

UNIT 3 CONCEPT OF SUPPLY

★ STRUCTURE ★

- The Meaning of Supply
- Changes in Supply : Increase and Decrease in Supply
- Elasticity of Supply

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Price of a commodity is determined by the demand for and supply of a commodity. In some previous chapters we have studied the factors which determine the demand for a commodity. We have also studied the law of demand according to which the demand for a commodity is inversely related to its price. Supply of a commodity depends upon how the physical returns and costs change as more output of a commodity is produced. After having explained the behaviour of costs and physical returns in the previous chapters, we are now in a position to explain the law of supply and the concept of elasticity of supply.

THE MEANING OF SUPPLY

As demand is defined as a schedule of the quantities of a good that will be purchased at various prices, similarly the *supply refers to the schedule of the quantities of a good that will be offered for sale at various prices*. To be more correct, supply of a commodity is the schedule of the quantities of a commodity that would be offered for sale at all possible prices at any moment of time or during any one period of time, for example, a day, a week and so on, the conditions of supply remaining the same.

Supply should be carefully distinguished from stock. *Stock is the total volume of a commodity which can be brought into the market for sale at a short notice* and supply means the quantity which is *actually brought in the market*. For perishable commodities like fish and fruits; supply and stock are the same because whatever is in the stock must be disposed of. The commodities, which are non-perishable, can be held back if prices are not favourable. In case of a non-perishable or durable commodity if the price is high, larger quantities of it are offered, by the sellers from their stock. And if its price is low, only small quantities are brought out for sale. In short, *stock is potential supply*.

Supply Schedule, Supply Curve and Law of Supply

Supply of a commodity is functionally related to its price. The law of supply relates to this functional relationship between price of a commodity and its supply. In contrast to the change in quantity demanded in response to the changes in price, the *quantity supplied generally varies directly with price*. That is, the higher the price, the larger is the quantity supplied. *The supply schedule or supply curve of a commodity means how price of a commodity is related to the quantity which the sellers (or producers) are willing and able to*

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make available in the market. The supply schedule giving various prices of wheat and quantities of wheat supplied at those prices is shown in Table 3.1. It will be seen from this table that at a price of Rs. 275 per quintal sellers are willing and able to supply 200 quintals of wheat. When the price of wheat rises to Rs. 325 per quintal, the greater quantity (300 quintals) of it is supplied in the market. If the price of wheat further goes upto Rs. 375, the still greater quantity 400 quintals are offered for sale in the market by the suppliers.

Table 3.1. Supply Schedule

Price (Rs.)	Quantity Supplied
225	100
275	200
325	300
375	400
425	500

It is important to note that like the concept of demand, the concept of supply does not refer to a fixed quantity of a good which the sellers are willing and able to make available in the market. Instead, the supply of a commodity implies how the quantity supplied of the commodity varies with the change in price under the given conditions of cost and technology. Thus, *supply refers to the whole schedule or curve depicting the relationship between price and quantity which the sellers produce and offer for sale in the market.*

Law of supply. The supply schedule and supply curve reflect the law of supply. According to the law of supply, *when the price of a commodity rises the quantity supplied of it in the market increases, and when the price of a commodity falls, its quantity demanded decreases, other factors determining supply remaining the same.* Thus, according to the law of supply, the quantity supplied of a commodity is directly or, positively related to price. It is due to this direct relationship between price of a commodity and its quantity supplied that the supply curve of a commodity slopes upward to right as seen from supply curve SS in Fig. 3.1. When price of wheat rises from Rs. 225 per quintal to Rs. 425 the quantity supplied of wheat in the market increases from 100 quintals to 500 quintals per period.

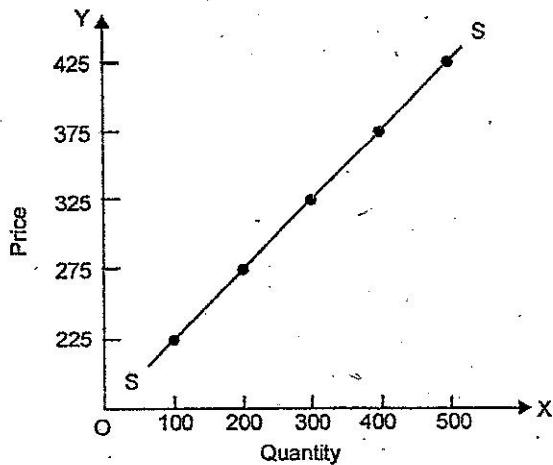


Fig. 3.1. Supply Curve Showing Direct Relationship Between Price and Quantity

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which is sloping downward. Suppose OL is the income of a poor person and OH is the income of a rich person. If rich person is subjected to the income tax and amount of money equal to HH' is taken from him and the same amount of money LL' (equal to HH') is given to the poor man, it can be shown that the welfare of the community will increase. As a result of this transfer of income, the income of the rich man falls by HH'' and the income of the poor person rises by LL' ($HH' = LL'$). Now, it will be seen in Fig. 4.2 that the loss of satisfaction or utility of the rich man as a result of decline in his income by HH' is equal to the area $HDCH'$. Further, it will be seen that the gain in satisfaction or utility by the increase of an equivalent amount of income LL' of the poor man, is equal to $LABL'$.

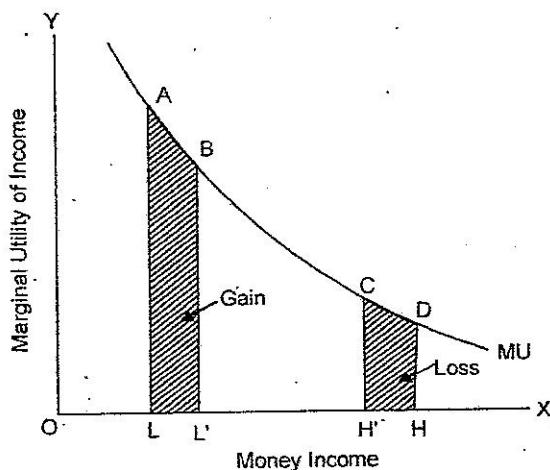


Fig. 4.2. Redistribution of Income to Increase Social Welfare

It is thus obvious from the figure that the gain in utility of the poor person is greater than the loss of utility of the rich man. Therefore, the total utility or satisfaction of the two persons taken together will increase through transfer of some income from the rich to the poor. Thus, on the basis Money Income of the diminishing marginal utility of money many economists and political scientists have advocated that Government must redistribute income in order to raise the economic welfare of the society. However, it may be pointed out that some economists challenge the validity of such redistribution of income to promote the social welfare. They point out that the above analysis of marginal utility is based upon interpersonal comparison of utility which is quite inadmissible and unscientific. They argue that people differ greatly in their preferences and capacity to enjoy goods and, therefore, it is difficult to know the exact shapes of the marginal utility curves of the different persons. Therefore they assert that the losses and gains of utility of the poor and the rich cannot be measured and compared.

Principle of Equimarginal Utility : Consumer's Equilibrium

Principle of equimarginal utility occupies an important place in marginal utility analysis. It is through this principle that consumer's equilibrium is explained. It is also called law of substitution because in it for reaching equilibrium position consumer substitutes one good for another. A consumer has a given income which he has to spend on various goods he wants. Now, the question

is how he would allocate his money income among various goods, that is to say, what would be his equilibrium position in respect of the purchases of the various goods. It may be mentioned here that consumer is assumed to be 'rational', that is, he coldly and carefully calculates and substitutes goods for one another so as to maximise his utility or satisfaction.

Suppose there are only two goods X and Y on which a consumer has to spend a given income. The consumer's behaviour will be governed by two factors : Firstly, the marginal utilities of the goods and secondly, the prices of two goods. Suppose the prices of the goods are given for the consumer. The law of equimarginal utility states that the consumer will distribute his money income between the goods in such a way that the utility derived from the last rupee spent on each good is equal. In other words, consumer is in equilibrium position when marginal utility of money expenditure on each good is the same. Now, the marginal utility of money expenditure on a good is equal to the marginal utility of a good divided by the price of the good. In symbols,

$$MU_m = \frac{MU_x}{P_x}$$

MU_m where MU_m is marginal utility of money expenditure and MU_x , is the marginal utility of X and P_x is the price of X. The law of equimarginal utility can therefore be stated thus : *the consumer will spend his money income on different goods in such a way that marginal utility of each good is proportional to its price.* That is, consumer is in equilibrium in respect of the purchases of two goods X and Y when

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$$

Now, if $\frac{MU_x}{P_x}$ and $\frac{MU_y}{P_y}$ are not equal and $\frac{MU_x}{P_x}$ is greater than $\frac{MU_y}{P_y}$, then the consumer will substitute good X for good Y. As a result of this substitution, the marginal utility of good X will fall and marginal utility of good Y will rise. The consumer will continue substituting good X for good Y till $\frac{MU_x}{P_x}$ becomes equal to $\frac{MU_y}{P_y}$. When $\frac{MU_x}{P_x}$ becomes equal to $\frac{MU_y}{P_y}$ the consumer will be in equilibrium.

But the equality of $\frac{MU_x}{P_x}$ with $\frac{MU_y}{P_y}$ can be achieved not only at one level but at different levels of expenditure. The question is how far does a consumer go in purchasing the goods he wants. This is determined by the size of his money expenditure. With a given money expenditure on a good, the consumer will derive some utility from it. Now, the consumer will go on purchasing goods till the marginal utility of money expenditure on each good becomes equal. Thus the consumer will be in equilibrium when the following equation holds good :

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = MU_m$$

If there are more than two goods on which the consumer is spending his income, the above equation must hold good for all of them.

Let us illustrate the law of equimarginal utility with the aid of Tables 4.2 and 4.3.

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Table 4.2. Marginal Utilities of Goods X and Y.

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Units	MU_x (Utils)	MU_y (Utils)
1	20	24
2	18	21
3	16	18
4	14	15
5	12	12
6	10	9

Table 4.3. Marginal Utility of Money Expenditure.

Units	$\frac{MU_x}{P_x}$	$\frac{MU_y}{P_y}$
1	10	8
2	9	7
3	8	6
4	7	5
5	6	4
6	5	3

Let the prices of goods X and Y be Rs. 2 and Rs. 3 respectively and the consumer has Rs. 24 to spend on the two goods. It is worth noting that in order to maximise his utility the consumer will not equate *marginal utility of the goods* because prices of the two goods are different. He will equate the marginal utility of the last rupee (i.e., marginal utility of money expenditure) spent on

these two goods. In other words, he will equate $\frac{MU_x}{P_x}$ with $\frac{MU_y}{P_y}$ while spending

his given money income on the two goods. Therefore, reconstructing the above Table 4.2 by dividing marginal utilities of X(MU_x) by Rs. 2 and marginal utilities of Y(MU_y) by Rs. 3 we get Table 4.3 which show marginal utility of money expenditure.

By looking at the Table 4.2 it will become clear that $\frac{MU_x}{P_x}$ is equal to 5 utils

when the consumer purchases 6 units of good X and $\frac{MU_y}{P_y}$ is equal to 5 utils when he buys 4 units of good Y. Therefore, the consumer will be in equilibrium when he is buying 6 units of good X and 4 units of good Y and will be spending $(Rs. 2 \times 6 + Rs. 3 \times 4) = Rs. 24$ on them. Thus, in the equilibrium position where he maximizes his utility :

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = MU_m$$

$$\frac{10}{2} = \frac{15}{3} = 5$$

Thus 5 is the marginal utility of the last rupee spent on each of the two goods he purchases is the same, that is, Rs. 5.

Consumers' equilibrium is graphically portrayed in Fig. 4.3. Since marginal

utility curves of the goods slope downward, curves depicting $\frac{MU_x}{P_x}$ and $\frac{MU_y}{P_y}$

also slope downward. Thus when the consumer is buying OH of X and OK of Y, then

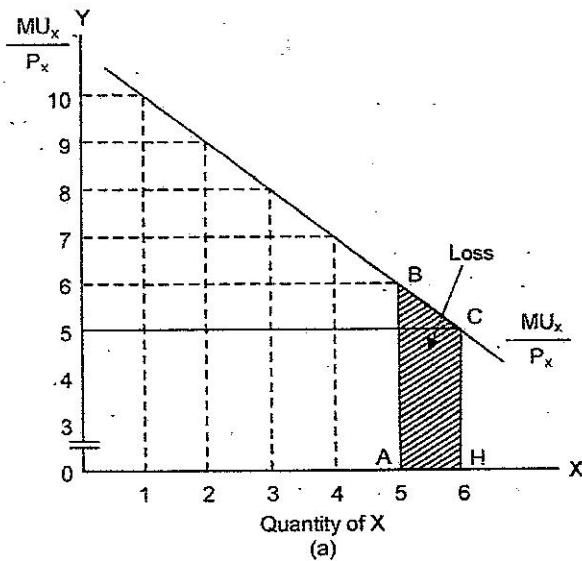
$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = MU_m$$

Therefore, the consumer is in equilibrium when he is buying 6 units of X and 4 units of Y. No other allocating of money expenditure will yield greater utility

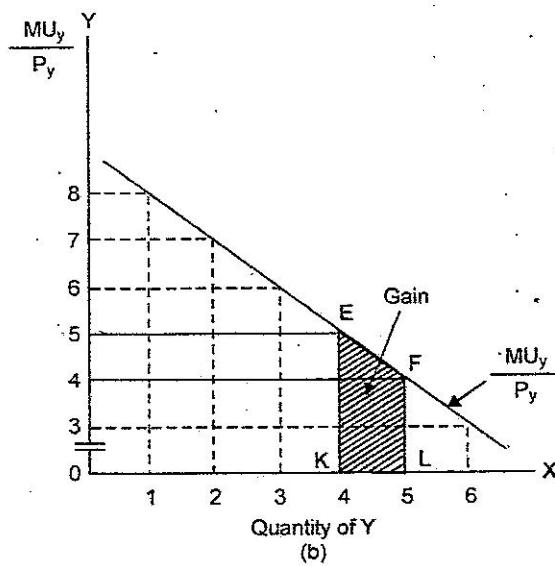
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than when he is buying 6 units of X and 4 units of commodity Y. Suppose the consumer buys one unit less of good X and one unit more of good Y. This will lead to the decrease in his total utility. It will be observed from Fig. 4.3 (a) that the consumption of 5 units instead of 6 units of commodity X means a loss in satisfaction equal to the shaded area ABCH and consumption of 5 units of commodity Y instead of 4 units will mean gain in utility by the shaded area KEFL. It will be noticed that with this rearrangement of purchases of the two goods, the loss in utility ABCH exceeds gain in utility KEFL. Therefore, his total satisfaction will fall as a result of this rearrangement of purchases.



(a)



(b)

Fig. 4.3. Equimarginal Principle and Consumer's Equilibrium

Thus when the consumer is making purchases by spending his given income

in such a way that $\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$, he will not like to make any further changes

in the basket of goods and will therefore be in equilibrium situation by maximizing his utility.

The above equimarginal condition for the equilibrium of the consumer can be stated in the following ways :

demand of the commodity at all. In this perfectly inelastic demand, demand curve is a vertical straight line as shown in Fig. 6.3. As will be seen from this figure, whatever the price quantity demanded of the commodity remains unchanged at OQ. An approximate example of perfectly inelastic demand is the demand of acute diabetic patient for insulin. He has to get the prescribed dose of insulin per week whatever its price.

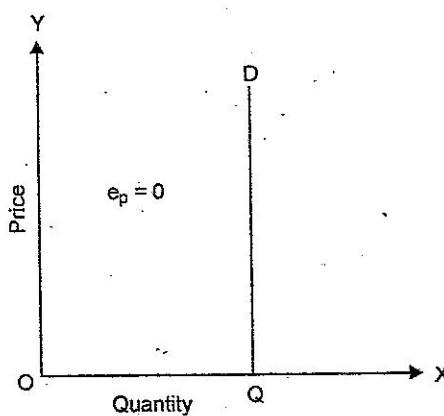


Fig. 6.3. Perfectly Inelastic Demand Quantity ($e_p = 0$)

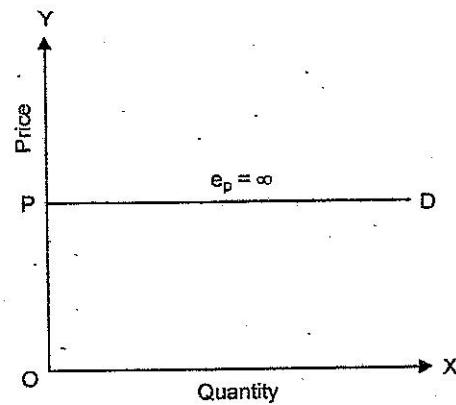


Fig. 6.4. Perfectly Elastic Demand ($e_p = \infty$)

The second extreme situation is of perfectly elastic demand in which case demand curve is a horizontal straight line as shown in Fig. 6.4. This horizontal demand curve for a product implies that a small reduction in price would cause the buyers to increase the quantity demanded from zero to all they could obtain. On the other hand, a small rise in price of the product will cause the buyers to switch completely away from the product so that its quantity demanded falls to zero. We will see in later chapters that perfectly elastic demand curve is found for the product of an individual firm working under perfect competition. Products of different firms working under perfect competition are completely identical. If any perfectly competitive firm raises the price of its product, it would lose all its customers who would switch over to other firms and if it reduces its price somewhat it would get all the customers to buy the product from it.

MEASUREMENT OF PRICE ELASTICITY

As said above, price elasticity of demand expresses the response of quantity demanded of a good to changes in its price, given the consumer's income, his tastes and prices of all other goods. Thus price elasticity means the degree of responsiveness or sensitiveness of quantity demanded of a good to a change in its price. An important method to measure price elasticity of demand is the percentage method. Price elasticity can be precisely measured by dividing the percentage change in quantity demanded in response to a small change in price, divided by the percentage change in price. Thus we can measure price elasticity by using the following formula :

Price Elasticity. = $\frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$

or, in symbolic terms

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$$e_p = \frac{\frac{\Delta q}{q} \times 100}{\frac{\Delta p}{p} \times 100} = \frac{\Delta q}{q} \div \frac{\Delta p}{p}$$

$$= \frac{\Delta q}{q} \times \frac{p}{\Delta p} = \frac{\Delta q}{q} \times \frac{p}{p}$$

where e_p stands for price elasticity

q stands for the original quantity

p stands for the original price

Δ stands for a small change

Mathematically speaking, price elasticity of demand has a negative sign since the change in quantity demanded of a good is in opposite direction to the change in its price. When price falls, quantity demanded rises and vice versa. But for the sake of convenience in understanding the magnitude of response of quantity demanded of a good to a change in its price we ignore the negative sign and take into account only the numerical value of the elasticity. Thus, if 2% change in price leads to a 4% change in quantity demanded of good A and 8% change in that of B, then the above formula of elasticity will give the value of price elasticity of good A equal to 2 and that of good B equal to 4. It indicates that the quantity demanded of good B changes relatively much more than that of good A in response to a given change in price. But if we had written minus signs before the numerical values of elasticities of the two goods, that is, if we had written the elasticity as -2 and -4 respectively as strict mathematics would require us to do, then since -4 is smaller than -2, we would have been misled in concluding that price elasticity of demand of B is less than that of A. But, as we have noted above, response of demand for B to the change in its price is greater than that of A, it is better to ignore minus sign and draw conclusion from the absolute values of elasticities. Hence, by convention minus sign before the value of price elasticity of demand is generally ignored in economics.

Arc Elasticity of Demand

We have explained above the concept of *point elasticity of demand* which refers to the price elasticity at a point on the demand curve or, in other words, which refers to the price elasticity when the changes in the price and the resultant changes in quantity demanded are infinitesimally small. In this case if we take the original price and original quantity or the subsequent price and quantity after the change in price as the basis of measurement, there will not be any significant difference in the coefficient of elasticity. However, when the price change is quite large or we have to measure elasticity over an *arc of the demand curve* rather than at a *specific point* on it, the measure of point

elasticity, namely $\frac{\Delta q}{\Delta p} \cdot \frac{p}{q}$ does not provide us the true and correct measure of price elasticity of demand. Further, in such cases, the coefficient of price elasticity would be different depending upon whether we choose original price and quantity or the subsequent price and quantity demanded as the basis for measurement of price elasticity and therefore there will be significant difference in the two coefficients of elasticity, obtained from using two bases.

3. Money is also used as standard of value.
4. Money facilitates deferred payments.
5. Money in any commodity have general acceptance.
6. Money has generalised purchasing power.

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Functions of Money

In the views of Crowther, "*the only essential requirement of money is general acceptability*". According to Walker, "*Money is what money does*". Money is known for what it does or performs.

Money was introduced to overcome the difficulties of the barter system and to help in exchange. The functions of money can be summarized by the following points :

1. Money is a standard for measuring values.
2. Money serves as a medium of payment.
3. Money as a means of transferring value.
4. Money is used as a store of value i.e., it keeps the resources liquid.
5. Money as a medium of exchange.
6. Money serves as a standard for deferred payments.
1. *Money is a standard for measuring values.* When money serves as a medium of exchange, it incidentally measures the value of things for which it is exchanged. One inconvenience of barter, was the lack of common measure or a common denominator of value in terms of which other values could be expressed and added and accounts kept. Money removes this difficulty too. Money serves as a unit of account. In a money economy, it is easy to compare the relative values of commodities and services which are dissimilar and entirely different from one another. The values are in proportion to their respective prices. Expression of value in prices enables us to add them up and have a definite idea of person's or a community's wealth. In matters of exchange, a common standard of value makes the transaction easy and also fair.
2. *Money serves as a medium of payment.* Money is a medium of payment, that is, it is used to make and receive all payments. A commodity is bought and sold with the help of money and it is also paid for in money. The function of money as a medium of payment is implied in the above function of money as a medium of exchange.
3. *Money as a means of transferring value.* There is also another function which money performs. One can sell one's immovable and movable belongings at one place and with the money so acquired he can buy them elsewhere, value will then be transferred. Such things have happened on a very large scale in India after the partition of the country.
4. *Money is used as a store of value i.e., it keeps the resources liquid.* Money serves as a store of value or more correctly i.e., enables a person to keep a portion of his assets liquid. Liquid assets are those which can be used for any purpose at any time one likes. Most persons in the modern world have to keep currency notes in their packet or at home, or they may keep current accounts with the

banks withdrawable by cheque. The necessity arises from the fact that the two streams of income and expenditure do not keep time with each other. An employer has to pay wages, etc., periodically; even daily, while his income does not come to him in the same periodical intervals. Money is best kept as a store of value to be used as and when need arises

5. *Money as a medium of exchange.* The first and the most important function of money is to help in buying and selling of goods and services. Commodities are not exchanged directly but are exchanged through money. In case of farmer, the farmer sells his produce in the market for money. He uses this money to buy clothes, pulses, rice, matches, sugar and other things which he requires. A teacher who sells his services to the college for money; he uses his money to buy all kinds of goods and services which he requires. Thus, money is the medium of exchange or medium of trade.
6. *Money serves as a standard for deferred payments.* Money helps us to buy goods and services not only in the present but also in the future. Suppose a person buys a pen from a shop and pays him money immediately. This is cash transaction. Suppose, instead, he buys a pen now and agrees to pay later it becomes a credit transaction. Further, if a person borrows from a moneylender and agrees to return the amount later, it is also credit transaction. Money helps to buy and sell or borrow and lend. In other words, money serves as a standard of deferred payment.

Defects and Drawbacks of Money

Though money plays an important and essential part in the economy of a country, it would be wrong to conclude that money is the cause of all economic changes and progress. Money is only an instrument which helps in economic progress but it is not the controlling authority. Money is a good servant but a bad master. Money can be proved dangerous in several ways :

1. Money leads to corruption.
2. Money leads to inequalities of incomes.
3. Money has instability.
 1. *Money leads to corruption.* Money has been responsible for all the corruption which is prevalent in modern society. As Ruskin stated: "*The devil of money has come to possess their souls. No religion or philosophy seems to have the power of driving it out*". Money is regarded as the cause of theft and murder, of deception and betrayal. It is the lust for money which induces man to go for illegal and dubious means of accumulating money.
 2. *Money leads to inequalities of incomes.* Money has proved to be a very convenient tool for amassing wealth and of the exploitation of the poor by the rich. It has created a yawning gulf between the 'haves' and the 'have nots'. The misery and degradation of the poor is thus, to no small measure due to the existence of money.
 3. *Money has instability.* A very great defect of money is that its value or purchasing power does not remain stable or constant. Different sections of people in the country are affected differently because of changes in the value of money. For instance, a fall in the value of

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money (inflation) leads to wrong distribution of income since the rich become richer while the poor becomes poorer. A rise in the value of money (deflation), meaning a fall in prices and decline in employment may lead to great suffering to all classes of people.

Role, Importance and Significance of Money in Modern Economy

There is no doubt that money facilitates and motivates all economic activities relating to consumption, production, exchange and distribution. Money enables a consumer to maximize his satisfaction. Money measures the intensity of desire and the utility of commodity to a consumer. The role and significance of money in modern economy can be summarized by the following points :

1. *Significance of money in production.* Without money, production on the modern scale would be impossible. The present day industrial production is based on extreme division of labour or specialisation which implies that the worker cannot be paid in the commodity he produces and also the existence of the extensive market to dispose off commodity. It is money which has made possible the extreme specialisation and, therefore resulted in large-scale production.

Again, money enables every man to concentrate his attention on his own job, without bothering about all other things and thus to add more effectively to the general flow of goods and services which constitute the real income of society.

It is clear, therefore, that without money, modern specialisation is impossible and without specialisation modern capitalist economy could not have come into existence.

The manufacturers use money to purchase materials for the construction of their factories, they use it to buy the materials necessary for their equipments. They bid competitively in the markets of the world for the raw materials used in the process of manufacturing. They employ money as a means of attracting to their business the requisite labour force, officials and professionals.

2. *Significance of money in consumption.* The consumer receives his income in the form of money, which he can convert into anything he likes. A worker in a cloth factory cannot be paid in a cloth or an employee in a shoe factory in shoes. It is impossible for workers to go about exchanging cloth or shoes for rice, wheat, vegetables and hundreds of old things they require. When payment is made in kind (and not in money) there is high possibility that the consumer gets too much of some goods and too little of others. The consumer, therefore, does not get maximum satisfaction in the absence of money. On the other hand, when the consumer receives his income in the form of money, he can distribute it on the different goods in such a way that his total satisfaction will be highest. The use of money and the system of prices give the consumers the necessary freedom to choose and substitute between goods and services. It is the system of money and prices which help the consumers to (a) choose the type of goods they consume; (b) the variety of goods they can choose; and (c) the amount which they could choose.
3. *Money as medium of exchange.* One important reason why money occupies a central position in a modern economy is the function of money as a

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medium of exchange, and of payments. Everything can be bought and sold, i.e., exchanged through the medium of money. Goods and services are exchanged through money. Shares and bonds (which are known as claims to wealth) are bought and sold in the form of money. Similarly, taxes to the government are paid in money. In other words, money is used as the general medium of exchange and of payment. Without it, there can be no trade and, therefore, no production. (In modern economy, there can be no production, if what is produced cannot be sold).

4. *Significance of money to the modern state.* The government is a large receiver as well as maker of payments. The state receives income by way of taxes, fees, fines, prices for service rendered etc. The income which the states get may be one-third or one-fourth of the total national income. It is impossible to collect taxes, fees, fines, etc., in the forms of goods. The farmer would pay in grains; the cobbler in shoes, the carpenter in chairs and tables; and so on. This would create problems of collection, storage or distribution. Similarly, the government has to make payment by way of wages, salaries, interest, etc. This would be impossible except in terms of money. Public revenues and public expenditures are so vast that they are possible only in a money economy. Moreover, modern governments plan their incomes and expenditure in advance. This would not be possible if they collect their revenue to kind. Revenues received in goods and payments made in kind would make calculation and budgeting an impossible task.
5. *All incomes are in the form of money.* All incomes that are received are in the form of money. This necessarily follows from the fact that money serves as a general medium of exchange and of payments in settlement of debts. The firms which sell its goods, receives money for it; its income, therefore, consists of money. The lecturer who sells his services to the college gets his salary in the form of money. Since all payments are made in money, every income is a money income (payment by one person becomes income for another). Thus, in a modern economy, all incomes are money incomes.
6. *Significance of money in trade.* The basic purpose of money is to help in the exchange of goods and services (i.e., trades). In a primitive economy, there was very little trade. Naturally, the system of exchange was barter. With extension of trade, the need for money rises. Large-scale production and extension of markets to sell the goods produced are impossible without the use of money. In the last two hundred years, trade has become very extensive and to facilitate this, new types of money have been involved. The use of bank cheques and bank drafts facilitates buying and selling of goods as well as of payments.

Not only internal trade, but international trade too is possible only through money. The currency of one country may be acceptable in India but cannot buy even a match box in England or the U.S.A. However, trade between two countries is financed by means of bank drafts.

Trade, both internal and international, is very important and indispensable for modern large-scale production. Money is the medium by which trade is undertaken. If there were no money, there would be no extensive trade; if there were no trade, there would be no large-scale production and no modern capitalist economy.

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7. *Wealth kept partly in money.* Another important factor responsible for the central position of money in modern times is that money constitutes the most important form of wealth. Everyone i.e., individual, company or corporation or the government wishes to have some cash to meet current obligations and as a precautionary measure (for reserves). The amount of cash held by people will naturally differ from individual to individual and from institution to institution. A rich man will obviously keep more cash than a poor man. But everyone keeps some cash with himself or as deposit in a bank.