UNIT-V STABILIZATION POLICY

Stabilization Policy

Money

Definitions:

1. **Money:** A medium of exchange, a unit of account, and a store of value.
2. **Types of Money:**
    - **Fiat Money:** Currency without intrinsic value that is used as money because of government decree.
    - **Commodity Money:** Money that has intrinsic value, like gold or silver.

Demand for Money

1. **Transactionary Demand:**
    - Money held for everyday transactions.
    - **Keynesian View:** Depends on income level.
2. **Speculative Demand:**
    - Money held for speculative purposes, to take advantage of future changes in the interest rate.
    - **Keynesian View:** Depends on interest rate expectations.

Supply of Money

1. **Bank's Credit Creation Multiplier:**
    - The process by which banks create money through lending.
    - **Formula:** Money Multiplier = 1 / Reserve Ratio.
    - **Example:** If the reserve ratio is 10%, the money multiplier is 10.

Integrating Money and Commodity Markets: IS-LM Model

1. **IS Curve (Investment-Saving):**
    - Represents equilibrium in the goods market.
    - **Equation:** $Y = C + I + G + (X - M)$, where Y is income, C is consumption, I is investment, G is government spending, X is exports, and M is imports.
2. **LM Curve (Liquidity Preference-Money Supply):**

- Represents equilibrium in the money market.
- **Equation:** $M/P = L(Y, i)$, where M is the money supply, P is the price level, L is liquidity preference, Y is income, and i is the interest rate.

IS-LM Intersection:

- The point where the IS and LM curves intersect represents the general equilibrium in both the goods and money markets.

Business Cycles and Stabilization

1. **Monetary Policy:**
   - Conducted by the central bank to control the money supply and interest rates.
   - **Tools:** Open market operations, discount rate, reserve requirements.
2. **Fiscal Policy:**
   - Conducted by the government to influence the economy through spending and taxation.
   - **Tools:** Government expenditure, taxation.

Central Bank and Government Roles:

- Central Bank: Manages monetary policy.
- Government: Manages fiscal policy.

The Classical Paradigm

1. **Price and Wage Rigidities:**
   - Prices and wages do not adjust immediately to changes in economic conditions.
   - **Consequences:** Can lead to unemployment and inefficiencies.
2. **Voluntary and Involuntary Unemployment:**
   - **Voluntary Unemployment:** When individuals choose not to work at the prevailing wage rate.
   - **Involuntary Unemployment:** When individuals are willing to work at the prevailing wage rate but cannot find employment.