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41 Explain critically the Cambridge version of Quantity theory of money ?

Cambridge Cash Balance theory of demand for money was put forward by Cambridge economists Marshall and Pigou. The Cash Balance theory emphasies on the fun of money as a store of value. The fun of money as a store of value give stress on holding money as a general purchasing power by individuals over a period of time between the sall of a good or service and subsequent purchas of a good or services at a later date. Marshall and Pigou focussed their analysis on the factors that determine individual demand for holding cash balances. They belived that current interest rate, wealth, expectation of future prices and future rate of interest are constant. They put forward a view that individuals demand for cash balances (Money) is proportional to the nominal income (i.e., money income). Thus according to their approach, aggregate demand for money can be expressed as:

$$M_d = kPY$$

where,
Y = Real national income.
P = Average price level.
PY = Nominal income.
k = Proportion of nominal income (PY) that people want to hold as cash balance.

Cambridge Cash Balance approach of demand for money is illustrated in figure (i) where, on the X-axis we measur nominal income (PY) and on the Y-axis the demand for money (M_d)

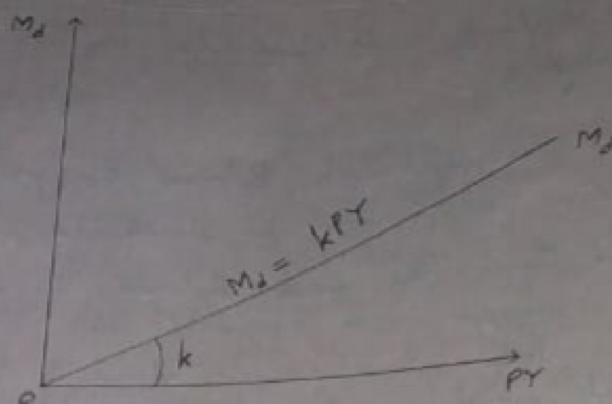

Figure – (i)

It will be seen from figure (i) that demand for money (M_d) is a linear fuⁿ of nominal income. The slope of the function is equal to k, i.e., $k = \frac{M_d}{PY}$. Thus important feature of Cash-Balance approach is that it makes demand for money ~~as~~ related ~~to~~ as a fuⁿ of money income alone. A merit of this formulation is that it makes the relation between demand for money and income as behavioural in sharp contrast to Fisher's approach in which demand for money was related to total transaction in a mechanical manner.

In this approach, other factors, i.e., interest rate, wealth etc. determine the proportionality factor **k**.

The another important feature of Cambridge demand for money fuⁿ is that the demand for money is proportional fuⁿ of nominal income ($M_d = kPY$). Thus, it is proportional fuⁿ of both price level (P) and real income (Y). This implies two things, First, income elasticity of demand for money is unity and, Secondly, price elasticity of demand for money is also unity. So any change in the price level causes equal proportionate change in the demand for money.

Criticism :- It has been pointed out by critics that other influences such as rate of interest, wealth, expectations regarding future prices and interest rate have not been introduced into this model. This factors also influence the demand for money of an individual.

Another criticism against this theory is that income elasticity of demand for money may be different from unity. Cambridge economists did not provide any theoretical reson for this. Nor is there any empirical evidence supporting ~~uniq~~ unitary income elasticity of demand for money. Besides price elasticity of demand is also not necessarily. In fact, changes in the price level may cause non proportional changes in the dd. for money.