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PRICE FLEXIBILITY AND INCONSISTENT SYSTEMS

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Perfect competition defined as the structural framework that brings about perfect flexibility of absolute (homogeneity of zero degree of excess-demand functions) and relative prices does not necessarily imply full employment.

1. SAY's LAW (1) $\sum_{i=1}^{n-1} p_i D_i \equiv \sum_{i=1}^{n-1} p_i S_i$ does not imply the excess-demand equations:

$$(2) \quad X_i = 0 \qquad i = 1, \ldots, n-1.$$

If the n-1 'real' goods are split into two groups α and β, Say's law allows $S_i \neq D_i$ provided

$$(3) \quad \sum_{\alpha} p_{\alpha} X_{\alpha} = \sum_{\beta} p_{\beta} X_{\beta}$$

2. Flexibility of relative prices will be considered to be perfect, when the excess-demands and supplies under Say's law are reduced to zero:

$$(2) \quad X_i = 0 \qquad i = 1, \ldots, n-1.$$

3. Perfect flexibility of money prices, however, is not sufficient for nil aggregate excess-demand, when money enters the utility function.

Pigou has argued that a positive partial derivative $S_p > 0$ is sufficient to wipe out total excess supply. Patinkin has shown[p] that this condition might be insufficient.

Pigou's argument, limited to consumption expenditures may be generalized to apply to aggregate expenditure. It might be assumed that the investment partial derivative be negative:

$$(4) \quad I_p < 0$$

4. Nevertheless, Patinkin's objection still applies:

$$(5) \quad \lim_{p_i \to 0} \sum_{i=1}^{n-2} p_i D_i \leqslant \lim_{p_i \to 0} \sum_{i=1}^{n-2} p_i S_i$$

(n-2 refers to the 'real' goods in the system below)

An excess-supply $\to -X^D > 0$ occurs namely when an inconsistency arises between the monetary and the 'real' equations:

X^D, X^S, Y : Homogeneous in p

B, M : Non-homogeneous in p

$$\begin{cases} (6)\ X^D = G(Y,r) \\ (7)\ X^S = \eta \\ (8)\ X^D = X^S \\ (9)\ Y = X^S \end{cases}$$

$$\begin{cases} (10)\ B(r,p,Y) = 0 \\ (11)\ M(r,p,Y) = 0 \end{cases}$$

X^D: aggregate expenditure

Y : national income

r : interest rate

X^S: aggregate supply

η: a constant

(10): bonds function

(11): money function.

The money or the bonds equation might determine a value for r that is larger than the one consistent with $X^D = \eta$.

This is an introduction into the "economics of coercion"......

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