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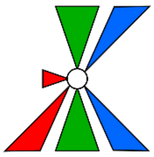

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deposit, note issue and loan-granting aspects of their business, and, as a result, a large number of private banks were established, mainly in the City of London. Some of these private banks issued too many notes and caused banking panics as large numbers of their own customers (and holders) presented notes all at the same time for redemption in gold. This invariably caused the bank's failure. Over the next two hundred years the issue of notes, i.e. paper money, was gradually taken over by the Bank of England which maintained an adequate gold stock to back the note issue. Gold redemption on demand for paper money was guaranteed. Several important European trading centres established banks to enable traders to deposit a variety of gold and silver coins then in circulation, in exchange for paper claims, e.g. Bank of Amsterdam, Holland. The origin and development of paper money in your own country should be ascertained. Did it arise through the actions of private bankers or a central issuing body established by the government (or a former colonial power)? Consider whether **your nation's paper money** (**bank notes**) meets the requirements of **a good monetary medium**. Is it acceptable, recognisable, portable and scarce? Most **bank notes** are printed on special paper that makes forgery more or less impossible, although with the passage of time, new **notes** have to be issued to replace worn-out and frayed **paper notes**. **Paper money** and **copper-nickel coins** are used for making payments in most countries but readers will appreciate that **most money** in advanced economies takes the form of bank deposits which are transferred between parties by means of cheque, giro and other payment mechanisms or techniques. The functions of **money** In any society or economy, **money** (bank deposits, paper notes and coins) has five main functions which must be fully appreciated and memorised to aid the reader's understanding of banking, finance and economics. **Medium of exchange** The existence of **money** gives the consumer greater freedom of choice than could ever exist under a barter system. Providing **money** is generally acceptable, a person will take it in exchange for goods and services he sells since no difficulty will be encountered in using **the money** so acquired to purchase other goods and services desired. **Money** thus facilitates trade and specialisation, two key conditions for the economic advancement of any society or nation. **Unit of account** **Money** is used as a common denominator in which **the value** of things can be expressed in the market. It enables a price system to operate and facilitates the production and exchange of goods. Without **money**, some other means to measure **the value** of goods against each other would have to be used.

Store of value

In a non-**monetary** economy, **wealth** is measured in terms of a person's tangible possessions - cattle, camels, grain, jewellery, etc. **Such wealth** is acceptable to others in return for goods and services. However, jewellery may be stolen, cattle may die and grain deteriorates in quality with the passage of time, thus **wealth** in these forms

	is inherently risky and to a certain extent illiquid, i.e. not usually suitable for instant transfer or use. In a modern economy, **liquid wealth** is **held** in the form of **money** - **bank notes**, and, more importantly, **bank deposits**. This provides a **temporary abode** of purchasing power for the holder which is both convenient and certain. It facilitates **saving** which is absolutely essential for the economic progress of any nation. Before **money** is accepted as **a store of value** two conditions must be satisfied: (i) **money** must retain its **value**, otherwise people will get rid of it in exchange for real (intrinsic) commodities; (ii) goods and services must be available in the future - wars and national crises result in a flight from **money** into non-perishable foodstuffs, cigarettes, fuel, etc. **Credit standards** The existence of money is essential to the modern system of production which depends upon the granting of credit to those who undertake the manufacture of goods in anticipation of sales. It facilitates the development of a sophisticated financial system and thus avoids the need for a pure cash economy, i.e. payment in notes and coin only. It enables capital investment (acquisition of plant and machinery) to take place. A manufacturer can thus borrow funds to purchase raw materials and machinery and to hire labour to produce goods to be sold later in the market, with the resultant receipts (money) being used to repay loans. Where a person borrows or enters a contract (agreement) involving some future form of payment, this will invariably be expressed in money terms. Thus the effective and efficient use of money as a credit standard requires it not to lose its value due to inflation. When money is falling in value (prices rising), borrowers gain at the expense of lenders because today's money is worth more than tomorrow's money. Consequently, borrowing is encouraged whilst savers in the economy demand a higher interest rate for the use of their funds, otherwise savers will spend/invest in commodities less likely to lose their value than money. Such action tends to make inflation worse. Once again the reader should note the importance of confidence (a belief in future values) in the acceptability of money as a store of value and as a credit standard. Influence on economic activity Money has a dynamic