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Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: English
Branch: Commercial Sciences
Level: Second year Bachelor

Lecture 03: Meaning, Function and Forms of Money

Money is a concept which we all understand but which is difficult to define in exact terms. This is because it fulfills many functions and comes in many forms

Objectives

After reading this unit, you should be able to:

- Define the money

- Discuss the functions of money
- Identify the various characteristics of Money

- List the various Forms of Money

1- Meaning of Money

Economists have defined 'money' in different ways. Some of their definitions are given below.

"Money is what money does." It implies that anything that performs the work of money is called money.
"Money is a commodity which is used to denote anything which is widely accepted in payment for goods or in discharge of other business obligations."
"Money is anything that is generally acceptable as a means of exchange (i.e. as a means of settling debts) and that at the same time acts as a measure and a store of value."
"Money is anything that is commonly used and generally accepted as a medium of exchange or as a standard of value."

"Money is the means established by law (or by custom having the force of law) for the payment of debts."

"Money is the most convenient way of laying claim which can be used by its owner to buy anything."

"Money is any commodity assigned by the State the role of settling debts."
"Money is purchasing power something which buys things."
"Money is one thing that possesses general acceptability."
"In order for anything to be classified as money, it must be accepted fairly, widely as an instrument of exchange."
It is to be noted that the acceptability should be voluntary and not forced by law. All the economists who have defined money agree that anything which is generally acceptable in payment of debt and

is commonly used as a medium of payments or as a standard of value can be regarded as money, whatever may be its legal status.

2- Characteristics of Money:

- Acceptability; Money should be generally acceptable by all in exchange of goods and services without hesitation. Suppose it does not fulfill this primary condition of acceptability, then it cannot be termed money because it does not act as a common medium of exchange. Gold and silver coins are generally acceptable anywhere in the world because they have many alternative values, apart from their exchange value. Under gold standard, gold is generally acceptable. Under silver standard, silver is generally acceptable. Under paper standard, paper money or currency (without having any intrinsic value of its own) is generally acceptable. It should be noted that paper currency notes and subsidiary coins are acceptable only in the country of issue.

- Portability; Money should be easily and conveniently portable. Portability simply means easily takeable, i.e. a good money material should be easily portable from one place to another without any delay or difficulty. Though gold and silver possess high value with small bulk, paper money and bank money are therefore preferred to be used as good money materials. It is because of the fact that gold and silver coins are of heavy weight, therefore their portability is difficult. Hence, paper money and bank money are more portable than gold and silver coins.

- Recognizability; A good money material should be recognizable, i.e. a good money material should be such that it is easily identified and distinguished from other materials by shift, sound or weight.

-Elasticity; A good money material should be highly elastic, i.e. money which can be expanded or contracted according to commercial needs is said to be elastic. Elasticity is one of the essential qualities of a good medium of exchange. A sound currency system should provide the characteristic of elasticity.

- Manageability; A good money material should be manageable, i.e. the total quality of money in circulation should be manageable by the issuing authorities so as to maintain the welfare of the economy through controlling the expansion and contraction of the money supply.

- Stability; A good money material should have stable value, i.e. its value must neither fall nor rise. If the value is unstable, it may not be accepted by all. The stability in the value of money makes the working of the economy smooth. Such a quality is not possessed by any material. Gold and silver coins are comparatively more stable in value than other materials. The value of paper money could be maintained by keeping its issue under control. Hence, the instability in price level may lead to a defective functioning of money’s other services, namely, being a standard of deferred payments, measure of value and store of value.

- Durability; A good money material should be durable. Money must be durable because it is stored up for future use. Gold and silver coins are good money material because they have durability. Paper money does not possess this quality because currency notes are easily destroyable. But small denomination coins and demand deposits in banks are more durable and indestructible than the paper money.

- Divisibility; A good money material should be capable of being divided into smaller denominations without any loss of value. The smaller units of money enable the fractional transactions without any difficulty.

- Accessibility; A good money material should be easily accessible, i.e. the money should have easy access to the foreign market for trade, investment and other purposes. The domestic money should be easily convertible into any foreign currency at reasonable rates and vice versa. For easy access to foreign markets, both short term and long term, the rate of exchange should be fixed at qualities of a good money material of any country.

- Homogeneity; A good money material should be uniform in quality and quantity. All prices of the material used as money should be homogeneous so that equal weight has been exactly the same value. If the quality is not uniform, it will not contain the same value in the same bulk. Diamonds and other precious stones are not uniform in quality. So they were not used as good money material. Gold and silver are homogeneous. Paper money of the same denominations is similar in shape, size and design. Similarly, subsidiary coins are uniform in appearance, design, weight and fineness.

3-Functions of Money:

It has primary, secondary and contingent functions in any economy.

A- The primary functions of Money; The primary functions of money include the following

Medium of Exchange; The most important primary function is that money serves as a common medium of exchange of goods and services and also as a general medium of payments. In the present day world economy, money is the only medium through which goods and services are exchanged. Hence money serves as a common medium of exchange.

Unit of Account; money is used to measure value in an economy. We measure the value of goods and services in terms of money, just as we measure weight in terms of pounds or distance in terms of miles.

Store of Value; The value of goods can be stored for any length of period in terms of money. Storing of money means storing of wealth itself. With other words, a store of value is used to save purchasing power from the time income is received until the time it is spent.

B-The Secondary Functions: The secondary functions of money include the following

Standard of deferred payments; By deferred payment we mean that the value is received but the payment is to be made at a future date, which is based on the assumption that the value of money will remain stable

C- Contingent Functions; Contingent functions of money include the following:

Money is an instrument of monetary policy; Therefore, monetary authorities resort to money supply as a monetary policy tool to influence economic activity. The goal of monetary policy becomes to control the quantity of money that achieves a certain level of economic equilibrium.

Money as a factor of production; Money is considered an essential factor of production.

It gives projects a margin of safety and guarantee that enables them to continue their production and investment activity, in addition to natural assets such as land and real estate, or human assets such as organized labor.

4-Forms of Money;

A-Commodity Money; is a commodity that has intrinsic value and is used as a medium of exchange. Salt, animal, gems, beads, gold, silver etc. are examples of commodity money. Money made up of precious metals or another valuable commodity is called commodity money, and from ancient times until several hundred years ago, commodity money functioned as the medium of exchange in all but the most primitive societies.

B-Metallic Money: The money made of any metal such as gold, silver etc is called metallic money. It exists in the form of coins. Metallic money has the following two types:

Full Bodied Coins: When the face value of the coin is equal to the value of metal contained in the coin, the coin is called a full bodied coin. The gold and silver coins of old times are examples of full bodied coins.

Token Money: When the face value of a coin is greater than the value of the metal it contains, it is called token money. In our country, all the coins are token money

C-Paper Money: Paper money refers to notes of different value made of paper which is issued by the central bank or government of the country. The paper money can be classified into following types:

Representative Money: Representative money is that money which is fully backed by equal metallic reserve. The holder of a bank note can easily get it converted into metallic (gold & silver) form on demand.

Convertible Money: It is the form of money which can be converted into gold, silver i.e. metallic reserves. But all these notes issued by the government are not fully backed by gold.

The amount of gold kept by the government is a particular proportion of the notes issued

Fiat Money (; currency has evolved into fiat money, paper currency decreed by governments as legal tender (meaning that it must be accepted as legal payment for debts) but not convertible into coins or precious metal. Paper currency has the advantage of being much lighter than coins or precious metal, but it can be accepted as a medium of exchange only if there is some trust in the authorities who issue it and if printing has reached a sufficiently advanced stage that counterfeiting is extremely difficult.

D-Scriptural Money; Scriptural or book money is the money available on the current accounts of households and businesses. It is a simple accounting entry made by a financial institution (usually a bank). Scriptural money is therefore intangible, unlike fiduciary money (bank notes and coins). Money deposited in a current account with a bank can be used at any time to make payments. To this end, the bank provides households and businesses with various means of payment, the main ones being: cheque, bank transfer.

E-Electronic Money; money that exists only in electronic form. The first form of e-money was the *debit card*. Debit cards, which look like credit cards, enable consumers to purchase goods and services by electronically transferring funds directly from their bank accounts to a merchant's account.

5-Gresham's Law; Thomas Gresham, an expert on Finance and founder of the Royal Exchange states the law as: "bad money tends to drive good money out of circulation", when both of them are full legal tender.

Eg; suppose that a country is on bimetallism where both gold coins and silver coins are in circulation. When the official value of gold (fixed by the government) is lower than the market value (fixed by the demand and supply of gold and silver), gold is undervalued which is called good money. The overvalued silver is called bad money. So the overvalued silver coins will tend to drive the undervalued gold coins out of circulation.

Gresham's law, as applied to bimetallism states that, "if the coins of precious metals be converted at a fixed ratio of exchange with one another, the overvalued metal will tend to drive the undervalued metal from circulation."

References;

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