

Characteristics of money to function effectively



Explain the characteristics required by money if it is to carry out its functions effectively.

What is money? Money is primarily a current medium exchange, for a person to buy goods and services from other person in the form of coins and banknotes (Freeman, 2012). It is critical to have a clear definition between money and wealth. In general, people may tend to use the term “ money” as a synonym for “ wealth”, such as Warren Buffet has a lot of money. However, economists clarify that these two terms are not in fact synonymous. In the side of economics, “ money” is specifically used to refer to the currency, but not an individual’s wealth or assets. Yet, technically anything can be served as money as long as it possesses the following four main functions (Beggs, 2014).

First of all, it must have the primarily function of serving as a medium of exchange. People need an item that is able to act as money to undergo the activities of buying and selling goods and services. In other words, an item that considered as money must be widely being accepted as payments for goods and services (Beggs, 2014). Money has made the transactions easier as everyone is willing to trade money for goods and goods for money.

However without money, the transactions must be conducted through the barter system where exchange can only happen if there is double coincidence of wants. This system will cause inconvenience to the people as they cannot buy what they want or need or the seller may hard to sell his goods unless double coincidence of wants happens. Hence, we can conclude that money has eliminated the inconvenience which was faced in barter transactions by eliminating the double coincidence when purchasing or selling goods and services (UPADHYAYA, 2012). People can buy what they

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need from the seller and inversely seller can sell all the goods and services to people who need. Besides that, money is able to create efficiency as it eliminates uncertainty regarding what is going to be accepted as payment by various businesses. With a generally accepted medium of exchange, trades are easier, more efficient, and resources can spend more time doing production (Money Functions, 2000-2014).

Besides that, an item must work as unit of value or standard value in order to consider as money. Money is being used as the common benchmark to designate the prices of goods throughout the economy (Money Functions, 2000-2014). Money provides and measures various goods and services with different value that produced in the economy, in the terms of monetary unit. Without this function, money is extremely hard to identify since there is no value in between, and also hard to make a decision on how much volume of goods and services should be given in exchange of a given quantity of a commodity in a barter economy (UPADHYAYA, 2012). However, money has solved this problem by letting people to know the exact value or price of a good. It enables both the suppliers and buyers to make wise decisions about how much to supply for the goods and how much to purchase in exchange (Function of Money, 2013).

Moreover, money must be able to hold its purchasing power over time to a reasonable degree so that people can store surplus purchasing power and use it whenever they want and need. If money could not store even for some period of time and still remain valuable in exchange, double coincidence in barter system would not solve and therefore would not adopted as a medium exchange. People will face a problem in buying whatever they want or

needed (Function of Money, 2013). So, this feature adds to efficiency as it gives producers and consumers flexibility in the timing of purchases and sales (Beggs, 2014). Money can also be accumulated to provide a source of wealth. It may not be the best store of value in economy since it depreciates with inflation, but money is more liquid than others as it is readily accepted everywhere. Furthermore, money is an easily transported store of value that is available in a number of convenient denominations (Function of Money, 2013).

The last main function of money is acting as a standard of deferred payment in an economy. It simply means that money is used for specifying future payments for current purchases. People who purchase some high value goods can pay off the payments in their future. This function may seem confusing or obliterate, but it is a direct result of the store of value and unit of account. However, for money to be deferred payment standard, it must retain its value and also store its value by anticipating future money values based on future inflation (Money Functions, 2000-2014). If money failed to do so, there would be a big different between the current price and future price that both creditors and debtors would stand to lose in this situation.

The characteristics of what item can be served as money always depend somewhat on the degree of complexity in the society. A relatively simple economy, with relatively few goods and services, few producers and consumers, and few transactions, may be able to function with a form of money that would not work in a more complex society. Nowadays, it is impossible for a shell or furs working particularly well as money in Canada. However at an earlier time, it could and it did in a simpler economy (The <https://assignbuster.com/characteristics-of-money-to-function-effectively/>

Characteristics of Money, 2000). There are some general characteristics that money should possess where it is usually important for whatever serves as money in a modern society.

First, money must be durable that needs to withstand every day wear and tear (Rouse, 2011). Money must have the ability to survive repeated usage over time by retaining the same shape, form, and substance. Money also must not be easily decomposed, deteriorated, degraded, or otherwise change form so that it can store its value a period of time. Durability is fundamental for money to perform the related functions of medium of exchange and store value. People who are willing to accept an item which act as money for the payment of goods, are due to the confidence and trust on that item where it can serve as a medium of exchange for something value and also able to trade in future time for other goods. If an apple is acting as money and pay for everything in apples, problem will arise since apples will be rotten in few days and can't store value although able to work as a medium of exchange. So when an item is able to work as a medium of exchange, it usually able to store value from one transaction to the next too. Somehow, it is also related to the function of standard of deferred payment that durability ensures that money can be survived over an extended period of time. Therefore, people are able to pay off their payments in their future (Money Characteristics, 2000-2014).

Second, money must be divisible where has ability to be broken down into smaller units or smaller denominations for transactional purposes of varying values goods. People will only need as much money as is necessary for their purchases. For example, 100 cents is equal to RM1. If the money is in bigger

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units, then people will find it hard to pay their low price goods as division is too big and will cause inconvenience. For an item to function as the medium of exchange, it must be divisible so that people can purchase goods with a wide range of different values. It must have increments that allow to be traded for both high value goods and also low value too with everything in between. Unit of account can also be performed in this characteristic by providing a common measure of the goods and services' value being exchanged. Therefore, it is necessary for money to be easily broken down for different types of transactions (Money Characteristics, 2000-2014).

Third, money must be portability or transportability where it can be easily moved from place to place for transportation. Money must be portable that give an advantage to all people for transporting or transferring their money from a place to another place or one to another. To perform the medium of exchange, money should be light and easy enough to bring everywhere for purchasing goods and even bring it for travelling. However, if money is as heavy as an elephant, it is hard to bring it everywhere and cause inconvenient to people. Hence, money must be portable for medium of exchange.

Fourth, money must be difficult in counterfeiting and limited in supply so that money is able to store its value. It simply means that money cannot be duplicated easily by everyone other than the government. It must be relatively hard to produce and obtain by people. If everyone is able to “ print up” or “ whip up” a batch of money at any time when they needed, the store value of the money will drop since they can produced easily without limit. Moreover, if money can be reproduced by people, price will highly likely be

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very high since everyone can obtain it easily and couldn't control the supply. Hence people need a lot of that item in order to exchange goods. It will affect the store of value and somehow the medium of exchange too (The Characteristics of Money, 2000).

Fifth, in terms of a form of currency being accepted within society, money must be accepted by everyone in the economy (Normanton). It simply means that money should be widely accepted as a means of payment that every country must agree to accept it as a medium of exchange. Everyone in an economy must be able to exchange for goods and services, and hence this acceptance is for the purpose of exchanging. Acceptability is important for money to perform the relatively functions of medium of exchange and standard of deferred payments. If a type of money is only accepted in certain areas and not others, it will be inconvenience for people to exchange goods and services outside the country. Moreover, it also related to the standard of deferred payments. The currency must be accepted by everyone so that the current purchases can be paid in future.

Last but not least, money should maintain a relatively stable value which is stability or uniformity. Money must be worth the same over time or simply means always maintain the same value for a long period (Rouse, 2011).

Money within that specific currency must look the same by depending on the various types of currency that are available (Normanton). If the money value is not stable every time, it will consider as useless money since money is the standard for people to measure accurately for the value of commodities (Studypoints, 2011). Stability helps to perform all functions of money in an economy. As the money is stable, people can exchange their goods and

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services with reasonable prices from each other. Other than that, money can be counted and measure accurately as the money is stability. By relating to the function of store of value, stability can provide people a source of wealth. If the money is not stable, people will get back less money than the money they have invested. Stability of money can also help to perform the function of standard of deferred payments by enabling people to pay in future time. If the money is not stable, people will tend to confuse on how much they need to pay for that good.

In conclusion, the functions of the money are interrelated with the characteristics of money. If one of the functions or characteristics failed to do so, it will seriously affect the currency of the value in an economy. Hence, the money needs to be durable, portable, and divisible, be stable, difficult in counterfeiting and limited in supply, and also acceptable to all countries and people. However, the most essential attribute of anything that serves as money is acceptability that it must be readily accepted by people in the economy.

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