

# Classification and Functions of Money



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# Classification of Money

- Different economists have classified money on the basis of nature, on the basis of legality of money and on the basis of its material. Here we will discuss it one by one:

# Classification of Money

## 1) Classification on the basis of Nature

### (i) Actual Money

It is that money which actually circulates in the country. It serve as medium of exchange, measure of value and store of wealth.

# Classification of Money

Lord Keynes has divided actual money into

**(a) Commodity (full-bodied) money:**

Commodity money is that whose face value is equal to its intrinsic value. This type of money was in existence when gold standard was prevalent.

# Classification of Money

conti....

## (b) Representative (full-bodied) money:

Representative (full-bodied) money is that whose face value is not equal to its intrinsic value. It is of two types:

Convertible and Inconvertible representative money

## Classification of Money      conti.....

- Convertible money can be exchanged for commodity as all paper currency notes in India.
- Inconvertible money as one rupee note of India, here authorities are not liable to convert it into commodity money.

# Classification of Money      conti....

## (ii) Money of Account:

It refers to that money in which all sorts of accounts are kept

## (2) Classification on the basis of Legality

(i) Legal Tender Money

(ii) Optional Money

(iii) Outside and inside money



# Classification of Money      conti....

**(i) Legal Tender Money:** It refers to the money which is recognised by the government of the country as a medium of payment and people accept it legally.

It is of two types:

(a) Limited Legal Tender

(b) Unlimited Legal Tender

## Classification of Money conti....

(ii) **Optional money:** It is ordinarily accepted by the people but legally nobody can be compelled to accept it. This type of money does not enjoy legal status.

# Classification of Money      conti....

(iii) **Outside and Inside Money:** Gurley and Shaw classified money as Outside and Inside Money.

## **(a)Outside Money:**

It has its origin in the act of the government purchase of goods and services or transfer payments.

# Classification of Money      conti....

## (b) Inside Money:

The money whose supply comes as a result of expenditure by the private sector is called inside money

# Classification of Money      conti....

## (3) Classification on the basis of Money Material:

It is of two types:

(i) Metallic Money

(ii) Paper Money

# Classification of Money      conti....

**(i) Metallic Money:** It means coins which are made of gold, silver etc. These are classified into three categories:

(a) Standard Coins

(b) Token coins

(c) Standard Token coins

# Classification of Money      conti....

- (a) **Standard Coins:** These coins are those whose face value is equal to its real value.
- (b) **Token coins:** These coins are those whose real value is less than the value written on it.
- (c) **Standard Token coins:** When token coin is converted as the main coin of the country as Indian Rupee.

# Classification of Money      conti....

(ii) Paper money:

Paper Money refers to money which is usually made of paper. The value of representative full-bodied money is much higher than its value as a commodity. It is accepted as money as it can be conveniently used for carrying out transactions.



# Classification of Money      conti....

**Paper Money** can be

(a) Representative Paper Money

(b) Convertible Paper Money

(c) Inconvertible paper money

(d) Fiat paper money

# **Classification of Money      conti....**

## **(a) Representative Paper Money**

These are those paper money or notes, equal to the face value of which gold or silver coins are kept in government treasury.

## **(b) Convertible Paper Money**

Paper money which can be converted into standard coins or gold or silver equal to its face value.

# **Classification of Money      conti....**

## **(c) Inconvertible paper money**

Paper money which can not be converted into standard coins or gold or silver equal to its face value.

## **(d) Fiat paper money**

It circulates on the authority of the government. It is also called as Emergency Money

# Classification of Money      conti....

## (4) Credit money

Credit money refers to the money whose intrinsic value (as a commodity) is much lower than its face value, i.e.  $\text{Money Value} > \text{Commodity Value}$ . Credit cards, bank deposits are some examples of credit money.

# Classification of Money      conti....

**Credit money is of following types**

**(a) Token coins:**

These refer to small coins of various denominations, like Rs 10, 5, 2 or Re. 1 coins since their value as money is more than value of metal contained in them.

# Classification of Money conti....

## **(b) Representative Token money:**

It is 100% backed and is fully redeemable in some commodity such as gold or silver. It is in the form of paper and market value of what is actually offered is less than value printed on paper notes.

# Classification of Money      conti....

**(c) Circulating promissory notes issued by central bank:**

These are currency notes issued by Reserve Bank in India. These include all currency notes of denominations like Rs 1,000, Rs 500, Rs 100, etc. The commodity value of a promissory note is much less than its money value.

# Classification of Money      conti....

## (d) Demand Deposits in bank:

Deposits are claims of creditors (depositors) against bank. Demand deposits are very convenient for making transactions of huge amounts as they remove the risk of carrying large amounts of cash.



# Functions of Money

- Money performs a number of primary, secondary, contingent and other functions which not only remove the difficulties of barter but also lubricate the wheels of trade and industry.

# Primary Functions of Money

- Primary Functions of Money

- (1) Medium of Exchange

- Money as medium of exchange removes the need for double coincidence of wants and the inconveniences and difficulties associated with barter.
    - This function also separates the transactions in time and place because the sellers and buyers of a commodity are not required to perform the transactions at the same time and place.

# Primary Functions of Money

- When money acts as a medium of exchange, it means that it is generally acceptable.
- As a medium of exchange, money enhance production indirectly as through specialisation and division of labour efficiency and output of labour

# Primary Functions of Money

## (2) Money as Unit of Value or Measure of Value

- Money act as a unit of value.
- To measure the value of all goods and services we use money.
- Money is the common denominator which determines the rate of exchange between goods and services which are priced in terms of the monetary unit.

# Secondary Functions of Money

## Secondary Functions of Money:

Money performs three secondary functions:

- (a) as a standard of deferred payments
- (b) as a store of value
- (c) as a transfer of value.

# Secondary Functions of Money

## (a) Money as a Standard of Deferred Payments:

- Money acts as a standard of deferred or postponed payments. All debts are taken in money. Both the taking and repayment of loans become easy due to durable unit of account.
- Money links the present values with those of the future.

# Secondary Functions of Money

- Money simplifies credit transactions.
- Money facilitates borrowing by firms and businessmen from banks and other non-bank financial institutions.

# Secondary Functions of Money

**(b) Money acts as a Store of Value:**

Money is demanded because we can purchase goods and services with it. All collects money and stores it for future needs.



# Secondary Functions of Money

## **(iii) Money acts as a Transfer of Value:**

Money is acceptable as a means of payment and 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.

# Contingent Functions of Money

## **(3) Contingent Functions of Money:**

According to Prof. David Kinley Money also performs contingent or incidental functions.

They are:

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

All types of wealth can be given liquid form with the help of money.

# Contingent Functions of Money

## **(ii) Basis of credit:**

Banks and other financial institutions create credit on the basis of money funds they deposit with them.

## **(iii) Gives mobility to capital**

Without money it is impossible to transfer immovable property from one place to another.

# Contingent Functions of Money

## **(iv) Means of getting maximum:**

We purchase goods and services to get maximum satisfaction and we can obtain this satisfaction only with the help of money.

## **(v) Basis of distribution of income:**

Money acts as the basis of distribution of national income among different factor of production as factor payments for their factor services.

# Contingent Functions of Money

## **(vi) Act as the Measures of National Income:**

With the help of money we can measure and compare national income of nations which was not possible in barter system.

# Other Functions of Money

## (4) Other Functions of Money :

(i) Helpful in making decisions

(ii) Money as a Basis of Adjustment:

- To carry on, the adjustment between money market and capital market is done through money.

# Other Functions of Money

- Adjustments in foreign exchange are also made through money.
- International payments of various types are also adjusted and made through money.

# Static and Dynamic functions of Money

W.R.L. Coulborn and Paul Einzig have classified all the functions of money into Static and Dynamic functions

## Static Functions of Money

These functions are:

- *A medium of Exchange*
- *A measure of Value*
- *The Standard of Deferred Payments*
- *Store of Value*



# Static and Dynamic functions of Money

## Dynamic Functions of Money:

These functions are:

- Money can activate idle resources and put them into productive channels.
- Money helps to increase income, output and employment levels of an economy.
- Money helps in converting savings into investments.

# Importance of Money

- Importance of Money can be studied under following heads:
  - (1) Direct importance of money in the field of economics.
  - (2) Indirect importance of money in the field of economics.
  - (3) Importance of Money in Non-economic Fields

# Importance of Money

**(1) Direct importance of money in the field of economics.**

(a) Importance in Consumption

(b) Importance in Production

(c) Importance in Exchange

(d) Importance in Trade

(e) Importance in Distribution

# Importance of Money

(f) Importance in Public Finance

(g) Helps in Capital Formation

**(2) Indirect importance of money in the field of economics.**

(a) Freedom from Inconvenience of Barter

(b) Basis of credit

(c) Index of Economics Development

# Importance of Money

- (d) Increase in Mobility of Capital:** Now it is easy to transfer wealth from one place to another with the help of money.
- (e) Incentive for Material Development:** as money encourage people to work harder and improve their standard of living.

# Importance of Money

- (f) National and International Unity:** Money helps to build strong national and international ties as new production units are established on the basis of collaborations.
- (g) Division of Labour and Extent of market:** With the help of money there is expansion in market which facilitates division of labour and specialization.

# Importance of Money

## **(3) Importance of Money in Non-economic Fields**

- a) Importance in Social fields:** Money have granted economic and social freedom.
- b) Importance in Political field:** Money strengthens political freedom and stimulates political freedom.
- c) Importance in field of arts:** Money helps to develop art and culture.

# Evils of Money or Disadvantage

- (i) Misallocation of Resources:** Due to price distortions and market imperfections the prices in capitalistic economies do not represent the real value of resources.
- (ii) Unequal Income Distribution:** The rich people become richer and the poor become poorer. Money leads to class conflicts and society get divided into 'Haves' and 'Have - Nots'



# Evils of Money or Disadvantage

- (iii) Leads to problem of black money
- (iv) Exploitation increases as people exploit others to make money.
- (v) Increase in Immoral tendencies and evils like bribe, black marketing, cheating increases.
- (vi) Money also generate many political evils.

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**Thanks**