The New Keynesian Phillips Curve: a critical assessment

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ABSTRACT

Two main versions of the Phillips curve can be found nowadays in the New Keynesian literature. The first, which is called the “triangular model” (Gordon, 1997), is based on a inertial component, a given (and exogeneous) long-run NAIRU and supply shocks. This version of the Phillips curve was dominant, until the mid nineties, and present also in the New Consensus Model (Blinder, 1997; Taylor, 2000). More recently, the second version, the so-called New Keynesian Phillips Curve, which includes a forward-looking expectations component and another based on deviations from the current markup of firms in relation to its optimum value, has become more dominant. This specification for the Phillips Curve belongs to the New Neoclassical Synthesis model (Goodfriend; King, 1997; Clarida; Galí; Gertler, 1999).

This paper evaluates both these recent interpretations of the Phillips Curve through a simplified model aiming to clarify the central theoretical foundations of these models. It shows the very special assumptions that are required to generate a unique NAIRU in the New Consensus Model and a single long-run equilibrium rate of unemployment in the New Neoclassical Synthesis. In both versions, the long-run neutrality of money are seem to be subject to different serious theoretical problems and, in addition, the empirical evidence does not really corroborate their predictions relating to the tradeoff between inflation and unemployment in the long-run. From this critical assessment of the neoclassical approaches to the Phillips Curve, the paper concludes in favor of a return to older non-neoclassical interpretations of the non neutral long-run Phillips Curve based on the work previously done by Stirati (2001), Serrano (2007) and Palumbo (2008).

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