Speculation and liquidity preference: from Keynes to Kaldor and back

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Abstract

The speculative demand for money has virtually disappeared from mainstream economics. This is partly due to the definitive departure of contemporary macroeconomics from its Keynesian origins, but there is also another more specific reason. The speculative demand for money is commonly seen as an obsolete notion in the context of modern developed economies.

The basic argument to support this point of view is that innovation has produced complex and sophisticated monetary and financial markets, in which there exist several instruments that are as liquid and riskless as money. Therefore, there are no longer rational reasons to demand money as a store of value in alternative to less liquid and riskier assets. Money is demanded only for the transactions and precautionary motives. A functional inverse relation between the interest rate and the demand for money is maintained by making the transactions and precautionary demand also depend on the rate of interest.

This approach to the speculative demand, although developed in a non-Keynesian context, poses a question also for Keynesian analysis. The question is whether the notion of speculative demand for money can still play a significant role in a more complex and sophisticated monetary and financial context than that considered by Keynes in *The General Theory*, in order to simplify his analysis and convey his essential ideas more clearly.

In the paper, this issue is considered in the light of an episode in the development of Keynesian macroeconomics. In 1939, Kaldor published an article on speculation in which he criticized some aspects of Keynes theory of money. In particular, Kaldor carried out his analysis by assuming that speculators do not regard money as an alternative to their holdings of long-term securities; short-term securities are the alternative. Kaldor, differently from Keynes, explicitly considered securities of different maturity and the term structure of interest rates.

Kaldor's contribution was an important attempt to develop Keynes's analysis by considering financial markets closer to the reality of advanced economies. But the response to Kaldor from other Keynesians was mostly negative. In particular, Joan Robinson and Richard Kahn criticized Kaldor's approach by adopting an analytical framework that is essentially the same as in *The General Theory*, with speculators who demand money as an alternative to securities. Positions similar to that taken by Robinson and Kahn remained dominant in the Keynesian orthodoxy, with the result that the analysis did not develop to adequately take account of significant features of the working of financial markets in advanced monetary economies.

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