# Concept of money

**<u>Introduction</u>**

Money is an economic unit that functions as a generally recognized medium of exchange for transactional purposes in an economy. Money provides the service of reducing transaction cost, namely the double coincidence of wants. Money originates in the form of a commodity, having a physical property to be adopted by market participants as a medium of exchange. Money can be: market-determined, officially issued legal tender or fiat moneys, money substitutes and fiduciary media, and electronic cryptocurrencies.

**Understanding Money**

Money is commonly referred to as currency. Economically, each government has its own money system. Cryptocurrencies are also being developed for financing and international exchange across the world.

Money is a liquid asset used in the settlement of transactions. It functions based on the general acceptance of its value within a governmental economy and internationally through foreign exchange. The current value of monetary currency is not necessarily derived from the materials used to produce the note or coin. Instead, value is derived from the willingness to agree to a displayed value and rely on it for use in future transactions. This is money's primary function: a generally recognized medium of exchange that people and global economies intend to hold, and are willing to accept as payment for current or future transactions.

Economic money systems began to be developed for the function of exchange. The use of money as currency provides a centralized medium for buying and selling in a market. This was first established to replace bartering. Monetary currency helps to provide a system for overcoming the double coincidence of wants. The double coincidence of wants is a ubiquitous problem in a barter economy, where in order to trade, each party must have something that the other party wants. When all parties use and willingly accept an agreed-upon monetary currency, they can avoid this problem.

In order to be most useful as money, a currency should be

**Fungible**

Units of the good should be of relatively uniform quality so that they are interchangeable with one another. If different units of the good have different qualities, then their value for use in future transactions may not be reliable or consistent. Trying to use a non-fungible good as money results in transaction costs of individually evaluating each unit of the good before an exchange can take place.

### Durable

The physical character of the good should be durable enough to retain its usefulness in future exchanges and be reused multiple times. A perishable good or a good that degrades quickly with use in exchanges will not be as useful for future transactions. Trying to use a non-durable good as money conflicts with money's essentially future-oriented use-value.

### Portable

It should be divisible into small quantities so that people appreciate its original use value - highly enough that a worthwhile quantity of the good can be conveniently carried or transported. An indivisible good, immovable good, or good of low original use-value can create issues. Trying to use a non-portable good as money could produce transaction costs of either physically transporting large quantities of the low value good or defining practical, transferable ownership of an indivisible or immobile object.

### Recognizable

The authenticity and quantity of the good should be readily ascertainable to the users so that they can easily agree to the terms of an exchange. Trying to use a non-recognizable good as money produces transaction costs of agreement on the authenticity and quantity of the goods by all parties to an exchange.

### Stable

The value that people place on a good in terms of the other goods that they are willing to trade should be relatively constant or increasing over time.
A good whose value varies widely up and down over time, or consistently loses value over time is less suitable. Trying to use a non-stable good as money produces transaction costs of repeatedly revaluing the good in each successive transaction and the risk that the exchange value of the good might drop below its other direct use-value or not be useful at all, in which case it will no longer circulate as money.

## Evolution of Money

**Evolution of Money** is probably one of the biggest invention
in human history.The money was not invented but it evolved with passage of time according to the changing requirements of economies.It is not a result of brain

storming of some economist rather there is a long process of evolution since start of civilization to this modern complicated credit system.
It is generally believed that evolution of money has passed through following six stages.

- **Barter**
- **Commodity Money**
- **Metallic Money**
- **Paper Money**
- **Credit Money**
- **Electronic Money**

These stages of evolution of money are discussed as under.

**1 Barter.**
In the beginning of civilization the needs of people were very limited and therefore they used to Exchange their goods with other people's goods or Service. Such a system of exchange where goods and services are directly exchanged for each other without the use of money is called barter system. Barter is possible only if the wants of the people are very few, area of exchange is limited and people are living a very simple life. There were many difficulties associated with barter system. So gradually this system of exchange was replaced with money system of exchange.

**2 Commodity Money:**
Money is in fact discovered to remove Difficulties of barter. In fact money has evolved in response to the urgent needs of the various stages of economic growth. In the beginning of civilization goats, animal-hides, axe-heads, knives, arrows, slaves etc., have been used as money in different

Perform the basic functions of money. It was difficult to borrow and lend and it was more difficult to measure and store the value of goods and services. Further the volume of trade remained very limited due problem of transportation of commodity money.

**3 Metallic Money.**
Money made of metal is called metallic money. In the beginning the pieces of gold and silver were used as money but it did not solve the complicated problems of exchange. It was very difficult to I measure the value with these jaw pieces of metal. Another problem was transportation and storage of precious metals. This

problem was solved by making standardized coins. In the beginning full bodied coins of gold and silver were introduced but latter on these were replaced with token coins. Now a day's different alloy are being used for minting of coins. The metallic coins have a specific weight and shape. Coins are only used for smaller retail payments because it is difficult to count, transport and store them.

**(4) Paper Money**

In the third stage of the evolution of money paper money was discovered. It is believed that the start of paper money was issuance and acceptance of receipts of gold smiths who were acting as money lender in old Iraq.

These goldsmiths were rich, respectable and were men of repute. They used to keep the valuables of the people in the safe rooms and issued receipts as a proof for the goods stored. These certificates became a convenient credit Instruments and were freely used for borrowing and lending and making payment. In the 19th century commercial banks started issuing their own notes of different colors and denominations.

It created confusion and were not generally acceptable. Central bank removed this confusion by taking over the power of issuing bank notes. In the beginning the paper money was fully convertible into full bodied gold coins. During the period between the two world wars, it became difficult to convert the paper money into gold. Now almost all the countries issue currencies according to the monetary requirements of the economy and government provides securities for issuance of currency.

**5 Credit Money:**

In the present day modern economies or bank money is used for making personal business payments. In the developed countries, transactions are taking place with the help of deposits or checking accounts with paper money. Demand deposits or money sited in current accounts are easily convertible cash, therefore they are convenient and safe.

**6. Electronic Money**

TODAY THE invention of computer and its application, the form and shape of business are changing fast. The concept OF commerce is gaining vast popularity. The mode payment is being transformed from cash or quest to electronic transaction from one account another. This form of electronic payment is early referred to as electronic money. There are many problems in this type of transactions, but it aiming popularity day by day. i evolution of money has not come to an end, it will, never come to an end.. As economies of the world are changing features and shapes, money is also changing its m with the due course of time. Globalization of the anomies and expansion of e-commerce has given new dimension to modes of payment and has angled the nature and features of money.

## Functions of Money

As stated above, money primarily functions as a medium of exchange. However, it also has developed secondary functions that derive from its use as a medium of exchange. These other functions include: 1) a unit of account, 2) a store of value, and 3) a standard of deferred payment.

**Unit of Account**

Due to its use as a medium of exchange for both buying and selling and its use to assign prices to all kinds of other goods and services, money can be used to keep track of the money gained or lost across multiple transactions, and to compare money values of various combinations of different quantities of different goods and services mathematically. This makes things such as accounting for profit and loss of a business, balancing a budget, or valuing the total assets of a company all possible.

**Store of Value**

Because money's usefulness as a medium of exchange in transactions is inherently future-oriented, it provides a means to store value obtained through current production or trade for use in the future in the form of other goods and services. In particular trading their non-fungible, non-durable, non-portable, non-recognizable, or non-stable goods or services for money here and now, people can store the value of those goods to trade for goods at other times and places. This facilitates saving for the future and engaging in transactions over long distances possible.

## Standard of Deferred Payment

To the extent that money is accepted as a general medium of exchange and serves as a useful store of value, it can be used to transfer value for exchange use at different times between people through the tools of credit and debt. One person can loan a quantity of money to another for a period of time to use, and repay another agreed-upon quantity of money at a future date. The stored value represented by the loaned money is transferred from the lender to the borrower in exchange for an agreed quantity of stored value in the future. The borrower can then use and enjoy the value of other goods and services that they can now purchase in exchange for payment at a later date. The lender in effect is able to loan the current use of real goods and services (which he does not himself originally possess) to the borrower. The sellers of the goods are able to receive payment for their goods now, instead of loaning the goods directly to the borrower in hope of future return or repayment.

## Types of Money

There are several types of money.

### Market-Determined Money

Money originates as a feature of the spontaneous order of markets through the practice of barter (or direct exchange), where people trade one good or service directly for another good or service. In order for a trade to occur in barter, the parties to the exchange must want the good or service that their counter-parties have to offer. This is known as the double coincidence of wants, and it sharply limits the scope of transactions that can occur in a barter economy.

However certain goods in a barter economy will be generally desired by more people in trade for whatever they have to offer in barter. These tend to be goods that have the best combination of the five properties of money listed above. Over time, these special kinds of goods can come to be desired in trade partly for their wide acceptance as a means to overcome the problem posed by the double coincidence of wants in future transactions with others. Eventually, people can come to desire a good mostly or solely for its use-value in reducing transaction costs in future exchanges.

### Legal Tender and Fiat Money

Sometimes a market-determined money is officially recognized as legal money by a government. Under some circumstances, goods that do not necessarily meet the five properties of optimal market-determined money outlined above, can be used to fulfill the functions of money in an economy. Typically this involves a legal mandate to use a specific good as money (known as a legal tender law) or some kind of prohibition on the use of money (such as the use of cigarettes as a medium of exchange among prison inmates). Legal tender laws specify a certain good as legal money, which courts will recognize as a final means of payment in contracts and the legal means of settling tax bills. By default, the legal tender will typically be used as a medium of exchange by market participants within the political jurisdiction of the authority that declares it to be money.

**Cryptocurrencies**
Cryptocurrencies are peer-based money, such as bitcoin. This type of money is electronically based on electronic accounting entries that can be used as a medium of exchange. Cryptocurrencies share many characteristics of both market-determined money and fiat money.