MACROECONOMICS: THE LONG AND SHORT OF IT

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The macroeconomy seems to experience (1) short-run cycles and (2) long-run growth. Should macroeconomists deal with these issues one at a time? Or should they look for the fundamental macroeconomic principles that underlie both? Opinions differ:

> One major weakness in the core of macroeconomics ... is the lack of real coupling between the short-run picture and the long-run picture. Since the long run and the short run merge into one another, one feels they cannot be completely independent.[1]

> [Trevor Swan's writings serve] as a reminder that one can be a Keynesian for the short run and a neoclassical for the long run, and that this combination of commitments may be the right one.[2]

Is the "lack of real coupling" between the short-run and the long run a cause for concern? Or are these two runs rightly decoupled? Rightly or wrongly, the decoupling and the shift of emphasis–from the long run to the short–began with the macroeconomics of John Maynard Keynes:

> *In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past the ocean is flat again.[3] But if our central controls succeed in establishing an aggregate volume of output corresponding to full employment as nearly as is practicable, the classical theory comes into its own again from this point onward.[4]

Keynes certainly offered us no "real coupling." He offered instead a basis for applying first one set of principles, then another. Keynesian theory and policy are applicable for an economy functioning below its full-employment potential; classical theory and policy are applicable once full employment has been achieved.

In the (Keynesian) short run, considerations of demand imply that current consumption and current investment move in the same direction. Scarcity is not a binding constraint. The economy experiences demand-driven oscillations of both consumption and investment.

In the (classical) long run, considerations of supply imply that, with allowance for ongoing secular growth, current consumption and current investment can only move in opposite directions. Scarcity is a binding constraint. The economy faces a supply-constrained trade-off between consumption and investment.

A major challenge to modern macroeconomics is one of reconciling the following statements.

(1) In the Keynesian short run, C and I move together.
(2) In the classical long run, C and I can only move against one another.
(3) The long run is nothing but a sequence of short runs.

Ludwig von Mises's own reconciliation points the way:

> [W]e must guard ourselves against the popular fallacy of drawing a sharp line between short-run and long-run effects. What happens in the short run is precisely the first stages of a chain of successive transformations which tend to bring about the long-run effects.[5]

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[1] Robert Solow (1997). "Is There a Core of Usable Macroeconomics We Should All Believe In? *American Economic Review*, vol. 87, no. 2 (May), pp. 230-232.

[2] Robert Solow (1997). Entry on "Trevor W. Swan," in Thomas Cate, ed., *An Encyclopedia of Keynesian Economics*. Edward Elgar, p. 594-597.

[3] John Maynard Keynes (1923). *Tract on Monetary* Reform, p. 65.

[4] John Maynard Keynes (1936). *The General Theory of Employment, Interest, and Money*, p. 378.

[5] Ludwig von Mises (1949) *Human Action: A Treatise on Economics*. New Haven: Yale University Press, p. 294.