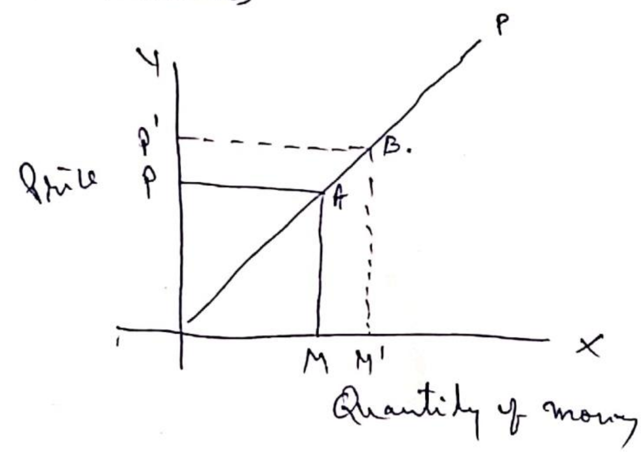
B.A.I

Value of Money

The Purchasing power of money is called the value of money.

Relation between quantity of money and its price level. There is ~~dire~~ positive relation between quantity of money and price level. Both go in the same direction. ~~Higher the level of~~ An increase in the quantity of money, its price level also increases



Elassical economists say

$$MV = PT$$

or $$P = \frac{MV}{T}$$

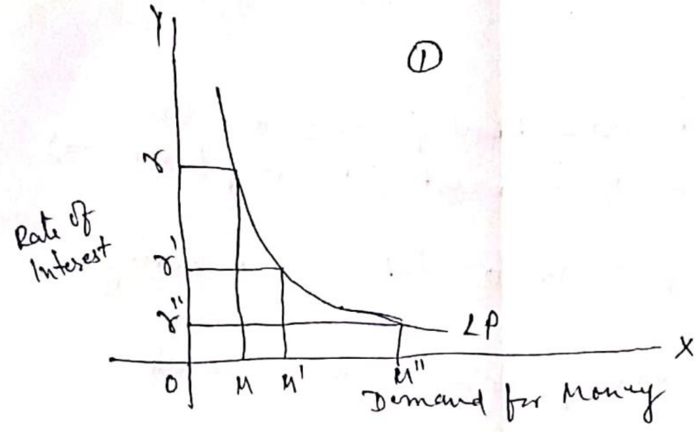
$$P = \frac{MV + M'V'}{T}$$

M' = Bank Deposits
V' = velocity of circulation of Rupees.

PT – demand for Money
MV – Supply of Money,

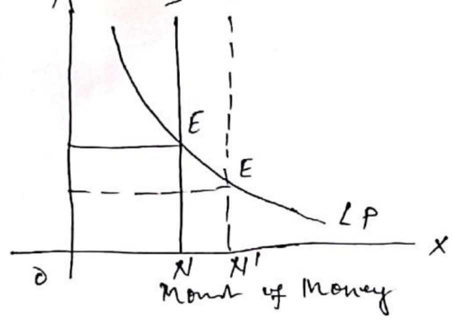
Assumptions.

1. velocity remain stable
2. Total Transaction remains the same
3. No interdependence P, V, T
4. Long period,



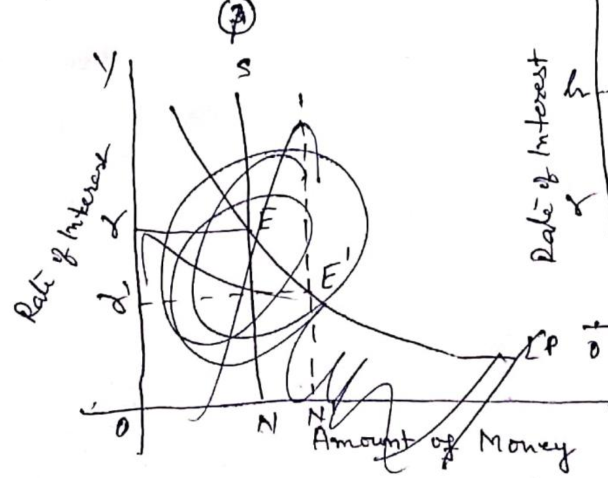
(2)

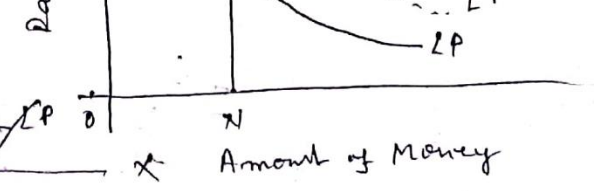
Determination of Rate of Interest : Interaction of Liquidity Preference and the Supply of Money.



Equilibrium between Demand for and supply of Money

(3)





The classical Theory of The Rate of Interest

Rate of Interest is determined by the demand for ~~it~~ and supply of savings.

= It was propounded by the old and classical economists like, Marshall, Pigou, Cassels, Walras, ~~Taugi~~ Taussig and Knight.

= According to this Theory the rate of interest is determined by the demand and supply of capital.

It should be noted that the classical Theory refers to saving as real saving and to investment as real investment.

= Real saving refers to those goods which instead of being consumed are employed for productive purposes. Real investment refers to the actual production of a new piece of capital – a machine, a workshop etc.

Demand for capital (Investment schedule)

The demand for capital arises on accounts of its productivity. But capital is not equally productive in all its uses. In some uses, it is more productive than in others.

= Since the supply of capital is scarce in relation to its demand, it is always employed in those uses where its return is comparatively high. If ~~the~~ its supply increases it is put to less productive uses. This means that the marginal productivity of capital diminishes as more and more of it is used for production. ~~This means that marginal productivity of capital~~

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The Transactions Motive

The transactions motive relates to the demand for money for the current transaction of individual and business exchanges.

= Most of the people receive their incomes by the week or the month while the expenditure goes on day by day. A certain amount of ready money is kept ~~for~~ in hand to make current payments.

= The businessmen and the entrepreneurs also have to keep a proportion of their resources to meet current needs of the various kinds, — (Business Motive)

Precautionary Motive

Precautionary Motive for holding money refers to the desire of the people to hold cash balances for unforeseen contingencies.

Individual — sickness, accidents,
Businessman — For raw-materials etc.

Speculative Motive

The speculative motive for holding money refers to the desire to hold one's resources in liquid form in order to ~~make~~ take advantages of market movements regarding the future changes in the rate of interest.

= The demand for money under speculative motive is a function of the current rate of interest, increasing as the interest rate falls and decreasing as the interest rate rises.

criticisms.

1. Based on the Assumption of Full Employment. (Less demand)

2. Ignores changes in Income Level.

3. Wrongly Assumes Independence of Saving and Investment.

4. Savings out of current Income not the only Source.

5. Only a Real Theory. – It takes only the real factors into consideration. It neglects other monetary influences.