KEYNES' FINANCE MOTIVE:

SOME THEORY AND EVIDENCE

An examination of the theoretical role of the finance motive in the theory of liquidity preference; of some of the implications of this role for the interaction between the real and the monetary sectors, with some cross-spectral and regression analysis tests of its empirical significance using Australian data.

by

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SUMMARY

This thesis examines (i) the theoretical role of the finance motive in Keynes' theory of liquidity preference and (ii) the implications of this role for the interaction between the real and monetary sectors. In addition, cross-spectral analysis and regression analysis of Australian data are used to test the significance of this role.

Chapter 1 defines the finance motive, explains the difference between it and the transactions motive, and identifies the critical element of finance demand. Chapter 2 considers the liquidity preference-loanable funds debate which occurred immediately after the publication of the General Theory and which formed part of the general review and criticism of that book. It has two objectives: the first is to trace the development of the finance motive and the second is to examine the perspective of the finance motive in the context of this debate.

Chapter 3 is a review of Paul Davidson's 'revival' of the finance motive. In common with others who have considered the finance motive, Davidson does not, at least in his formal statements of Keynes' liquidity preference function, distinguish between transactions demand and finance demand. A specification of the demand function for money which embodies this distinction is introduced in chapter 4. Variants of this function are used in all of the subsequent chapters.
In chapter 4 this function and its advantages are explained; it is compared with the alternative specification of Davidson and of A.G. Hines, and it is incorporated into an IS and LM framework.

The liquidity preference-loanable funds debates can be divided into that which took place immediately following the publication of the General Theory and those which took place in the 1950's and 1960's. In the first part of chapter 5, the role of the finance motive in these latter debates is considered, thus extending the examination begun in chapter 2. In the second part, the specification of the demand function for money introduced in chapter 4 is used as the basis for a formal statement of the theory of liquidity preference with which to compare the theory of loanable funds.

In chapter 6 the available evidence, adduced in the main by Milton Friedman, and by Friedman and Anna Schwartz, on the cyclical relationships between monetary and expenditure variables is considered. This evidence is compared with the implications for cyclical relationships that would follow from a Keynesian liquidity preference function which explicitly includes finance demand as an argument.

The results of cross-spectral tests on Australian monetary and expenditure data are reported in chapter 7. These tests are primarily designed to extend the evidence on cyclical timing relationships between monetary and expenditure
variables and, by including a proxy for finance demand, to present evidence on the perspective of the finance motive in these relationships.

In chapter 8 various models of the demand function for money are modified by including proxies for finance demand. The parameters of these functions are estimated using Australian quarterly data with a view to discovering (i) whether the proxies are significant, (ii) the extent to which their inclusion improves the explanatory power of each model, and (iii) whether the proxies are robust in the sense of maintaining significance and explanatory power in a variety of models.