

Chapter 11: Money

Question: 1

Fill in the blank with appropriate alternatives given below

Medium of exchange is _____ function of money.

Options

- primary
- secondary
- contingent
- additional

Solution

Medium of exchange is **primary** function of money.

Explanation:

The main function of money is to act as a medium of exchange. It facilitates exchange through a common medium i.e. facilitates exchange through currency and eliminates the need for double coincidence of wants for an exchange to take place. Therefore, it can be concluded that medium of exchange is the primary function of money.

Question: 2

Fill in the blank with appropriate alternatives given below

In the case of _____ coins, intrinsic value is less than their face value.

Options

- token
- full bodied
- representative
- standard

Solution

In case of **token** coins, intrinsic value is less than their face value.

Explanation:

Intrinsic value of token coins refers to the value of the metal which a token coin is made of. On the other hand, face value is the value which is mentioned on the coin. Since token coins are made up of cheap metals, in case of token coins, the intrinsic value is less than their face value.

Question: 3

Fill in the blank with appropriate alternatives given below

The most liquid asset is _____.

Options

- cheque
- money
- shares
- debentures

Solution

The most liquid asset is **money**.

Explanation:

Money is the most liquid asset. Gold, silver, land, cheques etc. are not as liquid as money. If the need arises, these assets have to be converted into money, but money need not to be converted into any other form as it is readily acceptable.

Question: 4

Fill in the blank with appropriate alternatives given below

Introduction of _____ removed difficulties of barter.

Options

- metals
- bank
- money
- shares

Solution

Introduction of **money** removed difficulties of barter.

Explanation: Barter system had many difficulties like the problem of double co-incidence, common measure of value, the problem of standard method of deferred payment etc. which were solved by the introduction of money. Money has overcome the drawbacks of the barter system and serves as an effective medium of exchange to facilitate trade.

Question: 5

Fill in the blank with appropriate alternatives given below

In the initial stage of development, _____ was used.

Options

- credit money
- paper notes
- metallic coins
- commodity money

Solution

In the initial stage of development, **commodity money** was used.

Explanation:

Initially, human beings exchanged goods and services for other goods and services. In other words, commodity exchange or commodity money was more prevalent. Commodities like sea-shells, salt, gold or other precious commodities were used as money for the exchange of goods and services.

Question: 6

Match the following:

Group A	Group B
1. Near Money	a. Sea Shells
2. Secondary function of money	b. Double coincidence of wants
3. Commodity Money	c. Fiat money
4. Barter	d. Measure of value
5. Legal tender	e. Bills of exchange
	f. Standard of deferred payments
	g. Metallic money

Solution

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Group A	Group B
1. Near Money	e. Bills of exchange
2. Secondary function of money	f. Standard of deferred payment
3. Commodity Money	a. Sea Shells
4. Barter	b. Double coincidence of wants
5. Legal tender	c. Fiat money

Explanations:

1. Anything which can be used as money or equivalent to money is called near money. Since bills of exchange can be used in the exchange of goods and services and can be converted into money at any point of time, they are an example of near money.

2. Standard of deferred payment is the secondary function of money. Standard of deferred payments means that money can be used to make future payments. This implies that wealth in the form of money can be stored easily as a medium of exchange for future use.

3. Sea shells are an example of commodity money as, in the initial stages of development, commodities like sea-shells, salt, gold or other precious commodities were used as money for the exchange of goods and services.

4. Double coincidence of wants is one of the drawback of barter system. It implies that the needs of any two individuals should complement each other for the exchange to take place. However, in reality, it is very difficult to find an individual who possess the goods and services that are needed by another individual at the same time to exchange what he/she has.

5. The currency issued by the monetary authority is known as legal tender money. It implies that the values of such currency notes and coins are backed by the monetary authority. Fiat money becomes the legal tender when it is backed by the monetary authority.

Question: 7

State whether the following statement is true or false.

Metallic coins are easily portable than paper notes.

Options

- True
- False

Solution

The above statement is **false**. Metallic coins are not easily portable because large amounts of metallic coins are difficult and inconvenient to carry and transport from one place to other. On the other hand, paper notes are easily portable as these notes are light weighted and possess high face value. Hence, it can be said that paper notes are more easily portable than metallic coins.

Question: 8

State whether the following statement is true or false.

Token coins are coins whose face value is greater than their intrinsic value.

Options

- True
- False

Solution

The above statement is **correct**. Face value of token coins is the value which is mentioned on the coin. On the other hand, intrinsic value of token coins refers to the value of the metal which a token coin is made of. Since token coins are made up of cheap metals, in case of token coins, the face value is greater than their intrinsic value.

Question: 9

State whether the following statement is true or false.

Money facilitates estimation of national income.

Options

- True
- False

Solution

The above statement is **true**. Money facilitates the estimation of national income as the value of all the goods and services produced in a country and all the factor payments made to factor inputs can be expressed in terms of money, which is summed up to calculate national income.

Question: 10

State whether the following statement is true or false.

A cheque is a fiat money.

Options

- True
- False

Solution

The above statement is **false**. The currency notes and coins issued by the Reserve Bank of India (RBI) and the Government of India (GOI) are collectively called 'Fiat Money'. Since cheques are not issued by the RBI and GOI, they are not fiat money.

Question: 11

State whether the following statement is true or false.

Money increases productivity of capital.

Options

- True
- False

Solution

The above statement is **correct**. Money increases productivity of capital. In the sense, with money, more capital can be raised. Since increased capital implies purchase of better machineries that produce superior quality products in less time, it leads to an increase in output and thereby increases productivity of the capital.

Question: 12

Define or explain following concept:

Barter system

Solution

Barter system of exchange: It refers to an exchange system in which goods and services are exchanged for other goods and services. Such a system is also known as commodity for commodity exchange (i.e. C-C exchange). For example - if a person having surplus wheat wants milk, then he/she can exchange that wheat with a person who has milk as well as who needs wheat at the same time.

Question: 13

Define or explain following concept:

Double coincidence of wants

Solution

Double coincidence of wants: It implies that the needs of any two individuals should complement each other for the exchange to take place. That is, the commodities owned by two different individuals are required by each other.

Question: 14

Define or explain following concept:

Money

Solution

Money: Money is anything that acts as a medium of exchange. Money is accepted by a seller in exchange of his goods and services. It also acts as a common measure of value. 5

Question: 15

Define or explain following concept:

Near money

Solution

Near money: Near money refers to those assets which may not be a perfect medium of exchange but are highly liquid i.e. those assets that can be easily converted into cash. For example bank deposits, bills of exchange, equity shares etc. Thus, highly liquid assets are referred to as near money.

Question: 16

Define or explain following concept:

Limited legal tender

Solution

Limited legal tender money: Legal tender money is that money which is backed by law and issued by the monetary authority. It cannot be refused by anybody. Limited legal tender money is that money which is accepted as legal tender but only up to a certain limited amount. In India, a maximum of 1000 coins be used for payments legally.

Question: 14

Give reason or explain.

Money works as a store of value.

Solution

Money can be easily stored without any loss in its value. Thus, store of value as a function of money implies that money can easily be saved and used for future needs. Money's function of storing value can be justified because of the following reasons:

- i. Money is the most widely accepted medium of exchange.
- ii. There is no loss in the value of money over time. Though there is a loss in the value of money due to inflation, it is negligible.
- iii. Money can be stored conveniently and does not involve any cost.

Question: 15

Give reason or explain.

Any commodity cannot act as money.

Solution

Any commodity can't act as money. For something to be used as money it must possess the following qualities.

i. General acceptability: Good money is the one which is readily accepted by all without any reluctance.

ii. Divisibility: Any commodity acts as good money if it can be divided into small units. For example, currency notes, gold, silver, and coins possess divisibility quality as it can be divided into different denominations.

iii. Durability: It should possess the quality of durability. That is, it should be long lasting. As currency coins are made up of metal, these are more durable compared to currency notes.

iv. Cognizability: By cognizability, we mean that good money is the one which is easily recognisable by all the members of the society and so no special efforts are required to recognise it.

v. Portability: It should be easy to carry from one place to other without any expenses and inconvenience.

vi. Homogeneity: Money of the same denomination should be homogenous in size and quality. For example, all 5 rupees coin should be of the same size, colour etc.

vii. Stability of value: Anything which is used as money should be stable in the sense that its value of money should not change frequently.

Question: 16

Give reason or explain.

Barter System had many difficulties.

Solution

Barter system had many difficulties. The difficulties in barter system were :

i. Problem of double coincidence of wants: Double coincidence of wants implies that the needs of any two individuals should complement each other for the exchange to take place. However, in reality, it is very difficult to find an individual who possesses the goods and services that are needed by another individual at the same time in exchange of what he/she has.

ii. Lack of a common unit of value: Under the barter system of exchange, there was no common unit for measuring the value of one good in terms of another good for the purpose of exchange.

iii. Difficulty in wealth storage and transfer of value: Individuals tend to store a part of their wealth or earnings as savings to be used for future needs or as an investment. However, it is very difficult to store many types of commodities.

iv. Lack of standard of deferred payments: It was very difficult to make future payments and contractual payments such as salaries, loans, interest payments etc. For example, it was difficult to decide whether wages for labour are to be paid in terms of food grains or any other commodity.

Question: 17

Give reason or explain.

Money is the basis of credit.

Solution

The commercial banks create credit in the economy through deposits. Money facilitates the functioning of credit instruments such as cheques, promissory notes, bills of exchange, etc. Such credit instruments facilitate transfer of value from one person to another. In this way, money forms the basis of credit.

Question: 18

Distinguish between -
Commodity money and metallic money

Solution

Basis of difference	Commodity money	Metallic money

1. Definition	Any commodity chosen to serve as money is called commodity money.	Precious metals or any other metal having high intrinsic value used as money are called metallic money.
2. Stage of development	It was developed in the initial stages of evolution of money.	It was developed after the development of commodity money.
3. Durability	Commodity money is less durable.	Metallic money is highly durable.
4. Portable	Possess lower degree of portability.	Possess higher degree of portability.
5. Examples	Sea-shells, slat, cattle, etc.	Gold coins, silver coins, etc.

Question: 19

Distinguish between
Paper money and metallic coins

Solution

Basis of difference	Paper money	Metallic money
1. Definition	Paper money is the money that consists of currency notes issued by the government or the central bank of that country.	Precious metals or any other metal having high intrinsic value used as money are called metallic money.
2. Developed	It was developed as a substitute of metallic currency.	It was developed before the development of paper money.
3. Durability	Paper money is less durable.	Metallic money is highly durable.
4. Portability	It possesses a higher degree of portability.	It possesses a lower degree of portability.
5. Examples	Paper notes of Rs. 5, Rs. 10 etc.	Gold coins, silver coins etc.

Question: 20

Distinguish between
Full bodied money and token coins

Solution

Basis of	Full bodied money	Token coins
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difference		
1. Definition	Full bodied money refers to that money whose intrinsic value (value of the metal) is equal to the face value of the engraving on the currency.	Token coins are those whose face value is more than its intrinsic value.
2. Made up of	It is made up of precious metals.	It is made up of cheaper metals.
3. Examples	Gold coins, silver coins etc.	Aluminium coins, nickel coins etc.

Question: 21

Distinguish between
Primary functions of money and Secondary functions of money.

Solution

Basis of difference	Primary functions of money	Secondary functions of money
1. Definition	Primary functions of money are those functions for which it was developed.	Secondary functions of money are those functions that money performs besides its primary functions.
2. Functions	Primary functions of money are medium of exchange and measure of value.	Secondary functions of money are standard of deferred payment, store of value and transfer of value.
3. Solves problem of	These functions solve the problem of double coincidence of wants.	These functions solve the problem related to borrowing and lending.
4. Leads to	It leads to increase in trade operations in the society.	It leads to increase in credit creation and evolution of financial institutions.

Question: 22

Distinguish between
Convertible paper money and inconvertible paper money

Solution

Basis of difference	Convertible paper money	Inconvertible paper money
1. Definition	It can be defined as the currency notes which are converted into	It can be defined as the money which is not

	standard money on demand by the issuing authority.	convertible into standard money on demand.
2. Backed by	It is backed by metallic reserves and government securities.	It is not entirely backed by metallic reserves.

Question: 23

Write Short Note.

Commodity money

Solution

Any commodity chosen to serve as money is called commodity money. For example - if a person having surplus wheat wants milk, he/she can exchange wheat with a person who has milk and who needs wheat at the same time. Thus, from the example it can be inferred that wheat and milk are commodity money.

Question: 24

Write Short Note.

Secondary function of money

Solution

The secondary functions of money are as follows:

i. Standard of deferred payments: Payments can be easily 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 payment of loans or interests can be made easily.

ii. Store of value: Store of value function of money implies that money can be easily stored in the form of wealth and can be stored used as medium of exchange in future.

iii. Transfer of value: Money can be transferred easily from one place to another and from one person to another. Therefore, with the help of money, purchasing power can be transferred.

Question: 25

Write Short Note.

Qualities of good money

Solution

The following are the qualities of good money:

i. General acceptability: Good money is the one which is readily accepted by all without any reluctance. This quality is possessed by gold and silver.

ii. Divisibility: Any commodity acts as good money if it can be divided into small units. For example, currency notes, gold, silver and coins possess the quality of divisibility as they can be divided into different denominations.

iii. Durability: It should possess the quality of durability. That is, it should be long lasting. As currency coins are made up of metal, these are more durable compared to currency notes.

iv. Cognizability: By cognizability, we mean that good money is the one which is easily recognisable by all the members of the society and so special efforts are not required to recognise it.

v. Portability: It should be easy to carry from one place to other without any difficulty, expenses or inconvenience.

vi. Homogeneity: Money of the same denomination should be homogenous in size and quality. For example, all Rs. 5 coins should be of the same size, colour etc.

vii. Stability of value: Anything which is used as money should be stable in the sense that their value should not change frequently.

Question: 26

Answer the following question

What are the contingent functions of money?

Solution

The following are the various contingent functions that money performs.

i. Facilitates credit - Money facilitates the functioning of credit instruments such as cheques, promissory notes, bills of exchange etc. Such credit instruments facilitate the transfer of value from one person to another.

ii. Facilitates distribution of income - Factor payments can be made easily in the form of monetary remunerations such as wages, rent, interest and profit.

iii. Maximises consumers' and producers' satisfaction - Since all goods and services are valued in terms of money, it is possible for a consumer to maximise his/her satisfaction by equalising marginal utilities of various goods consumed. Similarly, all the factors of production are valued in monetary terms. Consequently, it becomes possible for a producer to maximise production by equalising marginal productivity of the different factors of

production.

iv. Liquidity - Money is the most liquid of all assets and wealth. Gold, silver, land, cheques etc. are not as liquid as money. If need arises, these assets have to be converted into money, but on the other hand, money need not to be converted into any other form as it is readily acceptable.

Question: 27

Answer the following question
What are the different types of money?

Solution

The different types of money are:

i. Commodity money - Initially, human beings exchanged goods and services for other goods and services. In other words, commodity exchange or commodity money was more prevalent.

ii. Money in the form of metals - After commodity money was phased out, metals began to be used as a medium of exchange. Under the metallic monetary system, gold and silver were the two metals that were of particular important and were widely in use.

iii. Money in the form of paper - With further rise in the volume of trade, paper money came into existence and was widely used. This form of money was easier to carry and store. Thus, it became a medium of exchange in almost all the countries of the world.

iv. Bank money and credit money - Bank money can be said to be the most convenient and durable form of money. Nowadays, individuals frequently use credit money in the form cheques, drafts, credit cards etc..

v. Plastic money - Plastic money in the form of debit cards has also emerged as an attractive medium of exchange. Moreover, net banking facilities and online transactions have further reduced the risks involved in carrying paper money.

Question: 28

State with reason whether you agree or disagree with the following statement.
Barter System did not have any difficulty.

Solution

No. we disagree with the given statement. Barter system had many difficulties. The various drawbacks of the barter system are as follows:

i. Problem of double coincidence of wants: Double coincidence of wants implies that the needs of two individuals should complement each other for the exchange to take place. For example, suppose a person in the above case, the second person must need rice in exchange of tea.

ii. Lack of a common unit of value: Under the 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 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 in the 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.

Question: 29

State with reason whether you agree or disagree with the following statement.

Anything can function as money.

Solution

No. we disagree. Anything cannot function as money. For a thing to be used as money it must possess the following qualities:

i. General acceptability: Good money is the one which is readily accepted by all without any reluctance. This quality is possessed by gold and silver.

ii. Divisibility: Any commodity acts as good money if it can be divided into small units. For example, currency notes, gold, silver and coins possess the quality of divisibility as they can be divided into different denominations.

iii. Durability: It should possess the quality of durability. That is, it should be long lasting. As currency coins are made up of metal, these are more durable compared to currency notes.

iv. Cognizability: By cognizability, we mean that good money is the one which is easily recognisable by all the members of the society and so special efforts are not required to recognise it.

v. Portability: It should be easy to carry from one place to other without any difficulty, expenses or inconvenience.

vi. Homogeneity: Money of the same denomination should be homogenous in size and quality. For example, all Rs. 5 coins should be of the same size,

colour etc.

vii. Stability of value: Anything which is used as money should be stable. In the sense, value of money should not change frequently.

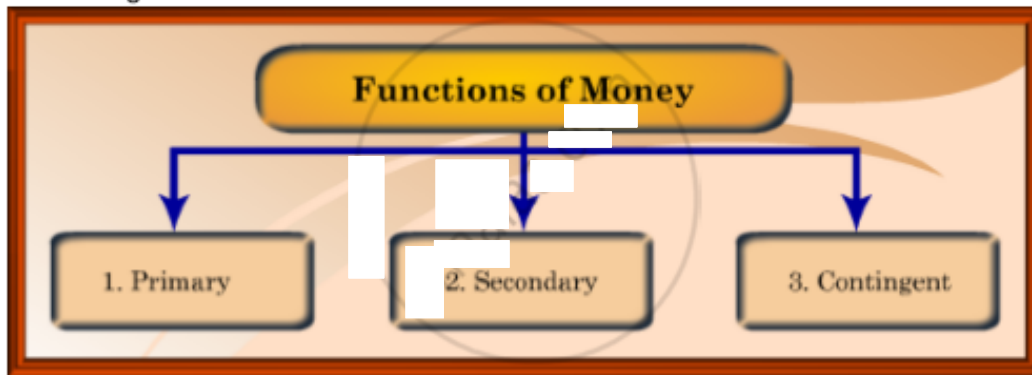
Question: 30

State with reason whether you agree or disagree with the following statement. Money performs various functions.

Solution

Yes. we agree. Money performs a variety of functions. According to professor Kinley, we can classify the functions of money into the following three categories:

1. Primary functions
2. Secondary functions
3. Contingent functions



i. Primary functions of money: There are two primary functions of money

a. Medium of exchange - Money acts as a medium of exchange as it facilitates exchange through a common medium i.e. facilitates exchange through currency.

b. Unit of value - Money serves as a common medium or unit of value. Money has provided a common yardstick to measure different units in a common denomination known as price.

ii. Secondary functions of money: These are those functions that money performs along with its primary functions. The secondary functions of money can be divided into the following three parts:

a. Store of value - Money performs the function of a store of value. It implies that money can be easily saved and used for future needs.

b. Standard of deferred payments - As money is widely accepted as a medium of exchange, and can be used to store value without much loss of value, it can be used for future payments.

c. Transfer of value - Money can be transferred easily from one place to another and from one person to another. Therefore, with the help of money, purchasing power can be transferred.

iii. Contingent functions of money: The following are the various contingent functions that money performs. **a. Facilitates credit-** Money facilitates the functioning of credit instruments such as cheques, promissory notes, bills of exchange etc.

b. Facilitates distribution of income - Factor payments can be made easily in the form of monetary remunerations such as wages, rent, interest and profit.

c. Maximises consumers' and producers' satisfaction - Money maximises the satisfaction of consumers and producers.

d. Liquidity - Money is the most liquid of all the assets and wealth.

Question: 31

Answer in detail -

Explain primary, secondary and contingent functions of money.

Solution

The different types of functions of money are:-

i. Primary functions of money

There are two main primary functions of money:

a. Medium of exchange - Money acts as a medium of exchange as it facilitates exchange through a common medium i.e. facilitates exchange through currency. With money as a medium, the two components of a transaction, namely sale and purchase, can be easily separated.

b. Unit of value - Money serves as a common medium or unit of value. The goods and services are of different types and are measurable in different units such as meter, litre, gram etc. Money has provided a common yardstick to measure all these different units in a common denomination known as price. This has made different goods and services comparable to each other in terms of their respective prices.

ii. Secondary functions of money

These are those functions that money performs along with its primary functions. The secondary functions of money can be divided into the following three parts:

a. Store of value - Generally, people have a tendency to save a certain portion of their income in form of savings to accumulate wealth. Under the barter system, such storage of wealth was not possible due to the perishable nature of certain commodities. Against this, wealth can be easily stored in the form of money without any loss in its value. Thus, the store of value as a function of money implies that money can be easily saved and used for future needs.

b. Standard of deferred payments - Deferred payments refers to the future payments and contractual payments such as loans and interest payments, salaries etc. As money is widely accepted as a medium of exchange, and can be used as to store value without much loss in its value, it can be used for future payments.

c. Transfer of value - Money can be transferred easily from one place to another and from one person to another. Therefore, with the help of money, purchasing power can be transferred. An individual who has money has purchasing power and he/she can transfer the purchasing power to anyone just by transferring this money. For example, when a father gives pocket money to his son, he transfers purchasing power to his son to buy different goods and services.

iii. Contingent functions of money

The following are the various contingent functions that money performs.

a. Facilitates credit - Money facilitates the functioning of credit instruments such as cheques, promissory notes, bills of exchange etc. Such credit instruments facilitate the transfer of value from one person to another.

b. Facilitates distribution of income - Factor payments can be made easily in the form of monetary remunerations such as wages, rent, interest and profit.

c. Maximises consumers' and producers' satisfaction - Since all goods and services are valued in terms of money, it is possible for a consumer to maximise his/her satisfaction by equalising marginal utilities of various goods consumed. Similarly, all the factors of production are valued in monetary terms. Consequently, it becomes possible for a producer to maximise production by equalising marginal productivities of the different factors of production.

d. Liquidity - Money is the most liquid of all assets and wealth. Gold, silver, land, cheques etc. are not as liquid as money. If need arises, these assets have to be converted into money, but on the other hand, money need not to be converted into any other form as it is readily acceptable.