

MONEY AND BANKING

2024

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— جامعة مدينة السادات —

DURING THE TERM WE WILL DISCUSS THE FOLLOWING CHAPTERS:

CHAPTER 1, MONEY: MEANING, FUNCTIONS AND CLASSIFICATION

- ✓ BARTER SYSTEM.
- ✓ DIFFICULTIES OF BARTER SYSTEM
- ✓ MONEY
- ✓ THE MAIN FUNCTIONS OF MONEY
- ✓ PHASES IN THE EVOLUTION OF MONEY
- ✓ PRINCIPLES AND METHODS OF NOTE ISSUE
- ✓ SIGNIFICANCE OF MONEY IN CAPITALIST ECONOMY
- ✓ DEFECTS OF MONEY

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CHAPTER 1

MONEY: MEANING, FUNCTIONS AND CLASSIFICATIONS

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BARTER SYSTEM



BARTER SYSTEM

- During the primitive stages of civilization, human needs were simple and every person produced all that was needed to sustain life
- He fulfilled all his requirements and exchanged nothing because it was a one man economy.
- In course of time, people started different occupations and with specialization in production of some goods and services, trade among people came into existence. In the beginning, trade was direct. It involved exchange of goods for goods. For example, exchange of rice for shoes by some individuals. **This exchange of goods for goods was known as barter.**

Difficulties of Barter System

- Barter system was the requirement for a double coincidence of wants.

A man, who wanted to exchange some rice for cloth, had to find another person who not only wanted that same good i.e., rice, but had cloth to offer in exchange.

- Those who enter in barter trade should know how to calculate the value of commodities exchanged
- There was no common measuring unit in terms of which value of goods could be expressed.

Difficulties of Barter System

- The exchange of services would be far more complicated than the trading of goods. For example, how to pay for the services rendered by a teacher or a barber is not easy to decide in a barter system
- In a barter system, it is very difficult to accumulate wealth for future use. Most of the commodities like, corn, cattle, wheat, etc., lack adequate durability and deteriorate over time and therefore **cannot be stored** conveniently for long duration for future use.

DEFECTS (DIFFICULTIES) OF BARTER SYSTEM

1- Lack of double coincidence of wants.

2- Difficulty in the measurement of value.

3- Difficulty in store of value.

4- Difficulty of Division of the Goods

5- The exchange of services would be far more complicated than the trading of goods.

Money

- Money may be anything chosen by common approval as a medium of exchange.
- The chosen thing or commodity should be commonly accepted in payment for goods and services and to clear debts.

- Money was once recognized with coins.
- coin: metal stamped in pieces of portable form as a medium of exchange and measure of value
- Currency, in turn is defined as anything that circulates from person to person in the process of exchange

Medium of
exchange

Measure of
value

A standard
of deferred
payment

The main
functions
of money

Unit of
account

Store of
value

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Functions of Money

1. Medium of exchange:

- When money is used to intermediate the exchange of goods and services, it is performing a function as a medium of exchange.
- It thereby avoids the inefficiencies of a barter system, such as the 'double coincidence of wants' problem.

Functions of Money

2. Unit of Account:

- A unit of account is a standard numerical unit of measurement of the market value of goods, services, and other transactions.
- Divisible into smaller units without loss of value
- one unit or piece must be perceived as equivalent to any other
- A specific weight, or measure, or size to be verifiably countable

Functions of Money

3- Store of value:

- To act as a store of value, money must be able to be reliably saved, stored, and retrieved – and be predictably usable as a medium of exchange when it is retrieved.
- The value of the money must also remain stable over time.
- Some have argued that inflation, by reducing the value of money, diminishes the ability of the money to function as a store of value.

Functions of Money

4- Standard of Deferred Payment:

- A "standard of deferred payment" is an accepted way to settle a debt. When debts are denominated in money, the real value of debts may change due to inflation and deflation.

Functions of Money

5- Measure of value:

- Money acts as a standard measure and common denomination of trade.

primary functions of money

Medium of Exchange

Measure of Value

secondary function of money

A standard of
deferred payment

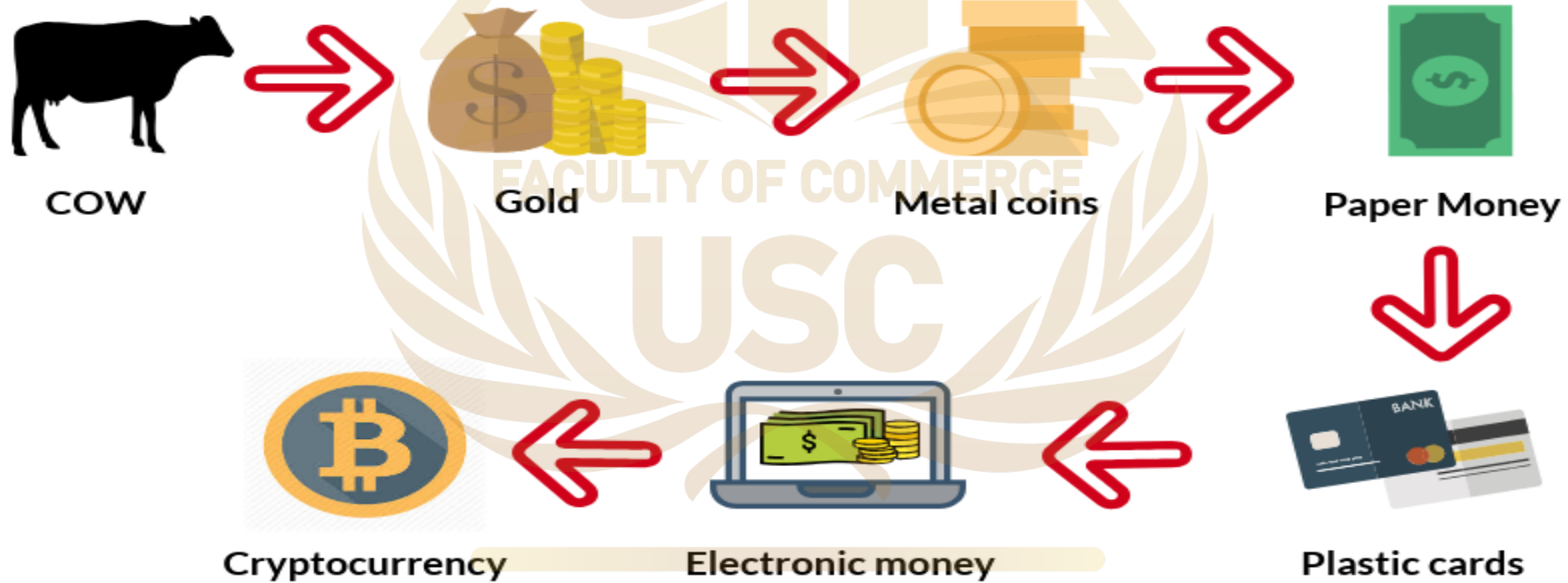
Store of value

Unit of
account

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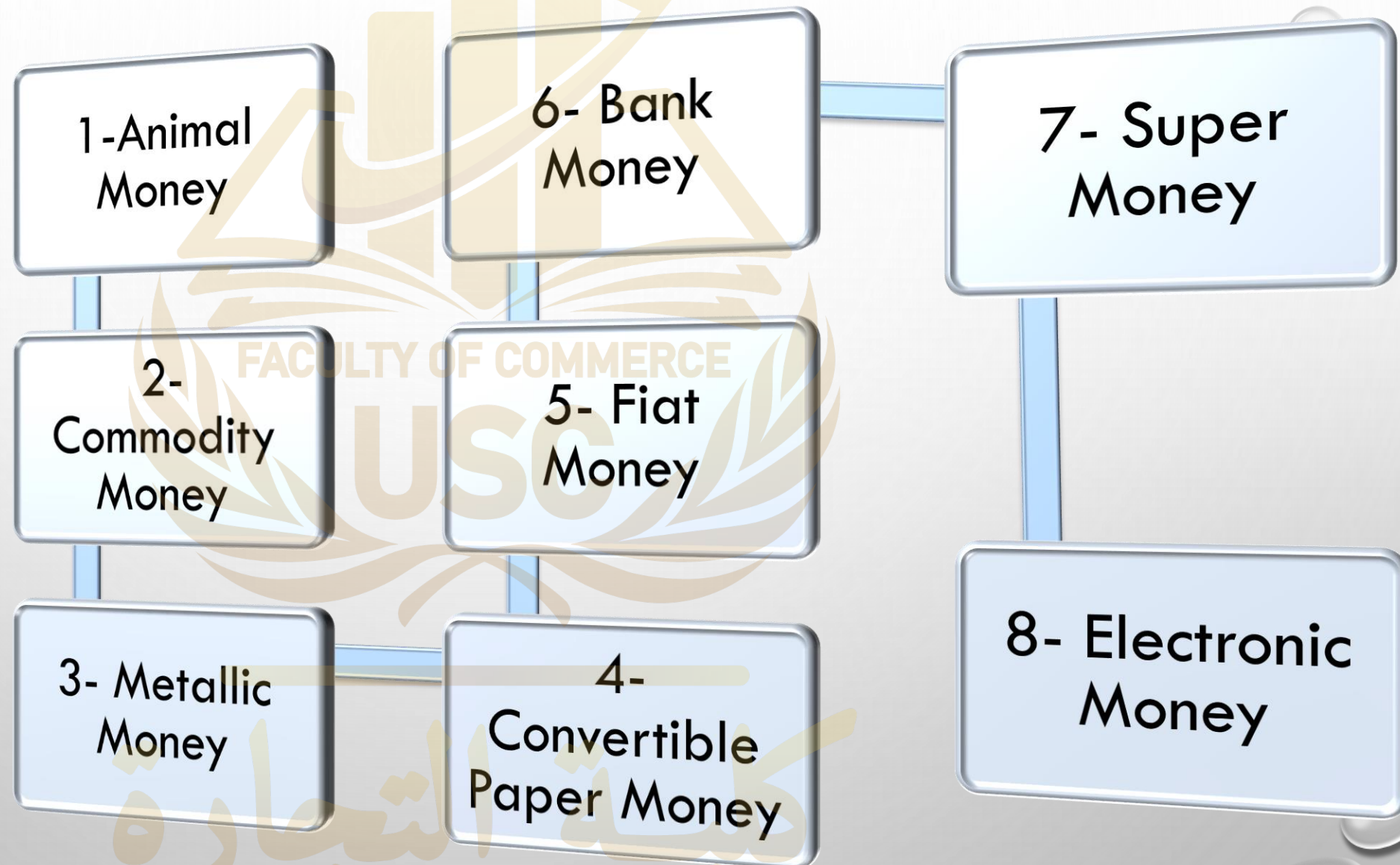
Evolution of Money



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phases in
the
evolution
of money



1- Animal Money

- ✓ In primitive hunting era, animals were used as a common medium of exchange.
- ✓ They used a tin animal money for Trading Purposes.



2- Commodity Money



- ✓ They used basic Commodities as generally accepted medium of exchange.
- ✓ Commodity money suffered from the limitations like lack of uniformity, inadequate store of value, lack of proper transferability and indivisibility.

3- Metallic Money



- ✓ Metallic money refers to coins prepared out of various metals like Gold, Silver, Bronze, Nickel etc. The standard configuration of the coin should be of given size, shape, weight and fitness. Its value is certified by an exclusive monopoly of the state.

Disadvantages:

- 1 - the face value of the coins may be less than the real value of the coins.
- 2- it can be Transacted only for small amounts.

4- CONVERTIBLE PAPER MONEY

- ✓ It was first used in china and later spread to europe.
- ✓ Goldsmiths used to store large quantities of gold, Silver and other precious metals in well- protected vaults, so, individuals began to hire these vaults to store their own valuable goods. The goldsmith issued a paper receipt 'convertible' into these deposits.
- ✓ Then, paper money was born.



Disadvantages

- 1- There is a chance of over issue of notes as they can be printed extensively. This leads to more supply of money which in turn results in inflation and thereby reduces the purchasing power of money.
- 2- The durability of paper money is also less than metallic money.

5- Fiat Money

✓ Fiat money comprises of simple currency (bills and coins) issued by the State as a medium of exchange, unit of account and store of value acceptable within a given Jurisdiction.

✓ **Disadvantages:**

Regrettably, public confidence in fiat money is tremendously delicate. The reason lies in its political and economic stability conditions.



6- Bank Money

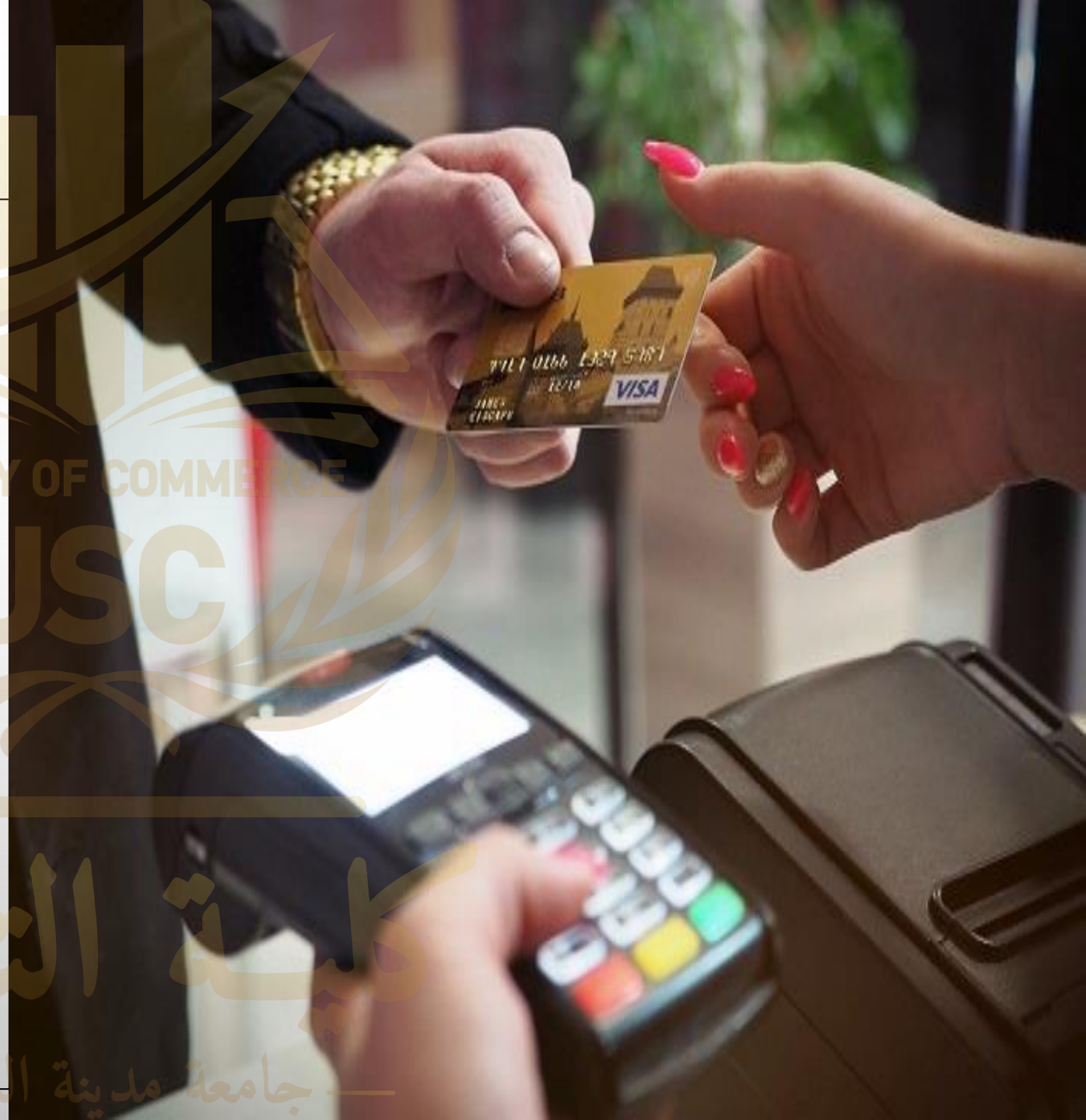
- ✓ The money developed in the form of credit money is referred to as bank money.
- ✓ Paper money and bank money together constitute total money supply:
 - M1 (bills and coins) is the most liquid.
 - M2 (personal deposits) needs a cheque or credit card.
 - M3 (term deposits) requires formalities and a penalty charge.

7- Super Money

- ✓ Super Money was founded in 2013.
- ✓ super money is an online financial comparison Platform that helps consumers evaluate financial services.
- ✓ Super money is based on the changing market value of stocks in the equity stock market. At a given point of time, market valuation of the stock can be used as 'collateral' for a bank. It can also be used as loan or line of credit in the form of fiat or deposit money.

8-Electronic Money

- ✓ Electronic money is defined as the digital payment message, which serves as a medium of exchange and store of value.
- ✓ As there is a danger of theft for paper currency and coins, electronic money evolved as a solution.
- ✓ This reduces transportation costs and improves economic efficiency.



PRINCIPLES AND METHODS OF NOTE ISSUE

Principles

(1) **Currency Principle:** - According to the currency principle, the central bank of the country should keep 100% gold for every note issued. The currency principle assures maximum safety for the notes, but it lacks elasticity.

2) **Banking Principle:** - According to this principle, there is no need to keep 100% gold or silver against notes issued.

The notes issued in the country should be according to the needs of trade and Industry. this Principle of note issue provides the country with an elastic currency.

The disadvantages of Banking principle

is the danger of over issue of notes, possibility of inconvertibility of excess notes, loss of public confidence in the currency and monetary instability.

Methods of Note Issue

1-
Fixed
Fiduciary
System

2-
Proportional
Reserve
System

3-
Minimum
Reserve
System

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(1) FIXED FIDUCIARY SYSTEM

- Under this system, a fixed amount is laid down by law which needs to be covered by government securities.
- Notes issued in excess of this amount must be fully backed by gold.
- England adopted this system in 1844.
- The system lacked elasticity and was not capable of satisfying the needs of trade and industry.
- This system was abandoned in 1913 in favour of proportional reserve system.

(2) PROPORTIONAL RESERVE SYSTEM

- Under this system, the central bank is to keep a certain percentage of the total notes issued in gold. There is to be covered by sound government securities, trade bills,...etc.
- This system was abandoned in 1965 as it was rigid and lacked elasticity.

(3) MINIMUM RESERVE SYSTEM

- According to this system, the central bank is required to keep only a minimum amount of reserve in the form of gold and foreign exchange securities.
- The central bank can expand note issue in accordance with the volume of business activities without backing of gold.
- The advantages of this system is that it ensures an adequate supply of currency to meet the business demands of the country. In other words, the method of note issue is sufficiently elastic.
- The disadvantages is that paper currency issued is practically inconvertible in this system.

SIGNIFICANCE OF MONEY IN CAPITALIST ECONOMY

- In a capitalist economy, where allocation of resources, production and distribution of national dividend are all decided by market mechanism i.e. by the forces of demand and supply.
- Money plays an important role in this system.
- It has substantial effects on output, income, employment, consumption and economic welfare of the community.

The Dynamic role of money Can be illustrated by The following Points:

Money → Purchasing power → consumption → economic development

Money → Store of value → investment → employment → economic development.

DEFECTS OF MONEY

A- The demand for money becomes an indirect demand.

B- It cannot serve as a store of value during the times of hyperinflation.

C- Money is believed to be responsible for inequalities in the society.

D- Money is also held responsible for corruption in the society.

**John Stiward
Mill's
Limitations of
money**

Finally,

Money may not produce anything; but in the absence of it, nothing can be produced in today's world. The small defects of money cannot undermine its importance in our society.





THANKS FOR ALL OF YOU

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