"बेटी बचाओ, बेटी पढ़ाओ"

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 – Tobin's and Solow's View on Philips Curve

Tobin's View

James Tobin in his presidential address before the American Economic Association in 1971 proposed a compromise between the negatively sloping and the vertical Phillips curve. Tobin believes that there is a Phillips curve within limits. But as the economy expands and employment grows, the curve becomes even more fragile and vanishes until it becomes vertical at some critically low rate of unemployment.

Thus Tobin s Phillips curve is kinked-shaped, a part like a normal Phillips curve and the rest vertical, as shown in Figure 8. In the figure, Uc is the critical rate of unemployment at which the Phillips curve becomes vertical where there is no trade-off between unemployment and inflation. According to Tobin, the vertical portion of the curve is not due to increase in the demand for more wages but emerges from imperfections of the labour market.

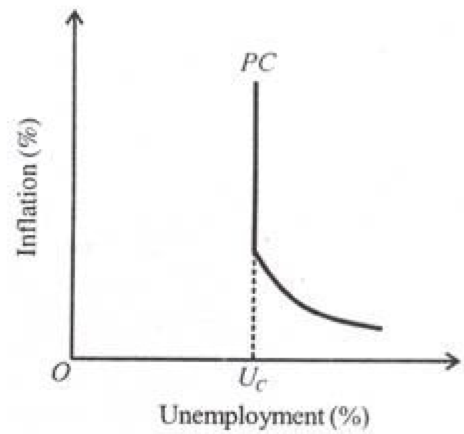


Fig. 8

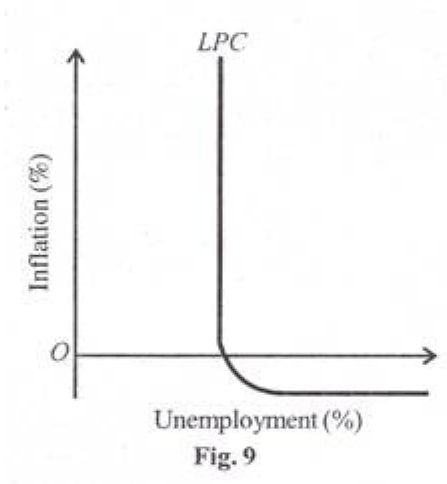
Source: Internet

At the Uc level, it is not possible to provide more employment because the job seekers have wrong skills or wrong age or sex or are in the wrong place. Regarding the normal portion of the Phillips curve which is negatively sloping, wages are sticky downward because labourers resist a decline in their relative wages.

For Tobin, there is a wage-change floor in excess supply situations. In the range of relatively high unemployment to the right of Uc in the figure, as aggregate demand and inflation increase and involuntary unemployment is reduced, wage-floor markets gradually diminish. When all sectors of the labour market are above the wage floor, the level of critically low rate of unemployment Uc is reached.

Solow's View:

Like Tobin, Robert Solow does not believe that the Phillips curve is vertical at all rates of inflation. According to him, the curve is vertical at positive rates of inflation and is horizontal at negative rates of inflation, as shown in Figure 9. The basis of the Phillips curve LPC of the figure is that wages are sticky downward even in the face of heavy unemployment or deflation. But at a particular level of unemployment when the demand for labour increases, wages rise in the face of expected inflation. But since the Phillips curve LPC becomes vertical at that minimum level of unemployment, there is no trade-off between unemployment and inflation.



Source: Internet

Conclusion:

The vertical Phillips curve has been accepted by the majority of economists. They agree that at unemployment rate of about 4 per cent, the Phillips curve becomes vertical and the trade-off between unemployment and inflation disappears. It is impossible to reduce unemployment below this level because of market imperfections.

Policy Implications of the Phillips Curve:

The Phillips curve has important policy implications. It suggests the extent to which monetary and fiscal policies can be used to control inflation without high levels of unemployment. In other words, it provides a guideline to the authorities about the rate of inflation which can be tolerated with a given level of unemployment. For this purpose, it is important to know the exact position of the Phillips curve.

While explaining the natural rate of unemployment, Friedman pointed out that the only scope of public policy in influencing the level of unemployment lies in the short run in keeping with the position of the Phillips curve. He ruled out the possibility of influencing the long-run rate of unemployment because of the vertical Phillips curve.

According to him, the trade-off between unemployment and inflation does not exist and has never existed. However rapid the inflation might be, unemployment always tends to fall back to its natural rate which is not some irreducible minimum of unemployment. It can be lowered by removing obstacles in the labour market by reducing frictions.

Therefore, public policy should improve the institutional structure to make the labour market responsive to changing patterns of demand. Moreover, some level of unemployment must be accepted as natural because of the existence of large number of part-time workers, unemployment compensation and other institutional factors.

Another implication is that unemployment is not a fitting aim for monetary expansion, according to Friedman. Therefore, employment above the natural rate can be reached at the cost of accelerating inflation, if monetary policy is adopted.

In his words, “A little inflation will provide a boost at first—like a small dose of a drug for a new addict—but then it takes more and more inflation to provide the boost, just it takes a bigger and bigger dose of a drug to give a hardened addict a high.” Thus if the government wants to have a genuine full employment level at the natural rate, it must not use monetary policy to remove institutional restraints, restrictive practices, barriers to mobility, trade union coercion and similar obstacles to both the workers and the employers.

But economists do not agree with Friedman. They suggest that it is possible to reduce the natural rate of unemployment through labour market policies, whereby labour market can be made more efficient. So the natural rate of unemployment can be reduced by shifting the long-run vertical Phillips curve to the left.

Johnson doubts about the applicability of the Phillips curve to the formulation of economic policy on two grounds. “On the one hand, the curve represents only a statistical description of the mechanics of adjustment in the labour market, resting on a simple model of economic dynamics with little general and well-tested monetary theory behind it.

On the other hand, it describes the behaviour of the labour market in a combination of periods of economic fluctuation and varying rates of inflation, conditions which presumably influenced the behaviour of the labour market itself, so that it may reasonably be doubted whether the curve would continue to hold its shape if an attempt were made by economic policy to pin the economy down to a point on it."

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.