Money

Introduction and Description

The properties of money, the functions of money and the definitions of money are important concepts for the students to understand in the initial study of money. Money has existed for a long time, and a wide range of commodities have served as money in different countries and at different times. Before money, economies used a barter system. The principal problem with a barter system is the *double coincidence of wants* required for success. Double coincidence of wants means that you must find someone who wants what you want to trade and has what you want! This search could be extremely time-consuming and limiting to the development of an economy.

Activity 34 asks the students to demonstrate an understanding of the functions and properties of money and evaluate different commodities' performances as money. Activity 35 helps the students grasp the different definitions of money used in the United States and the importance of the differences.

Objectives

1. Describe the properties of money.
2. Describe the functions of money.
3. Explain the definitions of money used in the United States.
4. Explain the concept of near-monies.

Time Required

Two class periods or 90 minutes

Materials

Activities 34 and 35

Procedure

1. Provide a brief lecture on the properties of any commodity used as money. The properties discussed should include portability, uniformity, durability, stability in value and acceptability.
2. Supply the students with examples of commodities that have served as money: cigarettes and chocolate bars in a prisoner of war camp, cattle and seashells. Ask them to indicate which properties the commodities have and which properties they do not have.
3. Provide a brief lecture on the functions of money: medium of exchange, store of value and unit of account.

   (A) The medium-of-exchange function eliminates the need for the double coincidence of wants.

   (B) The store-of-value function permits money to be held for use at a later time.

   (C) The unit-of-account, or standard-of-value, function means there is an agreed-to measure for stating the prices of goods and services. This simplifies price comparisons.

   Refer to the commodities listed in Procedure 2, and discuss how well they fulfill the functions of money.
4. Have the students start Activity 34 in class and complete for homework. Review the answers to the questions with the students.
5. Give a brief lecture on the definitions of money used in the United States today. Focus on M1, which consists of currency, traveler's checks and checkable deposits. Emphasize the function of medium of exchange in terms of each of the elements in M1. Now focus on M2, which includes M1 plus savings deposits, small time deposits, money market mutual funds and other deposits. Note that many items in M2 are constrained in the ability to serve as a medium of exchange. Time deposits may require a significant penalty if withdrawals are made before the maturity

date; frequently money market funds have a minimum withdrawal such as $500.

6. Present current data on M1 and M2. Emphasize here the proportion of M1 that checkable deposits represent. These data are available from the Federal Reserve.

7. Have the students complete Activity 35. Review the answers to the questions with the students.

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1. Use the table below to evaluate how well each item would perform the functions of money in today's economy. If an item seems to fulfill the function, put a + sign in the box; if it does not fulfill a function in your opinion, place a – sign in the box. Put a ? sign in the box if you are unsure whether the item fulfills the functions of money. The item with the most + signs would be the best form of money for you. In the space below the table, list the top six forms of money, according to your evaluation.

Item	Medium of Exchange	Store of Value	Standard of Value
Salt	–	–	–
Large stone wheels	–	+	–
Cattle	–	–	–
Gold	+	+	+
Copper coins	+	+	+
Beaver pelts	–	–	–
Personal checks	+	+	+
Savings account passbook	–	+	+
Prepaid phone card	?	+	+
Debit card	+	+	+
Credit card	+	–	+
Cigarettes	–	–	–
Playing cards	–	–	–
Bushels of wheat	–	–	–
$1 bill	+	+	+
$100 bill	+	+	+

Your top six forms of money: *Gold, copper coins, personal checks, debit card, $1 bill and $100 bill. Answers may vary.*

2. After you finish the evaluation in Question 1, rate the various items in the table below. Evaluate how well they meet the characteristics of money. Again, if an item seems to fit a characteristic, use a + sign; if the item does not seem to fit a characteristic, use a – sign. If there is a difference of opinion or if you are uncertain, use a ? sign. The item with the most + signs would best fit the characteristics of money. In the space below the table, list your six top items.

Item	Portability	Uniformity	Acceptability	Durability	Stability in Value
Salt	+	+	–	+	–
Large stone wheels	–	–	–	+	+
Cattle	–	–	–	?	–
Gold	+	+	?	+	–
Copper coins	+	+	?	+	–
Beaver pelts	+	–	–	+	?
Personal checks	+	+	?	+	+
Savings account passbook	+	+	–	–	+
Prepaid phone card	+	?	?	–	+
Debit card	+	+	+	+	+
Credit card	+	+	+	+	+
Cigarettes	+	–	–	–	–
Playing cards	+	–	–	–	–
Bushels of wheat	–	–	–	–	–
$1 bill	+	+	+	+	+
$100 bill	+	+	+	+	+

Your top six items: *Gold, copper coins, personal checks, debit card, $1 bill and $100 bill. Answers may vary.*

3. Why might factors such as ease of storage, difficulty in counterfeiting and security of electronic transfer of funds also be characteristics that you might use in evaluating money?
For an item to be a good medium of exchange, you would want to minimize the costs of holding or storing it. Counterfeiting and security affect the item's underlying value and might affect acceptability.

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What's All This About the Ms?

1. What are the three basic functions of money? *Medium of exchange, a standard of value (unit of account), and a store of value*

2. Why is it important for the Fed to know the size and rate of growth of the money supply? *The size of the money supply and the rate at which it is growing can have a significant impact on the economic well being of the country.*

   (A) What are the effects if the money supply grows too slowly? *If the money supply is growing too slowly, the likelihood of recession increases because the demand for money will increase, driving interest rates up. As interest rates rise, investment declines, slowing the growth rate of real output.*

   (B) What are the effects if the money supply grows too rapidly? *If the money supply is growing too quickly, it could lead to inflation.*

3. Name a type of money that serves primarily as a medium of exchange. *Currency, coin, debit cards or checkable deposits*

4. Name a type of money that serves primarily as a store of value. *Savings account or money market mutual fund account*

5. With the use of credit cards becoming more prominent and the availability of credit broader than ever, why are credit cards not included in the Ms? *Credit cards are short-term loans. Credit-card bills are not directly subtracted from checking accounts. Instead the credit-card holder pays the bill from a checking or NOW account. Not only should loans NOT be counted as money, but if they were and the payment were also counted, one economic transaction would be double-counted in the money supply.*

6. Why is it difficult for the Fed to get an accurate measure of the money supply?
Because of the volume of transactions in the United States, which can range into the trillions on a daily basis, getting an accurate measure of each transaction can be an arduous task. The inputs are constantly changing as banks make new loans and people repay loans ahead of schedule.

7. Why must the Fed continue to develop new ways to track the money supply?
Because of technological innovation in the financial services industry and profit maximizing behavior on the part of commercial banks, the Fed must find new measures for tracking the money supply to assist with monetary policy.

8. Use the data in Figure 35.1 to calculate M1, M2 and M3. Assume that all items not mentioned are zero. Show all components for your answers.

Figure 35.1

Calculating the Ms

Checkable deposits (demand deposits, NOW, ATM and credit union share draft accounts)	$850
Currency	$200
Large time deposits	$800
Noncheckable savings deposits	$302
Small time deposits	$1,745
Institutional money market mutual funds	$1,210

M1 = *850 + 200 = 1,050*

M2 = *1,050 + 1,745 + 302 = 3,097*

M3 = *3,097 + 800 + 1,210 = 5,107*

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