Chapter 31: Money, its Nature and Functions

What is Money?
- Money is anything accepted to pay for goods and services or to settle a debt.
- Money is best defined in terms of its functions.

Functions of Money

Medium of Exchange
- Money functions as a Medium of Exchange when it is used to purchase things.
- Exchange by barter requires a double coincidence of wants.
- A Double Coincidence of Wants is when traders must find other traders who want what they have and who have what they want.

Unit of Account
- As a Unit of Account (Measure of Value), money is used to express values.

Store of Value
- As a Store of Value, money is used as a liquid asset.
- Liquidity refers to the ease of converting a store of value into a medium of exchange.

Kinds of Money
- Notes and coins constitute currency.
- Canadian currency is Fiat Money, not backed by gold or any other precious metal.
- Legal Tender money must be accepted in settlement of debts.
- The face value of Good Money is equal to the value of metal it contains.
- The face value of Bad Money is greater than the metal’s value.
- Gresham’s Law states that bad money drives out good money.
- Checking accounts are bank deposits that are transferable by checks, these are known as Demand Deposits.
Near Money and Money Substitutes

Near Money
- **Notice Deposits** are interest-earning deposits subject to notice before withdrawal.
- **Near Money** is any highly liquid asset that can be easily converted into currency or demand deposits without much loss of value.

Money Substitutes
- Credit cards are not money; they are money substitutes.
- The use of money in transactions discharges debts, but the use of credit cards establishes debts that must ultimately be discharged by using money.

The Money Supply in Canada
- The narrow definition of Money (M1) emphasizes the medium of exchange function.
- Border definitions of money (such as M1A) include notice deposits and other highly liquid assets.
  - $M1 = \text{Currency outside banks} + \text{demand deposits in chartered banks} - \text{private sector float}$
  - $M1A = M1 + \text{daily interest checkable and non-personal notice deposits}$
  - $M2 = M1A + \text{other notice deposits} + \text{personal term deposits}$
  - $M2+ = M2 + \text{deposits at trust and mortgage loan companies} + \text{deposits and shares at caisses populaires and credit unions}$
  - $M3 = M2 + \text{other non-personal fixed-term deposits} + \text{foreign currency deposits of residents of Canada}$
- Demand deposits are the most important type of money in Canada

The Canadian Payments System
- The Canadian Payments System has evolved from using a very simple system using commodity money to a highly sophisticated system using electronic devices.

The Present Payments System
- The Canadian Payments Association facilitates transfers between financial institutions.
The Payments System of the Future
- The Electronic funds transfer system (EFTS) funds instantly between accounts.
- The use of Debit Cards (Payment Cards) permits the instantaneous transfer of purchasing power.

The Value of Money
- The Value of money is inversely related to the price level.

The Money Supply and Inflation
- Excessive increases in the money supply are inflationary.
- Continuous increases in the money supply at a tremendously rapid rate will result in severe inflation.

The Money Supply and Unemployment
- Inadequate growth in the money supply can cause unemployment.
- Reductions or inadequate increases in the money supply may result in economic slowdowns and increases in unemployment.