**Pakistan School , Kingdom of Bahrain**

**E- Support and Learning Material / Session 2020-2021**

**Subject: Economics Grade: 12(Arts)**

**Book: Intermediate Economics Part 2 FIRST TERM**

 **Unit 2: Money Pg. No: 18 -33**

**Short questions:**

* **What are three motives of demand for money according to Keynes?**

**Ans:** According to Keynes, money is demanded because of three motives -transaction, precau­tionary and speculative.

1. **The Transaction Motive:** People like to keep their money in liquid form (cash) to meet their day-to-day expenses during the period between the receipt and spending of their money.
2. **The Precautionary Motive:** Besides day-to-day transactions, there are many unforeseen con­tingencies in the life of individuals for which they hold money. The desire of the people for holding money under the precautionary motive is devoted to fulfil the function of a store of value. It may be compared with a water tank.
3. **The Speculative Motive:** The third and the last motive for liquidity preference is the desire to earn profits. Many people may think that the rate of interest in the future will be higher and in order to take advantage of this future increase in the rate of interest, they may like to keep money in the liquid form to be invested in securities when the rates of interest actually rise
* **What do you meant by double coincidence of wants?**

The double coincidence of wants mean that both the parties have to agree to sell and buy each other's commodity i.e. what a person desires to sell is exactly what the other person wishes to buy.

* **Differentiate between currency and money.**

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| --- | --- |
| Money cannot be touché d, neither it can be smelled; however money can be seen in terms of the numbers. | Currency is the promissory coin or note which is presented in the form of money |
| Online mode cheque , savings bank account etc.  | Coins, hard currency notes etc. |
| Money takes forms of numbers | Currency take forms of hard plastic or coins or say the currency notes. |
| Money is intangible concept  | Currency is tangible concept. |
| Money can be transferred through online mode | Currency must be transferred via physical i.e. hand to hand transfer |
|  |  |

* Differentiate between bearer cheque and crossed cheque.

A cheque which is payable to any person who presents it for the payment at the bank counter is called bearer cheque.

A crossed checque is a checque that is payable only through a collecting [banker](https://en.wikipedia.org/wiki/Bank) and not directly at the counter of the bank.

When two parallel [transverse](https://en.wiktionary.org/wiki/transverse) lines, with or without any word, are drawn generally, on the left hand top corner of the checque.

* **What is meant by bill of exchange?**

A bill of exchange is a written order once used primarily in international trade that binds one party to pay a fixed sum of money to another party on demand or at a predetermined date.

* **Write down any three characteristics of good money.**
* Must be generally accepted by a population
* Valuable – generally holds value over time
* Divisible i.e. it can be broken down into smaller denominations
* Durability i.e. it needs to last
* What is the difference between bond and share?

**Shares:**

Institutions looking to raise capital, issue a part of the ownership of the company in return of value. This is done y the means of issuing of share to general public. In exchange for providing a specific value the investor is entitled to ownership of the company in proportion to the actual value of the company.

**Bonds:** bond is a type of investment which acts as a fixed income reaping investment. The amount invested in bonds acts as a loan for issuing institution. The institution uses the money so raised for its current as well as long term expenses. The bondholders reap regular interests on their investment as well as are offered a surety of repayment of their invested amount.

* **Define cross checque**.

A **crossed check** is any **check** that is **crossed** with two parallel lines, either across the whole **check** or through the top left-hand corner of the **check**. This symbol **means** that the **check** can only be deposited directly into a bank account and cannot be immediately cashed by a bank or any other credit institution.

* **What is meant by bill of exchange?**

It is a document which a seller of products writes in the name of buyer that he has purchased goods of such and such value and agrees to make payment at sight or after a certain period of time. The buyer accepts that statement as valid and signs it.

* **Define order checque.**

When the account holder writes the name of a person, to whom the payment is to be made, on the checque and delete the word bearer, the checque becomes order checque.

* **What do you know about traveller’s checque?**

A cheque for a fixed amount that may be cashed or used in payment abroad after endorsement by the holder's signature. OR

* **Definition:**The **Traveller’s cheque** is an exchange medium that can be used as a substitute for the hard currency. As the name suggests, these cheques are issued to the individuals who travel on vacations to overseas.
* **What is meant by Bank draft?**

A bank draft used to transfer any amount from one city to another city generally. It is drawn by one bank to another bank. Its specified amount is order to pay to named person or to his order.

* **Define cheque.**

A cheque has been defined as “an order by an account holder to banker to pay the specified amount to the nominee or to bearer”.

* **What do you know about pay order?**

A draft issued for the transfer of money within a city is called pay order.

* **Differentiate Between sight bill and time bill?**

A bill of exchange can either be paid immediately, which is known as a “sight bill” or on a fixed date, which is known as a “term bill.”

* **What is credit money?**

The amount of money which is borrowed or landed out to a person is called “credit money”.

The document to that effect which represents the existence of credit is called the credit instrument.

* **Write any three instruments of credit money?**

The document to that effect which represents the existence of credit is called the credit instrument. Some of them are as under:

* Checque
* Bank draft
* Bill of exchange
* Government bonds
* Credit cards
* **What functions are performed by money?**

There are many functions of money some of them are as follows:

* **Medium of exchange:** Money's most important function is as a medium of exchange to facilitate transactions
* **Store of value:** In order to be a medium of exchange, money must hold its value over time; that is, it must be a store of value
* **Unit of account:** Money also functions as a unit of account, providing a common measure of the value of goods and services being exchanged.
* **Write down any three characteristics of good money.**
* General Acceptability: It should be accepted throughout the general region.
* Divisibility: It should be able to offer exact amounts of change after a transaction. This is the reason why we have smaller banknotes and coins to buy goods that are not exactly worth certain amounts.
* Portability – It should be easily transported from one place to another, even in bulk.
* **Define metallic money.**

The money made from metals such as gold, silver and copper in known as metallic money.

* **How many kinds of metallic money are there? Differentiate between them shortly.**

There are two kind s of metallic money are given as under:

Standard metallic money: it is the coin whose face value is equal to its intrinsic value .this means that value of the metal in the market is exactly the same as the value of the coin written on it.

Token metallic money: it is made of a coin whose face value s greater than its intrinsic value. This means that face value of the coin is much larger than the value of metal used in the coin.

* **What is meant by monometallism?**

When all the coins in the circulation are made of the same metal the monetary standard will be called monometallism.

* **What do you know about gold currency standard?**

Under this system gold coins which are certainly standard metallic money circle in the country the coinage is free under gold currency standard.

* **What is meant by Gold bullion standard?**

Under this system token coins and paper notes circulate in the country are primarily as medium of exchange. They allowed to be converted in gold bullion to take them out of the country for payments.

* **How you define Gold exchange standard?**

Under this system also gold coins are not issued to circulate in the country. Instead token coins and paper notes circulate as money. However token money is allowed to be exchanged with gold coins of another country.

* **Define paper money.**

Paper money is issued in the form paper notes which are brought in the circulation by the government or the central bank of a country. These notes are issued in accordance with the rules given in the constitution.

* **Differentiate between convertible and inconvertible paper money.**

Convertible paper money: this kind of money is issued by central bank of a country and is convertible in gold and silver on demand.

Inconvertible money: this kind of money is issued by the government of a country without keeping in reserve gold and silver it is issued under a law according to which everybody is bound to accept it as a legal tender.

* **What is meant by foreign bill of exchange?**

The definition of a foreign bill of exchange is a payment drawn up in one country that is payable in another country. *An example of a foreign bill of exchange is an agreement drawn up between two countries for trading purposes.*

* ***What is meant by near money? Define near money.***

Near money is a financial economics term describing non-cash assets that are highly [liquid](https://www.investopedia.com/articles/active-trading/102214/all-about-liquid-commodities.asp) and easily converted to cash. For example shares of joint stock companies and government bonds.

* **What do you know about legal tender money?**

This is a kind of money which the people are bound to accept in payment under the cover of law all notes and coins circulating in our economy are legal tender money.

* **Differentiate between limited and unlimited legal tender money?**

**Unlimited legal tender:** This is the type of money which people were bound to accept as a legal tender up to any extent they were being paid.

**Limited legal tender:** the type of money is acceptable only up to limited extent as a legal tender not necessarily beyond it.

* **What is meant by optional money?**

This is the type of money which falls to the option of person to accept it. For example cheques bills of exchange etc are optional money because anybody can refuse to accept them in payment.

* **Define Money of account.**

The basic unit of account in each country is called the money of account. For example, all accounts in Pakistan are made in rupees; therefore, rupee is our money of account.

* **Define supply of money.**

The quantity supplied of all three kinds of money, metallic, paper and credit money put together will make the supply of money in a country.

* **What is debenture?**

In order to expand their business joint stock companies sell debentures to get loan from the public at a certain rate of interest, debenture is therefore a loan document.

* **What do you know about stock exchange?**

It is a market where shares of joint stock companies, stock certificates of big business enterprise, debentures government bonds and bill of exchange are bought and sold.

**IMPORTANT QUESTIONS (Exercise Page 33)**

**Q1 # Explain the difficulties of barter system of exchange. Has the use of money removed these difficulties? (BOOK PAGE 18-190)**

**A. Meaning of Barter:**

‘Direct exchange of goods against goods without use of money is called barter exchange.’

Alternatively, economic exchanges without the medium of money are referred to as barter exchanges. An economy based on barter exchange (i.e., exchange of goods for goods) is called C.C. Economy, i.e., commodity for commodity exchange economy. In such an economy, a person gives his surplus good and gets in return the good he needs. Following are some of the drawbacks or inconveniences of barter system of exchange:

#### 1. Lack of double coincidence of wants:

Double coincidence of wants means what one person wants to sell and buy must coincide with what some other person wants to buy and sell. ‘Simultaneous fulfillment of mutual wants by buyers and sellers’ is known as double coincidence of wants.

There is lack of double coincidence in the wants of buyers and sellers in barter exchange. The producer of jute may want shoes in exchange for his jute. But he may find it difficult to get a shoe-maker who is also willing to exchange his shoes for Jute.

Thus, a seller has to find out a person who wants to buy sellers good and at the same time who must have what the seller wants. This is called double coincidence of wants which is the main drawback of the barter exchange.

#### 2. Lack of common measure of value:

In barter, there is no common measure (unit) of value. Even if buyer and seller of each other commodity happen to meet, the problem arises in what proportion the two goods are to be exchanged. Each article must have as many different values as there are other articles for which it is to be exchanged.

When thousands of articles are produced and exchanged, there will be unlimited number of exchange ratios. Absence of a common denominator in order to express exchange ratios creates many difficulties. Money obviates these difficulties and acts as a convenient unit of value and account.

#### 3. Lack of standard of deferred payment:

There is problem of borrowing and lending. It is difficult to engage in contracts which involve future payments due to lack of any satisfactory unit. As a result, future payments are to be stated in term of specific goods or services. But there could be disagreement about the quality of the good, specific type of the good and change in the value of the good.

#### 4. Difficulty in storing wealth (or generalized purchasing power):

It is difficult for the people to store wealth or generalized purchasing power for future use in the form of goods like cattle, wheat, potatoes, etc. Holding of stocks of such goods involves costly storage and deterioration.

#### 5. Indivisibility of goods:

How to exchange goods of unequal value? If a household wants to sell his cow and get in exchange cloth equal to the value of half of his cow, he cannot do so without killing his cow. Thus, lack of divisibility of goods makes barter exchange impossible.

In order to overcome the above disadvantages of the barter system, money was invented by the society.

The use of money has removed the difficulties of barter system by the followings means:

**Key Functions of Money**

1. **Medium of exchange:** money allows goods and services to be traded without the need for a barter system. Barter systems rely on there being a double coincidence of wants between the two people involved in an exchange
2. **Store of value:** this can refer to any asset whose “value” can be used now or used in the future i.e. its value can be retrieved at a later date. This means that people can save now to fund spending at a later date.
3. **Unit of account**: this refers to anything that allows the value of something to be expressed in an understandable way, and in a way that allows the value of items to be compared.
4. **Standard of deferred payment:**this refers to the expressing of the value of a debt i.e. if people borrow today, then they can pay back their loan in the future in a way that is acceptable to the person who made the loan.

#### 5. The Basis of Credit:

Money facilitates loans. Borrowers can use money to obtain goods and services when they are needed most. A newly married couple, for example, would need a lot of money to completely furnish a house at once. They are not required to wait for, say ten years, so as to be able to save enough money to buy costly items like cars, refrigerators, T.V. sets, etc.

**Q2 # Discuss the functions of money. Which one is the basic and primary function of money? (BOOK PAGE 20)**

### 1. Primary Functions:

Primary Functions include the most important functions of money, which it must perform in every country,

**These are:**

#### (i) Medium of Exchange:

Money, as a medium of exchange, means that it can be used to make payments for all transactions of goods and services. It is the most essential function of money. Money has the quality of general acceptability so; all exchanges take place in terms of money.

1. This function has removed the major difficulty of lack of double coincidence of wants and inconveniences associated with the barter system.

2. Use of money allows purchase and sale to be conducted independently of one another.

3. This function of money facilitates trade and helps in conducting transactions in an economy.

4. Money has no power to satisfy human wants, but it commands power to purchase those things, which have utility to satisfy human wants.

For, “How does money separate the acts of sale and purchase”, refer HOTS.

#### (ii) Measure of Value (Unit of Value):

Money as measure of value means that money works as a common denomination, in which values of all goods and services are expressed.

1. By reducing the value of all goods and services to a single unit (i.e. price), it becomes very easy to find out the exchange ratios between them and comparing their prices.

2. This function facilitates maintenance of business accounts, which would be otherwise impossible.

3. Money helps in calculating relative prices of goods and services. Due to this reason, it is regarded as a Unit of Account’. For instance, ‘Rupee’ is the unit of account in India, ‘Pound’ in England and so on.

### 2. Secondary Functions:

These refer to those functions of money which are supplementary to the primary functions. These functions are derived from primary functions and, therefore, they are also known as ‘Derivative Functions’.

#### (i) Standard of Deferred Payments:

Money as a standard of deferred payments means that money acts as a ‘standard’ for payments, which are to be made in future. Every day, millions of transactions take place in which payments are not made immediately. Money encourages such transactions and helps in capital formation and economic development of the economy.

#### (ii) Store of Value (Asset Function of Money):

Money as a store of value means that money can be used to transfer purchasing power from present to future. Money is a way to store wealth. Although wealth can be stored in other forms also, but money is the most economical and convenient way. It provides security to individuals to meet contingencies, unpredictable emergencies and to pay future debts. Under barter system, it was difficult to use goods as a store of wealth due to perishable nature of some goods and high cost of storage.

**1. Medium of Exchange:**

As a medium of exchange, money has removed the major difficulty of lack of double coincidence of wants in barter system. It separates the acts of sale and purchase of goods and services and helps both the parties in obtaining maximum satisfaction. A buyer can buy goods through money and a seller can sell goods for money.

**2. Measure of value:**

Under Barter system, different goods were of different values and there was no common denomination to express their exchange ratios. But, money is the measuring rod which expresses the value of other commodities. It becomes easier to compare the relative values of any two commodities.

**4. Standard of deferred payments:**

Barter system lacks suitable standard of deferred payments which creates difficulty in credit transactions. Borrower may not be able to arrange goods of exactly the same quality at the time of repayment. On the other hand, due to general acceptability of money, future payments are expressed in terms of money. Money has simplified the borrowing and lending operations and encouraged capital formation.

**Q3 # What is meant by paper money? Discuss its merits and demerits. (Answer book page 24-26)**

##  Paper Money:

Paper money means the paper instruments such as bank notes, cheques, bills of exchange and other forms that take the place of money and act as currency or circulating medium.

Paper money is a country's official, paper currency that is circulated for transaction-related purposes of goods and services. The printing of paper money is typically regulated by a country's central bank or treasury in order to keep the flow of funds in line with policy. There are two kinds of paper money.

**Convertible paper money:** this kind of money is issued by central bank of a country and is convertible in gold and silver on demand.

**Inconvertible money:** this kind of money is issued by the government of a country without keeping in reserve gold and silver it is issued under a law according to which everybody is bound to accept it as a legal tender.

**Merits of Paper Money**

**1. Cheap** **and Economical**

Normally paper money is much easier to issue. Practically it cost nothing to government. Printing of paper currency is requires certain special types of paper, ink, and printing technology. These things no doubt are costly but overall printing cost is quite low.

**2. Convenience**

Paper money is convenient to transfer and carry. It can be easily kept in pocket. Further it can also be readily converted into cheques, drafts, etc.

**3. Copying**

The design of paper money is very difficult to copy. Further special type of paper and ink is used in paper money that makes it quite impossible to copy. Even if it copied by some fake means then it can be checked by electronic machines.

**4. Homogeneous (Uniform quality)**

The paper money has another advantage that it has uniform quality and the holder does not bother for possession of new or old money.

**5. Elastic Supply**

Paper money due to its elasticity is very useful for government. Supply of money can be increased or decreased according to the needs of the economy. For example at a peak level of business activity the demand of money increases and the monetary authorities can easily issue paper money to fulfill the demand of money.

**6. Advantage of Unlimited Legal Tender**

Paper money is unlimited tender i.e. any amount of payment or of debt can be paid in it. It can be used to discharge all kinds of business obligations.

**7. Precious Metals Saving**

Use of paper money results the saving of precious metals of the country. The metals can be used for other useful purposes.

**8. Ease of Counting**

Paper money is much easier to count than metallic money. The counting of large amounts in metal form is inconvenient and difficult. On the other hand counting of paper money is easy, convenient and requires little time.

**9. Recognizable**

The paper money is easily recognizable. There is no inconvenience of testing the exactness of the money material.

**10. Useful in Emergency**

The paper money can be used in emergency life war and floods. The government can meet the expenses by printing notes in shorter time. But metallic money takes long time period for mining, refining and minting the metals.

**11. Stable in Value**

The metallic money depreciates due to wear and tear. The paper money helps to control such loss. The depreciation means decrease in the value of coins due to usage.

**12. Easily Portable**

Paper money is portable i.e. it can easily be transferred from one place to another as compared to metallic money. The cost of transferring paper money is quite low and it can be transferred in a very short time period.

**Demerits of Paper Money**

**1. Demonetization**

The demerit of paper money is that the holder may have to suffer loss. The paper money is fiat money. It is issued by fiat (order) of the government. In case the government cancels the currency notes the holder has to bear full loss.

**2. Exchange Rate Instability**

The value of paper money is instable and is subject to fluctuations in the exchange rates. The fluctuations in the exchange rate market also produce serious effects on the price level in the economy.

**3. Monetary Mismanagement**

Purchasing power of paper money is an ever – changing process. This means that its face value remains same but its purchasing power may decline due to monetary mismanagement.

**4. Excess Issuance**

The printing of paper money is quite easy, so in times of need the government can issue notes more than the requirement. As a result supply of money increases that causes inflation in the economy.

**5. Restricted Acceptability (Limited Acceptance)**

One of the demerits of paper money is that it has limited acceptance. Its acceptance is limited within the boundaries of a country. It cannot be used to make payments to other countries.

**6. Inconvenience of Small Denominators**

Paper issue is not for small monetary denominators such as 1,10,25,50 paisa and even for Rs. 1, 2 and 5. In this case metallic money gets preference over paper money.

**7. Troubling Balance of Payments**

Over issue of money results in decrease of value of money and also causes inflation. Due to which price of imported goods increases because they are to be paid by exchanging devalued currency for foreign currency. It results in unfavorable balance of payment.

**8. Short Life**

Although the paper currency is not affected by wear and tear but it can be damaged due to fire or water. Due to this the life of the paper currency is much less than the metallic money.

**Q4 # Define money. Discuss its function (Answer book page 24-26)**

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