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Why Do We Use Currency?

- Currency is a **medium of exchange**
  - This means that currency is the intermediate commodity between transactions
  - Instead of **bartering**, we can use currency for exchange
    * Problems with bartering
      1. **Double Coincidence of Wants** = both parties must actively want each others goods
         - Currency fixes this, as one person can desire a good, and the seller can desire the purchasing power associated with some amount of money
      2. Some goods cannot be split into smaller denominations
         - Currency fixes this by being offered in everything from pennies to hundred dollar bills
- **Wealth** = the totality of someone's assets
  - Assets include
    * Land
    * Capital
    * Labor power
      - *You damn commie*
- **Income** = the rate at which someone's wealth changes with time

Commodity Currency vs Fiat Currency

- **Commodity currency** = a system of currency where the item of exchange has **intrinsic utility** to people
  - **Intrinsic utility** = a use or benefit that exists *within* the item of exchange
  - *e.g.*
    * Slips of paper that can be turned in at any time for food or water
    * Gold standard
      - The intrinsic utility of gold is doubtful, but I guess some people are stupid and like shiny things
- **Fiat currency** = a system of currency where the item of exchange has only **extrinsic utility** to people
  - **Extrinsic utility** = a use or benefit that exists *externally* to the item of exchange

        * This means that money is not useful in and of itself–aside from maybe warmth if you burn it
    - *e.g.*
        * Basically every modern economy(USD, Euro, British pound, etc)
        * I.O.U.'s

Three Functions of Currency

1. **Medium of exchange** = the currency can be easily used to purchase goods and services
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2. **Unit of account** = producers use the currency to broadcast the prices of their goods or services
    - If all the shops are charging for sheckles, you're going to be justifiably confused
3. **Store of value** = the currency can be saved
    - Explains why spoilable goods do not make for good currency

What Makes for a Good Currency?

1. **Widely accepted** = similar to the "unit of account" idea
    - Fiat currency is valuable if we all think it is
2. **Scarcity** = cannot be easily reproduced
3. Dividable into smaller denominations

- **Purchasing power** = the amount of goods and services a unit amount of currency can purchase
- **Inflation/Deflation** = the process of changing purchasing power with time
    - Can be caused by all kinds of things

Liquidity

- **Liquidity** = the difficulty by which an asset can be used as a medium of exchange
- Three levels
    1. **M1(Highest liquidity)**
        - *e.g.*

    - Circulating currency
    - Checking accounts

2. **M2(Near-Moneys)**
   - *e.g.*
     - All of M1
     - Invested currency