

Title: Relative Prices and the Trade Cycle: a Classical account of the empirical evidence

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Abstract

In this paper we show that average relative prices in the American manufacturing industry, as observed in business cycles from 1918 to 1990 – inclusive of the 1929's Great Crisis – present a remarkably smaller variation in the range of peak-trough production levels if compared to the behavior of the corresponding output series. In this sense, we extend Schwartz's (1961) test of the business cycle data provided in Mitchell (1941) and, by using a broader and more nearly all-inclusive data base, we benefit from the techniques of the econometrics of co-movements and get results strictly comparable with the original research.

In the second part of the article we critically review the different theoretical explanations for this phenomena. Specially in what concerns the canonical Post Keynesian short run price theory, we argue that any account represented by the notion of a constant-up-to-capacity average (marginal) cost curve can hardly be successful in elucidating this question, as it implies constant margins of profits. We demonstrate that the mark up series for the industry presents a strong pro-cyclical component and after this element is extracted we cannot rule out the hypothesis that the mark up is a random walk process.

Finally, we present a Classical model of theoretical and actual prices based on Shaikh (1998) and show that it provides an empirically robust framework for the explanation of the causes of the movements of relative prices over the cycle and likewise of its relation with the process of income distribution.

References:

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