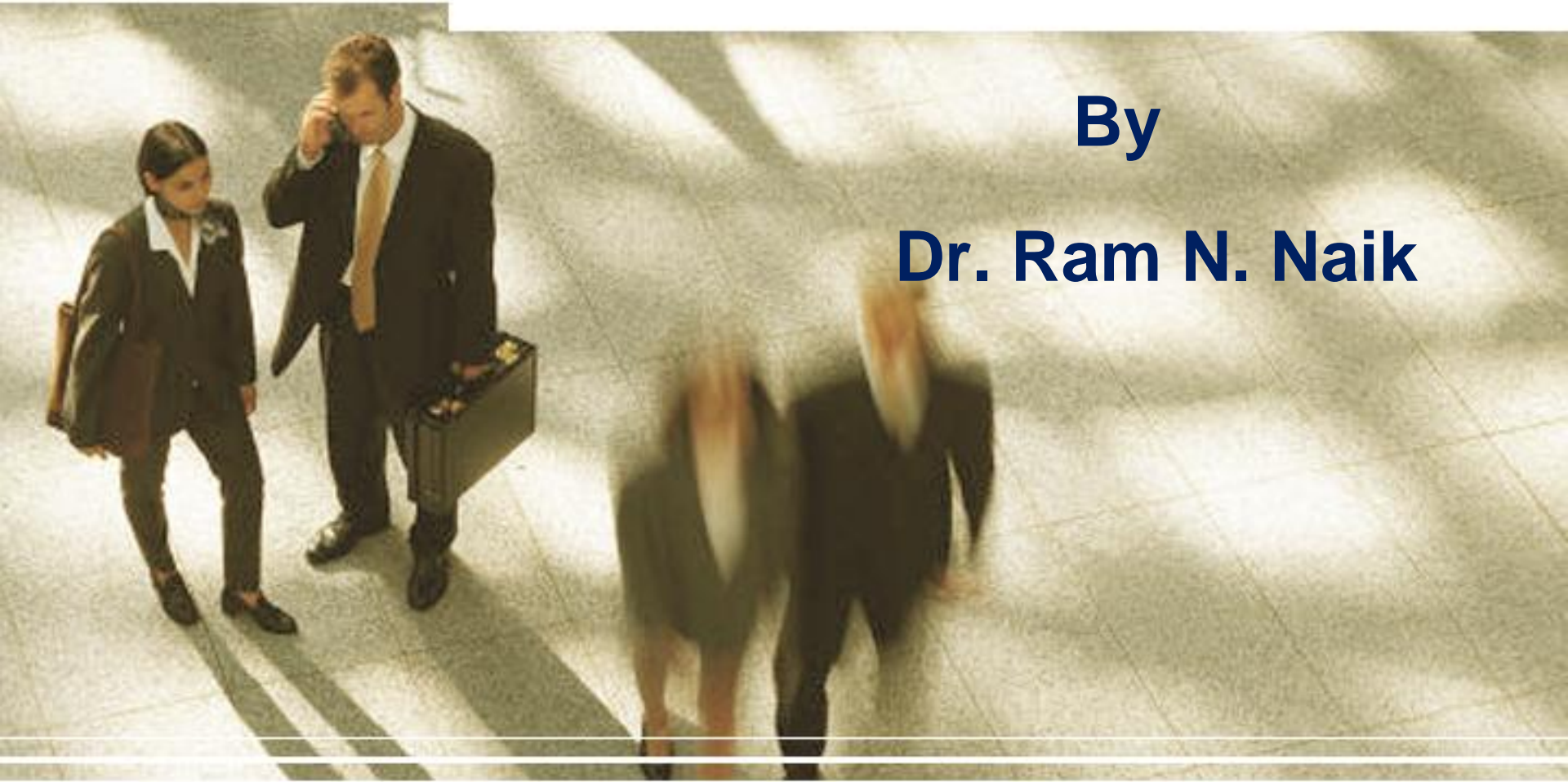


Functions of Money

By

Dr. Ram N. Naik



The Four Jobs of Money

- **Medium of exchange**
- **Standard of value**
- **Store of value**
- **Standard of deferred payment**

Medium of Exchange

- **The most important job of money is to serve as a medium of exchange**
 - **When any good or service is purchased, people use money**
 - **Money makes it easier to buy and sell because money is universally accepted**
 - **Money, then, provides us with a shortcut in doing business**
- **By acting as a medium of exchange, money performs its most important function**

Money as a Medium of Exchange

- Money facilitates exchange by reducing the cost of trading.
- Without money, we would have to barter.

Money As a Medium of Exchange

- Money does not have to have any inherent value to function as a medium of exchange.
- All that is necessary is that everyone believes that other people will exchange it for their goods.

Standard of Value

- **Money is a common denominator in which the relative value of goods and services can be expressed**
 - **A job that pays \$2 an hour would be nearly impossible to fill, while one paying \$50 an hour would be swamped with application**

Money as a Unit of Account

- Money is used as a common denominator to measure the relative values of goods and services.
- Without money, we would have to measure the value of goods and services in terms of other goods and services.
- Money is a useful unit of account only if its value relative to the average of all other prices doesn't change too quickly.

Store of Value

- **If you could buy 100 units of goods and services with \$100 in 1982, how many units could you buy with \$100 in 2000?**
 - **Answer: you could have bought just 51 units**
 - **During this period, inflation robbed the dollar of almost half of its purchasing power**
- **Over the long run, particularly since World War II, money has been a very poor store of value**
 - **However, over relatively short periods of time, say, a few weeks or months, money does not lose much of its value**

Money as a Store of Value

- Money is a financial asset that can be used to store wealth (income that you have saved and not consumed).
- As a store of wealth, money pays no interest, but is perfectly liquid.
- Money's usefulness as a store of wealth depends on how well it maintains its value.

Standard of Deferred Payment

- **Many contracts promise to pay fixed sums of money well into the future**
 - **A couple of examples are 30-year corporate bonds and a 20-year mortgage**

Standard of Deferred Payment

- **When Dave Winfield signed a 10-year, \$23 million contract with the New York Yankees in 1980, he really got stuck**
 - **Because over the next 10 years the consumer price index went up by almost 59%**
 - **Today when a professional ballplayer, entertainer, or virtually anyone else signs a long-term contract, she or he is generally protected by an escalator clause, which calls for increased payments to compensate for any future inflation**

Standard of Deferred Payment

- **How well does money do its job as a standard of deferred payment?**
 - **About as well as it does as a store of value**
 - **Usually quite well in the short run, but not well at all over the long run of, say, three years or more**

Money versus Barter

- **Without money, the only way to do business is by bartering**
- **For barter to work, I must want what you have and you must want what I have**
 - **This makes it pretty difficult to do business**
- **“Everything, then, must be assessed in money: for this enables men always to exchange their services, and so makes society possible”**
 - **Aristotle, Nicomachean Ethics**



5-9 rubeal@earthlink.net Creator Syndicate, Inc.
www.creators.com © 2005 Leigh Fisher

Leigh Fisher