

Chapter 17 of GT

American PKs and Fundamentalist PK think that chapter 17 is the most important chapter in the GT.

There is a difference between chapter 12 and 17

In chapter 12: uncertainty, waves of optimism and pessimism, outguessing other players in the market....

Chapter 17: is also about uncertainty, but it's mainly about the point of equilibrium in an economy that is subject to uncertainty. Chapter 12 PKs want to emphasize instability and disequilibrium (like Shackle). Chapter 17 PKs emphasize an equilibrium methodology (Davidson, Kregel, and Minsky). Neoclassical equilibrium means market clearing. PKs equilibrium means a state of rest with no tendency to Yf.

Kregel: Keynes adopts a shifting equilibrium methodology in chapter 17. For Keynes it is possible that the labor market clears but it is a very special case and very unlikely because of the 3 special properties of money. The main barrier to Yf is that we have this asset (money) that has a liquidity premium greater than its carrying cost.

Keynes's theory of the interest rate: Discussion of own rates

Anything that we can hold through time has an own rate that we can measure in terms of itself.

You can lend 100\$ now and receive 105\$ tomorrow

Interest is the $(105-100)/100$ that's the price of money today for money tomorrow ($i=5\%$)
See the wheat example in Chapter 17.

If you increase the quantity of an asset, its own rate of return will fall.

The asset for which the return falls the slowest; will be the asset that sets the standard (usually this is money except during hyperinflation).

Money has the highest own rate of return (it rules the roost).

Every asset gets a return comprised of 4 components:

$$q - c + l + a$$

q: expected yield of the asset (return we get from holding the asset)

c: carrying cost

l : liquidity premium (it is subjective return we get from remaining liquid).

a : Appreciation or depreciation

Cash: high l , no q , and no c .

Bond: no c , some q , high l

Capital equipment: high c , high q , and no l .

In equilibrium all assets will have the same expected returns (looking forward into the future).

If an asset has a demand price higher than its supply price then this asset will get produced. But as we increase production of this asset, its return will fall and becomes equal to the returns of all other assets before we reach full employment. Because the expected returns on all assets become equalized, and become equal to the expected return on money before full employment.

$MEK = MEM$ or interest rate, before we reach full employment.

Why is it that money tends to have the highest return?

Why is it that the return on money doesn't fall as fast as the return on other assets as its quantity is increased?

1. Small elasticity of production: when money is in high demand, no labor is directed to producing it (unlike capital assets)
2. Almost zero elasticity of substitution: as the value of money increases, people will want to hold more of it and not substitute it.
3. Zero or low carrying cost: $l - c > 0$

The special characteristics of money make the MEM too high. On page 235: "unemployment exists because people want the moon."

It is more likely that $MEK = MEM$ before full employment.

A monetary economy is an economy that has an asset with $l - c > 0$

A non-monetary economy does not have such an asset

In the past, land used to be such an asset. (Land kept communities poor, now it's money that keeps community poor).