Money
How money developed
Definitions
Functions
Value of money
Graphical presentation
Assumptions
Both equation's description
Criticism
Role of money in the economic system

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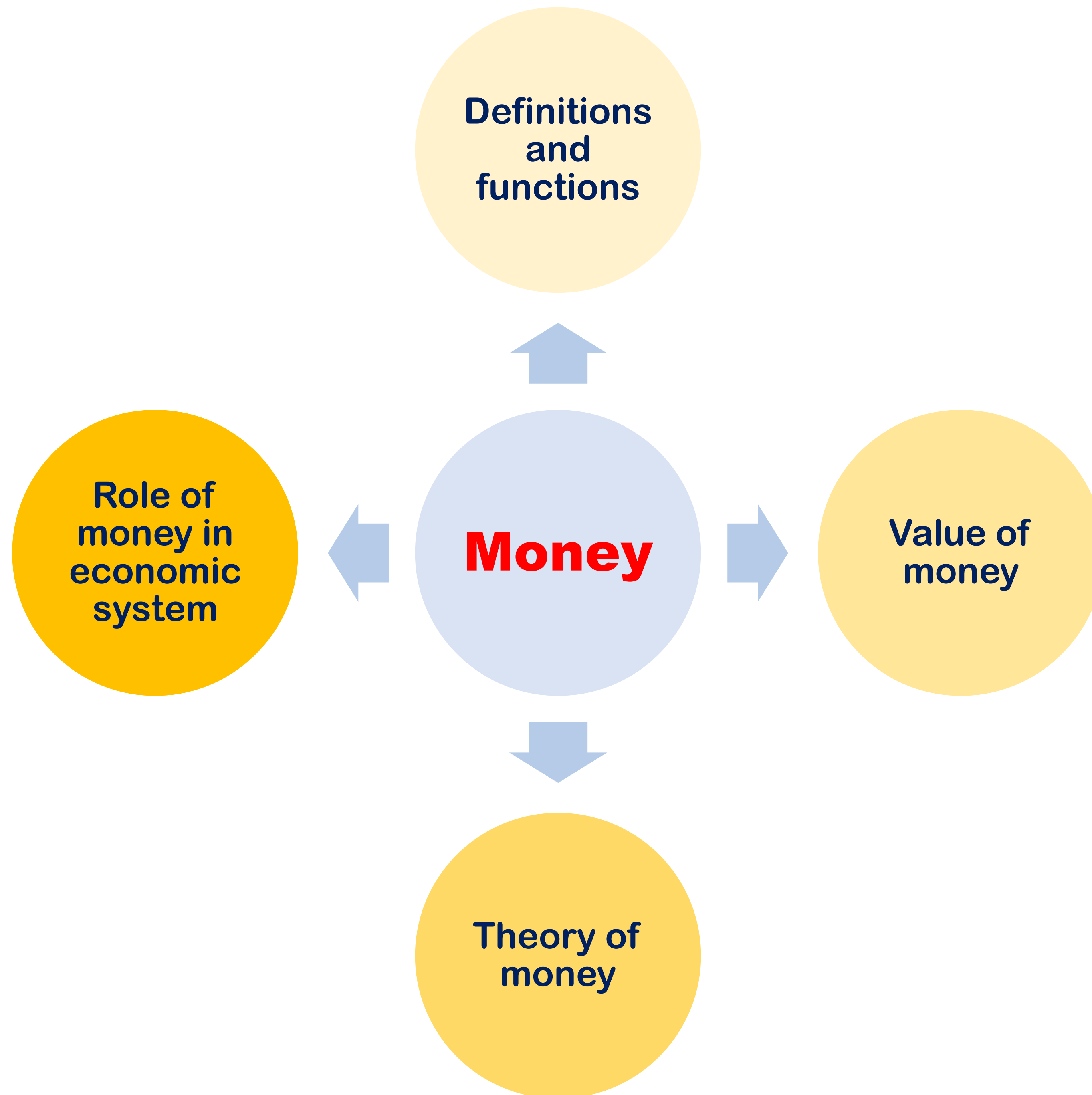
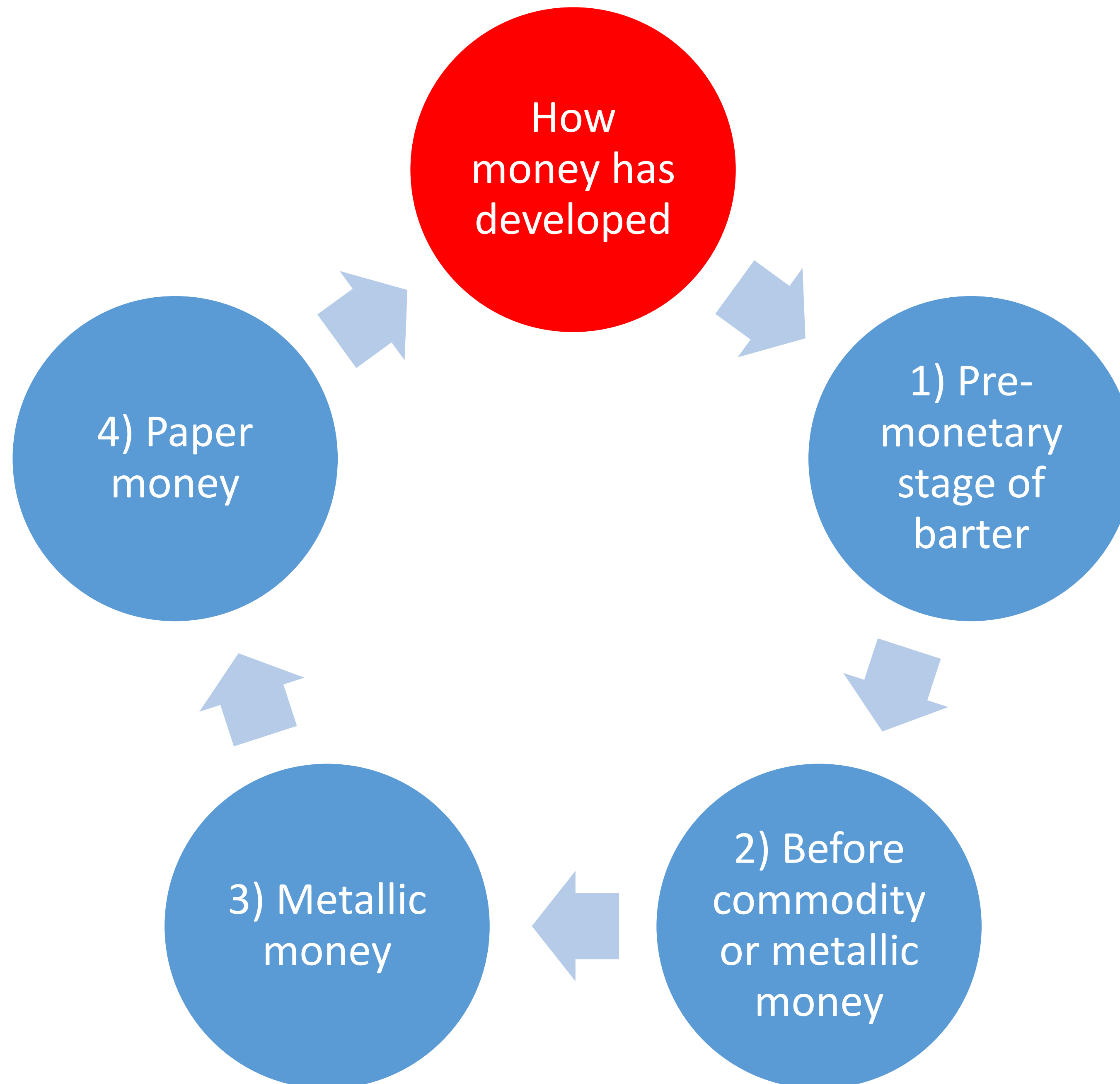

Definitions and functions
Role of money in economic system
Money
Value of money
Theory of money


How money has developed
1) Pre-monetary stage of barter
2) Before commodity or metallic money
3) Metallic money
4) Paper money

Definitions

- “Money is what money does”

  Walker

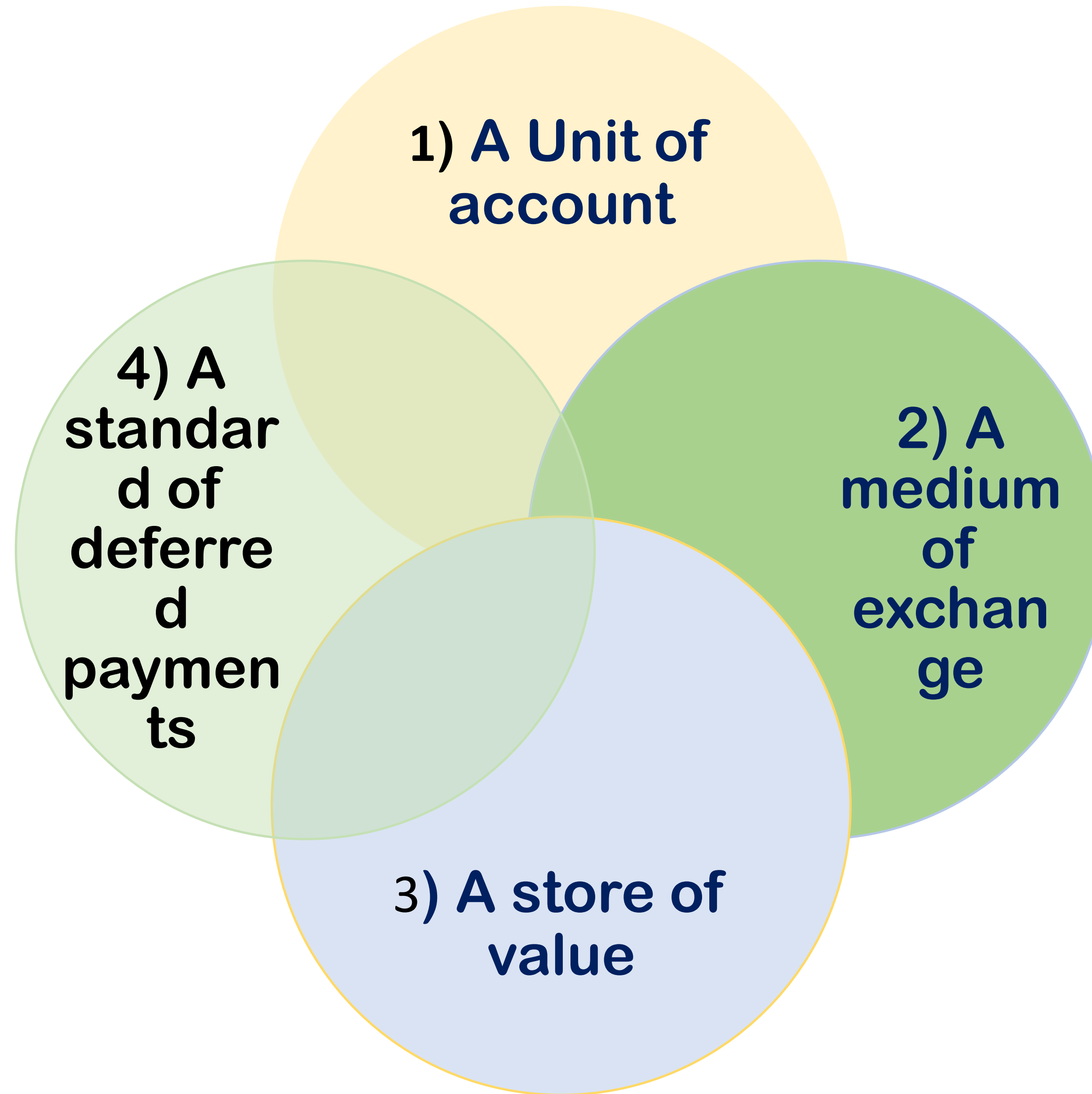
- “Anything that is generally acceptable as a means of exchange (as a means of settling debts) and which at the same time acts as a measure and as a store of value”

  Crowther

- “Money is that by the delivery of which debt contract and price contract are discharged and in the shape of which a store of general purchasing power is held”

  Keynes

Functions:



Value of money

"The value of money without qualification is almost meaningless" Crowther

"By the value of money we mean the amount of things in general which will be given in exchange for a unit of money"

D.H. Robertson

$$V_m = \frac{1}{P}$$

V_m = Value of money

P= Price

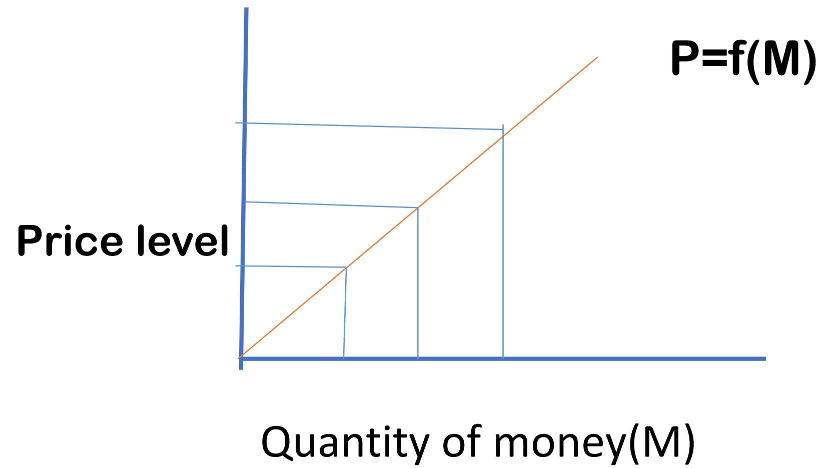
Means value of money is reciprocal to general price

$V_m = D_m = S_m$

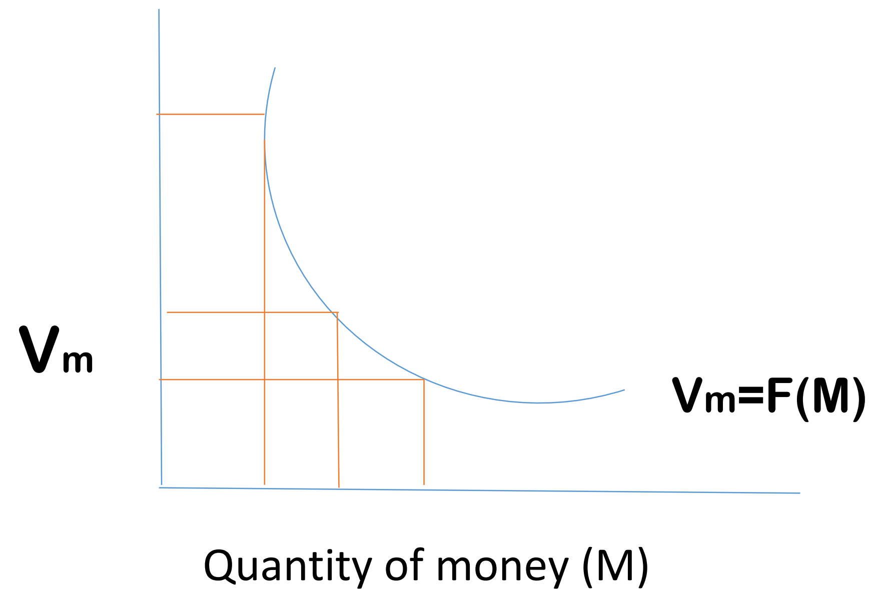
D_m = demand for money, S_m = supply for money

Transaction approach or cash transaction approach

- $P = f(M)$



- $V_m = \frac{1}{P}$



- “The value of money, other things being the same, varies inversely as its quantity; every increase of quantity lowers the value and every diminution rising it is a ratio exactly equivalent.”

  J.S.Mill

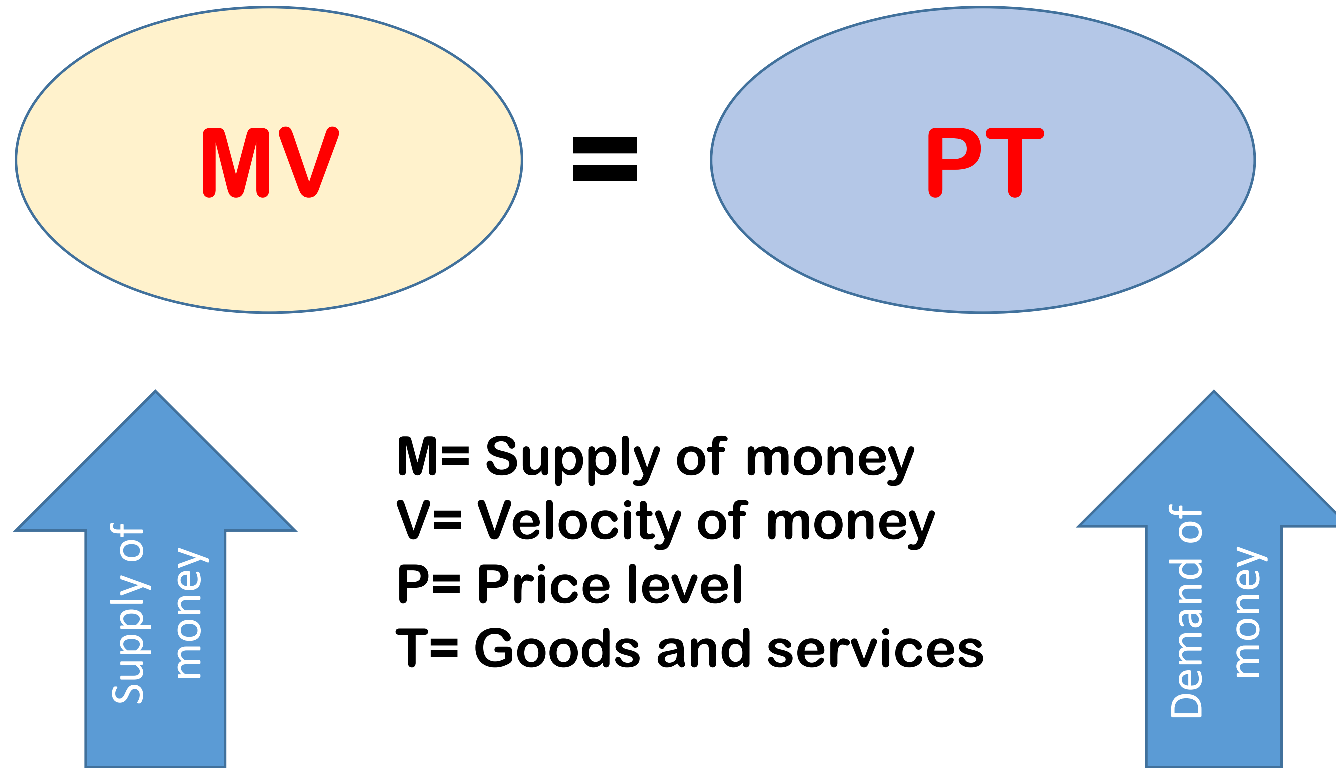
- “Double the quantity of money, and other things being equal, price will be twice as high as before and the value of money one half, the quantity of money and, other things being equal prices will be one half of what they were before and the value of money double”

  Taussing

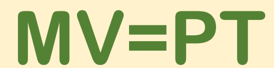
Fisher's Transaction approach Assumptions

- Price level is a passive factor
- T in equation is a constant
- V in equation is a constant
- Direct relationship between M and M'
- Money is only a medium of exchange
- Constant velocity of money

- **Fisher's transaction approach to the quantity theory of money is explained with the following equation of exchange.**



Irving Fisher’s modified equation of exchange



$MV+M'V'=PT$

M′ and V′ are constant

M′= credit instruments

V′= velocity of money M′

If PT=MV+M′V′

Than

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

Or $\frac{1}{P}$ **=** $\frac{T}{MV+M'V'}$

Supply of money ∝ Price level

M∝ P

Criticisms of the Quantity theory

- It is based on false assumptions
- A simple truism
- M is related to point of time
- V is related to period of time
- Long term perspective
- Reject the velocity of goods and services
- It focus only supply side of money

Role of money in the economic system

- Money is the pivot around which the economic science clusters. Marshall
- It removed the evils of barter system
- It is basis of modern market economy
- Money helps the state to evaluate the economic activities.
- Money promotes productivity and economic growth
- Money as precautionary motive
- Money as speculative motive