

THOUGHTS ABOUT THE PHILLIPS CURVE

Paul A. Samuelson, 3 June 2008

The famous 1958 Phillips Curve, which related statistically the level of growth rate of wages or of the general price level to changes in the percentage degree of unemployment, strictly speaking has to be a characteristic of a “disequilibrium economy.” That is to say that an ideal, perfectly competitive barter economy, where all variables are at their market-clearing levels, could not be capable of defining a Phillips Curve. Instead for such an idealized system, a Say’s Law would always be valid in the sense that (except for transition behavior when people are changing jobs) all would-be workers can find some good or bad job at a real wage that is not too high or too low.

So from Bill Phillips’s beginning, when his statistical regressions more or less covered a century of ups and down of the business cycle, implicitly readers are being warned that disequilibrium is a normal, ever-present phenomenon.

This quasi-paradox could be tolerated by economists living through the great post-1929 Depression. In those years, both in the U.S. and (say) Germany, about one-third of the labor force could find no work at all. And, broadly speaking, the two-thirds that did have jobs were lucky rather than being materially more proficient than their unemployed neighbors. That, par excellence, illustrates what disequilibrium economic paradigms really are.

Economic history is not a regimen of what statisticians call a “stationary time series.” Specifically, in the three or more decades after 1930-1939, primarily I believe because of the new international competition from Japan et al., and maybe simultaneous Schumpeterian technological change prejudicial to labor’s imputed sharing, the power of U.S. trade unions became mortally weakened. Every union victory in raising wages or keeping them from falling became a Pyrrhic victory. Such victories had earlier speeded

up the exodus of shoe, paper and textile industries from New England the North to the new South.

Therefore, in a brain-storming stretch, back in the years of Bill Clinton's second term, I came to speculate that the U.S. economy was becoming virtually a Say's Law economy. A cowed U.S. labor force had to perform, once they were out-competed by foreign lower-wage newly productive workers, accept other jobs at maybe 30 percent lower real wages.

This meant that the 1990's differed materially in its remnant of a Phillips Curve from say what prevailed in both the 1950's and the 1970's. Eisenhower's years suffered three NBER recessions in his eight years of office. Union-imposed limits on lowered wage rates exacerbated the amplitudes of those recessions.

Similarly the supply-shocked 1970's differed materially from the present decade's supply shocks. Cost of living guarantees à the 1970's would have no such role to play in the post-Clinton new era. "New era" was my name for the speculation that outsourcing competitors had wiped out much of the "disequilibrium economies" that had prevailed in the 1935-1980 time period.

After November 2008's presumed Democratic landslide, the promises being made by candidates in their bid to route the libertarian lobbyists of the past may revive protectionist fevers; and resurgence of union powers may well restore the Phillips Curve phenomena that were so familiar in the past.

Time pressures preclude my relating the above discussions to the puzzles faced now by central bankers pledged to serious inflation targeting.

Today's inflationary pressures are more *microeconomic* in nature than they are macroeconomic in the sense of the 1970's stagflation. \$100+ per barrel oil may be a permanent thing, rather than being an inevitable consequence of the liberal use of central bank credit aimed to quell financial turmoil and weak investment and consumption spending.

I will await with interest wisdoms from the June Federal Reserve Bank of Boston Chatham conference on the uncertainties outlined above.