The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of innovations that reduced the costs of exchanging goods and services.

Compared to an electronic payments system, a payments system based on checks has the major drawback that checks take longer to process, meaning that it may take several days before the depositor actually gets the cash.

The following sequence accurately describes the evolution of the payments system: barter, coins made of precious metals, paper currency, checks, electronic funds transfers.

Short Essay Type Questions

How do we measure the amount of money in the economy?

The measure depends upon the definition and function of money that you want to consider. A narrow aggregate of money is just a medium of exchange, a broader aggregate of money has other functions (e.g. store of value).

In prison, cigarettes are sometimes used among inmates as a form of payment. How is it possible for cigarettes to solve the "double coincidence of wants" problem, even if a prisoner does not smoke? Even if he or she is a non-smoker, since the prisoner knows that others in the prison will accept cigarettes as a form of payment, they themselves would be willing to accept cigarettes as a form of payment. So, rather than prisoners having to barter and trade favours, cigarettes satisfy the double child dence of wants in that both parties to a trade stand ready to use them to "purchase" goods or levices.

Most of the time it is quite difficult to separate the the first firstions of money. Money performs its three functions at all times, but sometimes we can these one in particular. For each of the following situations, identify which function of money is eighthusized: a) Brooke accepts money in Schange for performing the daily tasks at her office, since she knows she

a) Brooke accepts money in Schange for performing her daily tasks at her office, since she knows she can use that honey G buy goods and se vices

b) Tim wants to calculate the relative value of oranges and apples, and therefore checks the price per pound of each of these goods quoted in currency units.

c) Maria is currently pregnant. She expects her expenditures to increase in the future and decides to increase the balance in her savings account.

(a) This situation illustrates the medium-of-exchange function of money. We often do not think why we accept money in exchange for hours spent working, as we are so accustomed to using money. The medium-of-exchange function of money refers to its ability to facilitate trades (hours worked for money and then money for groceries) in a society.

(b) In this case we observe money performing its unit-of-account function. If modern societies did not use money as a unit of account, then the price of apples would have to be quoted in terms of all the other items in the market. This quickly becomes an impossible task. Suppose that a pound of apples sells for 0.80 pounds of oranges, half a gallon of milk, one third of a pound of meat, 2 razor blades, 1.5 pound of potatoes.

(c) Maria is contemplating the store-of-value function of money. As a medium of exchange and unit of account, measures of money known as M1 or M2 have no important rivals. With respect to the store-of-value function, however, there are many assets that can preserve value better than a checking account. Maria's choice to preserve the purchasing power of her income by increasing her savings account balance is fine for a small period of time. For a period of 20 years, however, you might choose to buy a U.S. Treasury bond that matures in 20 years (as many grandparents have done as a way to pay for their grandchildren's educations).