

- **Introduction**

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Money is at the centre of all economic activities in a modern world. To satisfy her/his needs an individual requires money to buy goods and services. Money is not only the medium of exchange but it is also used the store value. People save money for their future needs.

Human wants are unlimited and a person cannot satisfy all wants by one's own produce. Thus a person tries to satisfy maximum possible wants by way of mutual exchange of goods and services.

In ancient times, human beings used to satisfy their wants by exchanging goods and services among themselves. Such a system of exchange for satisfying wants was called a barter system.

3.1 Meaning of a Barter System

Barter system is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money.

3.1.1 Limitations of a Barter System : In the earlier years, individuals lived a simple village life, had less needs and carried out agricultural exchange, exchange of goods and service which was sufficient for their sustenance. For example a farmer cultivating wheat would store the required stock, and would exchange the remaining wheat to get rice, clothes or shoes. Similarly the shoe-maker would get clothes and food, ghee by exchanging the shoes he made. Teachers used to get food in exchange for knowledge and the artists would be patronized for their entertaining art.

Increasing population and socio-economic development resulted in an increase and change in demands, making them more specific. Industrialization, Urbanization, division of labour, and Specialization made the Barter system limited and less applicable. The mutual exchanges decreased and the personal needs increased.

The prominent limitations of barter system are :

3.1.1.1 Problem of Mutual Adjustment of Wants : With socio-economic development, the needs of human beings increased and so the economic structure which was simpler in earlier times

became more complicated. Now those who had rice to exchange for wheat did not need wheat but clothes under barter. While on the other hand one who had clothes did not want rice but wanted ghee in exchange for their clothes. Thus, there was a difficulty in establishing a need for each other's goods or services to make the barter possible, making it a challenge to establish a barter between indivisible and divisible goods.

3.1.1.2 Difficulty in Storing Value : There was an increasing problem in storing value. Here value means exchange value.

A farmer may exchange wheat for pair of shoes or cloth, but when productivity rises and she/he produces more wheat there arises a problem of strong surplus wheat. If wheat can be stored for a long period then at a future date such stock of wheat can be exchanged for new pair of shoes or cloths or rice. But the question arises, how to store wheat ?

When an individual produced on a large scale through one's own efforts, she/he had to exchange this produce instantaneously for other goods and services. It was otherwise difficult to store the surplus goods or store the exchange value of these goods.

3.1.1.3 Problem of Measurement of Value : With the introduction of division of labour and specialization in an industry driven economy, the issue of measuring the value of goods and services emerged. Exchanging wheat for rice was simpler but now large number of goods became available for exchange against wheat and hence it became difficult to determine and maintain the exchange value of wheat. If 20 kg. of wheat is equal to 40 kg. of rice, 10 meters of textile and 1 kg. ghee; in a modern structure the questions of measurement arise as, how much of textile can exchange for 1 kg. ghee? Or how much of rice can exchange for 1 kg. ghee? It became difficult to determine such measures and hence arose a need for a universally acceptable measuring rod.

This led to the origin of money, which became a standard measure of value and a common denomination of trade.

3.2 Origin and Development of the Concept of Money

Evolution of money : In order to simplify the procedure of exchange and to introduce a universally acceptable medium which satisfies the store of value function, under the barter system, commodities and animals were used as a medium of exchange in India.

Agriculture being the major sector of the economy, there was a large production of crops, of which the required stock stored rest of the crops were sold to buy animals. When required, the animals could also be sold to get goods, services or even the crops in return. In this way animals like horse, cow, and buffalo became the means of exchange values for money and trade.

The use of animals as a standard measure and a common medium of trade also became a limitation and caused difficulties. Animals are mortal, they get sick and die, therefore the storage of wealth (in terms of value for money) in form of animals was not advisable. Thus, valuable minerals-stones were used instead of animals. At the onset of imperialism the use of coins started, as a means of trade and exchange of goods and services in the kingdom. The only limitation was that they were used in limited societies and regions.

Democracy and Industrialization inspired the need for the modern money as a means of exchange. By the support of central government the money became widely accepted as a means of exchange of goods and services. Money also succeeded in overcoming the limitation of storage of value for money. The advent of banking system made it easier to transfer and storage of money.

3.3 Meaning of Money and Functions of Money

According to Marshall "Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place".

While Robertson defines money as "What is accepted universally in exchange of goods or services".

Thus, that which performs the functions of money is called money. In order to understand money, it is necessary to understand the functions of money.

Functions of Money

3.3.1 Money as a Medium of Exchange :

The most important function of money is to act as a medium of exchange and trade. It removes the limitation of the lack of 'double coincidence of wants' and makes exchanges easier. The farmer can get money in exchange of wheat and then from that money he can buy clothes, rice, ghee, etc. An individual can spend money to satisfy his present demands of goods and services, and also save the money for future to satisfy his future needs for goods and services. Basically money is used as a medium to satisfy the needs of an individual by buying goods or services.

3.3.2 Money as a Store of Value :

Another function of money is "Money is a store of value". If a person produced goods and services in exchange of other goods and services but saving wealth for future needs of goods and services was difficult before the use of money as a means of exchange. Animals were mortal and a long term saving of values was not possible using them. This made money the most successful means of storage of value in terms of time. It is easy to have money as storage of value. It became possible to get money in exchange of crops and save the money for future needs to buy goods or services.

Another advantage of using money was that it could be used as a standard of deferred payment. This characteristic of money became an important basis for the entire systems of credit, hire-purchase and instalment payments.

3.3.3 Money as a Measure of Value :

Money plays an important role as a measure of value. In Barter-exchange system it was difficult to remember the exchange rates and values of each of the goods or services for 20 kg of wheat equals to how much kg of rice? equals to how much meter of cloths ? equals to how much kg of ghee? while on the other hand, money makes this easier allowing the values of different goods or services to be compared and assessed against each other. Money implies the price system, allowing the measure of price of each goods or services which can be compared to each other. It also allows faster decision making and exchanges.

3.4 Types of Money

Since the time of barter system, animals or precious stones were used as the means of exchange and storage of value. Thereafter metal coins came into existence which were followed by government regulated notes and currency coins. This was succeeded by the banking system, credit card and e-banking system. The types of money are: (1) Commodity money (2) Animals money (3) Metal money (4) Paper money (5) Plastic money (6) Banking money (Invisible or e-money)

3.5 Meaning of Inflation

In a simple sense, inflation means a rise in the general price level. Generally people consider inflation to be a rise in the prices of goods and services; but economics gives a clear meaning of inflation.

3.6 Definition of Inflation

According to Dr. A. P. Lerner,

“A situation of excess demand over supply of goods is called inflation.”

According to Dr. A. C. Pigou,

“Inflation is said to occur when monetary income rises faster than real income.”

The constant and steady increase in price leads to decrease in the purchasing power of money.

Dr. J. M. Keynes believes that “The real situation of inflation is created with increase in money income beyond the level of the full employment of factors of production”.

According to the above definitions of inflation, various characteristics of Inflation are given below:

3.7 Characteristics of Inflation

- (1) Constant rise in price levels
- (2) Price rise in all sectors of the economy
- (3) Purchasing power decreases (value of money)
- (4) The rise in price level after full employment is inflation.

Some other points to be considered for a better understanding of inflation are :

(1) When government has kept control over and suppresses increase in price levels via rules, law and subsidies, it is considered inflation even if there is no price rise. It is called ‘Suppressed Inflation’.

(2) If in an economy for shorter period of time if there is an increase in the price of limited goods or services, then it is not inflation.

(3) When some factors of production are unemployed and there is a price rise, then producers get an incentive to produce more so economic activity gets a boost and factors get employment, production rises and prices fall.

- If there is unemployment in factors of productions leads an economy the increasing price of goods or services will allow employment to increase production to decrease the price of goods and services.

Therefore the increase in price levels in all sectors of an economy even after full employment is considered inflation and it proves to be harmful for economy.

3.8 Causes of Inflation

Inflation means constant increase in price of goods and services in all sectors of an economy. The two major factors affecting the price of goods and services are : Demand and Supply. So the major factors affecting inflation are : (1) Increase in demand (2) Increase in production cost.

3.8.1 Increase in Demand :

There is an increase in demand of a product which leads to the increase in its price. If the supply is not provided or if they are provided at a slower rate than the increasing demands, then there is an increase in price of the product. If there is inflation due to increase in aggregate demand as compared to the aggregate supply, then it is called ‘Demand-pull inflation’. The major reasons for increase in demand are following :

- (1) **Increase in Supply of Money** : Monetarists consider inflation as a purely monetary

phenomenon. According to them if there is an increase in money in a state, the individuals earn more income because of which the demands of necessities increase. Against the increasing demand the supply remains steady, leading to increase in price and inflation. Machlup says that “Too much money chasing too few goods causes inflation”

(2) Increase in Public (Government) Expenditure : The government of developing countries like India is involved in economic development of the country. Government incurs expenditure after installing infrastructures, provision of basic utilities or providing employment; which increases the supply of money in the economy. This increases the incomes and demands of the people which lead to a rise in the general price level. Thus, if the government circulates money in excess of the production of goods and services in the economy by increasing public expenditure then the rise of general price level gains momentum

(3) Over-population : In India there is 2 % annual increase in population, leading to an increase in demands of individuals. The increasing population causes increase in the demands of basic requirements and when the supply is insufficient the price level increases. When the population is constant but their purchasing power increases due to rise of their income there is an increase in price levels.

Thus, supply of money leads to increase in demands followed by increase in price levels of goods or services.

3.8.2 Increase in Cost of Production :

The other major factor affecting the price is the supply of goods and services. Supply-oriented economists believe that when there is an increase in production cost there is an increase in its price.

If there is an increase in cost of raw material, machines, electricity, water rates, worker's wages or transportation there is an increase in price of goods or services. The inflation caused due to increase in production cost is called 'Cost-push inflation' or 'Supply shock inflation'.

3.8.3 Other Reasons :

The major reasons for inflation are (1) increase in demand (2) increase in production cost. But practically there are also other factors which can affect the inflation. Even though the minor factors are for a short term they cause a spike in price levels. eg. In industry based on foreign import, if there is an increase in import expences or if there is a shortage during contingencies, it can lead to price rise.

Basically there is an increase in demand and production cost that leads to inflation, but the other minor factors are as follows :

(1) Taxation Policy : The taxation policy of the government causes inflation. The high increase in tax rates increases the production cost of the products which leads to rise in inflation.

(2) Increase in Price of Import : In India 70 % of petroleum products are supplied via import. If there is an increase in price of crude oil in international market then there will be an increase in rates of petrol and diesel which can also increase the price of other products.

(3) Scarcity : When there is a scarcity in terms of raw material, electricity or any requirement for production it leads to increase in price level of the goods or services. If scarcity prevails for a long period during production or is extensive in nature it can cause inflation.

Exercise

1. Choose the correct option for the following questions :

- (1) Who gave the definition “What is accepted universally in exchange of goods or services is money” ?
(a) Marshall (b) Keynes (c) Pigou (d) Robertson
- (2) What is the type of inflation called when there is an increase in demand ?
(a) Demand-pull (b) Cost induced (c) Salary induced (d) Profit induced
- (3) What is the value of money during constant and steady price increase ?
(a) Increases (b) Decreases (c) Constant (d) Doesn't change
- (4) What is the type of inflation when the government controls inflation via rules or laws ?
(a) Suppressed (b) Open (c) Galloping (d) Hidden
- (5) Which economist believes that the true inflation is caused when there is rise in prices even when there is full employment ?
(a) Marshall (b) Crowther (c) Keynes (d) Pigou
- (6) What is the economic system called that allows exchange of rice instead of clothes ?
(a) Monetary system (b) Banking system (c) Barter system (d) Loan system
- (7) Which of the following can be used as the best means for storage of value ?
(a) Crops (b) Animals (c) Stones- minerals (d) Coins

2. Answer the following questions in one line :

- (1) Write the meaning of barter system.
- (2) Write the definition of money given by Marshall.
- (3) Normally what is inflation?
- (4) What is cost-push inflation?

3. Answer the following questions in brief :

- (1) Discuss the function of money as a medium of exchange.
- (2) Discuss the function of money as store of value.
- (3) State the causes of inflation.

4. Give answers to the point for the following questions :

- (1) Define money and explain its functions in brief.
- (2) Write a short note on the origin and evolution of money.
- (3) Explain the statement “Too much money chasing too few goods causes inflation”.

5. Answer the following questions in detail :

- (1) Define barter system and explain limitations of barter system.
- (2) Define inflation and explain the causes of inflation.

