Title: Textbook Stagflation Theory and Beyond

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ABSTRACT

This paper reconsidered a conventional textbook IS-LM model of wage and price dynamics which seems to imply that the features of such dynamics support by and large monetarist propositions on the medium- and the long-run, and which consequently restricts the validity of Keynesian assertions to the short-run. We first show that this is not true even if the model is taken as initially formulated. The resulting dynamical structure is however often not a viable one. We therefore add a very basic (observed) institutional nonlinearity, given by a kinked Phillips curve in the place of the originally linear one. This implies viability of the model and allows in particular for persistent fluctuations in those cases where the steady state was locally repelling and thus totally unstable in the dynamics without 'kink'. We find that such extended IS-LM-PC dynamics has little to do with the restricted 'monetarist' model of stagflation we started from. We finally show that the discussion of this 'textbook' model type is closely related to modern discussions of Phillips curves and monetary or interest rate policy rules which indeed can be designed such that the simple instability mechanism of the considered dynamics, based on the so-called Mundell effect, can be overcome.

In an outlook to the paper we put the achieved results into perspective, with regard to further prominent macrodynamic feedback chains, of partially stablizabiling nature, such as Rose real wage effects, Fisher debt effects, and financial accelerator mechanisms.

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KEYWORDS: IS-LM-WP dynamics, instability, endogenous flactuations, monetary policy rules.