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The Price Level, the Quantity Theory of Money, and the Fiscal Theory of the Price Level

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WORKING PAPER 9084

DOI 10.3386/w9084

ISSUE DATE July 2002

We consider price level determination from the perspective of portfolio choice. Arbitrages among money balances, bonds, and investment goods determine their relative demands. Returns to real balance holdings (transactions services), the nominal interest rate, and after-tax returns to investment goods determine the relative values of nominal and real assets. Since expectations of government policies ultimately determine the expected returns to both nominal and real assets, monetary and fiscal policies jointly determine the price level. Special cases of the fiscal and monetary policies considered produce the quantity theory of money and the fiscal theory of the price level.

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Acknowledgements and Disclosures

Citation and Citation Data

Published Versions

Gordon, David B. and Eric M. Leeper. "The Price Level, The Quantity Theory Of Money, And The Fiscal Theory Of The Price Level," Scottish Journal of Political Economy, 2006, v53(1,Feb), 4-27. citation courtesy of RePEc

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Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

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