5 Macroeconomics of Rationing Equilibria

5.1 INTRODUCTION

From a Keynesian point of view, the assertion that policy is neutral decrees the failure of a scientific programme that could also explain every possible level of employment, not only natural full employment. The debate between schools highlights this failure because it forces us to consider the n.c.m. as the final stage of a gradual process which started with the Keynesian principle of effective demand and ended with the monetarist natural rate of unemployment. Moreover, the natural-rate-of-unemployment hypothesis precludes the concept of involuntary unemployment, so the very existence of unemployment equilibrium becomes debatable and policy invariance appears to be a mere variation on the theme of the natural rate of unemployment.

The possibility that the Keynesian point of view might be outmoded motivated Keynesians to try to refute the n.c.m. We can see these attempts in at least three approaches.

The first is a frontal attack on the neutrality of stabilisation policy. It suggests verifying the solidity of natural-rate models by changing some of the basic assumptions. There is now extensive literature demonstrating that whether policy is neutral or not depends upon the particular assumption made (Fischer, 1977 a, b; Barro, 1977; Taylor, 1980; Buiter, 1983; Pesaran, 1984, 1987; Marini, 1985).

The second approach reconceives the concept of involuntary unemployment. It proposes various macroeconomic re-elaborations of the labour market in a partial equilibrium approach. These re-elaborations differ from the neoclassical elaboration of the labour market and do not assume the continuous market clearing hypothesis (see Baily, 1974; Aziariadis, 1975; Malcolmson, 1981; Aziariadis and Stiglitz, 1983; Hart, 1983; Pissarides, 1985; Rosen, 1985; Taylor, 1987 a, b).

The third approach elaborates general equilibrium models of involuntary unemployment. It uses a Walrasian general equilibrium framework to elaborate models of non-Walrasian equilibria based on sound microeconomic foundations but antithetical to those of n.c.m.
In this chapter we shall deal only with the third approach. We shall put forward a simple, rigorous analysis of the disequilibrium theory, better known as the theory of non-Walrasian equilibria or of quantity rationing equilibria. Agents' actions, which are now considered standard in the rationing equilibria approach, were formerly regarded as disequilibrium actions in a Walrasian framework (Patinkin, 1965; Clower, 1965; Leijonhufvud, 1968) because they were assumed to be performed by agents when prices differed from those of the Walrasian general equilibrium. This explains why the theory is also called the theory of disequilibrium.

The theory of rationing equilibria is both a bridge between microeconomics and macroeconomics and an aggregate theory of involuntary unemployment. In addition to explaining Keynesian unemployment, it explains another form of mass unemployment which is admitted by the classical theory. This other, classical, unemployment is created when firms do not sell their current output; it is not caused by insufficient effective demand but by low profits, because it is not worthwhile for the firms to sell all they can produce.

The chapter is organised as follows.

Section 5.2 deals with the idea that involuntary unemployment is a consequence of a demand constraint on production (Patinkin, 1965).

Section 5.3 considers the dual-decision hypothesis and the distinction between notional and effective demand and supply (Clower, 1965).

Section 5.4 considers the idea of involuntary unemployment as a consequence of constrained dynamic adjustment processes (Leijonhufvud, 1968).

Section 5.5 contains further observations.

Section 5.6 describes the basic microeconomics of agent behaviour and combines arguments of sections 5.2, 5.3 and 5.4 in a single framework consistent with the general economic equilibrium approach.

Section 5.7 deals with different types of rationing equilibria according to a generalised version of Malinvaud's prototype (1977).

Section 5.8 extends the static model of the prototype to an intertemporal context which includes price and quantity expectations.

Section 5.9 deals with the effects of rational expectations on equilibria.

Section 5.10 reconsiders the static model in a simple aggregate demand–supply scheme.