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Keynesian Dynamics and the Wage-Price Spiral: Analyzing and Estimating a Baseline Disequilibrium Model

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Abstract

In this paper, the authors reformulate the theoretical baseline DAS-AD model of Asada, Chen, Chiarella and Flaschel (2004) to allow-following Chen, Chiarella, Flaschel and Semmler (2005)-for its empirical estimation. The version of the model used here exhibits a Taylor interest rate rule in the place of an LM curve and a dynamic IS curve and dynamic employment adjustment. It is based on sticky wages and prices, perfect foresight of current inflation rates and adaptive expectations concerning the inflation climate in which the economy is operating. The implied nonlinear 5D model of real market disequilibrium dynamics overcomes striking anomalies of the old Neoclassical Synthesis and also the rational expectations methodology-the new Neoclassical Synthesis-despite formal similarities as the latter is based on both staggered prices and wages. It exhibits typical Keynesian feedback structures with asymptotic stability of its steady state for low adjustment speeds and with cyclical loss of stability-by way of Hopf bifurcations-when certain adjustment speeds are made sufficiently large. In the second part we provide system estimates, for the US economy, of the equations of the model in order to study its stability features with respect to its various feedback channels from the empirical perspective.

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