

## Phillips Curve Model in connection with AD/ AS Model

1. Which correlation is illustrated in the SR Phillips Curve?

Phillips, Samuelson, Solow

- SR relationship btw. Unemployment Rate and Inflation Rate
- Negative Correlation btw. UR and Infl.R
- Economists believed observation to be important regarding economic policy making (monetary and fiscal policy)
- Data seemed to provide evidence that a decrease in UR and simultaneously a decrease in Infl.R or v.v. are impossible

AD/AS Model	Phillips Curve Model - SR
Change AD / AS	Change of the SR Phillips Curve

2. Which correlation is illustrated in the LR Phillips Curve?

Friedman and Phelps

- denied negative correlation btw. UR and Infl. R in LR
- argue that increase in MS leads to inflation, thus effects only nominal variables but not real variables
- natural unemployment rate is more effected by labor policies (minimum wage, bargaining laws, unemployment benefits, job training programs)
- also, increase in LRAS can occur do to better educated work force and improvements in quality of products due to technology - has nothing to do with changes in Ms
- *In the long run, there is **NO** tradeoff between inflation and unemployment as is in the short run Phillips Curve.*
- *Any rate of inflation is consistent with the NRU - Increase in AD beyond NRU → temporarily boost profits, output, employment → nominal wages increase → profits fall → back to original level of unemployment*
- *Therefore, the Long Run Phillips Curve is **VERTICAL**, with only a movement along it (changes in the price level).*
- *When the inflation rate of an economy is left unchecked, it will continually rise.*
- *Rising prices--> workers demand higher wages-->AS decreases-->inflation increases-->unemployment increases-->because there are so many people looking for jobs, wages decrease-->unemployment decreases-->AS increases-->inflation decreases*

AD / AS Model - LR	Phillips Curve Model - LR
Change of LRAS	Change of the LR Phillips Curve