Money-Definition And Its Types

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The Concept of Money

- It is often said that money is not the most important thing in the world. For many people, however, it is right up there next to air in importance.
- Money is not necessarily Coins and Currencies.
- Money is something which facilitates the transaction of goods and services.
- Money is any good that is widely used and accepted in transactions involving the transfer of goods and services from one person to another.
- Money is the most important invention of modern times. It has undergone a long process of historical evolution. I
- n the absence of money when goods were exchanged for goods it was called barter exchange. The inconveniences of barter, led to the invention of a medium of exchange i.e. money.

Nature of Money

- It facilitates exchange of goods and services and helps in carrying on trade smoothly.
- The present highly complicated economic system will not exist without money.
- Money helps in maximizing consumers' satisfaction and producers' profit. It helps and promotes saving.
- Money promotes specialization which increases productivity and efficiency.
- It facilitates planning of both production and consumption.
- Money can be utilized in reviving the economy from depression.
- Money enables production to take place in advance of consumption.
- It is the institution of money which has proved a valuable social instrument of promoting economic welfare.
- The whole economic science is based on money; economic motives and activities are measured by money.

Definition of Money

- According to Prof. A. Walker "Money is What Money Does."
- According to Prof. D.H. Robertson "Anything which is widely accepted in payment for goods or in discharge of other kinds of business obligation is called money."
- According to Seligman "One thing that possesses general acceptability"
- According to Prof. Ely "Money is anything that passes freely from hand to hand as a medium of exchange and is generally received in final discharge of debts."
- But these definitions are defective because they do not lay proper emphasis on all the essential functions of money. Prof. Crowther's definition of money is considered better as it takes into account all the important functions of money. He defines money as – According to Prof. Crowther's "Anything that is generally acceptable as a means of exchange (i.e., as a means of setting debts) and at the same lime, acts as a measure and a store of value"

Evolution of Money

The money as we see it today is the outcome of evolution. The following are the stages of evolution:

- Commodity money
- Metallic money
- Coins
- Paper Money
- Bank Money or Credit Money
- Plastic Money
- E-Money

Commodity Money

- Various types of commodities have been used as money from the beginning of human civilization. Stones, spears, skins, bows and arrows, and axes were used as money in the hunting society.
- The pastoral society used cattle as money.
- The agricultural society used grains as money.
- The Romans used cattle and salt as money at different times.
- The Mongolians used squirrel skins as money.
- Precious stones, tobacco, tea shells, fishhooks and many other commodities served as money depending upon time, place and economic standard of the society.

Disadvantages of Commodity Money

- The use of commodities as money had the following defects.
  - All the commodities were not uniform in quality, such as cattle, grains, etc. Thus lack of standardization made pricing difficult.
  - It is difficult to store and prevent loss of value in the case of perishable commodities.
  - Supplies of such commodities were uncertain.
  - They lacked in portability and hence were difficult to transfer from one place to another.
  - There was the problem of indivisibility in the case of such commodities as cattle.

Metallic Money

- With the spread of civilization and trade relations by land and sea, metallic money took the place of commodity money.
- Many nations started using silver, gold, copper, tin, etc. as money. But metal was an inconvenient thing to accept, weigh, divide and assess in quality.
- Accordingly, metal was made into coins of predetermined weight. This innovation is attributed to King Midas of Lydia in the eighth century B C. But gold coins were used in India many centuries earlier than in Lydia.
- Thus coins came to be accepted as convenient method of exchange. As the price of gold began to rise, gold coins were melted in order to earn more by selling them as metal.
- This led governments to mix copper or silver in gold coins since their intrinsic value might be more than their face value. As gold became dearer and scarce, silver coins were used, first in their pure form and later on mixed with alloy or some other metal.

Disadvantages of Metallic Money

- It was not possible to change its supply according to the requirements of the nation both for internal and external use.
- Being heavy, it was not possible to carry large sums of money in the form of coins from one place to another by merchants
- It was unsafe and inconvenient to carry precious metals for trade purposes over long distances.
- Metallic money was very expensive because the use of coins led to their debasement and their minting and exchange at the mint cost a lot to the government.

Coins

- Coinage was the first great invention in the evolution of money.
- It is believed that first coins were struck in the 11th Century BC in China.
- For a long period of time full bodied coins, particularly of gold and silver, served as money.
- Now all coins of different metals are only token coins. In India only Government can issue coins.

Paper Money

- The development of paper money started with goldsmiths who kept strong safes to store their gold. As goldsmiths were thought to be honest merchants, people started keeping their gold with them for safe custody. In return, the goldsmiths gave the depositors a receipt promising to return the gold on demand. These receipts of the goldsmiths were given to the sellers of commodities by the buyers.
- Thus receipts of the goldsmith were a substitute for money. Such paper money was backed by gold and was convertible on demand into gold. This ultimately led to the development of bank notes.
- The bank notes are issued by the central bank of the country. As the demand for gold and silver increased with the rise in their prices, the convertibility of bank notes into gold and silver was gradually given up during the beginning and after the First World War in all the countries of the world. Since then the bank money has ceased to be representative money and is simply 'fiat money' which is inconvertible and is accepted as money because it is backed by law.
- The money made of paper is called paper money. It consists of currency notes issued by the government or the central bank of a country. In India, one rupee notes and all coins in circulation are issued by the Ministry of Finance of the Government of India, and all other currency notes of higher denominations and commodity coins are issued by the Reserve Bank of India.
- **Paper Currency is of four types:**
  - **Representative paper Currency or Money,**
  - **Convertible paper Currency or Money**
  - **Inconvertible paper Currency or Money, and**
  - **Fiat Currency or Fiat Money.**

Representative paper Currency or Money

- Representative paper money is fully backed by gold and silver reserves. Under the monetary system of representative money, gold and silver equal to the value of paper currency issued are kept hi the reserves by the monetary authority. Advantages of representative paper money
- It economizes the use of precious metals. These metals are kept hi the reserves,
- There is no fear of over- issue of representative money since paper money is fully backed by metallic reserves,
- It inspires public confidence because the public can get the paper money converted into gold as and when needed.

Disadvantages of representative paper money

- Since gold and silver reserves are to be maintained, these metals cannot be put to other uses,
- Representative paper money system lacks elasticity because under this system money supply cannot be increased unless equivalent amount of metallic reserves are kept,
- It is not suitable for the poor nations which have deficiency of gold and silver.

Convertible Paper Money

- The paper money which is convertible into standard coins is called convertible paper money. The main characteristics of convertible paper money are:
- The individuals can get their paper money converted into cash,
- The paper money is backed by gold and silver reserves. But, on the assumption that all the currency notes are not simultaneously presented by the public for encashment, the value of metallic reserves is less than the value of the notes issued,
- The reserves comprise of
  - metallic portion containing gold, silver and standard coins, and
  - fiduciary portion containing approved securities.
- Generally, the public gets gold and silver in exchange for paper money for making foreign payments.

Advantages & Disadvantage of the convertible paper money

Advantages of Convertible Paper money

- It economizes the use of valuable metals.
- It is flexible because money supply can be increased without maintaining cent per cent metallic reserves.
- It inspires public confidence because paper money is convertible into standard coins,
- It facilitates foreign trade because paper money is converted into gold and silver to make foreign payments.

Disadvantages of Convertible Paper money

- Since the paper currency under this system is not cent per cent backed by gold and silver, there is a fear of over-issue of money supply and the resultant danger of inflation,
- The convertible paper money does not inspire as much public confidence as the representative paper money.

Inconvertible Paper Money

- **Inconvertible Paper Money:** The paper money which is not convertible into standard coins or valuable metals is called inconvertible paper money. Under the system of inconvertible paper money, the monetary authority maintains no metallic reserves against paper currency. It also gives no guarantee to convert the paper currency into gold and silver.

Merits of inconvertible paper money

- Such a paper currency system economizes the use of valuable metals,
- It is also elastic in the sense that the monetary authority can change money supply according to the needs of the economy without keeping proportionate metallic reserves.

Demerits of in-convertible paper money

- The danger of paper currency, leading to inflation, always exists in this system,
- It inspires less public confidence than a system of representative paper money.

Fiat money

- **Fiat Money:** Fiat money is only a variety of inconvertible paper money. Fiat money is backed neither by the metallic nor the fiduciary reserves. In other words, the monetary authority gives no guarantee to convert fiat money into valuable metals.
- According to Keynes, "Fiat money is Representative (or, Token) Money (i.e., something the intrinsic value of the material substance of which is divorced from its monetary face value) now generally made of paper except in the case of small denominations - which is created and issued by the State, but is not convertible by law into anything other than itself and has no fixed value in terms of an objective standard."

Characteristics of the fiat money

- It has significantly less intrinsic value than its face value,
- It is not convertible into any valuable asset,
- It is accepted in transactions at face value because it is unlimited legal tender.
- Initially, fiat money was used during the period of war or emergency. But, now, it has become a common phenomenon in most of the countries of the world. Fiat money is particularly useful for underdeveloped countries which generally lack financial resources for economic development. Fiat money removes this deficiency and promotes economic development by providing sufficient resources to the government.

Demerits of fiat money

- The danger of over-issue of fiat money (or inflation) is always present in a system of fiat money,
- It lacks public confidence as it is not backed by metallic reserves,
- Foreign exchange rates are liable to wide fluctuations under fiat money system because fiat money is not linked with other country's money through gold.

Advantages of Paper Money

- **Cheap and economical:** Normally paper money is much easier to issue. Practically it costs nothing to government. Printing of paper currency requires certain special type of paper, ink, and printing technology. These things no doubt are costly but overall printing cost is quite low.
- **Convenience:** Paper money is convenient to transfer and carry. It can be easily kept in pocket. Further it can also he readily converted into cheques, drafts, etc.
- **Copying**: The design of paper money is very difficult to copy. Further special type of paper and ink is used in paper money which makes it quite impossible to copy it. Even if it is copied by some fake means then it can be checked by electronic machines.
- **Elastic Supply:** Paper money due to its elasticity is very useful for government. Supply of money can he increased or decreased according to the needs of the economy,
- **Legal Tender:** Paper money is unlimited legal tender i.e. any amount of payment or of debt can be paid in it. It can be used to discharge all kinds of business obligations.

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- **Saving of Precious Metals**: Use of paper money results the saving of precious metals of the country. The metals can be used for other useful purposes.
- **Ease of counting:** Paper money is much easier to count than metallic money. The counting of large amounts in metal form is very difficult. On the other hand counting of paper money is easy, convenient and requires little time.
- **Recognizable:** The paper money is easily recognizable. There is no inconvenience of testing the exactness of the money material.
- **Useful in emergency**: The paper money can be used in emergency like war and floods. The government can meet the expenses by printing notes in shorter time.
- **Uniform quality:** The paper money has another advantage that it has uniform quality and the holder does not bother for possession of new or old money

Disadvantages of Paper Money

- **Demonetization** – The demerit of paper money is that the holder may have to suffer loss. The paper money is fiat money. It is issued by fiat (order) of the government. In case the government cancels the currency notes the holder has to bear full loss.
- **Restricted acceptability Or Limited Acceptance** – One of the demerits of paper money is that it has limited acceptance. Its acceptance is limited within the boundaries of a country. It cannot be used to make payments to other countries.
- **Monetary mismanagement** – Purchasing power of paper money is an ever-changing process. This means that its face value remains same but its purchasing power may decline due to monetary mismanagement.
- **Exchange rate instability**– The value of paper money is instable and is subject to fluctuations in the exchange rates. The fluctuations in the exchange rate market also produce serious effects on the price level in the economy.
- **Troubling balance of payments** – Over issuance of money results in decrease of value of money and causes inflation. Due to which price of imported goods increases because they are to be paid by exchanging devalued currency for foreign currency. It results in unfavourable balance of payment.
- **Short life** – Although the paper currency is not affected by wear and tear but it can be damaged due to fire or water. Due to this the life of the paper currency is much less than the metallic money.

Bank Money or Credit Money

- Another type 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 obligations 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. 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 transactions. Further credit and debit cards issued by banks are also falls under credit money or bank money. In modem economies, with the development of banking activity, credit money is being widely used. Demand deposits of banks, which are withdraw able through cheques, serve as money and the cheques are accepted as a means of payments. It is to be noted that a cheque by itself is not money; it is only a credit instrument which performs the functions of money. That is why credit money is regarded as near money. In a modern economy, currency money (paper money and coins) and bank money constitute the major portion of money supply. As the economy becomes more and more advanced, the proportion of bank money in the total money supply increases. The currency money is a legal tender and is generally accepted. While bank deposits are conventional money and lack general acceptability.

E – Money

- Electronic Money (E – Money) is the term used for new age Money system.
- E-Money is also called online banking and it is an outgrowth of PC banking.
- E-money uses the internet as the delivery channel by which to conduct banking activity, for example, transferring funds, paying bills, viewing checking and savings account balances, paying mortgages and purchasing financial instruments and certificates of deposits.
- Electronic Money (E-Money) is broadly defined as an electronic store of monetary value

Internet Banking or online Banking

- Online Banking (OLB) is an electronic payment system that enables customers of a financial institution to conduct financial transactions on a website operated by the institution, such as a retail bank, virtual bank, credit union or building society.
- Online banking is also referred as Internet banking, e-banking, virtual banking and by other terms. To access a financial institution's online banking facility, a customer with Internet access would need to register with the institution for the service, and set up some password (under various names) for customer verification. The password for online banking is normally not the same as for telephone banking.
- To access online banking, a customer would go to the financial institution's secured website, and enter the online banking facility using the customer number and password previously setup. Some financial institutions have set up additional security steps for access to online banking, but there is no consistency to the approach adopted.

Advantages of E Money

There are some advantages on using e-banking both for banks and customers:

- Permanent access to the bank
- Lower transaction costs / general cost reductions
- Access anywhere

Plastic Money

- **Single or limited** - purpose cards – These are cards that can be used only in a specific store or group of stores, or for a specific purpose for e.g. Cards issued by Big Bazar, Lifestyle etc.
- **Debit Cards:** A debit card (also known as a bank card or check card) is a plastic payment card that provides the cardholder electronic access to their bank account(s) at a financial institution. Some cards may bear a stored value with which a payment is made, while most relay a message to the cardholder's bank to withdraw funds from a payer's designated bank account. The card, where accepted, can be used instead of cash when making purchases. In some cases, the primary account number is assigned exclusively for use on the Internet and there is no physical card. In many countries, the use of debit cards has become so widespread that their volume has overtaken or entirely replaced cheques and, in some instances, cash transactions.
- **Credit Cards** – A credit card is a payment card issued to users as a system of payment. It allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card creates a revolving account and grants a line of credit to the cardholder, from which the user can borrow money for payment to a merchant or as a cash advance. A credit card is different from a charge card: a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers a continuing balance of debt, subject to interest being charged. A credit card also differs from a cash card, which can be used like currency by the owner of the card. A credit card differs from a charge card also in that a credit card typically involves a third-party entity that pays the seller and is reimbursed by the buyer, whereas a charge card simply defers payment by the buyer until a later date.