sector can be fully utilized, this will increase output without much additional investment. In other words, real output will increase and prices will not rise.

Export surplus helps to fight deficient demand. Export surplus raises aggregate demand. Exports can be raised by increasing net investment abroad. An economy can give up a part of its domestic production of goods which are in demand abroad for increasing export. Government can take various measures to boost exports such as removing unnecessary restrictions, providing tax concessions, subsidies, incentives for exports etc, use of latest and modern technology and developing modern infrastructure.

Questions for Review

1. What happens in an economy when credit availability is restructured and credit made costlier?
2. Explain fiscal measures by which excess demand in an economy can be reduced?
3. Explain the impact of excess demand on output, employment and prices?
4. Show 'inflationary gap' (excess demand) with the help of a diagram.
5. Show 'deflationary gap' (deficient demand) with the help of a diagram.
6. What are open market operations?
7. How is monetary policy used to correct excess demand in the economy?
8. What is bank rate? How does it affect the availability or credit?
9. Give meaning of fiscal policy and monetary policy.
10. Discuss in brief the impact of deficient demand on output and employment.
11. Name any four instruments of monetary policy.
12. How does excess demand affect price?
13. What is the impact of demand deficiency on output, employment and prices in (*a*) industrially developed countries, (*b*) less developed countries?
14. What happens when credit availability is restricted and credit made costlier?
15. Write short notes on :
    (i) Export surplus
    (ii) Budgetary deficits
    (iii) Built–in income stabilizers
    (iv) Fiscal policy.
16. How does the introduction of government sector affect economy?

23 MONEY—MEANING AND FUNCTIONS

Money is widely used instrument in modern days and its role in economic system is indispensable. In earlier days, barter system was prevalent, which was beset with too many difficulties. As such a new medium of exchange was felt necessary by every society. Therefore a uniform medium of exchange was invented which is what today's money is. However, money did not come into existence overnight. It took several centuries of its present form to develop. Money itself must be a scarce good. Many items have been used as money, from naturally scarce precious metals and conch shells through cigarettes to entirely artificial money such as banknotes.

Commodity money was the first form of money to emerge. Under a commodity money system, the object used as money has inherent value. It is usually adopted to simplify transactions in a barter economy; thus it functions first as a medium of exchange. It quickly begins functioning as a store of value, since holders of perishable goods can easily convert them into durable money. In modern economies, commodity money has also been used as a unit of account. Gold-backed currency notes are a common form of commodity money. A variety of commodities had been used to serve as money. The most common commodities used were cattle, leather and hides, bear, wine, corn, tobacco, salt, rice, and so on. In medieval Iraq, bread was used as an early form of currency. In his book, "Primitive Money", Paul Einzing, listed almost 172 objects and materials which had been used as money in the past.

Development of economic life has changed commodity money to metallic form of money. Metals such as gold, silver, copper, iron, lead and bronze were used to make money. Metals like gold and silver have been used as commodity money for thousands of years, being in the form of metal dust, nuggets, rings, bracelets and assorted pieces. Eventually the Lydians began coining gold and silver around 560 BC.

Gold and silver, in due course, came to be recognized as universal and natural money. Then came the era of abstract money which includes paper currency and bank deposits together with coins; it is the modern system of money came into existence during depression of 1930s. According to G.L.S. Shackle, *"Money began as commodity money and ended as a system of recording transactions and bringing every act of purchase and sale of borrowing and lending, of working and producing at any time, into some degree of relation with every other such act".*

The origin of the word "money" comes from the Latin word "moneta", which comes from the temple of Hera the Moneta where the Roman money came from, in the early days of Rome. In the Olympian pantheon of classical Greek Mythology, Hêra (Greek) was the wife and sister of Zeus. In Greek language, "*Hera Mone tas*" means the lonely Hera. Zeus, once upon times, punished Hera and tied her with a golden chain between earth and sky. Hera, because she was alone between sky and earth tied with gold, was called moneres or mone which means lonely, and this is where the word money comes from. Hera, with the help of Hephaestus, broke the golden chain and released herself. It is said that all gold found on earth (which forms approximately a single cube 20 m a side, so you can imagine how Hera looked inside it) originates from the fragments of this golden chain, which fall from the sky and became human's mone(y).

May be due to this fable, gold was used in ancient Greece only in temples, graves and jewels and there is not any ancient Greek golden coin, until the days around 390 BC, when the Greek king Philip II of Macedon coined golden coins. The first golden coins in history were coined by Lydian king Croesus, around 560 BC. The first Greek coins were made initially of copper, then of iron and this is because copper and iron were powerful materials used to make weapons. Pheidon king of Argos, around 700 BC, changed the coins from iron to a rather useless and ornamental metal, silver, and, according to Aristotle, dedicated some of the remaining iron coins (which were actually iron sticks) to the temple of Hera. King Pheidon coined the silver coins at Aegina, at the temple of the goddess of wisdom and war Athena the Aphaia (the vanisher), and engraved the coins with a Chelone, which is used until nowdays as a symbol of capitalism. Chelone coins were the first medium of exchange that was not backed by a real value good. They were widely accepted and used as the international medium of exchange until the days of Peloponnesian War, when the Athenian Drachma replace them. According to other fables, inventors of money were Demodike (or Hermodike) of Kyme (the wife of Midas), Lykos (son of Pandion II and ancestor of the Lycians) and Erichtonius, the Lydians or the Naxians.

BARTER SYSTEM

Barter system involves the system of trading or exchange where goods and services are exchanged with other goods and services. This system was prevalent before the invention of money. A producer of rice can purchase cloth by exchanging rice from a producer who produces cloth. This system is as old as human civilizations. Barter system of trading originated when man required such things which he cannot produce himself. He started producing such goods and services which he is able to produce and fulfilling the satisfaction of those goods by buying from others which he cannot produce in best way. Thus in a barter, one person sells goods to other in exchange of other goods.

Difficulties of Barter

Barter system is beset with many difficulties which are explained as under:

1. *Lack of double coincidence of wants*: The most serious problem in barter system is the lack of double coincidence of wants. Thus, a seller of a commodity must not find some person who is willing to purchase and sell his goods to him. In other words, double coincidence of wants means that a person who owns goods and services, must find some person, who not only wants this commodity but who also possesses the good and service which the first person wants. If a person wants to sell his cow in exchange with rice, he must find a person who is willing to sell rice and buy cow.

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2. *Absence of common unit of measure*: There was no common unit of measuring the values of different goods and services. As such the value of each commodity in the market does not remain as same and constant. It had to be determined in as many separate quantities as there were kinds and qualities of other goods and services meant for bartering in the market.
3. *Lack of store of value*: There is lack of any good method to store the generalized purchasing power or wealth. People can store wealth in terms of specific commodities. The stored commodities may lose its value due to damage with passage of time. Moreover, the method of storing goods is somewhat expensive.
4. *Problem of future payments*: A barter system suffered from the disadvantages of lack of any satisfactory unit in terms of which deferred payments for any future contracts can be made. Contracts concerning payments in future period are important feature of an exchange economy. Agreements relating to payments of wages, rent, interest, salaries etc extend over a period of time. These payments have to be made in future. Barter system is unable to undertake such transactions. The reason are controversy regarding the quality of goods and services accepted for payment; disapproval in regard to exchange of specified commodity and risk involved in the contract due to fall or rise of value of commodity accepted for payment.

MEANING OF MONEY

Money is any marketable good or token used by a society as a store of value, a medium of exchange, or a unit of account. Money objects can meet some or all of these needs. Since the needs arise naturally, societies organically create a money object when none exists. In other cases, a central authority creates a money object; this is more frequently the case in modern societies with paper money.

Money plays an important role in the determination of income and employment. Money has been defined in different ways by different economists. F.A. Walker defines it in terms of its functions. Cole, Keynes, Seligman and Robertson defined in terms of its 'general acceptability'. According to Robertson, *"anything which is widely accepted in payment for goods or in discharge of other kinds of business obligation is called money."* Prof. Crowther has given a very comprehensive definition of money. He defined money as, *"anything that is generally acceptable as a means of exchange and at the same time, acts as a measure and store of value."*

FUNCTIONS OF MONEY

The important functions of money can be discussed under the following heads:

1. Primary Functions

(i) **Medium of exchange:** Money serves as a medium of exchange. It facilitates the buying and selling of goods.

(ii) **Measure of Value:** Money acts as a common and uniform measure of value. The values of various commodities are measured in terms of money. Now a days, money made transactions simple and easy. Thus, money serves as a unit of account. For instance, in India the unit of account is Rupee.

2. Secondary Functions

(i) **Store of value:** Money also serves as a store of value. It means people can keep wealth in the form of money. In other words, storing money means holding of purchasing power. Money is a very liquid (quick conversion of assets into cash) asset, and therefore it can purchase goods and services at any time.

(ii) **Standard of deferred/delayed payments:** Standard of deferred payment means that future payments of any transaction can be made in terms of money. It means payment can be spread over a period of time. A person who borrows a certain sum of money in the present may make payment in the future, and the amount of money to be paid is definite.

(iii) **Transfer of value:** Money helps to transfer value from one person to another. For example, when we purchase a good from a seller, we actually transfer value to the seller by making payment in terms of money equal to the price of the good.

3. Contingent Functions

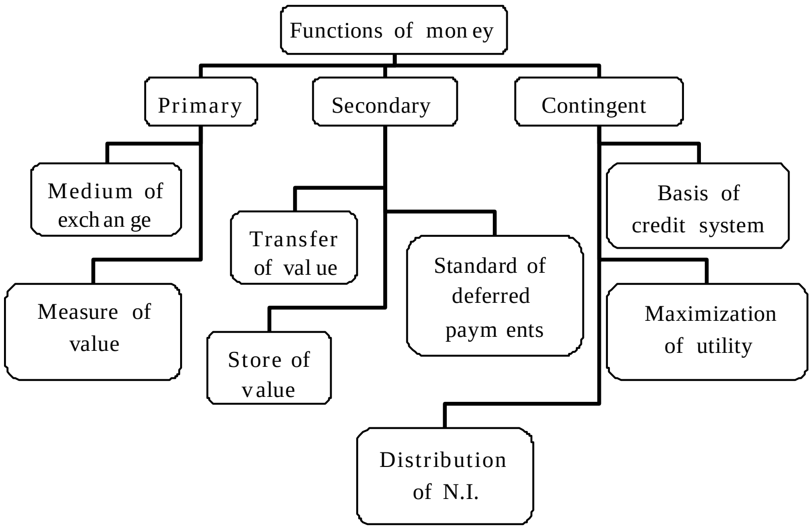
This refers to the use of money in assisting various economic entities, such as consumers, producers etc in taking important decisions.

(i) **Distribution of income:** Money helps in the distribution of national income. In other words, factors of production contribute to production process by rendering their services and for such act they get reward in terms of money and not in terms of goods and services.

(ii) **Maximization of utility:** A rational consumer or a producer always tries to maximize utility (satisfaction). For instance, a consumer equalizes his total utility by equalizing the ratios of marginal utilities of different goods with the price ratio of different goods in terms of money.

(iii) **Basis of credit system:** Credit plays important role in the modern economy. Commercial and business activities are highly dependent upon the credit system. All credit instruments like cheques, bills of exchange etc., cannot be used in absence of money.

The chart below summarizes various functions of money:



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SUPPLY OF MONEY

Money supply refers to total amount of money in circulation in an economy. It is a stock at any point of time held by the public. Money supply is determined jointly by monetary authority, banks and the public. According to Reserve Bank of India, stock of money includes – (a) currency with public and (b) deposit money. Currency includes all coins and paper money issued by the government and the banks. RBI has included the four alternative measures of money supply. These are – M_1, M_2, M_3, and M_4. M_1 is the sum of currency held by public, net demand deposits of banks and other deposits of the RBI. M_2 is M_1 + savings deposits with post office; M_3 is M_1 + net time deposits of banks. M_4 is M_3 + total deposits with post office savings. Net demand deposits include deposits held by public and other deposits of RBI include deposits other than those held by the government, banks, and others.

Ordinary Money and High powered money: There are two types of money—ordinary money (M) and high powered money (H). Ordinary money is the sum of currency and demand deposits. High powered money (H) is the money produced by the RBI and government of India (small coins including one rupee notes) held by the public and banks. RBI calls it 'reserve money'. Thus H is the sum of currency held by public, cash reserves of the banks and other deposits of RBI. The difference between ordinary money and high powered money is due to demand deposits in ordinary money and cash reserves in high powered money. Banks produce demand deposits and these are treated as money at par with currency. To create demand deposits, banks have to maintain a cash reserve, which is the part of high powered money, produced only by monetary authority and not by banks. We know that demand deposits are multiple of cash reserves, which are component of H; it gives H the quality of high poweredness, that is, the power of serving as a base for multiple creations of demand deposits. High powered money, for this reason, is also called as base money. Thus, H is the dominant factor in determining money supply.

It is thus clear that the main components of the supply of money are coins, paper currency and demand deposits or credit money created by commercial banks.

COMPONENTS OF MONEY

Money is classified on the basis of its form, legal recognition or its nature.

Metallic Money: It is made out of different metals such as gold, silver, copper, lead, nickel etc. Metallic money may be classified into three categories. These are—standard money, token money and subsidiary money. Standard money is also known as full-bodied money. Standard coins are made of gold or silver, which have well defined weight and fineness. Their face value is always equal to their intrinsic (metallic) value. Token money is used for making smaller payments. It is made of inferior metals such as copper, nickel etc. It is the money whose face value is higher than its intrinsic value. Coins are token money used for making smaller payments. Whereas token money is a limited legal tender, standard money is unlimited legal tender. The subsidiary money or coins are used to make smaller payments like token money. These are low value coins made of generally aluminum. These are also limited legal tender.

Paper Money: Currency notes are the paper money. In India, paper money consists of all paper currency of various denominations issued by the central bank (Reserve Bank of India) of the country. The first bank to issue paper currency in India was Bank of Bengal in 1806.