

What exactly is money?

THE ESSENTIALS

The word **money** comes from the Latin name for the goddess *Juno Moneta*, whose temple was used to mint coins in ancient Rome.



Money can be defined by its uses, i.e. by its **economic functions**. This **functional approach** towards money is extremely old, since it comes from the Greek philosopher **Aristotle** (384 - 322 BC) who deliberated that for an instrument to be considered 'money,' it must serve three functions:

- to be a **unit of account**
- a **medium of exchange** and
- a **store of value**.

Firstly, money is a **unit of account** - used to express the prices of goods and services. In other words, money allows us to express the economic value of a product or service as well as its desirability. It also makes it possible to compare the value of goods - for example, instead of saying that a kilogram of apples is equivalent to a third of a kilogram of strawberries, we will say that a kilogram of apples is worth £3 and a kilogram of strawberries is worth £9. Thus, we compare the value of these goods and services against a single benchmark, in this example, pound sterling.

Secondly, money is a **medium of exchange**. Since the economic value of any goods or services can be measured with money, then it can be used by individuals, businesses or governments who wish to carry out a transaction. Thus, money can be used to settle transactions (to buy or sell) or to take on or repay a debt.

Finally, money is a **store of value** - it can be stored for future use, consumption or investment. According to John Maynard Keynes (1883 - 1946), money is a 'link between the present and the future.'

Why is it so important?

Because money is an essential instrument for the proper functioning of the economy.

Indeed, an economy based on money is much more efficient than an economy based on bartering, where it would be necessary for each party to identify another party with the exact opposite need for goods or services.

Economic historians have also shown that societies in which exchanges exist are always based, even partially, on monetary instruments. Shells, wheat and salt used during ancient times were all examples of commodity money, whereby their value was based on their intrinsic value.

Similarly, accounting entries on clay tablets have been found to have been used in Mesopotamia, more than **4000 years ago**.

Because money is at the heart of individuals' lives - hence, questions of purchasing power and inflation are closely linked to the value of money. Similarly, the emergence of crypto-assets at the end of the 2000s has led to many lively debates about their usefulness compared to currencies in circulation.

Finally, **because money is one of the attributes of a state's sovereignty** - in the UK the currency is the pound sterling, whilst in France and the other countries within the Eurozone, the currency is the euro. Economic agents (households, companies, governments, etc.) may hold other monetary units, issued by foreign countries - this is called **currency**. These can be used for example, to pay foreign suppliers or to save. However, these foreign currencies do not fully perform the three functions of money outside their home territory. Thus, in the UK, even the US dollar, which is a currency in high demand, will not be easily accepted to pay for everyday consumer purchases, except perhaps in the most touristic areas. However, some currencies are widely used around the world for trading, debt or building up reserves.

These are called **international currencies**, including the Euro, the US dollar, the Pound Sterling, the Japanese Yen and the Chinese Yuan.

How does money work?

For a currency to perform all three functions, it must be **easy to use** in its various forms. Above all, it must have a **stable value** over time.



Historically, to ensure this stability, currencies were most often based on **precious metals**, such as gold or silver. The **gold standard** system was therefore used to refer to the currencies that were based on this metal. In the twentieth century, any reference to a metal was gradually abandoned. In 1976, the **Jamaica Accords** formally abolished the role of gold in the international monetary system. From then on, it is fully up to the **central bank** which is responsible for issuing a currency, to ensure the stability of its value and consequently its purchasing power, through the implementation of an appropriate **monetary policy**.

For this reason, in most countries, the main objective of central banks is **price stability** which is necessary in order to instil **confidence for its citizens**. Thus, whatever the form of money, they will know that their money retains its value and can be easily accepted.

On an operational level, the central bank issues **central currency**, which is accessed by commercial banks, which in turn issue **commercial currency** when they grant credit. However, this power of money creation from commercial banks is governed by banking regulations and limited by the need to hold a minimum quantity of central currency in order to maintain the confidence of savers.

Economic agents can hold money in various forms: fiduciary, scriptural and electronic.



Fiduciary money refers to coins and notes. Its name comes from the Latin **fides** which means trust (trust in the issuer of money in the form of 'simple paper' as opposed to commodity money and metal money associated with a precious metal).

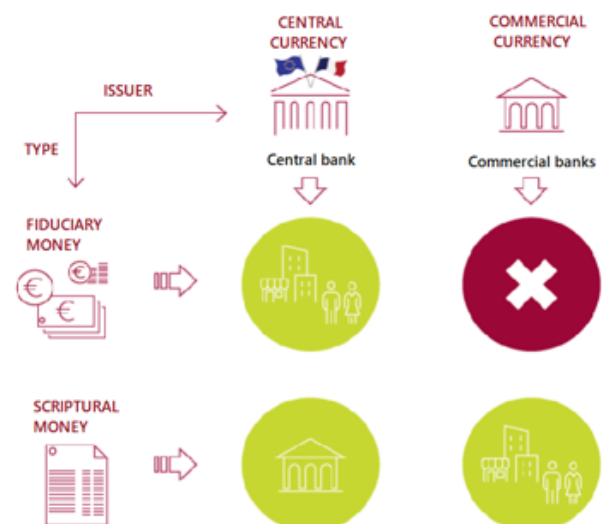
In the UK, as in France, fiduciary money is the only one to be **legal tender**, therefore pound sterling and euro coins and notes cannot be refused in the payment of a debt-claim.

Similarly, only fiduciary money has an immediate **discharge value**, i.e. the debt-claim ends instantly once the required amount has been exchanged. In major advanced economies, this form of money is issued directly by the central bank. Therefore, fiduciary money consists of a debt-claim on the central bank which must be able to guarantee its value. When it comes to coins, it is sometimes referred to as **divisional money**, because when it comes to pence or cents, these coins divide the value of the monetary unit.

When the money arrives in a bank account, it is then **scriptural money**. When a payment is made in scriptural money, one account is credited, and another account is debited. It is up to the commercial banks which keep these accounts to ensure the reliability of these entries in order to retain confidence in this form of commercial scriptural money. This currency, guaranteed by commercial banks, can then be used to carry out transactions using means of payment, such as when using debit or credit cards, cheques, direct bank transfers, or other electronic payment systems.

Innovation has also enabled the development of **electronic money**. This is money stored in the form of units of account, on digital platforms independent of a bank account. It is commercial currency and should not be confused with digital currency projects led by central banks.

THE CIRCULATION OF MONEY



4% Fiduciary money as a percentage of UK's total currency in circulation

96% Scriptural money as a percentage of UK's total currency in circulation



Currency used by economic agents



Currency used by commercial banks