ENDOGENOUS BANKING MARKUP, DISTRIBUTIONAL CONFLICT AND CAPACITY UTILIZATION

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ABSTRACT

This paper develops a post-keynesian dynamic macromodel of capacity utilisation, distribution and conflict inflation, in which the supply of credit-money is endogenous. Nominal interest rate is determined by banks as a markup over the base rate, which is set by the monetary authority. Over time, banking markup falls with firms' profit rate on physical capital, while the base rate rises with excess demand in the goods market under full capacity utilisation. A rise in the profit rate on physical capital raises firms' ability to serve outstanding financial obligations, lowers their perceived risk of default and, therefore, leads to a fall in the banking markup. The base rate, in turn, is raised by the monetary authority whenever an excess demand in the goods market cannot be accommodated by an increase in the degree of capacity utilisation, that is, when productive capacity is being fully utilised.

Following the post-keynesian monetary tradition, banks are supposed to operate with excess reserves, or at any rate attempt to increase their deposits when their loans increase, and the monetary authority, as lender of last resort, is assumed to make liquidity available to banks at the base rate. The supply of money is thus endogenous at the given nominal interest rate, which is anchored to the base rate through the banking markup.

When the economy is operating with excess capacity, the equality between desired investment and saving is brought about by changes in capacity utilisation, while inflation is fully determined within a framework of conflicting claims on income by firms and workers. While firms' desired markup is positively related to the nominal rate of interest (because firms also have to make interest payments out of their

markup income), workers' desired real wage is positively related to their bargaining power in the labour market, which is the stronger, the higher the level of activity. Capacity utilisation, in turn, is positively (negatively) related to the real wage (nominal interest rate). Once full capacity is reached, however, the inflation rate is also determined by whatever excess demand may prevail in the goods market at the given price.

Regarding dynamics, it is seen how restrictive are the stability conditions of the long-run equilibrium solution of the system having the real wage and the nominal interest rate as state variables. Once the cases of excess capacity and full capacity utilisation are combined, in turn, it becomes possible the emergence of multiple equilibria and endogenous cyclical fluctuations of the relevant variables.