UNIT 5 EXCHANGE AND MONEY*

Structure

5.0 OBJECTIVES

After going through this unit, you will be able to:

- explain the notions of money and exchange,
- discuss the patterns of exchange in the past,
- describe changing dimensions of exchange,
- describe the basic functions of money,
- differentiate between various forms of money, and
- understand the legal issues concerning money.

5.1 INTRODUCTION

In unit: 4 Reciprocity and Gift you had learnt about the nature and process of reciprocity and gift and its social significance. Here in this unit on "Exchange and Money". We will explain another aspect of social significance.

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At the onset, it is important to know that exchange or money cannot be discussed in absence of the other. Scholars across social science disciplines have always dealt with one in relation to the other. Since money is always used as a medium of exchange, a function of the money that will be pondered upon in this unit. Therefore these two terms i.e. exchange and money will be discussed concurrently in this unit also. However, to understand the notions of money and exchange, the unit initially offers a discrete understanding of money and exchange and then provides a historical account of exchange in relation to the money by accentuating on various media of exchanges that existed in societies in the past. The unit also offers an understanding of the changing dimensions of exchange from traditional forms of commodity as a means of exchange to the modern forms of e-money, cheques and bills. As mentioned above, money serves as a medium of exchange, but it also serves other functions which will be emphasized upon in this unit. Also, how value is attached to the commodity used for manufacturing money is a question that the unit enlightens about by emphasizing on the legitimizing aspects of money. On a broader note, the unit will enlighten about the social aspects of economy (from past to present) that binds the groups and communities together and pushes them towards establishing relationships based on exchange.

5.2 UNDERSTANDING MONEY AND EXCHANGE

When we discuss and explain the different forms of exchange the two immediate notions come to our minds. These are money and exchange:

5.2.1 Money

Money as a means of exchange is something that people give to obtain goods or services. But it can also be something that people accept to deliver goods or services. Money, according to Zelizer (1994) is the sole ‘interchangeable’ and a completely ‘impersonal instrument’. For economists especially, money is specific in its meaning however the usage of money in daily exchanges carries different meanings. The way in which money is used by economists is at variance from the conventional use of money. For economists, money is a channel through which exchange takes place and is accepted only in the form of payments for tangible or intangible goods or against any unpaid amount. Currencies such as *Rupee* or *Dollars* are the appropriate forms of money. Thus when people speak of the money, they are in essence referring to the currencies (that exist in the form of paper money or in coins). In this sense then, people all across the globe exchange money to receive something in return, and therefore imagining of a world without money is challenging. However, there is a contradiction in the sense that if imagining of a world without money is difficult, then how the exchange system existed in the primitive societies? To elucidate, we will first see how the exchange took place among people in primitive societies and the subsequent transition from non-monetary to monetary exchanges. But before delving into how exchange operated in the past and the transition thereof, let us first understand the meaning and notions of exchange.

5.2.2 Exchange

Exchange is a process of giving and taking, a mutual dependence characterised by two separate features – cooperative and competitive. The cooperative characteristic of exchange has its roots in shared benefits. This is to say that the cooperative feature of exchange involves benefitting both the parties through the exchange process. The other is competitive exchange exhibiting conflict intrinsic in exchange process (Blau, 1964). The comparative explanation of two aspects of exchange – cooperative and competitive – keeps changing depending on the objective aspects and subjective discernments of exchange. Two important forms of exchange i.e. *reciprocal* and *negotiated* exchanges largely depend on the two broader aspects of exchange i.e. cooperation and competition. The negotiated form of exchange binds the actors thus reflecting cooperation. In such exchange, both the actors involved in exchange encounter fair rewards through exchange wherein the rewards of one correspond to the rewards of the other thus reflecting cooperation among the two. The other is reciprocal exchange reflecting the conflict of interests. In reciprocal exchange, though both the actors are given benefits but there is no negotiation and so there is a tendency towards conflict in this form of exchange which becomes apparent through competition in the exchange process. Also, while in negotiated exchange, the parties accept the conditions of exchange which are binding upon them; but in reciprocal exchange, the parties give away for others' benefits without any anticipation of when or if the other party will reciprocate.

5.3 HISTORY OF EXCHANGE

While people lived in communities since ages and using money in the form of commodity was customary, but money also existed in the form of metallic things such as gold and silver. However what constitutes the currency in any given social system varies from time to time and includes various tangible things accepted as substitute of money. This reflects that money through ages has been understood and realised in various forms and the various forms of money acceptable in societies depended largely upon the necessities of people in these societies. As such, there are two forms of money. One that involves the exchange of goods for goods and other involves exchanging currency for goods. The former is with intrinsic value called as *commodity money* and the latter is called as *paper money* with no intrinsic value (Mishkin & Serletis; 2011). But different stages of the evolution of money can be traced through the growth of human civilization across time and space. Money initially evolved in the form of commodity (based on the barter system), transited through metallic money (coins), paper money (bank notes) and credit money (cheques) until it reached to the plastic money (credit and debit cards) and e-money used for online transactions (Chinnammai, 2013). In the following sections, we will discuss about the transiting nature of money from commodity to bank notes to electronic money (or e-money).

5.4 CHANGING DIMENSIONS OF EXCHANGE

In the past, societies largely used commodity (both tangible and intangible) as the medium of exchange which were unanimously acceptable to all in a given social setting. Every person accepted goods as payment in exchange for their own goods or services delivered. This means that commodities carry certain value for which it qualified to be accepted as money. However, there was a precondition for any form of material goods to be considered as commodity money and this is how it distinguishes from other forms of commodity exchanges. This form of commodity money has been existent since hunting and gathering societies, pastoral societies and agricultural societies. The commodities in each successive society, however, differ from the other and can best be understood separately.

5.4.1 Medium of exchange in hunting and gathering societies

One of the most undeveloped societies was the *hunting and gathering society* in which survival largely depended on hunting. The most surviving state of affairs in such societies was the property met out due to hunting which carried certain value acceptable to all. For example, skin of the hunted animals was being exchanged for clothing thus constituting one of the earliest commodity money. This form of commodity money is still existent in some parts of the world where exchange in the form of goods for goods of this kind takes place. Alongside the commodity money made through hunting, people also exchanged weeds and roots as forms of food and also used for medication purposes.

5.4.2 Medium of exchange in pastoral societies

While there was a transition from hunting and gathering societies to the *pastoral societies*, the commodity money also marked a shift thus bringing in a significant change in the nature of commodity money from skin and fur of the hunted animals to commodities in the form of cattle, which constituted expensive yet negotiable forms of commodity money. These domestic animals were suitable for quick transfer and be kept for longer periods of time in the form of live-stock than skin or fur of the hunted animals.

5.4.3 Medium of exchange in agricultural societies

In *agricultural societies,* commodity money existed in the forms of produce from the fields. The produce from the fields included vegetables, fruits, maize, rice, wheat and so on besides other cultivated produce of daily use. At the same time, certain kinds of animal food such as eggs were also used as a form of commodity money in agricultural societies. However this is not to say that currency did not exist during this phase. But people practiced exchange more in terms of the commodity money and the currency would be used to make purchases of the goods or services which were not available for exchange against commodities. While the commodity money of this form is still existent in rural India, however there has been a transformation in the type of money being used for exchange. Again, this is not to say that the commodity money does not exist in the present societies. It does exist but the exchange takes place at a broader level in the form of export and import of goods for goods or goods for money and so in modern (industrial) societies, there exists a dual currency in the form of commodity and bank notes. While the nature of commodity money also transformed from material goods of daily use to the precious metallic commodities such as gold, the paper money too emerged in the form of bank notes as well as cheques.

5.5 MODERN FORMS OF ECONOMIC EXCHANGE

As mentioned in the previous section, paper money emerged in the form of bank notes as well as cheques. These are the modern forms of monetary economy and generally accepted as a mode of payment within the process of exchange. Both bank notes as well as cheques are legally accepted as the forms of payment-making-currency which originated due to the growth and expansion of modern technologically advanced banking (Eisenstein, 2011). Due to its legitimation factor, currencies are being exchanged across countries. However, the evolution of paper money was not the manifestation of the vanishing of metallic money. Paper money had a strong backing of the metallic money in the form of gold in the sense that it was an easy go task to convert paper money into gold in times of demand. Due to this, there was a sudden rise in the cost of gold and silver. After this transition in the form of money and the inconvertible feature of paper money into metallic money, bank notes came to be the accepted form of money only because it is considered as a legal tender. However the negative aspects of paper currency, such as being easily stolen and difficult to transport larger amounts, led to the evolution of modern banking system in which cheques were the means of exchange. While cheques evolved as the portable form of money, it did not replace the bank notes. Both bank notes and cheques existed simultaneously and continued to be major forms of money in the modern world. However the difference between the two is that bank notes did not lose its value on exchange but a cheque expires after the transaction is made. For larger transactions, cheques are the means of exchange unlike bank notes used for petty exchanges.

Illustration

There has been yet another major transformation in the modes of payment in the contemporary times. Alongside the existence of paper money in the form of cheques and bank notes, the transactions are done through bills and saving certificates as well as through online payment mode. The online transaction is a kind of digitalised form of economic transaction commonly called as e-money. This digital economic exchange is ensured by the technological innovations such as online banking system, mobile banking, paytm and so on. While through paper currency, the transactions are done for larger amounts however digital mode of transactions does not allow for larger amount transactions so as to come in line with the paper currency transactions. There is always some limit on the amount being exchanged through online mode. However the online payments are a quick mode of exchange and done in a little amount of time. The other form of money for exchange in the digital world is through plastic money. Plastic money exchanges take place through credit, debit and other cards.

Check Your Progress 1

1. Define money in your own words?

   ....

   ....

2. Plastic money is the money made of plastic. True or false.

3. Transaction through digital money involves .... payments.

4. Negotiated exchange is a form of exchange characterised by .... (cooperation/competition).

5. Payments through Credit/Debit card is a form of .... money.

5.6 FUNCTIONS OF MONEY

The functions of money can be determined in the way it is used in exchange of goods and services or other transactions thus acting a medium ensuring exchange. It retains the value till the time it is under possession. Money also functions as a measuring factor in determining the value of relative goods and services thus enabling a better buy among corresponding goods. It is also through money that the value of commodities in the market is determined. John Hicks in his *Critical essays in monetary theory* published in 1967 states that money can be defined through the way it functions. Economists (such as Ingham, 2004; Mishkin & Serletis, 2011) and Social scientists alike (such as Maurer, 2006; Carruthers, 2010) have mentioned three important functions of money. They are *medium of exchange*, *store of value*, and *unit of account*. According to them, the distinguishing factor between 'money and other assets' lies in the former for being a medium of exchange.

5.6.1 Medium of Exchange

The foremost function of money is that it is the medium of exchange. Medium of exchange in general means receiving anything in exchange for goods and/or services. However, since the focus here is on money, therefore money acts as a medium of exchange for being used to buy goods or services. In making transactions, we use money in the form of bank notes and cheques in exchange to goods and/or services. The notion that money is a medium of exchange lies in its value that holds significance while making transactions. And for the transactions to be successful requires an on-hand medium of exchange. Unlike in the ancient societies where there was the exchange of commodities for commodities and the exchange occurred only when there was the need of certain goods, the modern modes of payment involves money as a medium of exchange for goods or services free from any difficulties in the mechanism of exchange. Money as a medium of exchange is based on two pre-conditions: one identifying a person who is in need of what the one offers; and two this identified person must have what the other is looking for. The former fits into the form of exchange that existed in the past where commodities were exchanged for commodities, but the latter fits into both the traditional as well as modern societies. This process of identifying the suitable person based on the goods they possess for exchange against what they do not have is termed as double coincidence. The double coincidence of the medium of exchange ensures the dependency for commodities based on the division of labour and the production of goods which in turn encourages specialization of roles and thereby resulting in a growth in the production.

5.6.2 Store of Value

Store of value is another function that money serves. Money acts as a storehouse of purchasing power. The purchasing power is reflected through the amount of money saved for future purchases. People tend not to spend all of the money upon receiving it. They keep a fraction of the received money for future use. For instance, a labourer who receives some money in exchange to the labour spends only a proportion of it and preserves some proportion of it for use during paucity thus ensuring future exchanges. The underlying idea of the store of value embodies money as a channel through which it can be saved which guarantees the purchasing power at different intervals of time. This involves shifting of purchasing power from present to future thus holding the value of money over time. A common example of this kind involves keeping money in a locker and taking it out during times of needs. Also while utilizing the preserved money, it does not lose its value but can buy almost the same things which it could buy in the past.

Now the question arises that why money only serves the function of store of value when the commodities also preserve the value? Answer to this question rests on the fact that while both money and commodities (such as land, house, or other commodities) can be the stores of value but the difference lies in the liquidity of the money. While the money and commodity can be exchanged and preserved but money is the most liquid of all assets. This means that money does not require any conversion to determine its value or to make any purchases. It is a value in itself. But commodities have to be converted into money in order to make purchases and the nature and measure of commodity determines its value. Also the value of commodity is always in flux. For example, a person sells his piece of land in order to pay the debt. He most likely settles down for a low price in the deal thus reducing the value of commodity being sold. Therefore land, in this case, cannot be considered as a good store of value. Money, being most liquid, is the good store of value because its value is fixed and does not change over time.

Activity 1

Visit a "Sabji Mandi" i.e. a fruits and vegetables wholesale market for a few days, observe the sale of fruits and vegetable and the rate of their prices. Talk to the vendors or sellers about the reasons for price fluctuation in various items.

Write a note on "value of Fruits and Vegetable and their marketing" Share your 'note with others in your Study Center.

5.6.3 Unit of Account

The third function of money i.e. unit of account helps determine the measure of value. Unlike in barter economy with no measure of value except that there was the exchange of commodities for commodities, money as a unit of account helps measure the value of goods or services being exchanged. For example, if we measure the monetary value of one kilogram of chicken and one kilogram of mutton (such as chicken for Rs. 150 and mutton for Rs. 450), we would say that mutton is thrice as expensive as chicken. The relative value of money and commodities in this case can easily be compared. Prices of the commodities are measured only through its monetary value. Money as a unit of account is used to compare the prices of various goods. This means that the measurement of value depends on the medium of exchange.

To simplify the process of measuring the value of goods and services, let us take the example of currency in different countries such as United States, United Kingdom, India, Europe, etc. Each of these countries use a different currency as the medium of exchange and their respective currencies are the basic unit to measure the value. In these countries, any kind of goods that are being sold at some price reflects certain value in terms of the currency of selling country. Using currency as a factor in comparing goods, we can make a better bargain by selecting the currency which offers goods at minimal prices in the exchange market. The prices of goods are quoted in various units differing from one country to another. The unit in which price is quoted in a country is the unit of account of that country. In India, the unit of account is rupee, Dollar in US, Euro in Europe and so on.

5.7 MONEY AND LEGITIMATION

While in the above section we have made clear what constitutes money through the ways in which money functions in its various forms such as commodity money, paper money, plastic money and/or digital money or e-money. All forms of money serves as a medium of exchange but can e-money be accepted as money because it serves all the three functions discussed above? To clarify, all forms of money can be the medium of exchange but all means of exchange does not necessarily constitute money. This argument stands as a base to elucidate what actually constitutes money. There apparently comes in something that is beyond the economic aspects of defining money and this something is 'legal'. The legal aspect places restriction on what constitutes the legally accepted money as against the means of exchange. Therefore, while e-money qualifies to be called as a medium of exchange, however it does not qualify to be accepted as money because there is no legal sanction to e-money in India however transactions done through e-money are predominantly based on mutual agreement between two actors.

The argument above can be explained through the value that is given to money by the government without considering the manufacturing material of money. Government releases money, places some value over it and legalizes it for transactions. The money released by the government has a legal endorsement and therefore economists call it "legal tender money" (Fuller, 1989) and this makes it obligatory for the people to accept it as a medium of exchange. The legal tender money is the only medium which is accepted by the finance organizations to realise debts from its customers. However there is limit to the value of currency being accepted in return to the debts. For example, in India during the end of 20th century, there was a limit in the value of lower coins, such as 25 paisa or 50 paisa, being received against the debt upto a value of rupees twenty five. In India, RBI legally invalidated the circulation of coins in the denomination of 25 paisa or below and this came into effect from 30th June, 2011 (Chinnammai, 2013). Therefore in exchange market, people may refuse to accept money paid in lower denominations if it exceeds the set limit. In such a case, coins of lower denominations, if exceeding the limit, cease to be a legal currency.

Check your progress 2

1. Mention the three basic functions of money.

   (1) ....

   (2) ....

   (3) ....

2. Only e-money can determine the value of goods or services in the modern societies. (True or false).

3. What is 'e' in e-money. (.............................. money)

4. What is legal tender money?

   ....

   ....

5.8 LET US SUM UP

In this unit, we have discussed the two terms of money as exchange and well as the mechanism of exchanges that existed in our societies in the past and the forms of money that were used in exchange process. The unit offers a brief historical account of money and exchange. It traces the changing dimensions of exchange from commodity to bank notes that existed from past to the present respectively. The unit then marks a shift towards elucidating what constitutes paper money vis-a-vis the modern forms of exchange. The unit also offers the functional aspects of money by shedding light on money as a medium of exchange, its value and money as the unit of account. It also informs about the legal aspects of money by focussing on how money becomes legal commodity.

5.9 REFERENCES

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5.10 SPECIMEN ANSWERS TO CHECK YOUR PROGRESS

Check Your Progress 1

1. Money is a medium of exchange utilized to receive goods or services.
2. False
3. Online
4. Competition
5. Plastic

Check Your Progress 2

1. (a) Medium of Exchange, (b) Store of Value, and (c) Unit of account
2. False
3. Electronic
4. Legal tender money is the money that has a legal endorsement of the government.