CHAHAT AZAM
FACULTY OF COMMERCE
DSPMU

SUBJECT = ME & IB

UNIT I – MONEY (PART – I)

I. INTRODUCTION OF MONEY

The Barter System

Before the evolution of money, exchange was done on the basic of direct exchange of goods and services .This is known as barter. Barter involves the direct exchange of one good for some quantity of another good. For example, a horse may be exchanged for a cow, or 3 sheep or 4 goats. For a transaction to take place, there must be a double coincidence of wants. It is also a simple economy where people produce goods. Either for self-consumption or for exchange with other goods which they want. Bartering was found in primitive societies. But it is still practiced at places where the use of money has not spread much. Such non-monetised areas are to be found in many rural areas of underdeveloped countries.

Difficulties of Barter

But the barter system is the most inconvenient method of exchange. It involves loss of much time and effort on part of people in trying to exchange goods and services. As a method of exchange, the barter system has the following difficulties and disadvantages.

1. Lack of Double Coincidence of Wants - The functioning of the barter system requires a double coincidence of wants on the part of those who want to exchange goods or services. It is necessary for a person who wishes to trade his good or service to find some other person who is not only willing to buy his good or services, but also possesses that good which the former wants. For example, suppose a person possesses a horse wants to exchange it for a cow.

*2. **Lack of a Common Measure of Value*** - Another difficulty under the barter system relates to the lack of a common unit in which the value of goods and services should be measured. Even if the two person who wants each other‘s goods meet by coincidence, the problem arises as to the proportion in which the two goods should be exchanged. There being no common measure of value, the rate of exchange will arbitrarily fixed according to the intensity of demand for each other‘s goods. Consequently, one party is at a disadvantage in the terms of trade between the two goods.

*3.**Indivisibility of Certain Goods*** **-** The barter system is based on the exchange of goods with other goods. It is difficult to fix exchange rates for certain goods which are indivisible. Such indivisible goods pose a real problem, under barter. A person may desire a horse and the other a sheep and both may willing to trade. The former may demand more than four sheep for a horse but the other is not prepared to give five sheep and thus there is no exchange.

4. Difficulty in Storing Value **-** Under the barter system it is difficult to store value. Anyone wanting to save real capital over a long period would be faced with the difficulty that during the intervening period the stored commodity may become obsolete or deteriorate in value. As people trade in cattle, grains, and other such perishable commodities, it is very expensive and often difficult to store and to prevent their deterioration and loss over the long period.

5. Difficulty in Making Deferred Payments **-** In a barter economy, it is difficult to make payments in future. As payments are made in goods and services, debt contracts are not possible due to disagreement on the part of the two parties on the following grounds. Both parties would run the risk that the commodity to be repaid would increase or decrease seriously in value over the duration of the contract.

6. Lack of Specialisation **-** Another difficulty of the barter system is that it is associated with a production system where each person is a jack-of-all trade. In other words, a high degree of specialization is difficult to achieve under the barter system. Specialization and interdependence in production is only possible in an expanded market system based on the money economy. Thus no economic progress is possible in a barter economy due to lack of specialization.

II. DEFINITION OF MONEY

Money has been defined differently by different economists. But the most acceptable definition of money can be stated in terms of all the functions of money.
Money is anything which is generally accepted as a means of exchange, a measure and store of value and which also acts as standard of deferred payments.

i. ***According to Crowther, "Money is anything that is commonly used and generally accepted as means of exchange and at the same time acts as measure and store of value."***
ii. ***According to Coulborn, "Money may be defined as the means of valuation and payment."***
iii. ***According to Prof. Keynes, "Money itself is that by delivery of which debt contracts and price contracts are discharged and in the shape of which a store of general purchasing power is held."***
iv. ***According to Seligman, "Money is one thing that possesses general acceptability."***

v. ***According to Robertson, "Money is anything which is widely acceptable in discharge of obligation."***

III. EVOLUTION OF MONEY

The word —money is derived from the ***latin*** word —***moneta*** which was the surname of the ***Roman Goddess of juno*** in whose temple at Rome, money was coined. The origin of money is lost in antiquity. Even the primitive man had some sort of money. The type of money in every age depended on the nature of its livelihood. In a hunting society, the skins of wild animals were used as money. The pastoral society used livestock, whereas the agricultural society used grains and foodstuffs as money. The Greeks used coins money.

Stages in the Evolution of Money

The evolution of money has passed through the following five stages depending upon the progress human civilization at different times and place.

1. Commodity Money

Various types of commodities have been used as money from the beginning of human civilization. Stones, spears, bow and arrows and axes were used as money in the hunting society.

2. Metallic Money

With the spread of civilization and trade relation by land and sea, metallic money took the place of commodity money. Many nations started using silver, gold, copper, tin, etc. as money.

3. Paper Money

The development of paper money started with goldsmiths who kept strong safes to store their gold. As goldsmith was thought to be honest merchants, people started keeping their gold with them for safe custody. In return, the goldsmith gave the depositors a receipt promising to return the gold on demand. These receipts of the goldsmith were given to the sellers of commodities by the buyers. Thus the receipts of the goldsmiths were a substitute for money. Such paper money was backed by gold and was convertible on demand in to gold. This ultimately led to the development of bank notes.

4. Credit Money

Another stage in the evolution of money in the modern world is the use of the cheque as money. The cheque is like a bank note in that it performs the same function. It is a means of transferring money or obligation from one person to another. But a cheque is different from a bank note. A cheque is made for a specific sum, and it expires with a single transaction. But a cheque is not money. It is simply a written order to transfer money.

However, large transactions are made through cheques these days and bank notes are used only for small transaction.

5. Near Money

The final stage in evolution of money has been the use of bills of exchange, treasury bills, bonds, debentures, savings certificates, etc. They are known as —near money. They are close substitutes for money and are liquid asserts. Thus in the final stage of its evolution money has become intangible. Its ownership is now transferable simply by book entry.