

# **Nalanda Open University**

## **Department of Economics**

- Name of Counsellor – Prof. (Dr.) D. N. Jha
- Name of Course Coordinator – Prof. (Dr.) D. N. Jha
- Course – MA Economics (Part –I)
- Paper – II (Macro-Economic Analysis)
- Topic – Fisher version of Quantity Theory of Money

# Quantity Theory of Money

- Quantitative Theory of Money presented by Prof. IRVING FISHER (in his Book 'The Purchasing Power of Money' in the year 1911)
- This is also known as The Transaction Version of Quantity Theory of Money
- Alternately it is called Fisher's Version of Quantity Theory of Money

# Quantity Theory of Money-

## Assumptions

- The price level or  $P$  is an inactive element in the equation of exchange ( $P$  is a passive factor in the equation of exchange)
- The volume of trade or  $T$  is an independent element in the equation of exchange
- The velocity of circulation of money or  $V$  is an independent element in the equation and like  $T$  is also constant in the short period
- The ratio of credit money and legal tender money remains constant

# Equation of Exchange

$$MV = PT$$

Where,

M = Money Supply,

V = Velocity of Money in Circulation,

P = Price Level and

T = Volume of Transactions

# Equation of Exchange including Bank Deposits or Credit Money

$$MV + M'V' = PT$$

Where

$M'$  = Demand Deposit in Bank (or, Credit Money)

$V'$  = Velocity of Circulation of Credit Money

# Criticism of Fisher's Quantity Theory of Money (continued...)

- The relation between quantity of money and price level is not direct proportional.
- Velocity of money can not be constant.
- Velocity of money may not be independent.
- $M$  and  $V$  are non-comparable in terms of time.
- Economy do not always operate at full employment.

# Criticism of Fisher's Quantity Theory of Money

- Rate of Interest not recognized in the equation of money.
- Factor affecting demand for money not discussed.
- Influence of consumption and investment expenditure not included in the equation of money.
- Not applicable in the Dynamic Society.