Chapter II

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2.1. INTRODUCTION
The history of exchange of goods for something is as old as the civilization. This is continued since time immemorial in one form or the other. The exchange activity remained present whenever two or more persons were there. It has become integral part of the human society. The modern economy is a money economy. “Today we can not think of life without money.”¹. At the very heart of almost all economic activities lies the institution of money. “Anything that performs the functions of money is money.”² Money is a facilitator of exchange process, having the basic feature of an indirect exchange. Indirect exchange means, the exchanges of goods take place with the help of a common medium-money. Here, there is no direct exchange of goods; first goods are exchanged for money and then the receiver for purchasing some other goods that are required by him uses that amount of money again.

“ The word money is believed to originate from a temple of Hera located on Capitoline, one of Rome’s Seven Hills. In the ancient world Hera was often associated with money. The temple Juno Moneta at Rome was the place where the mint of ancient Rome was located”³.
Money is anything, which is generally acceptable as a medium of exchange or a means of payment in the settlement of every type of transaction-purchasing goods and services or settling debts. The unique feature of money is its general acceptability as a medium of exchange. Money becomes money only when it is widely accepted as a means of payment. Money should be receivable without question by the entire economic society in payment for goods or in the discharge of other kinds of business obligations or in the settlement of debts. The essence of money is its general acceptability as a common means of payment. It must be generally acceptable to each one of the members of a community without any hesitation. If people in the community think that a particular thing should be generally acceptable as money, then only it becomes money, otherwise not. Anything, thus, can be money when it is universally acceptable as a means of payment. “Conventionally money is supposed to perform four functions viz., medium of exchange, unit of account, a standard for deferred payment and a store of value.”

Different economists defined money based on their perceptions. Some have laid emphasis on its generally acceptability characteristic, while others have stressed on its ‘functions’. “Money is a commodity chosen by common consent to be a measure of value and a means of exchange between all other commodities.” Money is that thing which is commonly acceptable as an enabler of exchange “ Money is regarded as anything that is generally accepted within a community as a medium of exchange and a measure of value.” From the angle of acceptability various authors have advocated that money must have the feature of acceptability. Seligman, for instance, defines money as a ‘thing that
possesses general acceptability.’ Prof. F. A. Walker, on the other hand, says ‘Money is what money does’. What he means is that money is defined by its functions. Some considers money as anything is money which functions generally as a medium of exchange”. “Money is the medium of exchange and a store of purchasing power.”

A more comprehensive definition of money is given by Crowther, which covers the aspects, general acceptability as well as functions of money. According to Crowther, money is ‘anything that is generally acceptable as a means of exchange and which, at the same time, acts as a measure and store of value’.

Along with the general acceptability condition, Crowther’s definition pinpoints the major functions of money. It reveals that anything can become money provided it is generally accepted as money, i.e., it should serve a medium of exchange, measure of value and store of value. The difficulty of arriving at a single clear-cut definition of money has led economists to describe money in terms of the functions it performs. The British economist Sir Ralph Hawtrey stated – “Money is one of those concepts which, like a tea spoon or an umbrella, but unlike an earthquake or a butter cup, are definable primarily by the use or purpose which may serve”.

2.2.1. BARTER SYSTEM

In the earlier stages of man’s economic civilization, in the absence of money, transactions relating to exchange of goods were based on the barter system. “Barter” means direct exchange of goods without use of money. Under barter exchange, goods are exchanged directly against goods. For example, apples may be exchanged for oranges, sugar for
wheat, baskets for bananas, cloth for shoes and so on. In the barter system, thus, one has to give one kind of goods to get some other kind of goods. The direct exchange of one commodity for another is termed barter”.  

**Features of Barter Economy**

Barter economy is an economy where the exchange of goods and service takes place by the methods of barter.

The main features of barter economy are narrated hereunder:

1. **Barter Exchange**: In a barter economy, commodities are directly exchanged for one another without the mediation of money.

2. **Non-monetised Economy**: There is no use for money or any medium of exchange in a barter economy, Thus, barter economy is a money less economy. “When exchange is done without the intervention of money, we call it barter.”

3. **Double Coincidence of Wants**: In a barter economy, a successful transaction between two persons requires the existence of double coincidence of wants. Suppose, there are two persons Mr.X and Mr.Y. Mr.X wants mango in exchange for oranges. If Mr.Y has apples to give and wants oranges in exchange, then only the transaction between them can be possible, otherwise not.

4. **Simple and Slow Moving Economy**: It is a simple and a slow process of economic trade and transactions.
(5) **Primitive System**: Barter system is a primitive system of exchange. In short, barter prevails in the non-monetized part of the economy. It is estimated that even today, in some tribal areas the barter system exists.

### 2.2.2. DIFFICULTIES OF BARTER SYSTEM

Many difficulties and inconveniences are inherent in the barter system. As society becomes more civilized and the complexities of economic organization begin to multiply, exchange through barter tends to become more and more difficult and complicated. In fact, the main propelling force behind the invention of money sprang from the inconveniences and difficulties experienced in the barter system of exchange. The following are the major shortcomings or difficulties of the barter system:

1. **Requirement of Double Coincidence of Wants**: Barter is the most inconvenient method of exchange, as it requires “a double coincidence of wants”. Two persons can have barter exchange only if their disposable possessions mutually suit each other’s needs. In barter trading, thus, two parties must agree on their mutual exchange, which is possible only if there exist a double coincidence of wants. In above-mentioned example of Mr. X and Mr. Y, no transaction between the two would be possible, if Mr. Y does not possess oranges and is ready to offer something else but Mr. X is not willing to accept it. In a barter, therefore, a person who wants to exchange his goods for some other goods has not only to find another person who possesses what he has to offer. In practice, it is difficult always to have such a double coincidence of wants, and therefore, there are delays in transactions, and a considerable amount of time and effort is wasted in bringing about the exchanges.
In practice, lack of double coincidence of wants creates many difficulties in exchange of goods and satisfaction of wants in the barter economy. Even if there is a double coincidence of wants, it would take considerable time for the two parties to come into contact with one another. Transactions cannot take place quickly or in large numbers under a system of barter. Clearly, trade and business cannot develop rapidly within the framework of a barter economy. Barter as such is a great barrier to economic progress.

(2) **Lack of Common Measure of Value**: Another serious drawback of the barter economy is that it lacks any common measure of value or a unit of account. In the absence of a well-defined unit of account, in barter, the values of goods are measured in a relative sense; hence there is no absolute measurement of value. Since the value of each commodity can be expressed in terms of every other commodity, one has to remember a large number of cross relations of values in exchange for different goods, which is physically impossible to do when there are an infinite number of commodities.

(3) **Difficulty in the Exchange of Indivisible Commodities**: Barter exchange also suffers from a severe inconvenience on account of the indivisibility of many bulky commodities and there is no means of sub-dividing and distributing values. One can easily portion out a bag of food-grains, a basket of fruits, etc., which are divisible goods and can give more or less in exchange for what is wanted. But, the real difficulty arises in the process of exchange between indivisible and divisible goods. For instance, a camel is not divisible and cannot be exchanged in parts against different divisible goods like rice, sugar or potatoes in small quantities. Thus, barter trade between divisible and indivisible goods in
small values cannot be conducted, since it is not possible to make fractional payments without the loss of value.

(4) **Lack of Standard of Deferred Payments:** Another drawback of barter is that it lacks a standard of deferred or future payments. So that contracts involving future payments or loan transactions cannot take place with ease in such a system. Credit transactions cannot be promoted smoothly under barter trading. Controversy about the quality of goods or service to be repaid can arise. Credit transactions would also involve high risks to both parties as the real value of a commodity to be repaid may drastically increase or decrease in the future. Lending and borrowing is thus difficult under barter.

(5) **Lack of Efficient Store of Value:** Certainly, the major inconvenience of the barter system is the lack of facility to store value or the lack of existence of a generalised purchasing power. Under barter, people can store value for future use by storing wealth, but the difficulty arises when wealth consists of perishable goods. Moreover, the store of value in terms of real wealth involves cost and further, the problem of storing the goods arises. In addition, bulky goods cannot be easily exchanged for other goods as and when required. A quick exchange of such goods sometimes involves a heavy loss, too. Thus it suffers from many bottlenecks.

**2.3. EVOLUTION OF MONEY**

Invention of money in the economic life of man is the outcome of the difficulties encountered in the barter system of exchange. The growing inconvenience of barter in the complex economic societies necessitated the invention of money. With the increased volume of trade and growing process of division of labour and specialisation, barter
became more and more difficult in its direct exchange aspect. Hence, to overcome the basic difficulties of barter such as want of double coincidence, want of means of subdivision, etc. it was thought that exchange of goods should be made indirect by using some medium. Thus, money came into the picture as a medium of exchange.

In pre-historic time there was no such thing as money. When people needed to buy something they had to change it. “By 9000 BC the most commonly accepted form of animal money was cattle. When you bought something, you would give the other person a cow, and the person would give your change in calves. This was better than squirrels but still not an efficient system. By 3000 BC, the Mesopotamians had invented two concepts that revolutionized economic activities (1) Writing and (2) banking.”

Another view on origination of money is “Money is to be thought of as having originated out of religious and social custom rather than directly out of barter. Commodities that later came to be important as a standard of value or medium of exchange seem first to have been important as ransom, ceremonial offering or means of ostentation. The application to economic ends generally developed out of the earlier discharge of religious, legal and ritualistic uses.”

Numerous things like shells and sheep, grains and precious stones, tea and tobacco, ivory and iron, gold and silver have been used as money at different times and different places before the invention of modern day’s metallic and paper money. The origin of money as such is difficult to trace for want of record. Lord Keynes considers that the origin of money is deep-rooted in antiquity, and it is an extremely ancient institution. Indeed, money is the epitome of the history of human civilization. “There
have been since the world began say a diligent and respectable author, the Marquist de Mirabeau “three great inventions which have principally given stability to political societies independent of many other inventions which are enriched and adorned them. The first is the invention of writing, which alone gives human nature the power of transmitting without alteration, its laws, its contracts, its annals, and its discoveries. The second is invention of money, which binds together all the relations between civilized societies. The third is economic table, the result of the other two, which completes them both.”

The development of money has passed through various stages in accordance with time, place and circumstances with the progress of economic civilization of mankind. Economics have recognised five such stages in the evolution of money; (i) Animal Money, (ii) Commodity Money, (iii) Metallic Money, (iv) Paper Money, (v) Credit Money.

2.4.1. FUNCTIONS OF MONEY

Money confers inestimable benefits on one’s economic life. Money performs multifarious functions in an economy and to an individual.

The following are the major functions of money:

(i) It serves as a medium of exchange.

(ii) It is a measure of value and a unit of account.

(iii) It serves as a standard of deferred payments.

(iv) It is also used as a store of value of wealth.

(v) It transfers value.

The first two functions are regarded as the primary functions of money and the rest are considered as secondary functions. In addition to captioned functions another dimension may include basis of credit.
money, uniformity and liquidity, distribution of national income and equalization of marginal utility.

I. Primary Functions

(i) **Money as a Medium of Exchange**: This is the most basic function of Money. It is primary and the most important function to act as a medium of exchange or as a means of payment. Viewing it as a medium of exchange only, money is usually identified as money. On account of its general acceptability as a medium of payment, money has ready purchasing power and becomes a circulating medium. Being a generally acceptable medium of exchange, money facilitates the multiple exchanges of goods and services with minimum efforts and time.

(ii) **Money as a Measure of Value or a Unit of Account**: Money conventionally as well as technically acts as a unit of account or numeraire. In a monetised economy, where money is the medium of exchange, money can be treated as a common measure of common denominator of value. The value in exchange of all goods and services can be expressed in terms of money. Such an expression gives rise to the price system. Money, in fact, acts as a means of calculating the relative prices of goods and services. In this sense, it has been regarded as a unit of account. For instance, the rupee is the unit of account in India; the dollar is the unit of account in the U.S.A., and so on.

Money as a Medium of Exchange vs. Money as a Unit of Account: There is a marked distinction between money as a medium of exchange and money as a unit of account.

As a medium of exchange, money functions as something real—a coin, a currency note, a credit entry in a bank account, but as a unit of
account, money functions as an abstract measure of value—the rupee, the dollar, the yen etc. Thus, money as a unit of account is only a made of expression and does not necessarily have physical substance. In other words, the unit of account is something abstract, while the medium of exchange is concrete. The rupee, as a notion, has no physical existence but the rupee note is a physical entity. “Originally in all countries, I believe a legal tender of payment could be made only in the coin of that metal, which was peculiarly considered as the standard or measure of value”\(^1\)

As a pure unit of account, money is just a measure like the metre or the kilogramme. It is viewed in an abstract sense. However, unlike physical measures, money as a measure of value is not perfect—as its own value, namely, its purchasing power, is not stable over a period of time. Instability in the value of money leads to many socio-economic problems. As a medium of exchange, however, money is viewed with some physical attributes.

II. Secondary Functions

(i) **Money as a Standard of Deferred Payments**: Money also serves as a standard of deferred or future payments. It is a unit in terms of which debts and future transactions can be settled. In India, for instance, the rupee or unit of account is the standard of deferred payments of future payments. Since a barter economy lacks a standard of deferred payments, its progress is dull and slow. In a modern economy, however, money acts as a means of settling debts, or measuring deferred payments or future payments. Thus, loans are made and future contracts are settled in terms of money. Lending and borrowing has become easy because of money.
The existence of money in a modern society has enabled people to effectuate widespread credit transactions.

(ii) **Money as a Store of Value**: Money acts as an efficient store of value. The function of money as a medium of exchange makes it a convenient asset to hold. Holding of money enables a person to avoid the time and effort, which would otherwise have to be involved in synchronising market exchanges (as in the barter system). Money being a permanent abode of purchasing power holds command over goods and services all the time-present as well as future. To hold money or to keep cash balances, in fact, becomes a form of holding wealth. The function of money here is the form of an asset or a form of an asset or a form of wealth, because it confers power on its holder to claim real goods and services. It is a convenient means of keeping any income, which is surplus to immediate spending needs and it, can be exchanged for the required goods and services at any time. Rather than keeping their wealth in non-liquid assets such as houses, or less liquid asset such as shares, many people in modern societies prefer to keep their wealth in the form of money. The function of money as an asset is the direct result of one of the most important properties of money, namely, its liquidity.

People tend to keep money balances as a representative part of their income (the value stored) in anticipation of future monetary transactions. Money, in fact, is held to bridge over the period between receipt of income and its expenditure. As such, money is a link between the present and the future. It serves as a store of value because it has purchasing power and its exchange utility can be used at any time. The holder of money is empowered to spend it at his will.
Significance of Stable Value of Money: To serve as a good medium of exchange and to be a good standard deferred payment and a serve as an efficient store of value, the value or purchasing power of money must be stable. Since the purchasing power of money depends on the prince level, it is essential to maintain a stable value of money. If money shrinks in its purchasing power or its exchange value over a period of time, as happens during an inflationary period, people may lose confidence in cash balances as an efficient store of value.

However, the use of money as a store of value is not without drawbacks. Value of money never remains stable, so that the hoarder of money suffers a loss when its value deteriorates and gains when it appreciates. Moreover, variation in the value of money is liable to disturb the smooth functioning of the economic system.

Interrelationship among the functions of Money

The above-stated primary and secondary functions of money, in fact, are interrelated. The basic function of money is that it serves as a medium of exchange. All other functions of money such as money as a measure of value, standard of deferred payments and store of value are the corollaries of money being a medium of exchange.

Since money is used as a medium of exchange for all goods and services, it becomes a common measure of value. In this way, money as a medium of exchange and as a measure of value appears together, hence, these are regarded as the primary functions of money.

Since money possesses purchasing power all the time and as anything can be purchased with money at any time in an economy, money becomes a store of value. Money is demanded as a store of value because it is regarded as the most liquid asset. Liquidity here implies
ready or easy exchangeability or spends ability. All other assets (financial or real) have a lesser degree of liquidity than money. Money possesses perfect or hundred percent liquidity, because it serves as a means of payment or medium of exchange all the time on account of its general acceptability. When money is held as a store of value, it is implied that it can be used as a medium of exchange after some time. Since money is a medium of exchange, it can also be used to make payments in future for the present transactions. Thus, credit transactions are facilitated by the use of money as it serves as a means of settlement of debt. In this way, money, being a medium of exchange and a common measure of value, also becomes a standard of deferred payments.

As a matter of fact, the functions of money as a store of value and as a means of payment, both current and deferred, are inseparable.

In short, all the functions of money such as measure and store of value and standard of deferred payments follow from the fact that money is primarily a medium of exchange.

**2.4.2. CONTINGENT FUNCTIONS OF MONEY**

The scope of the functions of money in a modern economy is very wide. Besides the major functions discussed above, money also render certain contingent or incidental functions, such as:

1. **Base of the Price System**: The price system in a market economy emerges on account of the use of money. It helps in reflecting economic choices in the market economy. Consumers can express their sovereignty by spending money and reflect their choices. Price system is the pillar of market mechanism. Its functioning is based on the use of money.
(2) **Base of the Credit System:** Money being the standard of deferred payments facilitates credit transactions and supports the credit system, which is the lifeblood of modern commerce. The whole banking system, which generates credit in the economy, functions on the base of the money. In a barter economy, there is no banking because there is no money.

(3) **Means of Distribution:** Use of money facilitates distribution of national income among the owners of the factors of production. Factor rewards such as rent, wages, interest and profit are determined and paid in terms of money. Thus, money incomes become equivalent to the value of real income in a money economy.

(4) **National Income Accounting:** National income accounting is made possible because of money. In the absence of money, as in case of barter economy, national income accounting is a difficult or rather impossible task.

(5) **Liquidity:** Money imparts liquidity to its holder. Money being a store of value serves as liquid wealth, it is the most liquid asset, and therefore, those people who have liquidity preference keep cash balances. Money brings uniformity through its liquidity to different forms of wealth. Wealth can be converted into money in an exchange economy and made liquid. Holding of money empowers a claim over the other forms of wealth to the holder. Thus, a person can store value in the form of real assets or money. Introduction of money has, thus, revolutionised modern economy altogether.
2.4.3. MONEY REMOVES THE DIFFICULTIES OF THE BARTER ECONOMY

A money economy is an improvement over the barter economy. Introduction of money as a medium of exchange removes the major difficulties of barter as follows:

(1) Money overcomes the need for double coincidence of wants: Being a generally acceptable medium of exchange, money obviates the main difficulty of the barter system—the need for a double coincidence of wants, and quickness the process of exchange transactions. In fact, the essential function of money is to obviate the difficulties of the barter system by serving as a medium of exchange. In doing so, it breaks up barter into sales and purchases. Commodities, instead of being exchanged directly for other commodities, are exchanged for money, which is again exchanged for other goods. Thus, money, as a medium of exchange, permits an exchange of goods and services that need not be simultaneous. This is, perhaps, the most significant property of money in a modern complex economy.

(2) Money provides a unit of account: Barter economy has no unit of account. Money provides a unit of account by becoming a common measure of value. The use of money as a unit of account in a monetized economy is a great technological improvement over the barter system. It is enough for people to know the relative prices of different goods and there is no need for them to remember multiple cross-relationships of the exchange values of these goods. Again, in a monetized market, the real cost (measured in terms of time and effort) of exchanging goods is low, since a minimum amount of information is required to conclude a
transaction. This has far-reaching effects on the development of trade and economy.

(3) **Money serves as the basis of the credit system:** Difficulties of lending and borrowing and credit transactions experienced in the barter system due to lack of standard of deferred payments are removed by money as it also serves as a standard of deferred payments.

(4) **Money provides a means of sub-division:** Difficulties encountered in the exchange of indivisible bulky goods in the barter economy no longer exist in a money economy since money being a medium of exchange and unit of account provides a means of sub-division and enables the people to make fractional payments.

(5) **Money facilitates the store of value:** The problem of storing wealth no longer remains in a money economy wince money being the most liquid asset is an efficient store of value.

Thus, though the barter system of exchange being direct appears to be simple but not so smooth, money serves as a lubricant and makes its operation smooth.

**2.5. DYNAMIC ROLE OF MONEY**

Money is a facilitator and a motivator also covering all the spectrum of economic activities. “Money facilitates and motivates all economic activities relating to consumption, production, exchange and distribution.”\(^{15}\) It promotes all economic activities from manufacturing to consumer satisfaction. “Money measures the intensity of human wants and the utility of the commodity to a consumer. Money enables a consumer to maximize his satisfaction”\(^{16}\)

On account of its static or technical functions, money tends to play a dynamic role in determining economic trends. It plays a very active and
highly important part in the economic system by influencing the general level of prices. Its volume and velocity, whether the motivation comes from the state itself or from the general public, can lead to a rise or fall in the general price level. Since rising prices generally stimulate production, and falling prices check it, a general rise or fall in the price level is liable to affect, for better or for worse, the welfare of most sections of the community. Monetary conditions are inclined to stimulate or discourage consumption as well as production. Money, thus, is a potent factor that can stimulate or hinder economic progress.

The changes in the flow of money have a definite influence in determining the course of free enterprise economy. The laws of nature do not provide the means of ensuring that there should be just enough money, neither too much nor too little, under an “automatic” operation of the system. Money, therefore, plays an important and active part in influencing economic trends through either an inadequate or excess of its supply compared with the amount required for maintaining the stability of its value and the volume of economic activities.

Money directs idle resources into productive channels, and thereby affects output, income, employment, and the economic welfare of the community at large.

Money makes it possible to have financial economic planning as a workable proposition of physical planning at the micro-level and macro-level.

Being an essential part of them modern exchange mechanism and the market economy, money is surely productive, in the sense that it is an aid to specialisation and production in a capitalist economic system.
2.6. MONEY AS ENCOURAGEMENT TO DIVISION OF LABOUR

Use of money makes exchange process efficient and quick. It eliminates enormous costs and delay involved in searching for double coincidences of wants. It breaks up the stationary state of self-sufficiency of the barter economy. Due to the smooth exchange system and market mechanism created by the use of money, the need to produce all goods, which one may require, is eliminated. In a money economy, one may specialise in the production only of that good in which he is very proficient and has a greater interest and aptitude. And, he would tend to produce more in excess of self-consumption requirement in order to create a marketable surplus. By selling his marketable surplus of the commodity, he earns money. Money, thus, is the abode of purchasing power. Through money he can buy different goods to satisfy his varied wants.

It may be concluded that, in a money economy, different persons tend to specialise in different goods and through the marketing process, these goods are bought and sold for the satisfaction of multiple wants. In this way, occupational specialisation and division of labour are encouraged by the use of money.

The scope of complex division of labour, however, depends on the extent of the market. Smooth exchange facilities ordained by the use of money, in turn, facilitate increased and diversified production of goods and services and consequent expansion in the size of the market. The market tends to be winded and spread over the country with the increased monetization. The increased size of the market and the consequent increase in demand and rising prices encourage more output. Larger output needs a large scale of operation in the process of production. A large scale of production implies greater specialisation and a greater
degree of complex division of labour. It causes improved productivity of labour. This leads to cost economy and lower prices. Cheaper goods attract more demand. This, in turn, means further extension of the market, including further output and so on. Money, as such, by aiding division of labour, encourages large scale of production and

Consequent to industrial expansion and rapid economic progress. Modern civilization owes its growth to the economic efficiency of the people. The improvement in economic efficiency is, by and large, a product of the degrees and complexities of specialisation and division of labour in the economic society. The progress of specialisation is, however, determined by the efficient system of exchange. The system of exchange in a modern economy has become efficient basically because of the institution of money.

2.7 MONEY AND TRANSFORMATION OF SAVINGS INTO INVESTMENTS.

In a modern economy, savings and investments are affected by two distinct sets of people- Households and Firms. The Households saves the money whereas the firms invest the money. In real terms, there is no direct link between the savers and the investors. Economy, thus, need transformation of savings into investments. In real terms, investment means using of the surplus of real income (in excess of consumption) as resources saved from consumption in producing goods meant for further production. When savings are aptly invested, there is equality between investment and savings, which is an essential condition for equilibrium level of income, output and employment.
Money translates real resources into liquid form. Savings in terms of money can be easily mobilised. Households can lend their savings (money saved from income) to firms. The mobilisation of savings can be effectuated through the working of various financial institutions: banks and non-bank financial intermediaries. Money capital so borrowed by the investors when used for buying raw materials, labour, factory, plant etc. becomes investment. Investment, in real terms, thus, leads to generation of employment, income and output. Money being the best liquid asset, saving in terms of money or money capital can be channelised into any direction of productive investment.

In this way, money smoothens the transformation of savings into investment in a modern economy.

Use of money as a means of deferred payment has given birth to credit transactions-lending and borrowing- as a consequence of which the money market and capital market have developed in a modern economy. The main function of money and capital markets is to mobilise savings for investment. Thus, money is the basis of transforming savings into investment.

Indeed, money and the consequent development of monetary and financial institutions is an important factor in the process of economic development of a country.

Furthermore, as Paul Einzing points out, with the aid of the modern monetary system, a government is in a position to spend much in excess of the amounts it can raise by taxation, because it can borrow any amount from the public and from the banking system. The money economy, thus, enables the government to pursue costly economic, social, and political policies. Further, money may also play an important part in the social
sense by redistributing income and wealth by means of taxation expenditure.
The institution of money is an extremely valuable social instrument, which makes a large contribution to economic welfare. In the absence of money, many of the transactions of a modern economy and in particular, credit transactions, would not be worth making and as a consequence, division of labour would be hampered and lesser amount of goods and services would be produced. Real income would, therefore, not only be allocated less satisfactorily from the standpoint of economic welfare, but it would also contain a smaller amount of money, if not all sorts of goods. Obviously then, money is not merely a veil or a garment. It is a key by means of which the productive energies could be released. Though money by itself creates nothing, it strongly influences the creation of utilities. Chandler writes: "Money is sterile in that by itself it can produce nothing useful, but it has a very high indirect productivity owing to its ability to facilitate exchange and specialisation”.

2.8. CHARACTERISTICS OF GOOD MONEY
Anything can be a money of it is generally accepted. But all things cannot serve as good money. According to Stanley Jevons, to be good money, the thing or money material should possess the following attributes or qualities:

(i) General acceptability; (ii) Cognisability; (iii) Homogeneity; (iv) Durability;
(v) Portability; (vi) Divisibility; (vii) Stability of value.

(i) **General Acceptability**: General acceptability is the prime condition of any money. The commodity, which is used as money, must be such that anyone will take it without hesitation in exchange as a means of
payment if it has some intrinsic worth. Thus, precious metals like gold and silver are always acceptable as money, because apart from their monetary uses they have many alternative uses. Even a piece of paper which has no value whatsoever can also become generally acceptable as money when it is legally endorsed as legal tender. Sometimes, a thing, as money, becomes acceptable by custom or convention also. Bank money in the form of bank cheques, for instance, is conventional money, but it lacks general acceptability.

(ii) **Cognisability:** The material of which money is made must be instantly recognisable and distinguishable from other materials whether by sight, ear or touch. This is essential if counterfeiting is to be made difficult. In this respect, gold and silver can easily be recognised by their distinctive features. Further, the cognisability characteristic of money also implies that monetary units such as coins and notes of the same denomination must be the same size and quality, but a one rupee note must be distinct from a ten rupee note so that illiterate masses also can easily recognize them and their worth.

(iii) **Homogeneity:** All coins of the same metal must be as nearly as possible of the same quality throughout, i.e., one coin of the same denomination must not be superior to another. Similarly, paper notes of the same denomination must have uniformity in paper, design, colour, etc. This is very necessary for general acceptability.

(iv) **Durability:** The commodity—the metal or substance used as money—must be durable in nature. Evidently, of course, a perishable commodity cannot be used as money. Money can serve as a store of value if it is durable so that it can be held for a period of time without any deterioration in quality. Thus, from the durability point of view, gold or
silver coins are much better than paper notes, though both are legal tenders.

(v) **Protability**: The money is good which is easily portable and transferable. It should be capable of being carried from place to place without inconvenience, expense or difficulty. It is for this reason that coal does not qualify for money, but gold does. But under modern conditions, the weight of gold and silver proved to be a hindrance and therefore, their place has been taken by paper and credit money. For large transactions, the use of notes, cheques and bank draft is safe, ideal and convenient.

(vi) **Divisibility**: The property of divisibility of money implies that as a unit of account it must be capable of being split into simple smaller denominations. In the case of metallic money as money proper, it must be divisible so that all pieces, of whatever value, are of uniform quality. Such divisibility is necessary to make money of different values. They must also be capable of being easily remitted without loss.

(vii) **Stability**: Money, being a measuring rod of exchange, must be stable in value. Commodities, which are subject to violent changes in supply and demand and their prices, are useless as money. The commodity used as money must have a stable value so that it can serve the purpose of a standard of value in relation to other commodities. Money can function well as a store of value only when it has a stable value-a constant purchasing power throughout. For this there should be some control over its supply. An excess of quantity of money over its normal requirements for the community’s transactions may cause a fall in its purchasing power and *vice versa*, so that it cannot be a good store of value.
Though its physical substance does not have much relevance to the ability to perform its task as a medium of exchange, nevertheless, in order that it becomes a good circulating medium, money should possess certain attributes such as uniformity, cognisability, durability, portability, divisibility and general acceptability. Uniformity or homogeneity and its cognisable characteristics facilitate money’s universal acceptability as a means of payment; durability confers on money its role of purchasing power; its portability is desired for the convenience of making transactions; its divisibility facilitates the smooth operation of small and big transactions and its general acceptability generates public confidence in money.

2.9. TYPES OF MONEY OR CLASSIFICATION OF MONEY
Money may be classified on the basis of two major criteria; (I) Monetary system criterion; and (II) Acceptability criterion.

2.9.1. Monetary System
In the modern monetary systems, there are three forms of money in actual use;
(1) Metallic Money, (2) Paper Money, (3) Bank Money or Credit Money. The first two kinds of money are in the form of currency money and the last one is credit or bank money.

(a) Metallic Money:
Metallic money refers to coins made out of various metals like gold, silver, bronze, nickel, etc. A coin is a piece of metal of a given size, shape, weight and fineness whose value is certified by the state. The right of minting coins is the monopoly of the state. The department of government minting coins is called the Mint.
Coins are of two types; (i) Standard or full-bodied coins and (ii) Token coins.
(i) Standard Coins: A coin is regarded as a standard coin or full-bodied coin if its “face value” (i.e., the exchange value fixed by the issuing authority and embossed on it) is equal to its “intrinsic value”, i.e., the worth of the metallic content of the coin. In the past, coins made from precious metals like gold and silver were regarded as standard coins and the monetary systems adopting them were referred to as “gold and silver standards.”
(ii) Token Coins: A token coin refers to a coin having the face value of more than its intrinsic value. Token coins are usually made of cheap metals like nickel, copper or bronze. They are generally of lower denominations. Token coins are issued primarily as a form of subsidiary money which is to be used for small change only. They are useful as a convenient means for the payment of small sums. In India, coins of five, ten, twenty, twentyfive and fifty paisa are such token coins.
Since all types of coins are issued by the state authority—either the Treasury or the central bank of the country—they are regarded as legal tender. Legal tender money’s acceptability is sanctioned or backed up law; hence, a refusal to accept it is a punishable offence. Standard coins are, however, unlimited legal tender in the sense that they are acceptable as a means of payment up to any amount, while token coins are limited legal tender as payments can be made up to a small sum only.
(b) Paper Money:
Paper money consists of currency notes issued by the State Treasury or the central bank of the country. In India, the Ministry of Finance of the
Government of India issues one-rupee notes, while all other currency the Reserve Bank of India issues notes of higher denominations. There are three types of paper money: (i) Representative, (ii) Convertible, and (iii) Inconvertible.

(i) Representative Paper Money: Paper money which has a hundred percent metallic reserve behind it, held by the government and payable to the holder of the paper money on demand, is known as representative paper money. The quantum of such money never exceeds the amount of the reserve (generally of gold and/or silver). They are freely convertible into full-bodied coins or gold. The Gold Bullion Certificates recommended by the Royal Commission on Indian Currency and Finance for India I 1927 provides a good example of this kind of paper money.

(ii) Convertible Paper Money: Paper money is said to be convertible when the issuing authority take upon itself the responsibility of converting it into gold of full-bodied money on demand. Paper money, which is convertible but not fully backed by metallic reserve is not a representative money. It is called fiduciary money as it is issued against securities rather than metallic reserve of full-bodied coins or precious metals. Fiduciary money may be partially backed by valuable metals and full-bodied coins, whereas representative money must have the full backing of the reserve. In India, all currency notes issued by the Reserve Bank of India are fiduciary money only in theory.

(iii) Inconvertible Paper Money: When the government or the central bank does not undertake to exchange currency notes with gold or full-bodied money on demand, it is called “inconvertible” or “Fiat” paper money. As the term indicates, this kind of money is accepted because of
the fiat or authority of the government. Fiat money is money by command. It is enforced by law and is legal tender. One rupee notes issued by the Government of India is fiat money, Similarly, token coins are also fiat money.

In a practical sense, all currency notes issued by the Reserve Bank of India are inconvertible, because notes of higher denomination are convertible into notes of lower denomination only.

**Advantages and Disadvantages of Paper Money**

In modern era, the use of paper money is widespread owing to its following advantages:

1. Paper money is economical. Obviously, paper is much cheaper than any metal.
2. Paper money economises the use of precious and scarce metals by serving as representative money.
3. It is very convenient to carry paper money from place to place.
4. It is also easy to store paper notes. Currency notes of lakhs of rupees can be stored in a small vault.
5. It is easier to count paper notes than metallic coins.
6. Supply of paper money is easily adjustable as per the need of the economy. Thus, paper money is of great monetary and fiscal advantage to the government.

**Disadvantages of paper money are listed below:**

1. There is the danger of over-issue of notes as they can be easily printed and their supply depends upon the whim of the government. An excessive money supply
3. may lead to rising prices or inflation thereby reducing the value (purchasing power) of money.
4. Paper money lacks general acceptability if the people lose confidence in the
5. Government for one reason or the other.
6. Durability of paper money is much less than metallic money.
7. Paper money can circulate within the domestic economy only. For making foreign
8. Exchange payments, paper money is not acceptable unless it is a key currency like dollar.

But these disadvantages are surmountable and controllable by a proper check. Therefore, paper money is in wide circulation.

(c) **Bank Money or Credit Money:**

With the development of banking system, along with paper money, another form of convertible money has developed in the form of credit money or bank money. Bank demand deposits, withdrawable by cheques, have started functioning as money, and the business community now conventionally accepts cheques as a mode of payment in general. It must be noted that a cheque by itself is just a credit instrument. Actually, it is the bank deposit behind the cheque that serves as money. Thus, a cheque by itself is valueless, but the transfer of deposit through it has value. That is why a cheque does not command general acceptability as a medium of exchange, because the payee cannot be certain that it will be honoured, as he does not know whether there really is any money or deposit to be transferred. Thus, the limitation on acceptability, which attaches to bank money, derives not from a lack of acceptability of the bank money itself
but from a limitation on the part of the mechanism of transfer, i.e., cheque. Therefore, the demand deposits are customary money and it has no legal status like currency notes. In fact, bank deposit or cheque money is optional money, which may or may not be accepted in the discharge of debts. Cheque money means money deposited in a bank account transferable through cheques. Thus, a cheque by itself is not money, though it is used as a mode of payment.

In a modern economy, currency money and bank money together constitute the total stock of money or money supply. Currency money is a legal tender and has general acceptability, whereas bank deposits are conventional money and lack general acceptability.

2.9.2. Classification According to the Acceptability Criterion

On acceptability criterion, there are two categories of money; (i) Legal tender money;
(ii) Optional money.

(1) Legal Tender Money: Legal tender is an attribute granted to money by law. Thus, legal tender money is the money which has the sanction or backing of law. The law stipulates that certain types of money being a legal tender can serve as a valid payment of all debts and a refusal to accept it as a means of payment will be punishable by the state. Legal tender is a fiat money, i.e., money on the fiat (order) of the government. The state authorities issue coins and currency notes, so they are fiat money. Legal tender money is of two types: (a) limited legal tender money; and (b) unlimited legal tender money.

(a) Limited Legal Tender Money: money is limited legal tender when debts up to a certain limit can only be legally discharged by its use. In
India, the low denomination coins or small coins-25 paise and 50 paise are limited legal tender.

(b) Unlimited Legal Tender Money: Unlimited legal tender money is one, which has to be accepted as a means of payment up to any amount. Debts up to any amount can be discharged by the use of unlimited legal denominations, issued by the Reserve Bank of India, are unlimited legal tender.

(ii) Optional Money: Optional money is non-legal tender money. It does not have any sanction or backing of the law but is acceptable in payment, due to the faith and goodwill of the members of the community. Optional money is conventional or customary money. It may or may not be accepted in the discharge of debts. Bank cheques and bank drafts are examples of optional money. A creditor need not accept a cheque from a debtor in disbursement.

Apart from cheques, other credit instruments like Bills of Exchange, Postal Orders, Promissory Notes, etc. are also regarded as ‘optional money’ as they are used for making payments among known parties but are not generally acceptable to all. They cannot, therefore, be considered as “money” in the strict sense of the term, but only as “money substitutes” or “near money”. These money substitutes are tokens used for arranging the transfer of money.

2.10. CHANGING ROLE AND FORM OF MONEY IN MODERN ECONOMY.

There is no doubt that money facilitates and motivates all economic activity relating to consumption, production, exchange and distribution. Money enables a consumer to maximise his satisfaction. Money measures the intensity of desire and the utility of a commodity to a
consumer. Money facilitates production by stimulating saving and investment. It gives mobility to capital and helps in capital formation. It enables the harnessing of various factors of production so that the entrepreneur is able to maximise his profit. Introduction of money facilitates exchange and helps in the development of trade and commerce, both national and international. Money functions as a common denominator for the distribution of social product. It is in terms of money that, wages, rent, interest and profits are determined. Money helps the price mechanism to operate and serve as an instrument for the allocation of resources among competing uses. Money is an extremely valuable social instrument, which has largely contributed to the growth of national wealth and social welfare. It has ensured the smooth functioning of the economic system. It has accelerated the process of industrialisation. In money economy, there is a continuous flow of money payments. This circular flow is essential for promoting economic welfare.

Whatever the type of economic system money is found to be of great service. In a capitalist economy, money plays an important role because capitalism basically depends, on price mechanism, which operates through the medium of money. As Prof. Robertson observes, “the existence of monetary economy helps society to discover what people want and how much they want. And to decide what shall be produced and in what quantities, and to make the best use of its limited productive power. And it helps each member of society to ensure that the means of enjoyment of which he has access, yield him the greatest amount of actual enjoyment which is within his reach.” Even in a socialist economy, price tags are essential for its smooth, efficient and economical working. It is said while money is a master in a capitalist economy; it is a servant
in a socialist economy. Money also plays a significant role in a mixed economy. It plays a crucial role in determining employment, output and income in the private sector. In the public sector, it is helpful in the allocation of resources and for changing the pattern of income distribution. It is a powerful instrument for capital formation and economic development in a developing economy.

The new horizon of money is E-money or Electronic Money. It is nothing but the change of hands through electronic means. “E-money is electronic store of monetary value on a technical device that is used for making payments to undertakings other than the issuer without necessarily involving bank accounts in the transactions, but acting as a prepaid bearer instrument.”

The forms and acceptance criteria of money getting changed rapidly due to the pace of development and technological up-gradation coupled with expanding businesses in a borderless world. What today one accepts as money may not be same in the days to come. Certainly, its form and the acceptance norm will change due to change in the business environment, as the money has came a long way from sea shell to, metals, paper, and now to digital form.
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