M.A. ECONOMICS: SEM-II

CC-8 : MODULE -1

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FRIEDMAN RESTATEMENT OF QUANTITY THEORY OF MONEY:

Milton Friedman in his essay – "The Quantity Theory of Money—A Restatement" (1956). In his restatement he asserts that " the quantity theory is in the first instance a theory demand for money. It is not a theory of output, or of money income, or of price level". The demand for money may be from the ultimate wealth owning units. For them money is one kind of asset, one way of holding wealth and it is identical with demand for a consumption services i.e. holding the money gives utility to the consumer. Money is also demanded by the productive enterprises, for them money is a capital good, a source of productive services that are combined with other productive services to yield the product that the enterprises sell. Friedman analysed that wealth can be held in numerous form and affected by same factor as the demand for other asset

a) Total wealth (permanent income)

b) relative return on asset(which incorporate risk)

c) The taste and preference of wealth owning units

According to Friedman wealth can be held in different forms and analysed 5 of them :—money ,Bond ,Equities , Physical non – human goods ,human capital. Each form of wealth has a unique characteristic of its own and a different yield either explicitly in the form of interest, dividend, labour income or implicitly in the form of services of money measured in terms of P, and inventories.

1. Money: It include currency, demand deposit, and time deposit which yields interest on deposits.

2. Bonds: It is a claim to a time stream of payment that are fixed in nominal units

3. Equities: It is a claim to time stream of payment that are fixed in real units.

4. Physical Non- Human goods : These are inventories of producers and consumer durable.

5. Human Capital: It is the productive capacity of human beings.

The Present discounted value of these expected flows from these five form of wealth constitute the current value of wealth expressed as: W=y/r. Here W represent the current value of total wealth and r is the rate of interest. This equation shows that wealth is a capitalised income.

<u>Friedman expresses Demand function for money for an individual wealth holder as-</u>

$M_d/P = f(y, w, , r_m, r_b, r_{e,}; \frac{\Delta p}{p}; \mu)$

Where, $M_{d/}/P$ =real money balances

W = fraction of wealth in non- human form

r_m =rate of return on money

r_b = rate of return on bond

r_e =rate of return on equity

μ = any variable other than income which may affect utility attached to the service of money

$\frac{\Delta p}{p}$ = expected rate of change in prices of goods.

Features of Friedman Demand for money:

1. Friedman treated money as one type of asset, in which wealth holders can keep a part of their wealth

2. According to him, demand for real money balance (M_d/P) is directly related to permanent income(Y) and indirectly related to returns from bonds, stock(equities), and goods and expected rate of inflation.

3. Income Elasticity of demand for money is greater than unity.

4. In the long-run demand for money function is stable and is relatively interest- inelastic.

Difference between Keynes'and Friedman Approach:

1. Keynes emphasized current income as the main determinant of demand for money, while Friedman emphasized on wealth ,both human and non human wealth as the main determinant of money.

2. Keynes has regarded money demand function as unstable while Friedman considered it as stable over time.

3. Keynes has concentrated on money vs. bond choice but Friedman analysed the wide substitution among bond, equities, and durable goods.The changes in alternative rate of return may lead to shift from money to bond equities, or other durable asset.

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