The Steady State

What do we mean by the “steady state” and does it make any sense? Think in macro terms: most economies hum along with a few percentage points of ***growth*** annually, punctuated by ***fluctuations*** of greater or lesser amplitude and duration. Where do these fluctuations come from? In the short run, they may be caused by policy changes – monetary and fiscal policies, regulatory changes, trade policies – and/or by unanticipated events - financial crises, housing bubbles, political upheavals, and on and on. But these are essentially ***temporary*** changes around whatever is the ***long-term trend***.

And where does that long-term trend come from? I am old enough that I studied with Nicky Kaldor, and he was famous for arguing that, in real terms, there are basically ***two sources for*** this long-term ***growth***: ***population growth*** and ***productivity growth***.

So if we strip out the effect of price growth converting our data to ***real*** terms, and of ***population growth*** by converting our data to ***(real) per capita*** terms, the remaining few percentage points of growth must come from ***productivity growth*** owing to technological and other unspecified changes.

Thus, if we take percentage changes (***dlogs***) of our ***real per capita*** data, and subtract the productivity growth trend, the transformed data series will essentially represent the ***short-term fluctuations around the productivity growth trend***. If these are on average zero, then we have found the ***steady state***.