Economics

2nd Sem
Paper C3T/Introductory Macroeconomics
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Q. What is money?
or
What is the definition of money?
or
What is the concept of money?

Ans. Money belongs to the category of things which are not amenable to any single definitions. It performs not one but four important functions with each function providing a criterion of moneyness and partly because these criteria are satisfied in different degrees by different assets.

Money is only one among many kinds of financial assets which consumers, business firms, governments and other economic units hold in their asset portfolios.

Money is the essential ingredient in conducting most economic transactions in the economy.

Money is a specie of a large genus — one among the class of things which perform monetary functions in the economy.

Q. What is the functions of money?

Money serves as the great instrument of commerce and industry in the economy by performing the four essential specific functions which have removed the difficulties of the pure barter exchange system. These four functions of money emerge from its serving in the economy as

1) a unit of value or account,
2) a medium of exchange,
3) a standard of deferred payments,
and 4) a store of value.

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Milton

We may now discuss each one of these four basic functions of money.

1) Money as Unit of Value or Account:

This function of money has been variously called as "unit of account", "standard of value", "common measure of value and" common denominator of value". The common idea present in all these terms is that money unit serves as a unit of measurement in terms of which of "values" of all the goods and services exchanged in the economy are measured and expressed. A monetary unit such as a rupee, dollar, or franc is adopted by the economy, the value of each commodity and service is expressed as a price which expresses the number of money units for which it will exchange or sell in the economy.

2) Money as Medium of exchange:

The speciality which distinguishes money from other commodities and places it in a separate class inheres in its role as the means of payment. Money has no power to satisfy human wants, but by acting as the medium of exchange in the economy it commands power to purchase those goods and services which satisfy human wants.

The use of money by greatly reducing the number of transactions effected substantial saving of time and effort.

It enabled people to sell in one place and time and to buy in another. Money, as a medium of exchange, opened the

floodgates of free multilateral trade and ~~the substantial~~

3. Money as Standard of Deferred Payments:

No sooner than money comes to be used as a unit of value and a medium of exchange, it is also inevitably used as the unit in terms of which future payments are stated. A large number of transactions relate to future contractual payments which are stated in terms of money unit.

Money as a standard of deferred payments is satisfactory only if its value or purchasing power remains stable over time. When the purchasing power of money either increases or decreases through time the interests of debtors or creditors are injured and people may mention certain safeguard clauses in future contractual obligations.

4. Money as Store of Value:

Money necessarily acts as a temporary store of value by virtue of its use as a medium of exchange. In other words, in order to perform the function of medium of exchange, the value or purchasing power has to be stored in money for temporary period in order to enable people to buy and sell at different times.

The role or function of money as a permanent store of value - non human or physical form of wealth - was least stressed by the early classical economists. Even the neo classical economists, to some extent Alfred Marshall excepted, ignored the demand for money

arising from wealth-holders' choosing to hold a part of their total assets in the form of money.

It was Keynes who first realised fully and drew attention to the significance of money's function as a permanent store of value for economic analysis and policy. The great significance of this role arises from the fact that only this function of money creats the demand for money which can be analysed in terms similar to those which are employed for analysing the demand for other goods and services.

In its role as a permanent store of value ie, as one of the many forms in which assetes may be held, money has many close substitutes in other productive assets for example, government bonds, quasi-government securities, shares and debentures of well-established corporations, bank deposits of various kinds, etc.

Q.

Q. What is supply of money?

The factors influencing the demand for money have been assumed as not influencing the supply of money with the result that in the monetary theory the supply of money and the demand for money have remained separate and mutually exclusive. The early classical economists and the quantity theorists believed that the important factors effecting the supply of money did not effect the demand for money.

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In this connection, the views of Milton Friedman – "the quantity theorist holds that there are important factors affecting the supply of money that do not affect the demand for money.

The total money supply (M) would comprise of the gold coins minted by the moneytary authority. However, even under these restrictive conditions the public could influence the money supply to suit the total needs of economy by influencing – increasing or decreasing – the rate per time unit each coin circulated in the economy (V) as the medium of transactions. This naturally gives the total money supply as a product of total high-powered money M issued by the moneytary authority and its transaction velocity V, ie, MV.

Apart from the power of banks to create credit, the public also influences the size of total bank deposits by influencing the velocity of these bank-created deposits. The bank created deposit money M' multiplied by its velocity V', ie, $M'V'$. In short,

The total money supply in circulation in the economy equals $MV + M'V'$.