Inflation, Endogenous Growth, Transaction Costs, and Varying Discount Rates

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Abstract

This paper explores the relation between inflation and economic growth using the transaction costs model with a socially determined discount rate and a linear production technology. Even when the labor decision is inelastic, this paper demonstrates that inflation affects the endogenous growth with nonconstant time preferences. In particular, if the degree of impatience is increasing in the economy-wide average ratio of total assets (the sum of capital and money) to consumption, then zero rate of the money supply could achieve the maximized endogenous growth; the relation between inflation and economic growth is hump-shaped. The numerical examples confirm such a hump-shaped relation, but the impact of inflation on economic growth is quantitatively small.

Key words: inflation; endogenous growth; transaction costs; varying discount rates; hump-shaped relationship

JEL classifications: E5; O42

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