FACULTY OF JURIDICAL SCIENCES

Lecture-8

MEANING OF MONEY

Money, a commodity accepted by general consent as a medium of economic exchange. It is the medium in which prices and values are expressed; as currency, it circulates anonymously from person to person and country to country, thus facilitating trade, and it is the principal measure of wealth.
Money is a liquid asset used in the settlement of transactions. It functions based on the general acceptance of its value within a governmental economy and internationally through foreign exchange. The current value of monetary currency is not necessarily derived from the materials used to produce the note or coin.

Money, in simple terms, is a medium of exchange. It is instrumental in the exchange of goods and/or services. Further, money is the most liquid assets among all our assets. It also has general acceptability as a means of payment along with its liquid nature.

Usually, the Central Bank or Government of a country creates and issues money.

FUNCTIONS OF MONEY

1. Medium of Exchange*:*
The only alternative to using money is to go back to the barter system. However, as a system of exchange the barter system would be highly impracticable today.

For example, if the baker who supplied the green-grocer with bread had to take payment in onions and carrots, he may either not like these foodstuffs or he may have sufficient stocks of them.

The baker would, therefore, have to re-sell the product which would take time and be very inconvenient. By replacing these complicated sales by the use of money it is possible to save a lot of trouble. If the baker accepts payment in money this can be spent in whatever way the baker wishes. The use of money as a medium of exchange overcomes the drawbacks of barter.

Thus, money provides the most efficient means of satisfying wants. Each consumer has a different set of wants. Money enables him (her) to decide which wants to satisfy, rank the wants in order of urgency and capacity (income) and act accordingly.

This type of system also enables specialization to extend. Take, for example, a person who performs only a single task in a shoe factory. He has not actually produced anything himself. So what could he exchange if a barter system were in operation? With money system the problem is removed. He can be paid in terms of money and can use that money to buy what he wants.

2. A Measure of Value:

Under the barter system, it is very difficult to measure the value of goods. For example, a horse may be valued as worth five cows or 100 quintals of wheat, or a Maruti car may be equivalent to 10 two- wheelers. Thus one of the disadvantages of the barter system is that any commodity or service has a series of exchange values.

Money is the measuring rod of everything. By acting as a common denominator it permits everything to be priced, that is, valued in terms of money. Thus, people are enabled to compare different prices and thus see the relative values of different goods and services.

This serves two basic purposes:

(1) Households (consumers) can plan their expenditure and

(2) Business people can keep records of income and costs in order to work out their profit and loss figures.

3. A Store of Value (Purchasing Power):

A major disadvantage of using commodities — such as wheat or salt or even animals like horses or cows — as money is that after a time they deteriorate and lose economic value. They are, thus, not at all satisfactory as a means of storing wealth. To realize the problems of saving in a barter economy let us consider a farmer. He wanted to save some wheat each week for future consumption. But this would be of no use to him in his old age because the ‘savings’ would have gone off.

Again, if a coal miner wanted to set aside a certain amount of coal each week for the same purpose, he would have problems of finding enough storage space for all his coal. By using money, such problems can be overcome and people are able to save for the future. Modern forms of money (such as coins, notes and bank deposits) permit people to save their surplus income.

Thus money is used as a store of purchasing power. It can be held over a period of time and used to finance future payments. Moreover, when people save money, they get the assurance that the money saved will have value when they wish to spend it in the future. However, this statement holds only if there is no severe inflation (or deflation) in the country.

In other words, it is quite obvious that money can only act effectively as a store of value if its own value is stable. If, for example, most people feel that their savings would become worthless very soon, they would spend them at once and save nothing. For the last few years the value (or the purchasing power) of money has been falling in India. Yet in the short run—for day-to-day purposes—money has sufficient stability of value to serve quite well as a store of value.

4. The Basis of Credit:

Money facilitates loans. Borrowers can use money to obtain goods and services when they are needed most. A newly married couple, for example, would need a lot of money to completely furnish a house at once. They are not required to wait for, say ten years, so as to be able to save enough money to buy costly items like cars, refrigerators, T.V. sets, etc.

5. A Unit of Account:

An attribute of money is that it is used as a unit of account. The implication is that money is used to measure and record financial transactions as also the value of goods or services produced in a country over time. The money value of goods and services produced in an economy in an accounting year is called gross national product. According to J. R. Hicks, gross national product is a collection of goods and services reduced to a common basis by being measured in terms of money.

6. A Standard of Postponed Payment:

This is an extension of the first function. Here again money is used as a medium of exchange, but this time the payment is spread over a period of time. Thus, when goods are bought on hire-purchase, they are given to the buyer upon payment of a deposit, and he then pays the remaining amount in a number of installments.

Under the barter system this type of transaction could involve problems. Imagine a farmer buying a video-recorder and agreeing to pay for it in terms of a fixed amount of wheat each week for a certain number of weeks. After a few weeks the seller of the video recorder might have more than enough wheat.

Yet he will have to receive more wheat in the coming weeks. If money had been used, the seller could then use it to buy whatever he wanted, whether it is wheat or something else—now or in future. In other words, the use of money permits postponement of spending from the present to some future occasion.