

B.A. Part I (Economics Honours)  
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## **Supply of Savings**

Supply of capital is the result of savings. It comes from those who have the excess of income over consumption. Thus, savings is the main source of capital which depends on the capacity to save, willingness to save, level of income and rate of interest etc. Capacity to save depends on the size of national income, size of personal income, size of family, price level and purchasing power of money etc. Willingness to save depends on the family affection, further expectations etc.

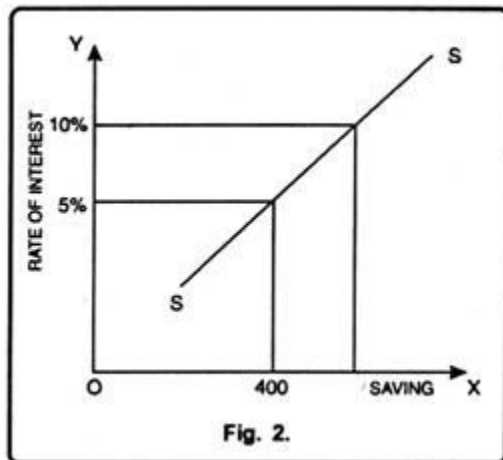
To a large extent, willingness to save is affected by the rate of interest. On a higher rate of interest people save more to earn the benefits of high rate of interest. On the other hand, at the low rate of interest, people save less. Thus, we may say that there is a direct relationship between the supply of savings and the rate of interest. The following table and diagram justifies this fact in a more clear way.

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Table 2

Rate of Interest	Savings (in crores)
10%	1000
9%	800
8%	700
7%	600
6%	500
5%	400

It is clear from the table 2 that rate of interest and savings have a positive relationship. As the rate of interest increases, savings will also increase. On the other hand, a fall in rate of interest leads to a decrease in savings. When the rate of interest is 10%, the savings are of Rs. 1000 crores.



In the successive periods, as rate of interest falls from 10% to 5%, the total savings also decline. Suppose as the rate of interest falls to 5%, savings also decrease to Rs. 400 crores.

In Fig. 2 savings have been represented on X-axis and interest rate on Y-axis. SS is the supply curve which moves upward from left to right. It shows that supply of savings is interest elastic. Higher the interest rate, more will be saved and vice-versa. With 5% rate of interest money savings are Rs. 400 crores. As the interest rate increases to 10% people are persuaded to save more and the money savings rise to Rs. 1000 crores. This signifies that there is a direct relationship between savings and the rate of interest.

### **Equilibrium Rate of Interest:**

**According to classical theory, equilibrium interest rate is restored at a point where demand for and supply of capital are equal i.e.**

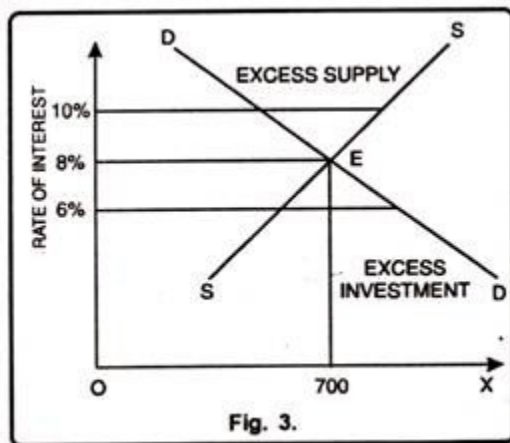
**Table 3**

<b>Rate of Interest</b>	<b>Investment</b>	<b>Savings</b>
10%	500	1000
9%	600	800
8%	700	700
7%	800	600
6%	900	500
5%	1000	400

The table 3 reveals that equilibrium rate of interest will be determined at a point where demand for and supply of capital are equal. As is clear from the table that equilibrium interest rate 8% is determined because at this level demand for and the supply of capital are equal i.e. Rs. 700 crores.

Now, if the rate of interest increases to 10%, investment is Rs. 500 crores and savings are of Rs. 1000 crores i.e. savings exceed the investment. On the other hand, if the rate of interest falls to 5% investment is Rs. 1000 crores and savings are Rs. 400 crores.

**This fact is clearer from the diagram below:**



In Fig. 3, rate of interest is determined by the intersection of demand and supply curves. Equilibrium is restored at point E which determines rate of interest as 8% and demand and supply of capital as Rs. 700 crores. Now, if the rate of interest increases to 10% supply of savings exceeds the demand for capital i.e. supply is more than demand. This will lead to a fall in interest rate to the level of 8%.

On the other hand, when the interest rate falls to 6%, demand for savings exceeds the supply of savings which will push up the rate of interest to restore an equilibrium rate i.e. 8%. Therefore, rate of

interest is in equilibrium only at a point where the demand for capital equals the supply of capital.