Keynes' Business Cycle Theory: A New Formulation*

Jumpei Tanaka**

The University of Kitakyusyu

Abstract

The purpose of this paper is to formulate Keynes' view regarding the business cycle by using a simple macro-dynamic model based on the intertemporal optimization behavior of firms' investment decisions under output constrained according to demand. We demonstrate that under certain assumptions regarding a firm's expectation modification behavior Keynes' insight with respect to the business cycle may be properly formulated, *i.e.*, the theory that economic fluctuations are caused by optimistic soars in the marginal efficiency of capital and their inevitable collapse. We also show that the "long-run" steady state of our model when the labor market clears basically corresponds to the steady state of the standard neoclassical growth model, but that introducing wage flexibility into our model destabilizes the economy by worsening unemployment.

JEL Classification : D50, D90, E12, E30

Keywords : Keynesian Economics, Business Cycles, Wage Flexibility, Intertemporal Optimization of Investment Decisions

---

* I thank the many participants at the workshops at Kobe University and the Japanese Society for Post Keynesian Economics for helpful comments. Of course, any errors remaining are my own.

** E-mail: j-tanaka@kitakyu-u.ac.jp