

Animal spirits of competitive markets and long-run growth

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Abstract

This paper uses a simple model with an endogenous discount rate and linear technology to investigate whether a competitive equilibrium has a higher balanced growth path (BGP) than the social planning solution and whether the BGP is determinate or indeterminate. The implications are as follows. To start with, people with an instinct to compare themselves with others have an endogenous discount rate. In turn, this instinct affects the economic growth rate in a competitive market economy. The competitive market economy also sometimes achieves higher economic growth than a central planning economy. However, market economy outcomes occasionally fluctuate because of the self-fulfilling prophecy or animal spirits.

Keywords: animal spirits, sunspot equilibrium, endogenous time preference, endogenous growth

JEL classifications: O10, O40, P10

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