Chapter Seven: Money

1 définition of Money

Money is any item or medium of exchange that is accepted by people for the payment of goods and services, as well as the repayment of loans. Money makes the world go 'round. Economies rely on money to facilitate transactions and to power financial growth. Typically, it is economists who define money, where it comes from, and what it's worth. Here are the multifaceted characteristics of money.

- Money is a medium of exchange; it allows people and businesses to obtain what they need to live and thrive.
- Bartering was one way that people exchanged goods for other goods before money was created.
- Like gold and other precious metals, money has worth because for most people it represents something valuable.
- Fiat money is government-issued currency that is not backed by a physical commodity but by the stability of the issuing government.
- Above all, money is a unit of account - a socially accepted standard unit with which things are priced.

2 How Money Is Created

We have discussed why and how money, a representation of perceived value, is created in the economy, but another important factor concerning money and the economy is how a country's central bank (the central bank in the United States is the Federal Reserve or the Fed) can influence and manipulate the money supply.

If the Fed wants to increase the amount of money in circulation, perhaps to boost economic activity, the central bank can, of course, print it. However, the physical bills are only a small part of the money supply.

Another way for the central bank to increase the money supply is to buy government fixed-income securities in the market. When the central bank buys these government securities, it puts money into the marketplace, and effectively into the hands of the public. How does a central bank such as the Fed pay for this? As strange as it sounds, the central bank simply creates the money and transfers it to those selling the securities. Alternatively, the Fed can lower interest rates allowing banks to extend low-cost loans or credit—a phenomenon known as cheap money—and encouraging businesses and individuals to borrow and spend.

To shrink the money supply, perhaps to reduce inflation, the central bank does the opposite and sells government securities. The money with which the buyer pays the central bank is essentially taken out of circulation. Keep in mind that we are generalizing in this example to keep things simple.

3 Classification of Money

There are four categories of money. They are fiat money, commodity money, fiduciary money, and commercial bank money. Depending on a nation's economic and political system, the society uses the types of money that best suit their transactions.

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Types of Money	**Definition**
Fiat Money	Fiat money is entirely backed by government orders rather than a physical good. It gets its status as a medium of exchange because the government declared it an official means of payment.
Commodity Money	This is money that is an actual commodity that has value outside of being a medium of exchange. Commodity money can be precious metals, gemstones, spices, and even coffee.
Fiduciary Money	This is money that is based on trust rather than the intrinsic value of the money itself with no government backing. This form of payment relies on the trust or promise that it will be accepted as a form of payment.
Commercial Bank Money	This is money in the economy in the form of debt created by commercial banks. Banks loan out money based on the fiat money their customers deposited to other customers to earn interest.

Table 1 - Types of Money

Of the different types of money, fiat money and commercial bank money are what the modern world is most familiar with since they are what are currently in use in developed nations such as the U.S. and European countries. Commodity money was often used in the past when societies were moving away from strict bartering systems and moving toward more convenient ways to engage in trade.