BPEA Fall 2007

George A. Akerlof and William T. Dickens Paper:

Why did our previous papers with George Perry find significant trade-offs between inflation and unemployment when inflation is low? The truncation of nominal wages can be considered a wedge. The multiplier of that wedge to obtain the trade-off between unemployment and inflation is the inverse of the slope of the price Phillips curve. That inverse has typically been estimated to be close to two. That would make the trade-off quite large. The paper also explains why, despite low estimates of microeconomic elasticities of demand for labor, this inverse slope is so high. The relevant elasticity of demand that is a component of this slope is instead a macroeconomic elasticity, which is an order of magnitude higher.

JEL classification codes: E1, E3, E5, E6, J3, J6