

Friedman's Restatement of Quantity Theory



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Friedman's Restatement of Quantity Theory



- Need for Restatement of Quantity Theory
- ✓ The Traditional Quantity Theory had the impact of The Great Depression
- ✓ The Traditional Quantity Theory- a mere demand theory
- Prof. Milton Friedman published an essay “**The Quantity Theory of Money- A Restatement**” in 1956

Friedman's Restatement of Quantity Theory



➤ According to Friedman demand for money- 3 factors

1. The total wealth to be held in various assets
2. The price and the return on these assets.
3. The taste and preferences of the asset or wealth holders.

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➤ Five broad ways to hold wealth- Friedman

1. Money (M)- to hold purchasing power, discharge of debts and obligations
2. Bonds (B) to earn interest
3. Equities (E) -ensures the perpetual income in the form of dividend.
4. Physical goods or non- human goods (G)- Movable or Immovable assets
5. Human Capital (H)- productive efficiency of an individual.

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$$M/P = f(Y, W, R_m, R_b, R_e, g_p, u)$$



- M = money stock
- P = price level
- Y = real income
- W = ratio of non human wealth to human wealth
- R_m = expected nominal rate of return on money
- R_b = expected rate of return on bonds
- R_e = expected nominal rate of return on equities
- $g_p = (1/p) (dp/dt)$ is the expected rate of return on real assets
- U = other factors except income

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Basic features of Friedman's theory:

- Conceptual integration of Income and Wealth- Wealth is a means to earn income; and special emphasis on Human Wealth which was neglected so far.
- Introduction of Real Income i.e. expected yield on wealth.
- The term money has been used in a wider sense- currency, demand deposits and time deposits.
- All types of assets are taken into account.

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Criticisms



1. Broad definition of money.
2. Money supply is not exogenous
3. Ignores effect of price, output & interest rate on money supply.
4. Does not consider time factor
5. No positive correlation between money supply & GNP.