

Accepted Manuscript

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PII: S0022-0531(17)30098-4
DOI: <https://doi.org/10.1016/j.jet.2017.09.006>
Reference: YJETH 4695

To appear in: *Journal of Economic Theory*

Received date: 12 December 2016
Revised date: 11 September 2017
Accepted date: 14 September 2017

Please cite this article in press as: Burdett, K., et al. A new suggestion for simplifying the theory of money. *J. Econ. Theory* (2017), <https://doi.org/10.1016/j.jet.2017.09.006>

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A New Suggestion for Simplifying the Theory of Money*

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October 5, 2017

Abstract

We propose a new search-theoretic model of monetary exchange with indivisible assets, based on price posting instead of bargaining, and incorporating noisy search. This yields some familiar results, plus a lot more. The model admits multiple steady states due to the self-referential nature of liquidity. It admits cyclic, chaotic and stochastic equilibria, and compared to bargaining versions, the dynamics are more general and have better microfoundations. It generates price dispersion, with interesting efficiency implications, plus sticky prices and rational inattention. Parametric examples yield closed-form solutions. Based on these results, we suggest this should become a benchmark model in monetary economics.

Key words: Money, Search, Dynamics, Dispersion

JEL nos: D83, E50, E44

*For input we thank Chao Gu, Ben Lester, Peter Norman, Allechar Serrano, Lucas Herenbrueck, and Yu Zhu, plus audiences at NYU, Wisconsin, Chile, INCAE, Getulio Vargas, Newcastle, Lisbon, the 2016 African Search and Matching Conference, BCCR, the Philadelphia Fed and the St. Louis Fed. Burdett acknowledges support from the James Joo-Jin Kim Chair at the University of Pennsylvania. Trejos acknowledges support by FMECA. Wright acknowledges support from the Ray Zemon Chair in Liquid Assets at the Wisconsin School of Business, and thanks the Economics Department at the University of Chicago for their hospitality, where we worked on this project during Fall 2015. The usual disclaimers apply.

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