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13. Critically explain the transaction version of the quantity theory of money?

The transaction version of the quantity theory of money put forwarded by Fisher. In this theory Fisher give stress on the medium of exchange function of money, i.e., money as a means of buying goods and services. In accounting identity / sense, value of goods and services sold must be equal to the value of money paid for them. Thus, in any given period, the value of all goods, services or assets sold must equal to the number of transactions T , made multiplied by the average price of this transaction (P) . Thus, the total value of transactions made is equal to $'PT'$

On the other hand, value paid is identically equal to the value of money flow used for buying goods services or assets. The value of money flow is equal to the nominal quantity of money supply $'M'$ multiplied by the average number of times the quantity of money is circulated for transaction purpose. The average number of times a unit of money is used for transaction purpose is called transaction velocity of circulation (V) .

Symbolically, Fisher's equation of exchange is written as —

$$MV = PT \quad \text{----- (i)}$$

- Where,
- M = The quantity of money in circulation
 - V = Transaction velocity of circulation
 - P = Average price.
 - T = Total number of transaction.

The above equation (i) is an identity and taking some assumptions Fisher transformed

for money depends on the following three factors:-

- (i) The number of transaction T ,
- (ii) The average price of transaction P
- (iii) The transaction velocity of circulation of money V .

Criticism :-

First, In Fisher's transaction approach, not only transactions involving current production of goods and services are included but also those which arise in sales and purchase of capital assets such as securities, shares, land etc. are also involved. Due to frequent changes in the value of this capital assets, it is not appropriate to assume that T will remain constant.

Secondly, It is difficult to define and determine a general price level that covers not only goods and services currently produced but also capital assets just mentioned above.

it into a theory of demand for money.

Assumption -

Fisher's approach to the ^{quantity} theory is based on the following assumptions:

- (i) Transaction velocity of circulation (V) is constant.
- (ii) There is always full employment in the economy.
- (iii) Money supply (M) is autonomously given.
- (iv) The total number of transaction (T) is fixed in short run.

As we know for money market to be equilibrium, nominal quantity of money supply (M_s) must be equal to the nominal quantity of money demand (M_d). In other word -

$$M_s = M_d = M$$

Where, M is fixed by the Central Bank (RBI) of a country.

~~with~~ With the above assumptions Fisher's equation of exchange can be written as -

$$M_d = \frac{PT}{V}$$

$$\Rightarrow M_d = \frac{1}{V} (PT)$$

Thus, according to Fisher's transaction approach, de