About Sticky Price

- New Keynesian Economics

Weng Wei

June 2023

"Economic theory has suffered in the past from a failure to state clearly its assumptions." - R.H. Coase 1937

Economic theory have covered:

- Profit-maximising Monopolist
- Competetive Market
- Preferences and Utility
- Consumer Choice
  - budget constraint
- Consumer Demand
- Consumption-Saving Model

What's the assumptions that they all held?

Assumptions

- Market are always cleared
- “Instant”

Can these stand against an empirical test?

If no, why make such assumptions? How would it affect the conclusions?

“The criterion of congruence with reality should have been sharpened - sharpened into the insistence that theories be examined for their implications for observable behavior. Not only where such implications not sought and tested, but there was a tendency, when there appeared to be a threat of an empirical test, to reformulate the theory to make the test ineffective. Economist did not anxiously seek the challenge of the facts.” - Geoge. J. Stigler

Sticky Price

- Prices (and **wages**) are sticky
  - May not changes instantly as circumstance changes

Classic text book example

- Menu cost
    - prices are printed on menu, in order to change the price restaurant need to re-print all the menu, which could be costly


RESTAURANT
Scan the QR-Code
to view the menu

Classic text book example

- Contractual Agreements
  - Long-term contracts for the supply of goods or services often specify fixed prices
  - Wages are normally reviewed once a years or opon change of job

Sounds more reasonable?

Wages

- Increase, sticky?
- Decrease, supter sticky for various reason
  - Economic
  - Social
  - Psychological

Greek debt crisis: “Before the government could lower the wage, itself was taken down.” - Prof Tan Kim Seng

Price are sticky, so what?

- Money Neutrality
  - The stock of money affects only **nominal variables** in the economy such as prices, wages, and exchange rates, with **no effect on real variables**, like employment, real GDP, and real consumption.

Money is NOT neutral!:

- Central Bank & monetary policy are critical

It's unforturnate that economists only come to such conclusion after great depression / stagnation.

Greek debt crisis

- Greek had debt
- Usually, a country could use **monetary** instrument like exchange rate
  - Depreciate own currency to boost export
  - Increase export -> Increase foreign reserve -> Repay the debt
- Greek can’t do all these
  - Greek joined euro zone in 2001
  - Greek government surrender all its **monetary policy** control to EU central bank.
- So, Greek government could only try to convince its people to accept a lower wage
  - It’s super sticky

What’s the sub-title of my presentation?

Evolution of economic theories

- Classical (Neo -> New)
- Neo Keynesian
- **New** Keynesian Economics
  - **Sticky Price** is the critical concept that ditinguish **New** from **Neo**
- …

In general, Keynesian economists advocate government intervention other than believe in “the invisible hand”.

Will there be anyone in society argue that “Sticky Price” is another execuse to give government more power and control the people?

- I hope no.

Besides **monetary** policy, **fiscal** policy is also critical.

Once again, economists only come to such conclusion after GFC - Global Financial Crisis.

Are there any other more mis-assumption in current economic theory?

Our task to find out ^_^

Thank You!