

MACROECONOMICS

Policy and Practice

Second Edition

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Epilogue

**Policy and
Practice:
Where Do
Macroeconomists
Agree and
Disagree?**



Preview

- To understand where the areas on which macroeconomists agree
- To understand where the areas on which macroeconomists disagree
- To discuss where the field of macroeconomics stands today



Where Macroeconomists Agree

- Inflation Is Always and Everywhere a Monetary Phenomenon
- The Benefits of Price Stability
- No Long-Run Tradeoff Between Unemployment and Inflation
- The Crucial Role of Expectations
- The Taylor Principle
- The Time-Inconsistency Problem
- Central Bank Independence
- Commitment to a Nominal Anchor
- Credibility
- Institutions Rule



Where Macroeconomists Disagree

- How Much Time It Takes to Get to the Long Run
 - Classical economists believe that it takes only a very short time to get to the long run because wages and prices are flexible
 - Traditional Keynesians view that it takes a long time to get to the long run indeed because of Keynes's adage that, "in the long run we are all dead"
 - New Keynesian economists, who believe in rational expectations and adopt microeconomic foundations, see the economy as moving to the long run far more quickly than traditional Keynesians who adopt the view that expectations may be slow to adjust because they are adaptive



Where Macroeconomists Disagree (cont'd)

- Sources of Business Cycle Fluctuations
 - Real business cycle theorists see fluctuations in economic activity as solely a result of shocks to long-run aggregate supply
 - Keynesian economists see demand shocks as a major source of economic fluctuations
 - New Keynesian economists see the short-run aggregate supply curve as shifting faster than traditional Keynesians because of rational expectations



Where Macroeconomists Disagree (cont'd)

- The Dangers of Budget Deficits
 - While the majority of macroeconomists see budget deficits as dangerous, those who believe in Ricardian equivalence are much more sanguine about government budget deficits as they do not improve any further burden on future generations



The Future Of Business Cycle Theory

- Our discussion of where macroeconomists agree and disagree suggests that a key topic of future research will be on understanding the sources of price stickiness: Why it occurs and how long it takes prices to adjust?
- Other researchers are looking deeper into expectations formation, such as how it may be rational for firms to adjust prices infrequently
- In the wake of the recent financial crisis, another area of active research is examining how financial disruptions affect the economy