Introduction to Money

Dr. Kiran Chanda
Assistant Professor
School of Management
Maharaja Agrasen University, Baddi
Himachal Pradesh

Introduction

Money is a concept which we all understand but which is difficult to define in exact terms.

Money is anything serving as a medium of exchange. Most definitions of money take ‘functions of money’ as their starting point. ‘Money is that which money does.’ According to Prof. Walker, ‘Money is as money does.’

This means that the term money should be used to include anything which performs the functions of money, viz., medium of exchange, measure of value, unit of account, etc. Since general acceptability is the fundamental characteristic of money, therefore, money may be defined as ‘anything which is generally acceptable by the people in exchange of goods and services or in repayment of debts.’

Definition

- Money has been defined differently by different economists.

1. Descriptive Definitions
2. Legal Definitions
3. General Acceptability Definitions

(1) Descriptive definitions

- “Anything that is generally acceptable as a means of exchange and that at the same time acts as a measure and store of value.- Crowther

- “Money may be defined as a means of valuation and of payment” – Coulborn
- “Money is anything that is widely used as a mean of payment and is generally acceptable in settlement of debts.” – Cole

2) Legal Definitions:

- "Anything which is defined by the state as money is money" – Professor Knap
- Professor Hartley believes that money should be legal tender.

(3) General Acceptability Definitions:

- "Money is anything which is commonly used and generally accepted as a medium of exchange or as a standard of value." – Kents
- Money is described as "anything which is widely accepted in payment of goods or in discharge of other kinds of business obligations," by D.H. Robertson.
- "Money is anything that is generally accepted in payment of goods and services or in the repayment of debts." – E. Mishkin

ORIGIN OF MONEY

Money has evolved through five different stages during history:

1. Commodity money
2. Metallic money
3. Paper money
4. Credit money
5. Electronic money

1. Commodity money:

- Commodity money has a value apart from its use of money.
- A large number of items such as cows, goats, sheep, rice, grains, etc were used
- However they lacked storage capability, durability transportability, divisibility, and homogeneity.

2. Metallic money:

- **Coinage**: gold and silver were used as coins, stamped by a competent authority.
- As time passed, transportation and storage of coins became inconvenient and dangerous

3. Paper Currency:

- Paper currency is made of paper and functions as a medium of exchange
- Initially paper currency carried a promise that it was convertible into a fixed quantity of precious metallic gold and silver
- This promise was eliminated in 1914 in England and in 1933 in America.
- **Fiat money**: this newspaper money which is considered legal tender because the government says it is money. It has no backing of gold, silver or government securities

4. Credit money or bank money:

- Bank money is the use of cheques as the medium of exchange.
- Cheques have made it possible an easier to make transactions for large amounts. They are easier to transport.
- They are safe and provide receipts
- Checks are not legal tender. They cannot be enforced in payments of debts

5. Electronic banking stage:

- This is a modern system of transferring funds using Electronic Communications.
- Payments are now made through magnetic strip cards such as bank debit cards, credit cards, telephone cards etc.
- This form of banking has reduced processing costs, lead times for payments and increasing flexibility.
- These are also not considered legal tender

Functions of Money:

In general terms, the main function of money in an economic system is “to facilitate the exchange of goods and services and help in carrying out trade smoothly.” Its basic characteristic is general acceptability. Functions of money are reflected in the following well- known couplet:

“Money is a matter of functions four A medium, a measure, a standard, a store.”

Functions of Money

Primary Functions of Money	• Money as a medium of Exchange • Money as a unit of account • Money as a standard of deferred payments • Money as a store of value
Secondary Functions of Money	• Aid to specialization, production and trade • Influence on income & consumption • Money is an instrument of making loans • Money as tool of monetary management • Instrument of economic policy
Contingent Functions of Money	• Distribution of national income • Basis of credit system • Measure of marginal productivity • Liquidity of property

Primary functions

1. **Medium of Exchange:** Money act as a medium of exchange. It has the quality of general acceptability. In modern days, exchange is the basis of entire economy and money makes this exchange possible. It was on account of the difficulties and inconveniences (lack of double coincidence of wants) of Barter system the money came into existence.
2. **Measure of Value:** Money act a unit of measure of value. In other words, it acts as a yardstick of standard measure of value to which all other things can be measured. Value of all goods and services is expressed in terms of money

SECONDARY FUNCTION

Standard of Deferred Payments : Money has proved to be a suitable standard of deferred payment as it is more durable and stable compared to values of other commodities . It has the quality of general acceptability. Hence it is always desirable.

Store of Value : Money can be stored for future use. It has this merit because its utility is never lost. It serves as an excellent store of wealth, as it can be easily converted into other marketable assets , such as land, machinery , plant etc.

Transfer of Value : Money is a liquid means of exchange. Hence purchasing power of money can easily be transferred from one person to another and from one place to another.

Contingent functions

Basis of Credit : At present credit is used as money on the basis of money, Bank and Financial institutions create credit on the basis of money.

Basis of Distribution of Social Income : Total output of the country is jointly produced with the help of different factors of production (Land, Labour, Capital and Enterprises).So, the output should be distributed among them. Money helps in the distribution of the national product in the form of Rent, Wage, Interest and Profit, which are expressed in money terms.

Basis of Maximum Satisfaction and Production : A Consumer maximizes his satisfaction by equating the prices of each commodity(in terms of money) with its marginal utility. Similarly, a Producer maximizes his satisfaction by equating the marginal productivity of a factor with price of that factor.

Cont...

Helpful in Making Capital Liquid and Mobile : Money makes capital liquid and mobile.

Guarantee of Solvency : Money acts as a guarantee of solvency for an individual or institution. Every individual or institution prefers to keep some money ready as cash deposits. Money deposits serve as a guarantee against solvency.

Bearer of Option : Money serves as a bearer of option which implies that accumulating wealth in the form of money , any individual can change their decision regarding the goods and services as and when the situation demands.

The Components of Money Supply

Paper Money and Coins – The Central Bank or Government issues these as Currency. Further, they have a 100% acceptance as a means of payment. The acceptance is based on a ‘promise to pay the bearer’ gold and/or foreign exchange in return.

Demand Deposit – A bank has a legal obligation to pay money on demand. The money-ness is highest in currency and demand deposits.

Near Money or Money Substitute – A commonly used Near Money is a bank cheque. many people accept it as a means of payment. However, there is no legal compulsion behind their acceptance.

Term deposit – This is less liquid than a demand deposit as the individual cannot use it before a fixed period of time.

Other Financial Assets – Many non-banking financial intermediaries issue these assets.