“On Sticky Prices: Academic Theories Meet the Real World”

Blinder, Alan S.

Weiqi Hu and Dylan McKenna

Paper Summary

- Evidence of price stickiness
  - Issue: Walrasian adjustment norm is unmeasured
  - Issue: Prices that actually clear markets might be long-run contract prices rather than spot prices
  - Blinder finds that random sample of GDP reveals a substantial degree of price stickiness
    - Though firms do not typically respond faster to demand shocks than to cost shocks and do not typically raise prices faster than they lower them
- Reasons for Price Stickiness
  - 12 Theories

The Twelve Theories

Table 4.3 The Twelve Theories

Theory Number and Name		Brief Description
B1	Nominal contracts	Prices are fixed by contracts
B2	Implicit contracts	Firms tacitly agree to stabilize prices, perhaps out of "fairness" to customers (Okun 1981)
*B3	Judging quality by price	Firms fear customers will mistake price cuts for reductions in quality (Allen 1988)
B4	Pricing points	Certain prices (like $9.99) have special psychological significance (Kashyap 1992)
*B5	Procyclical elasticity	Demand curves become less elastic as they shift in (Bils 1989; Shapiro 1988)
B6	Cost-based pricing with lags	Price rises are delayed until costs rise (Gordon 1981; Blanchard 1983)
*B7	Constant marginal cost	Marginal cost is flat and markups are constant (Hall 1986)
*B8	Costs of price adjustment	Firms incur costs of changing prices (Rotemberg 1982; Mankiw 1985)
B9	Hierarchical delays	Bureaucratic delays slow down decisions
*B10	Coordination failure	Firms hold back on price changes, waiting for other firms to go first (Ball and Romer 1991)
B11	Inventories	Firms vary inventory stocks instead of prices (Blinder 1982)
B12	Delivery lags, service, etc.	Firms prefer to vary other elements of the "vector," such as delivery lags, service, or product quality (Carlton 1990)

Results

Table 4.4 Ratings of the Twelve Theories

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Rank	Theory Number[a]	Mean Score	Standard Deviation	*t*-statistic[b]	Accept Rate	Premise?
1	*B10	2.77	1.25	1.0	60.6%	100.0%
2	B6	2.66	1.26	0.6	55.5	100.0
3	B12	2.58	1.20	1.6	54.8	77.0
4	B2	2.40	1.26	2.1**	50.5	68.3
5	B1	2.11	1.25	1.8*	35.7	62.2
6	*B8	1.89	1.18	0.4	30.0	64.3
7	*B5	1.85	1.07	0.8	29.7	58.5
8	B4	1.76	1.04	1.8*	24.0	50.8
9	*B7	1.57	1.03	0.1	19.7	48.4
10	B11	1.56	0.97	1.9*	20.9	85.6[c]
11	B9	1.41	0.87	1.2	13.6	100.0
12	*B3	1.33	0.77	—	10.0	21.0

[a]Refer to table 4.3 for descriptions of the theories.

[b]For the hypothesis that the mean score is significantly above that in the next row.

[c]The question was not asked of firms producing services. Thus 85.6 percent is the percentage of these firms that report holding inventories of finished goods.

*Significant at the 10 percent level.

**Significant at the 5 percent level.

Conclusion

- Direct survey evidence indicates existence of price stickiness
- Most popular theory: coordination failure (asymmetric)
- The worst theory: judging quality through price
- Marginal costs are not found to significantly cause sticky prices
- Countercyclically sensitive markups are not very important
- Adjustment costs are more often fixed (menu costs), asymmetric, and an important source of price rigidity for ~40% of the economy
- Survey methodology offers a new avenue of insight