Macroeconomic Instability and the Phillips Curve in Italy

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Abstract

The theme of this paper is whether there was a textbook-like Phillips curve in post-WWII Italy. We estimate a standard model of the relationship between inflation and the level of real economic activity over the 1949 to 1998 period and find no evidence of a significant and positive feedback from output to prices. We also estimate similar models for the UK and the US and compare them with the Italian experience. Italy stands out as “distinctive” with respect to the two Anglo-Saxon economies. We attribute this difference primarily to a fiscally dominated monetary policy and a rigid indexation mechanism aimed at protecting wages from inflation. These two institutions contributed to a persistent inflation bias and macroeconomic instability that lasted almost up until the entry of the country in the European Monetary Union.


Keywords: fiscal dominance, inflation, macroeconomic stability, wage indexation, Phillips curve.

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