THE INFLATION-BASED 'NATURAL' RATE OF UNEMPLOYMENT
AND THE CONFLICT OVER INCOME DISTRIBUTION*

by

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1. Introduction

In reviewing modern inflation theory H.Frisch (1980) in particular presents a monetarist model which - in a way that is comparable with Vanderkamp's (1975) and Dornbusch and Fischer's (1978) treatment of monetarist ideas - allows an analysis of the interaction among the growth rate of money supply, the growth rate of real income and the rate of inflation. In a revised presentation of this model [see Frisch and Hof (1981, pp.158f.)] it is no longer maintained that this textbook version of inflation and unemployment is "exclusively 'monetarist' because the quantity equation is linked with the real sector through the Phillips curve and Okun's Law." In contrast to this revised characterization of Frisch's model, we shall, however, continue to call it a 'monetarist standard model,' because its Phillips curve in particular is essentially 'monetarist' in spirit, since it is based on the so-called natural rate hypothesis. This hypothesis claims that there is a stable relationship between deviations from monetarist 'natural' unemployment (which is exogenously given) and unanticipated inflation. Furthermore Okun's Law as it is used in this model is based on a given growth trend of potential output, which is an important ingredient in proving several 'monetarist' assertions including the belief in the asymptotic stability of the private sector. Frisch and Hof's (1981) model thus not only summarizes some important results of the so-called 'monetarist debate,' but also includes important components of the monetarist view of the economy. This justifies our designation of this model, despite the fact that today's monetarists may prefer more complicated transmission mechanisms of monetary impulses as well as formally different structural equations - as e.g. a Lucas supply function - with regard to deviations from 'natural' unemployment to derive Frisch and Hof's results [cf. the end of section 2]

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In the following investigation, we intend to show by means of simple modifications of Frisch's standard model that the main building blocks [which are responsible for its monetarist implications], i.e., the 'natural' rate of unemployment and the NUR-hypothesis built upon it as well as the exogenously given trend growth of potential output, must be rejected as overly simplified, misleading and irrelevant to a proper analysis of the current problems of stagflation. To show this, we will present in section 2 a generalized continuous version of Frisch's model and a brief survey of its possible implications. Section 3 then questions the usual interpretation of the inflation-neutral (natural) rate of unemployment by showing that a quite different and endogenous interpretation may be more plausible to explain the high 'natural' rates of unemployment observed in the recent past. Section 4 finally will show that skepticism is justified in respect to the assumed stable relation between 'unnatural' unemployment and unanticipated inflation and will question the sense of assuming a given growth rate of potential output. Both sections derive their new views concerning natural unemployment and its relation to inflation by integrating aspects of the conflict over income distribution into Frisch's model, aspects which are complementary to each other but will not be integrated into a consistent whole in this paper. It is beyond the scope of this paper to provide a convincing and complete alternative to Frisch's prototype monetarist model. Our more modest aim is to question radically the theoretical usefulness of starting from given rates of 'natural' unemployment and potential output growth by assuming certain stable relations with regard to these rates. The problems concerning that part of unemployment not due to unexpected inflation and concerning capital shortage and cyclical accumulation are too important to be treated as exogenous, even in a simple model of stagflation. Yet, endogenizing these significant aspects of real development in our view will imply that a stable relationship of the NUR-hypothesis type can no longer sensibly be assumed.

2. A generalized 'monetarist standard model'

Below we shall introduce a general non-linear version of the monetarist 'textbook' model of Frisch and Hof (1981) - derived from Frisch (1980, II.4) - in order to present the so-called NUR-theorem and other standard monetarist assertions based on the concept of a natural unemployment rate (NUR). The significance of this rate - and of the theorem named after it - will be examined critically in two further paragraphs (§3 and §4), where especially the Phillips curve utilized - the so-called NUR-