ABSTRACT

This paper derives the modified Barro-Gordon restrictions of unemployment and inflation as cited in Peter N. Island (1998). It then tries to test empirically the alternative theory of the problem of time consistency of a monetary authority which is explained by the relationship between the variables, namely, inflation and public debt to GDP ratio. It uses quarterly data of the US economy starting from the first quarter of 1969 and ending in the last quarter of 2015. The results show that the data used in the analysis is consistent with the long-run relationship between inflation and public debt to GDP ratio. Thus, it is concluded from the empirical results that the US economy might face a high inflation with no less public debt to GDP ratio in the future.