5 Wage and Price Stickiness in Macroeconomics: Historical Perspective*
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INTRODUCTION

There is more to the history of macroeconomics than a series of bilateral conflicts between competing schools of thought, but such debates have been a significant part of the story. Most recently the competing schools have worn the labels 'New-classical' and 'New-Keynesian', and the major issue between them has been the role of money wage- and price-stickiness in generating those more or less regular fluctuations in economic activity which we refer to as 'the business cycle'. For New-classicals, output and employment fluctuations are either responses to shocks to tastes and technology, or to unanticipated shifts in aggregate demand, typically stemming from money supply changes. In either cases though, prices give signals to which quantities respond, and variations in real magnitudes take place precisely because prices change. New-Keynesians emphasise demand-side shocks but, in their view, quantities vary, not because prices vary, but because they do not.

Now, as I have argued elsewhere (Laidler, 1982, Ch. 3), the above-mentioned characteristic of New-classical economics implies a view of the economy in which Say's Law holds true at each and every moment; and just as surely, in New-Keynesian analysis, that Law — that there cannot exist a state of generalised excess demand or supply for all goods and

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services (excepting money) – may be violated for periods of time long enough to matter. Given that ‘everybody’ knows Say’s Law to have been the centreprice of ‘Classical’ economics, and the denial of its universal validity to have been one of the key characteristics of ‘Keynesian’ economics, it would seem at first sight that modern schools of thought have been well named. In this view, the recent renewal of interest in the price stickiness postulates on the part of certain erstwhile exponents of New-classical economics (for example, Lucas, 1989; King 1990) either signals a reaffirmation that Keynesian economics’ alleged reliance on wage stickiness did after all represent an important intellectual advance, and that an intriguing attempt to revive older ways of thinking has, in the end, failed; or it is a sign that macroeconomists are taking an ‘easy’ option by using a postulate from which it is trivially obvious that fluctuations in real variables can be predicted. In this lecture, I shall argue that either view represents a gross distortion of the historical record.

I shall show: that from the very outset, Classical and Neo-classical economists took money wage, and sometimes price, stickiness for granted, though their relationship to Say’s Law, and their potential importance for understanding the cycle, were not recognised until the final quarter of the nineteenth century; that The General Theory, far from placing additional emphasis on the phenomenon, downgraded its significance, and that Keynes treated money wage stickiness, and therefore price stickiness, as facts of life which had to be taken account of in analysing the causes and cures of unemployment, while disputing the Neo-classical view that they were, in and of themselves, an important cause of unemployment; that Haberler (1939), Pigou (1943, 1947) and Patinkin (1948, 1956) extended and clarified certain aspects of Keynes’s treatment of the analytic role of wage-price flexibility; that by the time the Phillips Curve came upon the scene, ideas about secular money wage stickiness, perhaps descended from Marshall, had come to play a key role in macroeconomics and underlay the idea that inflation was largely a matter of exogenous ‘wage-push’; and that, in the ensuing debate, what was characterized as ‘wage-price flexibility’ would, from the later perspective of New-classical economics, better be termed ‘wage-price stickiness’.

This lecture’s implications for the interpretation of modern macroeconomics can, therefore, be summarized as follows. If the criterion is the treatment of money wage and price flexibility, then New-classical economics is new, but it is surely not Classical; and New-Keynesian economics is neither new nor distinctively Keynesian. Moreover, there is nothing inherently ‘easy’ about understanding the effects of wage and price stickiness. If it is now trivially obvious that their presence in an