



Q1: What is a barter system? What are its drawbacks?

Ans: Barter system is a system that was used in ancient times to exchange goods. In other words, this system was used to exchange one commodity for another before the monetary system came into existence. For example, if a person having rice wants tea, then he can exchange rice with a person who has tea and needs rice. The economy having the barter system was called 'C-C economy', i.e. commodity is exchanged for commodity.

The various drawbacks of the barter system are as follows:

- i. Problem of double coincidence of wants: Double coincidence of wants implies that needs of two individuals should complement each other for the exchange to take place. For example, in the above case, the second person must need rice in exchange of tea.
- ii. Lack of common unit of value: Under barter system there was no common unit for measuring the value of one good in terms of the other good for the purpose of exchange. For example, a horse cannot be measured in terms of rice in the case of exchange between rice and horse.
- iii. Difficulty in wealth storage: It was very difficult to store commodities for future exchange purposes. The perishable goods like grains, milk and meat could not be stored to exchange goods in future. Therefore, wealth storage was a major difficulty of barter system.
- iv. Lack of standard of deferred payments: The future payments could not be met in a C-C economy (barter system) as wealth could not be stored. It was very difficult to pay back loans.

Q2. What are the main functions of money? How does money overcome the shortcomings of a barter system?

Ans: The main functions of money are as follows:

- i. Medium of exchange: Money acts as a medium of exchange as it facilitates exchange through a common medium, i.e. currency. In other words, money helps in the buying and selling of goods. For example, a person can sell his goods to another for money and that person can use money to purchase goods of his choice. Money solves the problem of double coincidence of wants.
- ii. Unit of value: The values of goods can be measured in terms of money. It is a common medium through which we can calculate the value of each and every good. The value of a good in terms of money is called the price. In barter system the lack of a common denominator for measuring values of goods was a major drawback.
- iii. Store of value: This function explains the importance of money as value storage. This implies that wealth in the form of money can be stored easily as a medium of exchange for future use. For example, money can be stored in banks for meeting emergency and future needs.
- iv. Standard of deferred payments: Payments can easily be made through the medium of money. In other words, it is very difficult to pay back a loan in terms of goods and services.

However, with the advent of money the payments of loans or interests can easily be made.

Money overcomes the shortcomings of barter system in the following manner:

- i. Money solves the problem of double coincidence of wants. For example, if a person needs wheat in exchange of tea, then he/she must search for a person who is ready to trade wheat for tea. Money made the need for such searches redundant.
- ii. In barter system, it was very difficult to measure the value of one good in terms of another. For example, it is difficult to calculate the value of a cow in terms of wheat.
- iii. It was very difficult to store goods, especially perishable goods (fruits, meat, etc.) for the purpose of value storage. Money serves this purpose.
- iv. The contractual or future payments are much difficult to be made in barter system. For example, a worker working on contract basis could not be paid in terms of rice or chairs.

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