

Money Non-neutrality: An Alternative Approach

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Abstract

This paper provides an alternative approach to money non-neutrality. Specifically, it modifies the monopolistic competition model developed by Blanchard and Kiyotaki (1987), in such a manner that an increase in nominal money balances has a positive effect on real economic activity, without any assumption of nominal rigidity being imposed. This non-neutrality result arises from a pecuniary externality that people want to consume a wider variety of goods as the price level becomes higher. In the presence of that externality, an increase in nominal money balances raises the price level, which induces people to consume a wider variety of goods. This, in turn, activates some idle abilities to produce differentiated goods, increasing the aggregate output, thereby improving economy-wide resource allocation. In fact, monopolistic competition is not essential to this non-neutrality result, although the presence of monopoly power has a positive effect on resource allocation when the supply of nominal money is sufficiently small.

Keywords: non-neutrality of money, pecuniary externality, love for variety.