Finding Another Linkage between the Short Run and the Long Run in a Macroeconomy

by Kazuyuki Sasakura, Waseda University

This paper presents a model which can explain basic aspects of a macroeconomy in the short run and in the long run at the same time. It is based simply on such principles as profit maximization of firms and utility maximization of households. The way the macro model is constructed is much the same as in microeconomics. No new concepts are introduced. The model used is *only one*. Nevertheless, it provides a new insight into the theories of consumption and investment. As an example, the once-famous consumption function controversy is reconsidered with this model, and the relationship between a short-run and a long-run consumption functions is made clear from quite a new point of view.

Recent macroeconomics textbooks adopt the theoretical structure consisting of three basic models, i.e., the *IS-LM* model, the *AD-AS* model, and the Solow model to explain the short run, the medium run, and the long run, respectively. But why are three models necessary for one economy? I do not think that the three-model structure as a whole is theoretically consistent and that macroeconomics is laid on a sound foundation. Therefore, another model should be newly constructed for all macroeconomists.

I do not at all, however, intend to destroy all of them. What can be regarded as useful should be used. My main proposals for a new macro model are as follows:

(1) For the *IS-LM* model, the *IS* part is used, while the *LM* part is abandoned.
(2) The *AD-AS* model is abandoned.
(3) The Solow model is basically accepted.
(4) The production sector is divided into two industries, i.e., the investment-goods sector and the consumption-goods sector.

The model called the Keynes-Solow model is both tractable and trustable in the sense that it is composed of only a few equations and that it can give quite new and consistent answers to important problems in macroeconomics.

References

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