Fisher's Quantity Theory of Money

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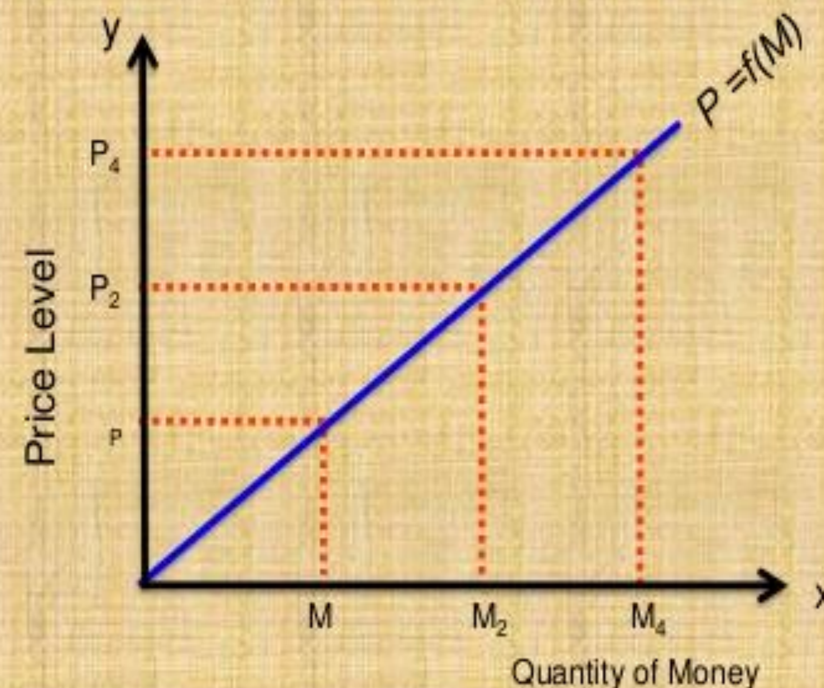
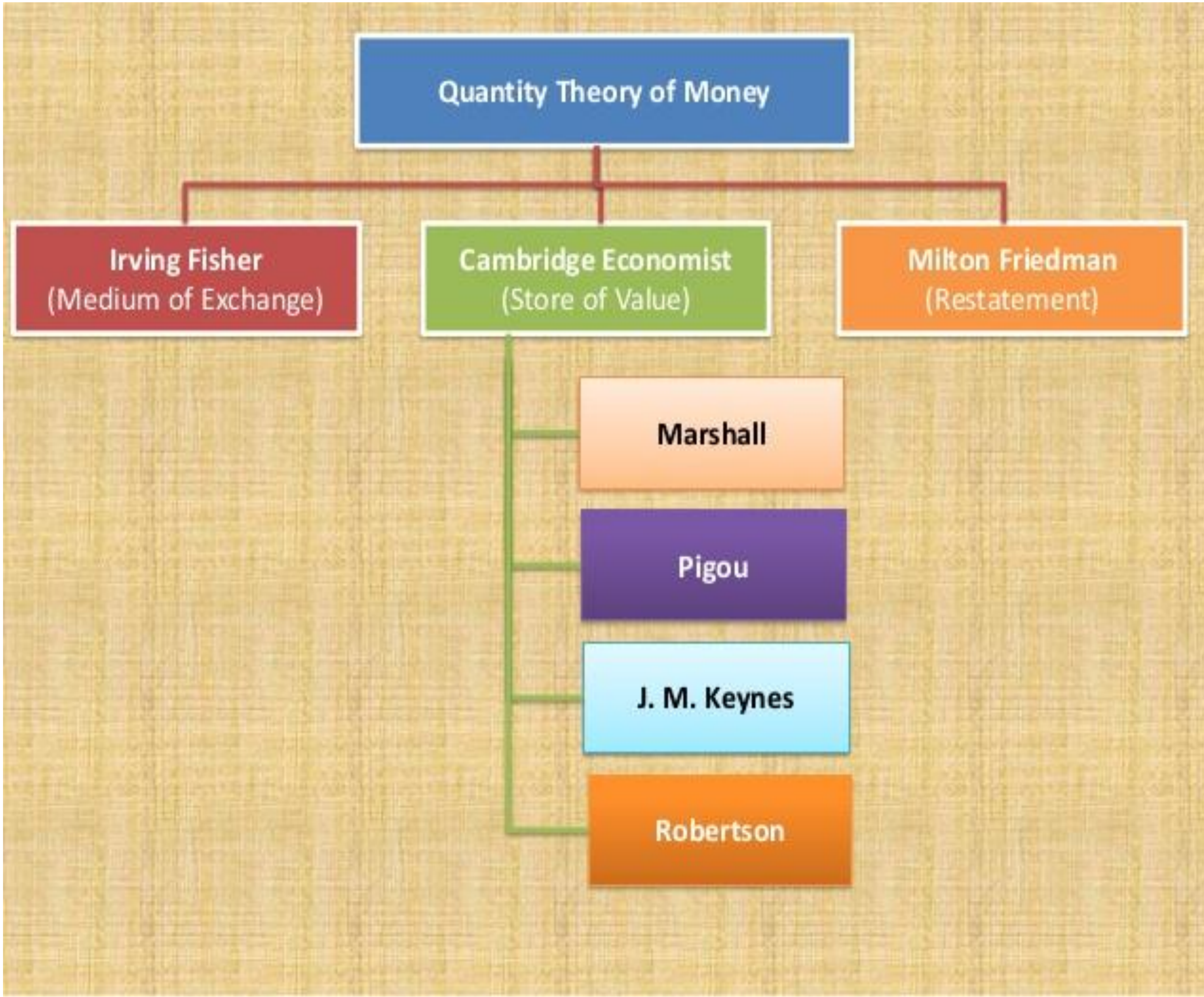
Quantity Theory of Money

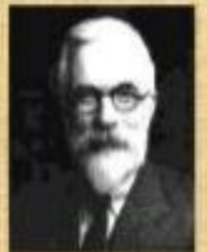
- Direct relationship between the **Quantity of Money** in an economy and the **level of prices** of goods and services sold.

- The amount of money in an economy doubles, price levels also double, causing inflation (the percentage rate at which the level of prices is rising in an economy).

- **P = f (M)**
  - P - Price Level
  - M - Money Supply
  - f – Functional Relationship




Quantity Theory of Money
Irving Fisher
(Medium of Exchange)
Cambridge Economist
(Store of Value)
Milton Friedman
(Restatement)
Marshall
Pigou
J. M. Keynes
Robertson



Irving Fisher (1867 – 1947)

"Purchasing Power of Money" - 1911

- Quantity of Money in circulation increases, the price level also increases in direct proportion and the Value of money decreases and vice versa.
- Quantity of Money is reduced by one half, the price level will also be reduced by one half and the value of money will be twice.
- $MV + M'V' = PT$
  - **M** - Money Supply
  - **V** - Velocity of Circulation of M (Number of Transaction)
  - **P** - Price Level
  - **M'** - Credit Money
  - **V'** - Velocity of Circulation of M' (Number of Transaction)
  - **T** - Transaction performed (Total no. of G/S exchanged for money)

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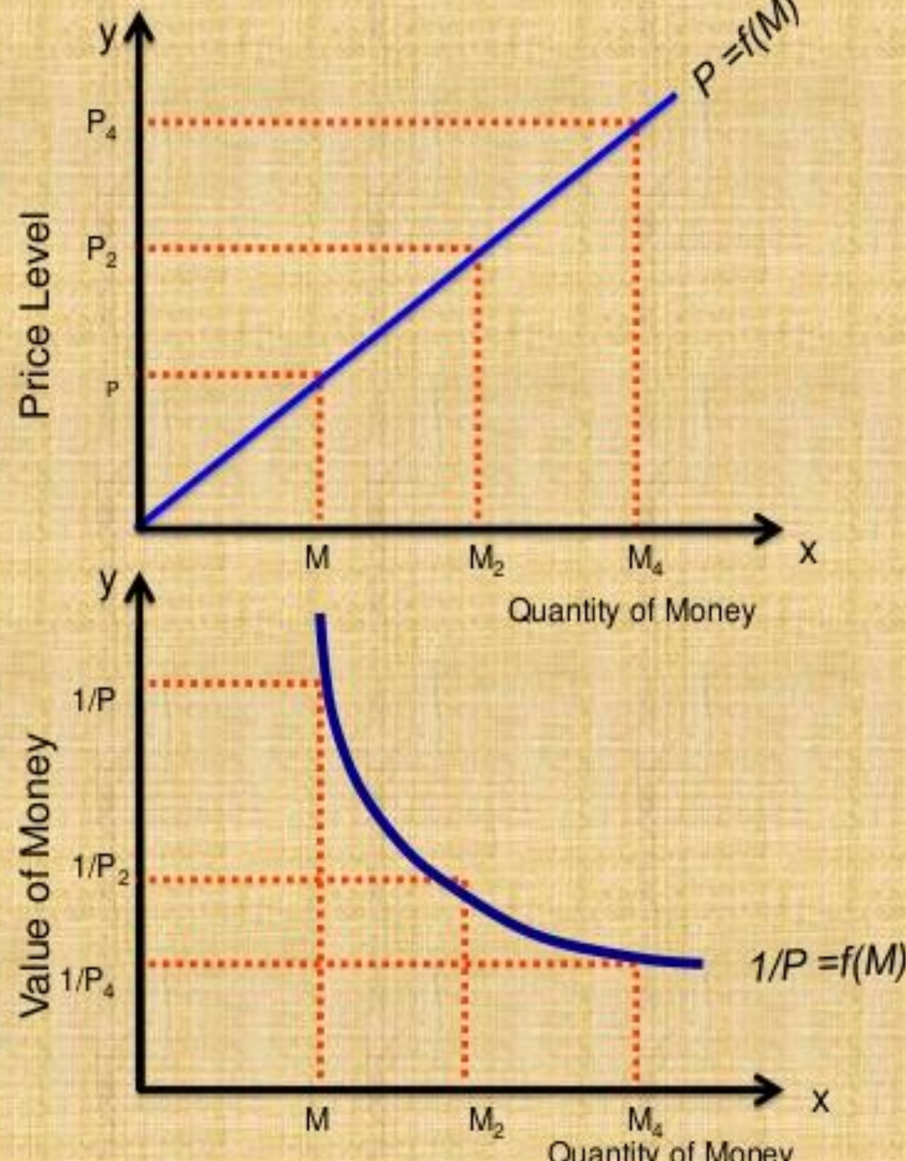

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Assumptions

- **P** is inactive element (Price level will not influence the Money supply)
- **V** & **V'** is assumed to be constant.
- The proportion of **M'** to **M** remains constant..
- **T** also remains constant.

Criticisms

- Equation of Exchange does not explain the cyclical behaviour of Prices and Production.
- Unrealistic assumption such as V, T etc., are constant.
- Price level depends upon many other factors like Consumption habits, Central Bank Policy etc.,
- Equation treed Money as Medium of Exchange only and required for Transaction purpose only.