THE QUANITY THEORY OF MONEY

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- The Transactions Approach

  Irving Fisher in his famous book *The Purchasing Power of Money (1911)* presented in the form of an Equation of Exchange which is set forth below

MV(Supply of Money)= PT(Demand for Money)

According to Fisher, the Purchasing Power of Money (or, the Value of Money) depends upon the quantity of money relatively to the amount of goods and services to be purchased

Equation of Exchange

When Credit Money is included, the equation becomes

$$PT = MV + M^1V^1$$

$$P = \frac{MV + M^1V^1}{T}$$

Equation of Exchange

Where

M = The Quantity of Money in Circulation

V = The velocity of Circulation of Money

M' = The Volume of Bank or Credit Money

V' = The velocity of Circulation of Bank or Credit Money

T = The Volume of Trade

P = Price Level

DIAGRAMATIC PRESENTATION OF EQUATION OF EXCHANGE

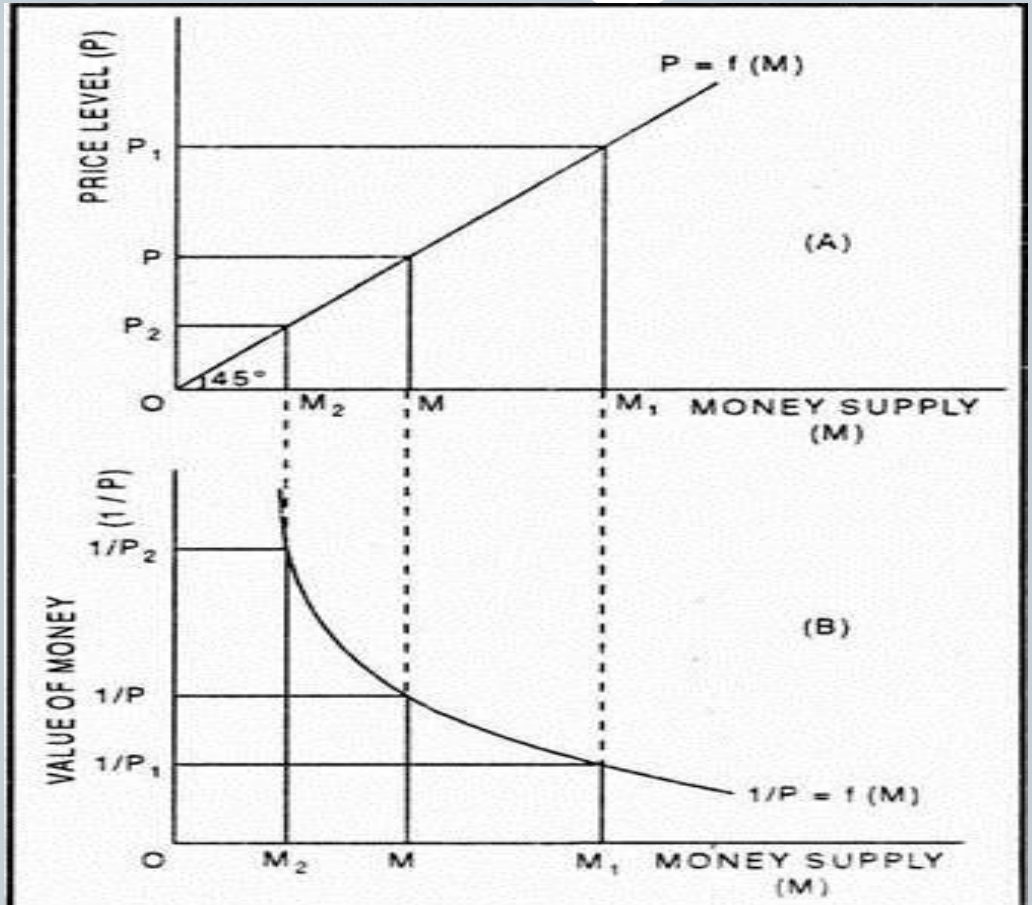

Fig. 1A & B.

ASSUMPTIONS OF FISHER'S EQUATION OF EXCHANGE

a) The Price Level or P is an inactive element in the equation of exchange
b) The Volume of trade (T) is an independent element in the Equation of Exchange
c) The velocity of circulation of money (V) is an independent element in Equation of Exchange
d) The ratio of Credit Money to Legal Tender Money remains constant

CRITISISMS OF FISHER'S EQUATION OF EXCHANGE

1) The quantity theory of Money is based on unrealistic assumption
2) The quantity theory offers as a long term analysis of Money
3) The quantity theory does not tell us precisely how changes in money supply influence the price level
4) There is no direct and proportional relationship between the quantity of money and the price level
5) The quantity theory is based on the wrong assumption of full employment
6) The quantity theory is not comprehensive
7) The quantity theory does not furnish a comprehensive explanation of price changes

CRITISISMS OF FISHER'S EQUATION OF EXCHANGE

8) The quantity theory is mechanical and neglects the human element in the analysis of the price changes.
9) The quantity theory is incomplete
10) The quantity theory ignores the rate of interest as a determinant of price level
11) Fisher's Equation of Exchange does not refer to any specific standard of value of money
12) The quantity theory gives no recognition to the importance of time-lags in its discussion.

THE END