Week 3

Money

Definition of Money

Money is anything that is generally acceptable as a medium of exchange and in the settlement of debts. Money is anything that is generally acceptable as a means of payment. Money is primarily a medium of exchange or *means* of exchange. It is a way for a person to trade what he has for what he wants. It is a medium of exchange, a store of value and a unit of account. It is used to pay debts, purchase goods and services and is accepted by the government for taxes.The term medium of exchange is used to describe money's ability to settle debts and to increase the purchasing power of individuals. Money derives its power and value from being the legal tender that is accepted as a universal method of payment within the boundaries of each country or an economic bloc. Legal Tender laws are enacted to require people to use the government's money in payment of lawful debts among private citizens. Money supply is the form in which money is available in the economy. It can be in the form of currency or bank money. Currency is described as the physical nature of money supply in an economy. It is grouped into coins and bank notes. Coins were the earliest forms of currency after barter trade and were later followed by notes.

Trade by Barter and its Limitations

Definition: Trade by Barter may be defined as a form of trading in which goods are exchanged directly for other goods without the use of money as a medium of exchange. For example, if someone has garri and is in need of beans, he must locate somebody who has beans and is in need of garri. Trade by Barter has many setbacks.

Problems or Disadvantages of Trade by Barter

1. **Problems of Double Coincidence of wants**: This involves looking for someone who is in need of what you have and at the same time has what you need. To do this amounts to a very serious problem.
2. **No Fixed rate of Exchange:** There is the problem of exchange rate determination between two products. Different rates of exchange have to be determined to cover every transaction before it can take place, e.g. How much of apples can you exchange for Rice.

3. **Wastage of Time and Effort:** Barter system leads to waste of time and energy because one has to search for somebody to exchange the goods with.
4. **Problems of Indivisibility:** Many goods cannot be divided into small convenient units because they are heavy and indivisible so it does not encourage divisibility.
5. **Problems Created by Bulkiness of some Goods:** Some of the good to be exchanged are so bulky that one finds it difficult to carry them about.
6. **No Room for Deferred Payment:** In Trade by Barter, there is no room for deferred payment. One cannot collect certain goods and hope to pay another day. Barter requires immediate settlement.
7. **It Discourages Borrowing and Lending:** Borrowing and lending under trade by barter is practically impossible as there is no standard unit of measurement.
8. **It Discourages Large Scale Production:** As a result of the difficulties in the system of exchange by barter, it therefore leads to people producing goods only for themselves and that of their immediate family. In other words, Trade by barter encourages self sufficiency hence it limits specialization of labour.
9. **Difficulty in Storing Wealth:** The barter system, unlike money does not encourage storage of wealth. It is difficult to store wealth or value, especially where perishable goods like fresh tomatoes and onions are involved.

The Characteristics of Money

1. **General Acceptability**: Money must be generally acceptable by all in the society or country as a means of exchange. This shows the confidence people have in money.
2. **Portability**: The object that serves as money must be something that can easily be carried about from one place to another, which means such object has to be light in weight.
3. **Relative Scarcity**: Money must be relatively scarce, that is, it must not be too many so as not to lose its value.
4. **Homogeneity**: Each unit of money must be same in size, colour and quality and be the same nationwide.
5. **Durability**: The object that will serve as money must be able to last long, it must not be a perishable commodity, it must be able to stand the test of time.
6. **Stability**: The value of money must be stable. The stability of its value will help business to be predictable and encourage lending and borrowing of money.
7. **Divisibility**: Money must be capable of being divided into smaller units, e.g. ₦100, ₦50, ₦20 etc., to enable it to purchase both high and low priced commodities.
8. **Recognisability**: Money must be easily recognized and identified by the totality of the people in the society. It must not be easily counterfeited.
9. **No Intrinsic Value**: The commodity that should serve as money must have little or no value in itself as opposed to its value of exchange.

Functions of Money

Money performs the following functions:

1. **Medium of Exchange**: Money can serve as a medium through which money can exchange goods and services. Money can be used to buy different variety of goods and services. This facilitates the means of exchange. It came into use as a result of the inadequacies of the barter system. Money is therefore widely acceptable as payment for debts.
2. **Standard of Deferred Payment**: Since money can be stored, it can be accumulated to pay debts that are fixed in terms of money. Money can serve as a medium by which business transactions on credit can be settled in the future. The use of money makes it possible for payments to be deferred from the present to some future date.
3. **Unit of Account**: In serving as a unit of account, it becomes practically possible for individuals and companies to keep accounting record of their transactions in bank statements, ledgers and invoices.
4. **Store of Value**: Money is a good store of value because wealth can be stored for future use. When there is no inflation, money stored or saved retains its value for many years.
5. **As a Measure of Value**: The values of goods and services are expressed by prices, therefore money is used as a yardstick to measure and compare the worth of goods and services as well as occupation.
6. As purchasing power to consumers to be able to buy goods and services

Four Types of Money

1. Commodity money
2. Fudiciary money
3. Representative money
4. Fractional money
5. Fiat money
6. Electronic Money

Commodity Money: Commodity money started as barter. The exchange of cattle and sheep advanced to one of gold and silver because metals are not perishable, their purity and weight can be measured easily and they can be traded for any good or service. A medium of exchange the units of which are fixed amounts of an actual commodity that has value other than as money alone. Many items have been used as commodity money such as naturally scarce precious metals, conch shells, barley, beads etc., as well as many other things that are thought of as having value. Commodity money value comes from the commodity out of which it is made. The commodity itself constitutes the money, and the money is the commodity. Examples of commodities that have been used as mediums of exchange include gold,silver, copper, rice, salt, peppercorns, large stones, decorated belts, shells, alcohol, cigarettes, cannabis, candy, etc. Historically, silver and gold coins of known, standard weights and designs have emerged as the preferred commodity monies of the entire civilized world. In the case of a commodity money, the actual commodity – silver or gold – is both the medium of exchange and the standard of value (that is, the unit in which prices are stated in the marketplace). The supply of commodity money is self-limited by the costs of mining, refining, and coining silver and gold. Unlike diamonds, metals can be melted down and reformed into smaller quantities for smaller purchases without losing value**.**

Fudiciary Money: A medium of exchange composed of some intrinsically valueless substance (such as paper) which the issuer promises to redeem on demand in a commodity money (such as silver or gold coin) or in a monetary commodity (such as silver or gold bullion). Historically, private bank notes and government treasury notes were fiduciary monies in general circulation prior to the 1930s. In the case of a fiduciary money, the paper promise to pay is the medium of day-to-day exchange, but the actual money and the ultimate standard of value remains the promised medium of payment, the silver or gold coin with which the note is to be redeemed.

Representative Money: Representative money is money that consists of token coins, paper money or other physical tokens such as certificates, that can be reliably exchanged for a fixed quantity of a commodity such as gold or silver. The value of representative money stands in direct and fixed relation to the commodity that backs it, while not itself being composed of that commodity.

Coins: Metals of particular weight are stamped into coins. There are various precious metals like gold, silver, bronze copper whose coins are already used in human history. The minting of coins is controlled by the state.

Paper Money: Paper money don't have any intrinsic value , as a fiat money it is approved by government order to be treated as legal tender through which value exchange can happen. Governments print the paper money according to the requirements which is tightly controlled as it can affect the economy of the country.

Interesting facts about various types of money

- In China cowry shells are regarded as money during 1000 B.C to 1200 B.C.
- Leather bags are treated as money in the ancient city of Carthage.
- Copper coins are treated as money by Romans 600B.C.
- Silver coins are treated as money by Ancient Persians between 600-300 B.C.
- Gold Coins are treated as money in 600 B.C in Anatolia (Asian Turkey or Asia Minor)
- Paper Money first appeared in China about 800 AD . In Europe, Sweden is the First country to issue Paper Money in 1661.

Fractional Money

Of course, goldsmiths quickly realized they only needed a small portion of their stockpiles on hand for redeeming customer receipts for "their" gold. So it logically followed that to collect more interest, they could loan more money than they had on hand by using receipts backed by nothing except the goldsmith's knowledge that all their depositors would not come to collect their gold on any given day. Thus was born *fractional receipt money*, the precursor to our present day banking system. As long as these illegal and fraudulent loans were repaid, no one was the wiser. But if the loans failed (flood, drought), the goldsmith was caught short. This began a “run on the bank” and only the first in the door were made whole. The rest lost their money and “hung” the goldsmith. Without the crime of loaning more money in receipts than the goldsmith had on hand in real gold, there would never be a run on the bank to redeem the receipts. Of course, at the time this was considered a serious crime because it was recognized clearly as fraud. The money did not exist and everyone understood it.

Fiat Money

Fiat money is money that has value only because a government says it has value. It is not backed by anything. Fiat money has two characteristics. a) It does not represent anything of intrinsic value. b) It is decreed to be legal tender (laws that require everyone to use it in settlement of private debts). These two characteristics always go hand-in-hand because fiat money is worthless and it would be rejected by the public without the government’s threat of fines or imprisonment for failure to accept it as money. Fiat money is a medium of exchange composed of some intrinsically valueless substance which the issuer does not promise to redeem in a commodity or a fiduciary money. Because a fiat money has no direct legal connection to a commodity money (in terms of redemption) and, therefore, no real economic cost to its production, the supply of a fiat money can never be self-limiting; and the value of a fiat money is always largely a matter of public confidence in the economic or political stability of the issuer.

Counterfeit Money

Counterfeit money is imitation currency produced without the legal sanction of the state or government. Producing or using counterfeit money is a form of fraud or forgery. Counterfeiting is almost as old as money itself. Plated copies (known as Fourrées) have been found of Lydian coins which are thought to be among the first western coins. Before the introduction of paper money, the most prevalent method of counterfeiting involved mixing base metals with pure gold or silver. A form of counterfeiting is the production of documents by legitimate printers in response to fraudulent instructions. During World War II, the Nazis forged British pounds and American dollars. Today some of the finest counterfeit banknotes are called *Super dollars* because of their high quality and likeness to the real US dollar. There has been significant counterfeiting of Euro bank notes and coins since the launch of the currency in 2002, but considerably less than for the US dollar.

Electronic money: Also called e-money, is the money balance recorded electronically on a stored-value card. These cards have microprocessors embedded which can be loaded with a monetary value. Another form of electronic money is network money, software that allows the transfer of value on computer networks, particularly the internet. Electronic money is a floating claim on a private bank or other financial institution that is not linked to any particular account. Examples of electronic money are bank deposits, electronic funds transfer, direct deposit, payment processors, and digital currencies.

Monetary Policy: The control of the amount of money in the economy is known as monetary policy. Monetary policy is the process by which a government, central bank, or monetary authority manages the money supply to achieve specific goals. Usually the goal of monetary policy is to accommodate economic growth in an environment of stable prices. Governments and central banks have taken both regulatory and free market approaches to monetary policy. Some of the tools used to control the money supply include:

- changing the interest rate at which the central bank loans money to (or borrows money from) the commercial banks
- currency purchases or sales
- increasing or lowering government borrowing
- increasing or lowering government spending
- manipulation of exchange rates
- raising or lowering bank reserve requirements
- regulation or prohibition of private currencies
- taxation or tax breaks on imports or exports of capital into a country