

What is MONEY?

Everyone uses money. We all want it, work for it and think about it. While the idea of what it is and where it comes from can be difficult to fully understand, money is a tool we use to get the things we need and want. Economists help define what money is, where it comes from and what its worth.

Before Money

In early societies, families or villages were a self-sufficient unit. Together, members took care of providing for their own basic needs like food, shelter, and clothing. Later, with advancements in farming and the division of labor—that is, the development of specialized workers like farmers, carpenters, tailors, and so on—came the need for exchange. Before the creation of money, exchange took place in the form of **barter**, where people traded to get the goods and services they wanted. Two people, each having something the other wanted, would agree to trade one another. In economics, we call this a double coincidence of wants. It works like this: Farmer A has a productive henhouse but no dairy cow while Farmer B has several dairy cows but no henhouse. The two farmers agree to exchange so many eggs for so much milk.



At first, when the wants of people were few and simple, the barter system worked well. But as time passed, it was found to have many difficulties. Unfortunately, it is not always as simple as the example above to find someone with whom to trade to get the goods and

services we want. For instance, suppose Farmer A has more than enough eggs, and wants milk. He must find someone who not only has more than enough milk, but also the desire for eggs. What if he finds someone (Farmer C) who wants eggs but does not have milk to trade? Instead, Farmer C can only offer you bananas. To get your eggs, Farmer C must first find someone who has milk and wants bananas ...and so on.

The problem of finding a double coincidence of wants to barter for goods and services, as you can see, can be tiring, confusing and inefficient. But that is not where the problem



ends: Even if Farmer A finds someone (Farmer B) with whom to trade milk for eggs, Farmer B may not think the dozen eggs offered by Farmer A is worth the gallon of milk he has to trade. Farmers A and B would then have to agree upon how to divide the eggs and milk in a way that they are both willing to trade. This early form of barter did not provide the transferability and divisibility that makes trading efficient.

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Characteristics of Money

To solve the problems associated with barter came **commodity** money: a type of good that functions as **currency**. In the 17th and early 18th centuries, for example, American colonialists used beaver pelts and dried corn in transactions to buy and sell things. The kinds of commodities used for trade had certain characteristics. They were widely desired and therefore valuable and also durable (long-lasting), portable (easy to carry), and easily storable.

Functions of Money

In addition to having certain common characteristics, money also provides some important services to the people who use it.



Medium of Exchange

The most important role money plays in a society is facilitating the trade of goods and services without the need to barter. Because everyone wants and values money, it is

accepted by people everywhere in exchange for goods and services. With money, the problem of needing to find a double coincidence of wants is eliminated, making it easier and more convenient for people to get the goods and services they want.

Unit of Value

Another important function money serves is acting as a common measure of value. When we buy a good or service, we pay a price measured in money. Just as we measure length using inches and feet, and weight using pounds, we measure the value of goods and services using money. Without a common unit, exchange is much more difficult as there is no way to set standard prices. Money offers a standardized way of comparing the value of goods and services that are alike and different.

Store of Value

Before money, there was no good way to save for the future. With money, people can use what they want today and save what they don't use for use at any time in the future. Money provides a safe and convenient way to save.



Think about it...

What are the three ways people use money? Describe the function of each.

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