

Exchange, Money, & Banking

A. Exchange

1. Exchange – trading goods & services with people for other goods & services or for money
 - a.
 - b. The most primitive form of exchange is **barter** (the direct trading of goods & services between people)
 - (1) Double coincidence of wants
 - (2)
 - (3)
 - c. Money has generally replaced barter as a more efficient system for exchange, because it greatly reduces the problems of barter
2. Money – a good that can be used to buy all other goods & services
 - a.
 - b. Money tends to serve 3 functions
 - (1) Medium of exchange
 - (2) Unit of account
 - (3) Store of value
 - c. There are 3 types of money
 - (1) Commodity money
 - (2) Representative money
 - (3) Fiat money (legal tender)
3. Money encourages specialization by decreasing the opportunity costs of exchange
 - a. This increased specialization leads to **interdependence** between producers & consumers
 - (1) Interdependence

(2) Ex)

b.

4. The frequency of exchange is affected by *transaction costs*

a. Transaction costs

b.

B. Development of Banking

1. When money was principally gold coins, it was not always easy to carry because gold is heavy & transporting numerous gold coins was an activity that easily drew the attention of thieves

a. Due to the disadvantages associated with gold coins, many looked to goldsmiths to store their gold for them

(1)

(2) Warehouse receipt

b. Instead of redeeming the gold for purchases, people began exchanging the warehouse receipts for purchases

2. With people not redeeming their gold, the goldsmiths decided to lend some of this gold to other people & charged them interest on these loans (the beginning of *fractional reserve banking*)

a. Fractional reserve banking

b. Fractional reserve banking effects the amount of money in the economy

(1)

(2)

3. Today, banking is conducted by several types of financial institutions

a. The four main types of financial institutions are commercial banks, savings & loan associations (S&Ls), mutual savings banks, & credit unions

(1)

(2)

- b. Banks & other financial institutions play a key role in providing currency & other forms of money to consumers & serve as intermediaries between savers & borrowers

C. The Money Supply

- 1. M1 (the basic money supply) – consists only of funds that are easily accessible & in actual circulation

- a. Currency (28.6%)

- b. Checkable accounts (demand deposits) (70.7%)

- c. Traveler's checks (0.7%)

- 2. M2

- a.

- b. Near money

- 3. M3 – includes M2 & all large time deposits, repurchase agreements, & some Eurodollars