

IN DEFENSE OF THE FINANCE CONSTRAINT

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Abstract

Simple models of monetary trade commonly impose a finance constraint on expenditure. It is often suggested that this finance constraint is artificial - a result of money's being the only asset, of the absence of credit, and of the special time structure of such models. This paper shows that the finance constraint on aggregate expenditure remains in force when other assets and credit are introduced and when the time structure is generalized to allow overlapping income periods of differing lengths. Most of the objections to the finance constraint are shown to involve fallacies of composition.

There are economists to whom a constraint of the form $pc < M$ (in units $\$/t < \$$) must appear unthinkable. R. E. Lucas, Jr. (1980)

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