

# *Macroeconomics and the Phillips Curve Myth* by James Forder

(Oxford: Oxford University Press, 2014)

Reviewed by Selwyn Cornish<sup>1</sup>

In 1958 A.W.H. (Bill) Phillips, professor of economics at the London School of Economics, published a highly influential paper in *Economica* entitled 'The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957' (Phillips 1958). A graph depicting the relation between the level of unemployment and the rate of change of wages (and given some basic assumptions, the rate of change in prices) was soon referred to as the 'Phillips Curve'. What appeared to be remarkable – bearing in mind the structural changes that occurred in the economy, including the labour market, over such a prolonged period – was the stability of the relationship between unemployment and wages/prices.

It appeared to some – Phillips himself was not one of them – that the Phillips Curve provided a menu from which policymakers would be able to choose from various combinations of unemployment and inflation. An article published two years later by Paul Samuelson and Robert Solow seemed to support that idea. Soon it was claimed that policymakers were using the Phillips Curve to implement policies favouring lower rates of unemployment even at the expense of faster rates of inflation. Next were a number of econometric studies which sought to establish whether a Phillips Curve existed in different countries and at different times. Towards the end of the 1960s, Milton Friedman and Edmund Phelps, in separate papers, argued that expectations of increased wages and prices would lead ultimately to the failure of any attempt to trade off higher inflation for lower unemployment; continuous inflation would alter expectations and consequently shift the Phillips curve – perhaps to a vertical position – confounding thereby the possibility of a long-run trade-off. Following Friedman and Phelps, it was

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claimed that a patch-up job was undertaken on the Phillips Curve, including the incorporation of special factors such as changes in trade union behaviour. This subsequent work, however, seemed to confirm that expansionary macroeconomic policy would have little lasting effect on unemployment.

Forder contends that most of this story – what he calls the ‘Phillips Curve story’ – is based on a number of myths. For a start, he asserts that Phillips’s ‘finding of a negative relation between wage change and unemployment was not original, and, in any case, his work impressed few’. Further, Samuelson and Solow ‘were not advocating inflation and practically no one thought they were. The idea that they had been highly influential in promoting an inflationist view is a later invention.’ As to the econometric work of the 1960s, Forder concludes that it ‘was hardly influenced by Phillips at all and certainly was not an attempt to refine his work. With few exceptions, the authors concerned showed no hint of believing their work indicated that inflation would be a sensible policy, and the few who were exceptions mostly had sensible reasons for favouring inflation.’ Forder argues, furthermore, that the ‘expectations argument was very widely known before Friedman or Phelps stated it. There is virtually nothing in the literature of the period to suggest it was ever doubted.’ Finally, he claims that ‘to describe the literature of the 1970s as an attempt to “patch up” Phillips’s work is quite mistaken’.

How did these myths become so widely accepted? While Forder does not attribute ‘the Phillips Curve’ story to any individual, Milton Friedman receives a disproportionate amount of his attention. Thus Forder states that ‘the best-known early statement of it is found in Friedman (1977) – that author’s Nobel Lecture’. What was Friedman’s motivation for propagating the story? Forder’s answer is that, in the Nobel Lecture, Friedman pursued one of his favourite themes, namely, the scientific nature of economics. The ‘Phillips Curve story’, Forder contends, is a ‘story of how the errors that led to policy failure have been put behind us, and how the dissent for which economists were once so notorious was ended. It is a story of how economics became the science it is today. The whole story revolves around the Phillips Curve.’ In short, writes Forder (pp. 216–7), in economics the ‘1970s saw a great war of truth against falsehood; our society against the primitives; or reason, logic, and rationality against superstition, ad hocery, and the denial of market forces ... this story is told, as Friedman ... intended and claimed, as a demonstration of scientific credentials’.

As to how Forder sees his own contribution to economic understanding, he dismisses the idea that it should be regarded simply as a historical curiosity. Rather there are important lessons to be learned from his critique of the Phillips Curve story, including the virtues of accuracy, modesty and humility. Economists, he argues (p. 218):

... should not be telling themselves that the progress of their understanding exhibits the best and most powerful aspects of the scientific approach, they also should not be telling themselves that their modern understanding was forged in professional humiliation. The great failure to understand economic behaviour which supposedly blights our history did not occur ... What the historical record offers as an alternative to a long-run vertical Phillips curve is not an exploitable curve, but doubts about the connection of inflation and unemployment.

This last point raises the question of what Keynes said in *The General Theory of Employment, Interest and Money* about the relation between unemployment and inflation. Here, it could be argued that Friedman was responsible for yet another myth. For according to Friedman (1977: 3), 'the hypothesis that there is a stable relation between the level of unemployment and the rate of inflation was adopted by the economics profession with alacrity. It filled a gap in Keynes's theoretical structure.' There is, in fact, no such gap in Keynes's 'theoretical structure'. To quote from *The General Theory* (Keynes 1936: 296):

... [an] increase in effective demand will, *generally speaking*, spend itself *partly* in increasing the quantity of employment and *partly* in raising the level of prices. Thus instead of constant prices in conditions of unemployment, and of prices rising in proportion to the quantity of money in conditions of full employment, *we have in fact a condition of prices rising gradually as employment increases.* [Italics added]

In other words, the relation between prices and unemployment is not stable. Having made that point, Keynes (p. 297) added:

the object of our analysis is *not to provide a machine, or a method of blind manipulation*, which will furnish an *infallible answer*, but to provide ourselves with an *organized and orderly method of thinking out particular problems*; and, *after we have reached a provisional conclusion* by isolating the complicating factors one by one, we then have to go back on ourselves and allow, as well as we can, for *the probable interactions of the factors amongst themselves. This is the nature of economic thinking. Any other way of applying our formal principles of thought ... will lead us into error.* [Italics added]

*Macroeconomics and the Phillips Curve Myth* is a significant contribution to our understanding of an important issue in modern macroeconomics. It is, in fact, a work of considerable scholarship, based on an exhaustive examination of the literature. Forder appears to have read nearly everything on the subject. The book reveals what hard work historical research can be; wading through hundreds of articles and books, summarising different arguments and weighing up the relative merits of each of the arguments – it is not a matter of simply asserting that someone said something without checking the literature to verify whether that was the case. As a result of his labours, Forder has done the

discipline a great favour by emphasising the point that, when it comes to the various elements of the Phillips Curve story, there is very little that is entirely original and not much that is true.

## References

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This text is taken from *Agenda, Volume 22 – Number 1, 2015*,  
edited by William Coleman, published 2015 by ANU Press,  
The Australian National University, Canberra, Australia.