Money-Role of Money In Economic System

What Is Money?

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B.A.Part-1(Hons.) (Paper-2)

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: 1) fungible, 2) durable, 3) portable, 4) recognizable, and 5) stable. These properties ensure that the benefit of reducing or eliminating the transaction cost of the double coincidence of wants is not outweighed by other types of transaction costs associated with that specific good.

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.