Is demand for money the same as demand for liquidity?

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Keynes's definition of money

- For Keynes, assets can be ranked according to their degree of liquidity. The set of the most liquid assets is defined as 'money'.
- Thus, the demand for money amounts to the demand for liquidity.
- Keynes's definition of money can be misleading.
- The assets within the set 'money' do not have the same attributes.
- Not all the assets in the set 'money' are standard of value, means of payment or medium of exchange.

An alternative

- There is an alternative approach, which can be traced back to Kaldor (1960) and Hicks (1989) and, partly, to Keynes himself (Keynes 1971).
- Money is crucial because is the economy's standard of value and the final means of payment.
- Money is a liquid asset, but not all liquid assets are money.
- What is money is established through a social and historical process.
- What is liquid is established by the market in a certain given context.

Kaldor's alternative

- Kaldor developed his analysis along the lines expounded above. In particular, he criticized Keynes's liquidity premium (Sardoni 2007).
- The long-term rate is not determined by the supply of long-term assets and the demand for liquid funds (money + bills).
- The interest rate brings to equality demand and supply of money only if one refers to the short-term rate and money denotes only what is used as a means of exchange.
- As for the long-term rate, what has to be considered is not the speculators' demand for liquid funds but their supply of long-term assets (Kaldor 1960, pp. 41-2).

An alternative: demand for money

1. Demand for money is strictly defined as demand for the medium of exchange and as demand for the means of payment (related to money as the standard of value).
2. There is no significant demand for money as a store of value.
3. Liquidity preference is expressed by an increase in the supply of illiquid assets.
4. If there is a decrease in the economy's liquidity preference (i.e. there is an increase in the demand for illiquid assets) there can be an increase in the demand for money. If transactions in financial markets are carried out through credit, a decrease in the liquidity preference implies an increase in the quantity of money strictly defined.

An alternative: demand for liquidity

- Keynes, in chapter 12 of *The General Theory* (Keynes 1936) gives a magisterial illustration of the role and importance of liquidity in capital markets.
- The possibility to transform illiquid assets into more liquid assets is fundamental for modern capitalism. This does not normally imply demand for money.
- Once we get rid of the demand for money as demand for liquidity, the analysis of the role of banks can be developed, also by following Keynes's indications (Keynes 1971).
- It is then possible to reconcile, at least to a certain extent, the circuitist approach (e.g. Graziani 2003) and the Keynesian theory, at least in its Minskyan approach (e.g. Minsky 1975).

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