¹

This paper tries to bridge the recent findings of a weakening of pass through from wages to prices, especially in manufacturing, to the structural changes in the labor market since 1985 **Abstract**

Keywords Wage Price Pass Through, Wage Price Spiral, Labor Productivity, Wage Productivity Gap, Spatial Wage Differences, Spatial Price Differences

The paper benefitted substantially from helpful comments by Prof. C. Carroll, Prof. L. Ball and Prof. R. Moffitt from the Department of Economics of the Johns Hopkins University. Further, I would like to thank my fellow PhD students for their comments and critical questions.

¹Contact: dosten1@jhu.edu, Department of Economics, 590 Wyman Hall, Johns Hopkins University, Baltimore, MD 21218.

1 The Introduction

The wage price spiral has seen considerable attention in the 80s and 90s in the wake of the high inflation during the 60s and 70s. Since then the interest in the topic has followed the steady decline of the inflation rate. The recent contributions concentrated on explaining how the mechanism of the wage price spiral got muted over time and can therefore explain the surprisingly low inflation rates of the 2000s. Mehra (2000) found that wages only had a significant effect on prices in the high inflation era of the 60s and 70s, but not in the 50s, 80s and 90s. It stands to reason that either lasting periods of high inflation are only observed if the wage price spiral is effective, or that an elevated level of inflation is needed to start the spiral. This distinction is particularly interesting in light of the revived inflation rates in of the 2020s. The big question is, will this start sufficient upward pressure on wages to spin the spiral into action, or are there underlying forces that muted the pass through so that rising prices are not self-reinforcing.

Peneva and Rudd (2015) and more recently Heise, Karahan, and Sahin (2020) found a weakened pass through from wages to prices, which Heise, Karahan, and Sahin (2020) explain by import competition and increased market concentration in the manufacturing sector. Heise, Karahan, and Sahin (2020) do control for total factor productivity (TFP) but not for labor productivity. In light of the structural changes since the mid 80s this might be a flaw in their analysis, as wages have been falling behind labor productivity between 1985 and 2012. Since then they have been stagnating and even slightly declining (see Figure 123). It might be worth exploring how much this wage-productivity gap influences manufacturers price setting decisions.

2 The Model

2.1 Setup

$$\bar{k} = \left[\frac{(1 - \epsilon)\beta^{1/(1-\epsilon)}}{\Xi(1 + \beta)} \right] \quad (1)$$

Just a citation test: Osten (2021); a second citation test: Osten (2013)
else

References

HEISE, SEBASTIAN, FATIH KARAHAN, AND AYSEGUEL SAHIN (2020): “THE MISSING INFLATION PUZZLE: THE ROLE OF THE WAGE-PRICE PASS-THROUGH,” *NBER WORKING PAPER SERIES*, (27663).

Table 1 Microeconomic Model Calibration

Calibrated Parameters			
Test1	Parameter	Value	Source
Test2	Γ	1.03	PSID: Carroll (1992)
Test3	R	1.04	Conventional
Test4	β	0.96	Conventional
Test5	ρ	2	Conventional
Test6	\wp	0.005	PSID: Carroll (1992)
Test7	σ_ψ	0.1	PSID: Carroll (1992)
Test8	σ_θ	0.1	PSID: Carroll (1992)

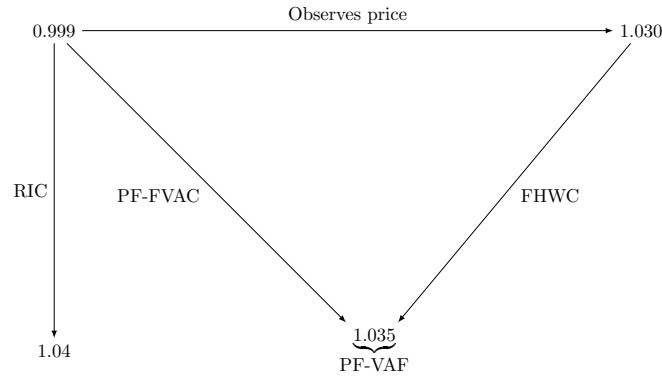


Figure 1 PF Unconstrained Model: Relation of GIC, FHCW, RIC, and PF-FVAC

A first visualization of the model's logic

MEHRA, YASH (2000): "Wage-Price Dynamics: Are They Consistent with Cost Push Shocks?," *Economic Quarterly*, 86(3).

OSTEN, DAVID L (2013): "Test Title," *Journal of Test*, 129, 104185.

——— (2021): "Test Title," *Journal of Test*, 129, 104185.

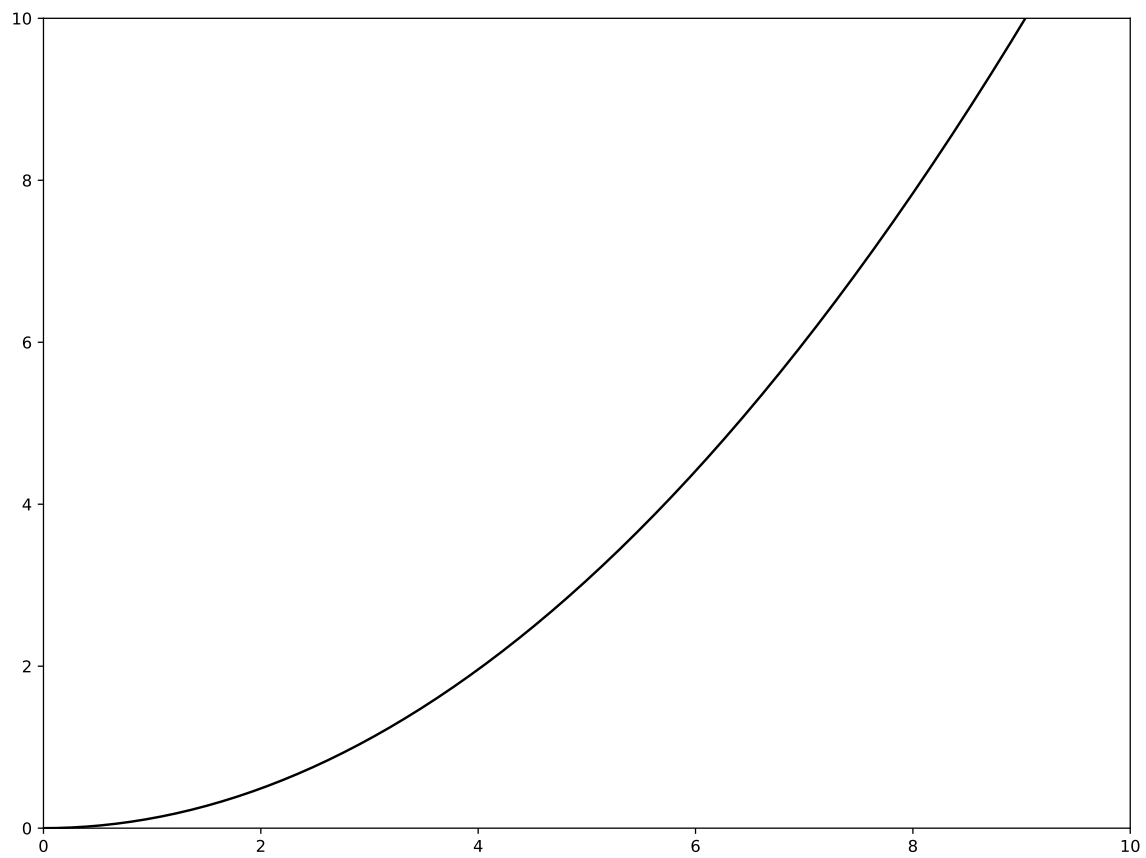


Figure 2 Test Figure from Jupyter Notebook