

MONEY & BANKING

PART-1

TOPIC – MONEY AND ITS SUPPLY

MONEY – Money is anything which is generally accepted as a medium of exchange, measures of value, store of value and standard of deferred payment.

In other words, Money is any good that is widely used and accepted in transactions involving the transfer of goods and services from one person to another.

{Money = Currency held by the public (C) + Demand Deposits (DD)}

CHARACTERISTICS OF MONEY - The characteristics of money are durability, portability, divisibility, uniformity, limited supply, and acceptability.

BARTER SYSTEM – Barter exchange refers to exchange of goods for goods. An economy, where there is a direct barter of goods and services, is called a ‘Barter Economy’ or ‘C-C Economy’.

DRAW BACKS OF BARTER SYSTEM –

1. Problem of Double Co-incidence of Wants – A can exchange goods with B only when A has what B wants and B has what A wants.
2. Lack of Common Measure of Value
3. Lack of Standard of Deferred Payment
4. Difficulty in Storing Wealth
5. Lack of Divisibility.

EVOLUTION OF MONEY – Cattle, which throughout history and across the globe have included not only cows but also sheep, camels, and other livestock, are the first and oldest form of money. With the advent of agriculture also came the use of grain and other vegetable or plant products as a standard form of barter in many cultures. Briefly, evolution of money was mainly through commodity money, metallic money, paper money and bank money. Human beings passed through a stage when money was not in use and goods were exchanged directly for one another. Such exchange of goods for goods was called Barter Exchange.

There are five stages of evolution –

1. Commodity Money (Goods),
2. Metallic Money (Coins),
3. Paper Money (Bank Notes),
4. Credit Money (Cheques & DDs) and
5. Plastic Money (Credit & Debit Cards).

Just for information

Fiat Money – It is the money backed by order (fiat) of the government.

Fiduciary Money – It is the money backed by mutual trust between the payer and the payee.

Full bodied money – Money in terms of coin whose commodity (intrinsic) value is equal to its money value is called full bodied money.

Credit Money – It refers to money where money value is more than the commodity (Intrinsic) value.

Legal Tender Money – Has a legal sanction by the government.

Liquidity – The ease with which any asset can be converted in to cash without loss of value or time.

FUNCTIONS OF MONEY

(Money has overcome the drawbacks of barter system)

1- Medium of Exchange – it means that money acts as a medium for the sale and purchase of goods and services. A buyer can buy goods through money and a seller can sell goods for money. In the absence of money, goods were exchanged for goods. This required double coincidence of wants. It has removed the major difficulty of the double coincidence of wants.

2- Measure of Value - Money serves as a measure of value in terms of unit of account. Unit of account means that the value of each good or service is measured in the monetary unit. Measurement of value was very difficult in the barter system one good was valued in terms of the other. Introduction of money has removed this difficulty. It acts as a yardstick of standard measure of value to which all other things can be compared.” Money measures the value of everything or the prices of all goods and services can be expressed in terms of money. This function of money also enables the trading firms to ascertain their costs, revenues, profits and losses.

3- Standard of Deferred Payments – Deferred Payments referred to those payments which are to be made in near future. Money act as a standard of deferred payments due to the following reasons –

- * Value of money remains more or less constant compared to other commodities.
- * Money has the merit of general acceptability.
- * Money is more durable compared to other commodities.

4- Store of Value – Money can be stores and does not lose value. Money acts as a store of value due to the following reasons.

- * It is easy and economical to store.
- * Value of money remains relatively constant.
- * Money has the merit of general acceptability.