JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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NAAC Accredited University

Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA (Hons) Economics 2nd Semester

Course – Macroeconomics II

Digital session name – Markup Inflation

Introduction:

The theory of markup inflation is mainly associated with Prof. Ackley, though formal models have also been presented by Holzman and Duesenberry independently of each other. We analyse below Ackley's simplified version of the markup inflation.

The analysis is based on the assumption that both wages and prices are "administered" and are settled by workers and business firms. Firms fix administrative prices for their goods by adding to their direct material and labour costs, and some standard markup which Covers profit. Labour also seeks wages on the basis of a fixed markup over its cost of living.

This model of inflation can lead to a stable, a rising, or a falling price level depending on the markups which firms and workers respectively use. If either or both use a percentage markup, the inflation will progress faster than if either or both fix the markups in money terms.

If each participant fixes prices on the basis of prices he pays, the inflation will be high and of long duration. If one firm raises its prices in order to maintain its desired markup, the costs of other firms are raised which, in turn, raise their prices and this process of raising costs and prices will spread to other firms in an endless chain.

When consumers buy such goods whose prices are rising, their cost of living rises. This causes wage costs to rise, thereby increasing the inflationary spiral. However, the inflationary spiral may come to a halt, if there is a gradual improvement in the efficiency and productivity of labour.

A rise in efficiency and productivity means that there is a rise in wage rates or prices of materials leading to a smaller rise in labour and material costs. But stability in prices may not come if firms and workers appropriate the gains of rising productivity by increasing their markups. If each participant increases its markup by 100 per cent of the gains of productivity increase, the inflationary spiral might continue indefinitely.

According to Ackley, the markup can be based on either historical experience or expectations of future costs and prices. Moreover, the size of the markup applied by firms and workers is a function of the pressure of demand felt in the economy.

When the demand is moderate, the markups may be applied to historically experienced costs and prices, and the price rise may be slow. But when demand is intense, the markups are based on anticipations of future costs, and prices rise rapidly. Thus there can be no inflation without some change in the size of the markup.

This theory can also be applied to cost-push and demand-pull models of inflation. If firms and workers believe that their markups are lower than the required costs and prices, regardless of the state of aggregate demand, they will increase the size of their markups.

Under such a situation, costs and prices rise in an inflationary spiral. This is similar to the cost-push inflation. On the other hand, if firms and workers raise the markups due to increase in demand, markup pricing is related to demand-pull inflation. To conclude with Ackley, “Inflation might start from an initial autonomous increase either in business and labour markups. Or it might start from an increase in aggregate demand and which first and most directly affected some of the flexible market-determined prices. But however it starts, the process involves the interaction of demand and market elements.”

The markup inflation can be controlled by the usual monetary and fiscal tools in order to restrict the demand for goods and increase productivity. Ackley also suggests wage-and-price guidelines or an incomes policy to be administered by a national wage-and-price commission.

It's Criticisms:

Ackley's theory suffers from two weaknesses:

First, the theory gives a very limited explanation of the cause of inflation, especially the motives which compel workers and firms to fix higher markups in the absence of demand conditions.

Course Outcome: The goal of this paper will be to expose the students to the basic principles of macroeconomics. The emphasis will be on thinking like an economist and course will illustrate how economic concepts can be applied to analyse real-life situations. In this course, the students are introduced to money and interest, theories of inflation, rate of interest, trade cycle and growth models.