JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

Government of Rajasthan established

Through ACT No. 17 of 2008 as per UGC ACT 1956

NAAC Accredited University

Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA B.Ed 4th Semester

Course – Money Banking and Public Finance

Digital session name – Functions of Money: Part - 2

Introduction:

In the first part of this e- notes we have discuss the primary function of money, now we will discuss the secondary, contingent and other functions of money.

Secondary Functions:

Money performs three secondary functions: as a standard of deferred payments, as a store of value, and as a transfer of value. They are discussed below.

(i) Money as a Standard of Deferred Payments:

The third function of money is that it acts as a standard of deferred or postponed payments. All debts are taken in money. It was easy under barter to take loans in goats or grains but difficult to make repayments in such perishable articles in the future. Money has simplified both the taking and repayment of loans because the unit of account is durable.

Money links the present values with those of the future. It simplifies credit transactions. It makes possible contracts for the supply of goods in the future for an agreed payment of money. It simplifies borrowing by consumers on hire-purchase and from house-building and cooperative societies.

Money facilitates borrowing by firms and businessmen from banks and other non-bank financial institutions. The buying and selling of shares, debentures and securities is made possible by money. By acting as a standard of deferred payments, money helps in capital formation both by the government and business enterprises. In fine, this function of money develops financial and capital markets and helps in the growth of the economy.

But there is the danger of changes in the value of money over time which harms or benefits the creditors and debtors. If the value of money increases over time, the creditors gain and debtors lose. On the other hand, a fall in the value of money over time brings losses to creditors and windfalls to debtors. To overcome this difficulty, some of the countries have fixed debt contracts in terms of a price index which measures changes in the value of money. Such a contract over time guarantees the future payment of debt by compensating the loser by the same amount of purchasing power when the contract was entered into.

(ii) Money as a Store of Value:

Another important function of money is that it acts as a store of value. “The good chosen as money is always something which can be kept for long periods without deterioration or wastage. It is a form in which wealth can be kept intact from one year to the next. Money is a bridge from the present to the future. It is therefore essential that the money commodity should always be one which can be easily and safely stored.”

Money as a store of value is meant to meet unforeseen emergencies and to pay debts. Newlyn calls this the asset function of money. “Money is not, of course, the only store of value. This function can be served by any valuable asset. One can store value for the future by holding short-term promissory notes, bonds, mortgages, preferred stocks, household furniture, houses, land, or any other kind of valuable goods. The principal advantages of these other assets as a store of value are that they, unlike money, ordinarily yield an income in the form of interest, profits, rent or usefulness…,and they sometimes rise in value in terms of money.

On the other hand, they have certain disadvantages as a store of value, among which are the following: (1) They sometimes involve storage costs; (2) they may depreciate in terms of money; and (3) they are “illiquid” in varying degrees, for they are not generally acceptable as money and it may be possible to convert them into money quickly only by suffering a loss of value.”

Keynes placed much emphasis on this function of money. According to him, to hold money is to keep it as a reserve of liquid assets which can be converted into real goods. It is a matter of comparative indifference whether wealth is in money, money claims, or goods. In fact, money and money claims have certain advantages of security, convenience and adaptability over real goods. But the store of value function of money also suffers from changes in the value of money. This introduces considerable hazard in using money or assets as a store of value.

(iii) Money as a Transfer of Value:

Since money is a generally acceptable means of payment and acts as a store of value, it keeps on transferring values from person to person and place to place. A person who holds money in cash or assets can transfer that to any other person. Moreover, he can sell his assets at Delhi and purchase fresh assets at Bangalore. Thus money facilitates transfer of value between persons and places.

3. Contingent Functions:

Money also performs certain contingent or incidental functions, according to Prof. David Kinley. They are:

(i)Money as the Most Liquid of all Liquid Assets:

Money is the most liquid of all liquid assets in which wealth is held. Individuals and firms may hold wealth in infinitely varied forms. “They may, for example, choose between holding wealth in currency, demand deposits, time deposits, savings, bonds, Treasury Bills, short-term government securities, long-term government securities, debentures, preference shares, ordinary shares, stocks of consumer goods, and productive equipment.” All these are liquid forms of wealth which can be converted into money, and vice-versa.

(ii) Basis of the Credit System:

Money is the basis of the credit system. Business transactions are either in cash or on credit. Credit economises the use of money. But money is at the back of all credit. A commercial bank cannot create credit without having sufficient money in reserve. The credit instruments drawn by businessmen have always cash guarantee supported by their bankers.

(iii) Equaliser of Marginal Utilities and Productivities:

Money acts as an equaliser of marginal utilities for the consumer. The main aim of a consumer is to maximise his satisfaction by spending a given sum of money on various goods which he wants to purchase. Since prices of goods indicate their marginal utilities and are expressed in money, money helps in equalising the marginal utilities of various goods. This happens when the ratios of the marginal utilities and prices of the various goods are equal. Similarly, money helps in equalising the marginal productivities of the various factors. The main aim of the producer is to maximise his profits. For this, he equalises the marginal productivity of each factor with its price. The price of each factor is nothing but the money he receives for his work.

(iv) Measurement of National Income:

It was not possible to measure the national income under the barter system. Money helps in measuring national income. This is done when the various goods and services produced in a country are assessed in money terms.

(v) Distribution of National Income:

Money also helps in the distribution of national income. Rewards of factors of production in the form of wages, rent, interest and profit are determined and paid in terms of money.

4. Other Functions:

Money also performs such functions which affect the decisions of consumers and governments.

(i) Helpful in making decisions:

Money is a means of store of value and the consumer meets his daily requirements on the basis of money held by him. If the consumer has a scooter and in the near future he needs a car, he can buy a car by selling his scooter and money accumulated by him. In this way, money helps in taking decisions.

(ii) Money as a Basis of Adjustment:

To carry on trade in a proper manner, the adjustment between money market and capital market is done through money. Similarly, adjustments in foreign exchange are also made through money. Further, international payments of various types are also adjusted and made through money.

It is on the basis of these functions that money guarantees the solvency of the payer and provides options to the holder of money to use it any way, he likes.