

## LESSON 17

### MONEY : MEANING FUNCTIONS AND IMPORTANCE

---

The invention of money is perhaps the greatest of all, of mankind of mankin invention. For instance, invention of wheel in field of mechanics, fire in science, of vote in political science, money is an important evolution in economics and in commercial aspect of social life of a man.

In ancient times, human beings were dependent on nature for their basic needs. With the advent of civilization they learned to live in groups. While living in groups men started choosing different occupations on basis of their interests, skills & efficiency, so that their various wants could be accomplished. In primitive period, as people lived in small groups, men made simple easy exchange of goods they wanted. Exchange of goods with goods, is called Barter System.

#### **Barter Exchange system:**

There was exchange between two or more than two persons of their surplus production of goods and services in Barter System. In ancient period, man was involved only in primary occupation e.g. agriculture, animal husbandry, fishery, hunting etc. Hence, through this system generally grains in exchange of clothes, clothes in exchanges of milk, milk in exchange of grams and exchange of domestic animals was done in this system. This system was completely based on mutual understanding and trust.

#### **Difficulties of Barter system :-**

With the development of human civilization, there was increase in economic activities of man and many difficulties started arising which were not there early. The monetary system replaced the Barter system . A few major difficulties of the barter system may be traced as below:-

**(1) Lack of double coincidence:-** Two persons can have barter exchange only if their disposable possessions mutually suit each other's needs. This double coincidence of wants is often difficult. For instance, a farmer wants to purchase sugar in exchange

of his surplus wheat, then he would have to search a person who has surplus sugar for exchange but also has a desire for what he has to offer. In practice , it is difficult to have such a person who not only has surplus sugar for exchange but also has a desire to buy wheat. In practice, it is difficult to have such double coincidence of wants.

**(2) Lack of common measure of value:-**It is difficult to measure the value of surplus produce available for exchange. Both persons exchange goods on the basis of mutual understanding and utility. It is very difficult to determine the exchange ratio of goods available in every transaction..

**(3) Store of value was not possible :-**There was also exchange of such goods in this system which were difficult to store in long for period, specially milk, fruits, vegetables, etc. can't be stored for future, so in this system there was no possibility of future saving of surplus products.

**(4) Difficulties in exchange of indivisible goods :-**On account of indivisibility of many kinds of goods, the barter system also suffered from severe inconveniences. For instance, if exchange value of a buffalo is four sackful of wheat and if the farmer requires only one sackful of wheat then the buffalo (which is indivisible) cannot be exchanged for one sackful of wheat.

**(5) Lack of standard of deferred payments:-** In Barter system only immediate transactions are possible. Credit transaction cannot be promoted smoothly under this system. Mode and value of exchange can't be easily estimated.

To recapitulate, the main difficulties in barter system:-

- Lack of double coincidence.
- Lack of a common measure of value.
- Future savings are not possible.
- Difficulties in exchange of indivisible goods.
- Problem in keeping account of creditor deferred

payment.

It follows that because of these difficulties and inconveniences of the barter system, it was replaced by Monetary System with invention of money.

### Evolution of money :

Ancient Indian history has been the history of kings. In such state of governance, in all economic & social policies, the final decision maker was the king. The metal on which they punched mark their symbols, it became state money. The issue of currency depicts the development of this system. Copper, bronze, gold, silver coins were issued according to circumstances of those times. Thus, in this manner money came to be regarded as any object with properties of general acceptability, legality and as medium of exchange in transacting goods & services.

### Meaning and definition :

Goddess Juno was regarded as the Goddess of Heaven. They believed that goddess Juno provided the pleasure of heaven in the same way, coins minted in her temple also provided heavenly pleasure.

Different economists have defined money differently. In fact, it is a difficult task to define money in exact sense. Still in wider perspective of our analysis, we make an effort to study the definition given by some scholars.

**Prof. D.H. Robertson** - “Any thing which is widely accepted in payment for goods or in discharge of other kinds of business obligations”.

**According to Nep** - “Any commodity which is declared as a money by state is called money.” -

**Seligman defines-** “Money is the thing that possesses general acceptability.”

**According to Marshall-** “All those commodities which at any time or place have general acceptability without doubt or special enquiry as a means of purchasing commodities and services and of defraying expenses are included in the money.”

**According to Kinley** – “Money is such commodity which we generally use and accept as a mode or medium of exchange.”

After the study of above definitions, we draw two

main characteristic of money. First-general acceptability and second legality. Thus, money may be defined as- Money is something which is freely used and generally accepted as a medium of exchange and as a unit of account.

Reserve Bank of India introduced four measures of money supply in India which are denoted by-

$$M_1 = C + DD + OD$$

$$M_2 = M_1 + \text{Post office saving bank deposits}$$

$$M_3 = M_1 + \text{Time deposits with commercial and co-operative banks}$$

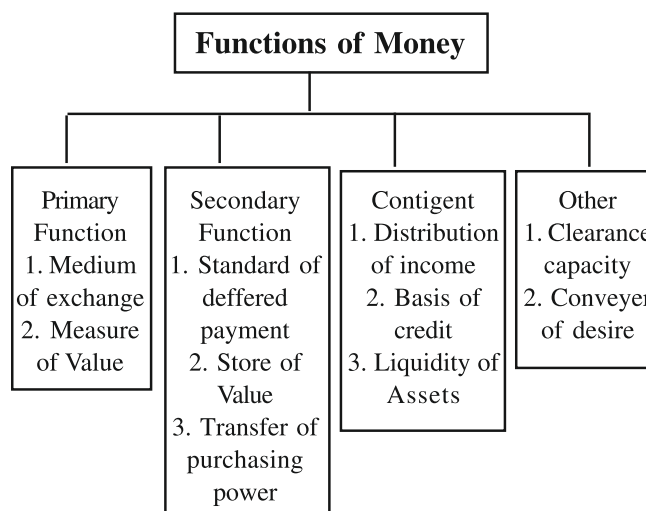
$$M_4 = M_3 + \text{Total post office deposits}$$

Here:

DD- demand deposits at commercial and co-operative banks

C- Cash in hand with the public (Notes and coins)

OD- Other deposits in RBI



### Functions of Money:

Main and primary functions of money are as follows:-

**1. Medium of exchange:-** The fundamental role of money is to serve as a medium of exchange because it has property of general acceptability. This function gives major identity to money. Money is a suitable mode for transactions in the market.

**2. Measure of value:-** It is the second important function of money.. The value of exchange of all goods and services can be easily expressed in money. It also

becomes easy to measure the National Income. By expenditure method, product method and income method the National Income of any country can easily be estimated in terms of money.

### Secondary functions of Money

Some functions of money are called secondary functions of money as the invention of money was not for these purposes but still for economic convenience, they are now used. These secondary functions are as follows:-

**1. Standard of deferred payments:-** The economic transactions where repayment is done in future, money serves as a standard of deferred payment. It is a unit in terms of which debts and future transactions can be settled. Thus, money functions in form of Standard of Deferred payment. The various types of loans transaction, like house loan, education loan, industrial loan etc., become easy. It enables people to effectuate wide scale credit transactions like sale and purchase of shares, debentures, and securities. In this process, the development of the money and capital market becomes possible which is essential to strengthen the economy.

**2. Money as a store of value:-** Those goods which are less durable can't be stored but, by means of money their value can be stored for future by selling these goods. This function facilitates large scale production. The property, house, gold, silver and bonds purchased through money can be stored for longer period. Though sometimes the value of money changes, the possibility of profit and loss is always there.

**3. Money as a transfer of value:-** A man can easily transfer their accumulated purchasing power to other person. Thus, money serves as a means of transfer of purchasing power. A man can also transfer the purchasing power to others in form of cash. In present cashless transaction economy, a person can transfer his purchasing power by using debit cum ATM card, credit card, or cheque to other person. The purchasing power is also transferred by sales of securities to another person. Moreover, he can sell his assets at one place and purchase at another place. Thus, money facilitates transfer of value between persons and places.

### Contingent functions:-

Money performs some contingent functions which prove it to be of more utility and convenience. These are as follows-

- 1. Distribution of National Income:-** In present times, large scale production and consumption is possible only by means of money. Money helps in distribution of National Income. Rewards of factors of production are determined and paid in terms of money.
- 2. Basis of credit system:-** In this period of Globalization, banks and all financial institutions provide various types of loans and also accept deposits. All these functions are performed by means of money.
- 3. Liquidity of assets:-** According to J.M. Keynes, an important function of money is to provide liquidity to capital and wealth. Money in the form of liquid can be used immediately for any work.

### Other Functions of Money:-

Money also performs other important functions beside the above mentioned functions which are as follows:-

- 1. Indicator of clearance capacity:-** The availability of money shows the clearance capacity of an economic agent (man or firm). The person who has money with him, has the ability to pay.
- 2. Helpful in making decisions:-** Money is means which provides help to a man in taking economic decisions according to his will. With the help of money, a man can fulfill his desire and wants. Such goods are produced more in the market for which a consumer is willing to pay high price. Thus, there is a famous quote on capitalism market "Consumer is the king of the market".

### Importance of Money

At present time, in economic field money has become an important factor. Thus we can understand the importance of money on the basis of following points:-

- 1. Axis of market system:-** In modern times, in an economy money is an easy medium of exchange. Thus, all transactions in a market system

are done by means of money.

**2. Measurement of economic development:-**

Money is an index of measurement of economic growth and development in country. In public welfare increasing by the government, public expenditure sets the path of expansion to development.

**3. Change in investment or saving in an economy:-**

In an economy the savings done by the people in the form of money are deposited with the banks which provides funds for purpose of investment in future.

**4. Work division and specialization:-**

In a country, money facilitates higher level of production by means of division of labour and specialization.

**5. Freedom in economic life :-**

Both consumers and producers are free to take rational decisions by use of money.

**6. Basis of social prestige :-**

In an economy, money with provisions of economic freedom also provides facility of storing value in the form of money, which becomes the basis of prestige.

It is clear from the above points that money has much importance in economic sphere but some economists suggest to keep a control over money in circulation because if not controlled it leads to inflation, due to which economy has to face several bad consequences. Therefore, a scholar has rightly remarked- “Money is good servant but a bad master”

**Demonetization :-** Demonetization is a process when the legal tender of currency units is declared invalid, and replaced with new currency by Central Bank of a country to eliminate black money and fake currency and put them out of circulation. Thus, in this way black money earned by illegal activities and fake currency automatically gets destroyed.



**Important points**

- Exchange of goods for goods is called Barter System.
- Money is that commodity which is freely used and generally accepted as a medium of exchange and as a store of value and transfer of value sanction to it is legal.
- Main functions; Medium of exchange, Measure of value
- Secondary functions- Standard of deferred payments, store of value, transfer of purchasing power.
- Contingent functions- Distribution of national income, basis of credit, liquidity of assets.
- Other functions- Conveyor of desire, Index of clearance of capacity.

**Exercise Questions :-**

**Objective Type Questions :-**

1. From the following M2 can be measured as-  
(A)  $M_1 + \text{Net Time deposits of banks}$   
(B)  $M_3 + \text{Total deposits with post saving organization}$   
(C)  $M_1 + C + DD$   
(D)  $M_1 + \text{Post office saving bank deposits}$
2. Which of the following is the main function of money?  
(A) Medium of exchange  
(B) Basis of social prestige  
(C) Payments of bills  
(D) Distribution of National Income
3. Which of the following is not the contingent function of the money ?  
(A) Medium of exchange  
(B) Measure of value  
(C) Basis of credit  
(D) Price stability

4. Which of the following is the main difficulty of Barter System?
  - (A) Double coincidence
  - (B) Not having currency value
  - (C) Future saving are not possible
  - (D) All of the above
5. Exchange of goods for goods is known as—
  - (A) Monetary system
  - (B) Goods and monetary system
  - (C) Barter system
  - (D) Paper currency system

#### Very Short Answer Type Questions:-

1. Write the meaning of Barter System.
2. Write any one definition of money.
3. Write any two functions of money.
4. Write any two difficulties of Barter System.
5. How does money help in the consumer decision making?

#### Short Answer Type Questions:-

1. Explain the Barter System of exchange with the help of an example.
2. What do you understand by value of money?
3. Explain the importance of money in the present scenerio.
4. What are the Contingent Functions of money?
5. Write any two Secondary Functions of money.

#### Essay Type Questions:-

1. Explain briefly the primary(main) functions of money.
2. What is Barter System? Describe the limitations of this system.
3. Giving the definition and meaning of money, throw light on its importance.

**Answer Table**

1	2	3	4	5
D	A	D	A	C