

# The Power of Macroeconomics

## Lecture Five: Inflation, Unemployment, and Stagflation



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## Purpose Of Lesson

### ■ Examine:

1. Unemployment
2. Inflation
3. Stagflation

## **Unemployment and Inflation**

- Two important problems in macroeconomics.
- In most cases, macroeconomists can solve at least inflation or unemployment.
- When economists solve one problem, they usually worsen the other.

## **The Inflation/Unemployment Tradeoff**

- Expansionary policies stimulate a recessionary economy – but cause inflation.
- Contractionary policies fight inflation– but can trigger unemployment and recession.

## **Keynesianism and Stagflation**

- What happens when an economy faces both high unemployment and inflation?
- Are traditional Keynesian-style monetary and fiscal policies still effective in fighting such “stagflation?”

## **An Inflation-Unemployment Tradeoff?**

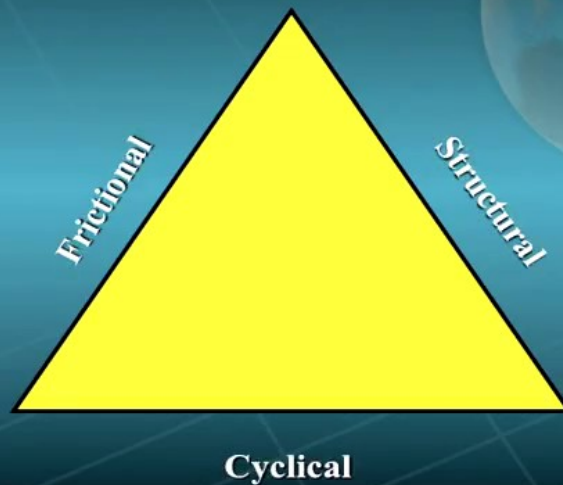
- One of the great macroeconomic debates:

- Is there a “Phillips Curve” tradeoff between unemployment and inflation?
- Or is the Phillips Curve simply a dinosaur concept of a failed Keynesianism?

## Keynesianism vs. Monetarism

- Compare and contrast the Keynesian and Monetarist views of stagflation.
- Illustrate why Supply Side economics emerged in the 1980s as a viable political alternative.

## Three Kinds of Unemployment





## Frictional Unemployment

- The least of the macroeconomist's worries.
- Arises because of movement of people between regions and jobs or through different stages of their "life cycle."



## Frictional Unemployment

- Reflects normal turnover in labor market
- Examples:
  - Students graduate and search for jobs
  - Women reenter labor force after giving birth



## Cyclical Unemployment

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- A much more serious problem.
- Occurs when economy dips into recession.
- Macroeconomists spend most of their time trying to solve it.

## Structural Unemployment

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- A mismatch between available jobs and worker skills.
- Structural unemployment often results when technological change makes someone's job obsolete.
- Examples:
  - The highly-skilled glass blower thrown out of work by the invention of bottle-making machines
  - The specialized auto worker replaced by a robot.

## **Location & Structural Unemployment**

- Structural unemployment can result from a mismatch between the location of workers and the location of job openings.

### **HISTORICAL EXAMPLE**

Oil workers out of work when oil prices plunged despite low unemployment in other parts of the country.

## **Distinction Between Three Types of Unemployment Helps With Diagnosis**

### **KEY POINTS**

1. Cyclical unemployment due to recession can be cured with expansionary fiscal or monetary policies.
2. Structural unemployment requires more targeted policies such as job retraining.