Central Bank of
Trinidad & Tobago

# What is Money?

## The Functions of Money

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The definition of money stems from its first and most commonly understood function – a generally accepted ***medium of exchange***. This essentially means that money is anything that will be widely accepted in society in exchange for goods and services. As a medium of exchange, money serves as a common form through which transactions can occur and therefore, easily facilitates the purchase and sale of goods and services. If there was no money, goods would be exchanged for other goods (bartering). While this may seem simple, it requires a 'double coincidence of wants'. This means that if one individual produces a specific good such as bananas, but wants to get oranges, he will have to search for someone who 1) has oranges and 2) also wants bananas. This may not always be easy. With money, the banana producer can simply sell his bananas to anyone who wants them and earn money, which he can then use to purchase oranges from someone else who has them for sale.

Although its role as a medium of exchange usually serves as its defining function, money also has other functions, namely, as a ***store of value*** and a unit of account. Its role as a store of value is related to the medium of exchange function. Revisiting the example involving the oranges and bananas cited above, it is possible that the both individuals want the respective fruit that the other is offering, but not necessarily immediately. However, because these items are perishable, they cannot be saved for an extended period of time. Money, however, is a convenient way to store value or purchasing power for use whenever needed. To be able to serve this role, the value of the money must be stable. This means that rising price levels (inflation) can affect the amount of goods and services a fixed amount of money can purchase. As such, in order not to undermine the store of value function, price levels should be stable.

Finally, money serves as a ***unit of account***. In this role, money acts as a standard way to measure different items and allow for a comparison of these different items. For instance, to continue with the above example, we can introduce a third producer of mangoes. If this third producer is willing to accept either oranges or bananas for his mangoes he will not know which is the better deal as one orange and one banana are not equal measurements. Therefore, having a common unit in which items can be measured or valued against ensures transparency and a common understanding.

## The Evolution of Money

Money has taken many forms over time and the use of products like sugar, and tobacco, and precious metals like gold and silver formed the local currency for many years before the establishment of currency as we know it today. Earlier more simple economies were known as barter economies, which are cashless economic systems where goods and services were traded for other goods and services of similar perceived value. These economies facilitated the use of ***commodity money***, a physical good that is traded for other goods and services but also holds value outside its use as a medium of exchange (intrinsic value). This form of money had some drawbacks as it required a 'double coincidence of wants' to facilitate trade as well as portability and durability of some commodities traded posed their own challenges.

Historically, certain goods in barter economies were desired by a wider cross section of traders, an example of some of the more prevalent commodities were precious metals like gold and silver. This fact along with the issues highlighted above, led to the evolution of representative money. This type of money takes the form of a paper note/certificate which has no intrinsic value itself but can be exchanged by its holder for a valuable commodity. A more modern example of representative money are cheques, these paper notes act as a promise of payment to vendors by the issuer, and just like the gold standard above holders must issue only amounts covered by their holdings in that particular financial institution.

As trade became more global in nature and economies grew, the use of commodity-backed monies became more challenging. Countries moved towards the use of fiat money. This form of money has no intrinsic value, but is declared by a government to be the legal tender of a country it is not backed by a commodity; its only backing is a promise by the government that the currency has value. This is the form we are all familiar with. Fiat currency can come in the form of banknotes, coins, and loan and deposit accounts with financial institutions. The value of this currency is based on what it can be used for. Its value is based on the trust between the issuer, holder and those that receive it which affects the supply and demand. In most countries it is the job of the central bank to maintain this trust through its monetary policy. If trust in a fiat currency is eroded the demand for this currency will drop which leads to loss of value in that currency.

Money is constantly evolving and technological advancements continue to push the boundaries of what we currently recognise as money and the mechanisms by which we make payments. One such development involves digital currencies, including ***e-money and cryptocurrencies. E-money involves*** monetary value represented by a claim on the issuer which is stored on an electronic device which accesses funds held with by the holder to facilitate payments. Examples of e-money instruments include pre-paid cards and digital wallets, both of which have become a staple in today's economies. The issuer of e-money instruments only gives out e-money on receipt of funds, therefore all e-money issued is backed by fiat money. Digital Currency options offer users benefits such as security and convenience, however the establishment of this payment method has high security requirements for e-money issuers.

Another stage in the evolution of money resulting from technological advancements is digital currencies such as ***cryptocurrency***. Cryptocurrency is a form of digital money which exists in an electronic format and does not have a physical form which was developed as a proof-of-concept principle that transactions can be securely processed without the need for a central clearinghouse which had previously always been used for other digital options. Cryptocurrencies do share some characteristics of fiat money, however, in the case of cryptocurrencies, governments do not control or manage the money supply. There are also a number of cryptocurrencies in existence with the most popular of these being Bitcoin. As with all forms of money these too have shortcomings. For more information on how this form of money works please visit the Bank's website https://www.central-bank.org.tt/fintech/glossary-terms .

## Characteristics of Money

To effectively carry out its functions, money needs to have certain characteristics. These are listed and explained below.

### • Durability

Durability refers to the ability for money to be used over and over again. Money changes hands several times daily; every transaction requires the use of money. Think about when you pay the maxi taxi five dollars when you arrive at your location. Your money is then used by the maxi taxi driver to purchase a bottle of water from a vendor. The vendor in turn uses it to purchase doubles and the money continues to change many hands. As such money must survive wear and tear for long periods.

### • Portability

Portability refers to the ease of carrying money. Think about the practicality of carrying a pig to purchase a newspaper! Consumers can carry money around with very little effort as notes, coins and cards can be carried in your wallet and now even on your smartphone or tablet

### • Divisibility

Money needs to be readily and conveniently available in varying increments that can be exchanged for any size or quantity of goods or services. This is not always possible in bartering. If a person wants to buy a certain amount of another's goods, but only has payment of one indivisible good which is worth more than what the person wants to obtain, a barter transaction cannot occur. However, money as we know it today can facilitate this. For example a $20.00 dollar bill can be exchanged for other denominations, a $10.00, $5.00 and $1.00 that add up to the same value The money has to be divisible into small enough units to buy a pack of Corn Curls from the mini-mart while also available in large units to buy a 42-inch flat screen TV from a furniture store.

### • Uniformity

Uniformity of money refers to the standardization of money so that it looks the same. The notes of Trinidad and Tobago are uniformed with the imagery of our national birds, such as the Mot Mot on the $5, the Cocrico on the $10 and the Hummingbird on the $20. Every denomination features the national flag and the country's coat of arms. On the back of the notes is an image of the building of the Central Bank of Trinidad and Tobago, along with landmarks and scenes of cultural importance. Such uniformity also contributes to the security of the notes as it makes them difficult to replicate. The money of

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Trinidad and Tobago is minted by a company based in the United Kingdom called De La Rue. This company has been printing our currency since 1904.

**• Acceptability**

Acceptability is the very essence of money. Unless a person knows that the money which he accepts in exchange for his goods or services will be taken without any objection by others as well, he will not accept it. Good money requires acceptance to all without any hesitation.