CYCLES

CHILD AND YOUTH CARETAKERS FINANCIAL LITERACY AND ENTREPRENEURSHIP SKILLS

IO4 – Training material

Module 1: Basic Financial Literacy for daily life

E-Learning: The meaning of money

Done by Gerhard Lechner, Sabrina Rinder

27 January 2019

Co-funded by the
Erasmus+ Programme
of the European Union

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Project number: *2017-1-AT01-KA204-035082*

Training Material E-Learning

Module 1: Basic financial literacy for daily life

1. Topic 1: Meaning of money

1.1 Currency, book money and wealth

The word "money" is used in many different ways in everyday life, but for economists it has a very specific meaning. To understand the way how economists´ understand money we have to clarify. They use the **currency** which consists of paper money and coins. The central bank of a country has the monopoly to produce currency. However, to define money merely as currency is too narrow for economists´. The second form of money is also called **book money** which is for example money on a checking account deposit. The money on a checking account deposit can also be considered as "money", because it can be quickly and easily converted into currency or checking account deposits. Book money can be "produced" by the central bank and also by the banking sector.

Sometimes the word money is used synonymously with **wealth**. When, people say "Joe is rich" they probably mean that Joe does not just have a lot of coins, banknotes and a high balance on his checking account, but he also has stocks, bonds, four cars, three houses, and a yacht. In this case the usage of the term money is too broad. Economists make a difference between money (or currency), demand deposits and wealth. Wealth does not only include currency, but also other assets like equities, bonds, art, land, furniture, cars and houses.

People in everyday life also often use the term money in the sense of income. "Sheila has a good job and she earns a lot of money." According to the definition of economists´ ***income*** *is a flow of earnings per unit of time.* Money by contrast is a stock: *It is a certain amount at a given point in time.*

Example: If someone tells you that he has an income of USD 1.000, you cannot tell whether he earned a lot or a little without knowing whether this USD 1.000 is earned per year, per month, or even per day. But it someone tells you that she has USD 1.000 in her pocket, you know exactly how much this is.

1.2 Functions of money

Money has three major functions in an economy: medium of exchange, unit of account, and as a store value.

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1.2.1 Medium of exchange

In almost all transactions in our economy, money in the form of currency or checks is a **medium of exchange**. Money as a medium of exchange promotes economic efficiency, because in a complex global economy it would be too complicated to exchange goods like in a barter economy. The time spent trying to exchange goods and services is called **transaction costs**. In a barter economy, transaction costs are

high, because people have to find someone who wants to exchange goods and services. So we can say that money is absolutely necessary in a complicated global economy.

1.2.2 Unit of Account

The second role of money is to provide a **unit of account**. Without money it would not be possible to measure and compare the value of goods and services. Why is this function important? We have to make a journey back to a barter economy. We just have to imagine how hard it would be to compare the value of goods in a supermarket if we do not use money.

1.2.3 Store of Value

Money also functions as a **store of value**. It simply means that the value of a EUR 10 banknote always has the same value. Why is this function of money important for us? Because most of us do not want to spend our income immediately upon receiving it and saving has also an important function in our monetary and financial system.

Other assets like stocks, bonds, land, houses or cars can be used to store value. Most of these assets have an advantage in comparison to money if we talk about the store of value, because these assets deliver a higher interest than money or currency where no interest can be earned. The interest of deposit accounts is also often below that of the mentioned assets. The major advantage of money is **liquidity**. With banknotes, coins and checks you can immediately pay your bills. If you have stocks, bonds or land it will take some time to make the assets liquid.

How good a store of value is in an economy depends on the price level. For example, if prices are doubling, then the value of money has dropped by half. On the side, when prices are falling by 50%, the value of money has doubled. During times of **hyperinflation** the value of money is rapidly losing its value (for example if inflation is 50% per month). In this case, money will lose its value for the society. During times of hyperinflation people often start to use alternative currency like cigarettes or bitcoins.

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1.3 The case of Zimbabwe

At the picture below you can see a boy of Zimbabwe, a country which experienced hyperinflation. Zimbabwe's peak month of inflation is estimated at 79.6 billion percent in mid-November 2008. The time of hyperinflation in Zimbabwe lasted from 2000 until 2008. Zimbabwe banknotes were ranging from 10 Zimbabwean dollars to 100 billion dollar. The small boy on the picture has a lot of money, but maybe he can buy a chocolate with that money. That means despite the fact that you were a billionaire in Zimbabwe, it could be that you are still poor, because the value of money is low.

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Picture 1: Two pictures of Zimbabwe on the internet

1.4 Electronic payment

Nowadays, the internet makes it more cheap to pay for bills. In the past, you had to pay bills by mailing check, but now banks provide the opportunity to transfer money electronically. You just have to log on an account and with few clicks you can transmit your payment electronically. With that kind of payment much money and resources are saved and does not take much time to make a transfer from one account to another. Therefore, electronic payment is becoming more and more common in the European Union and in the world economy.

1.5 E-Money

Electronic money can substitute not only for checks but also for currency. E-money exists just in electronic form. The first form of e-money was a debit card. With a debit card a consumer is able to pay a bill directly with the card (for example in a supermarket). The money will be transferred directly from the account of the consumer to the account of the supermarket. Big stores and also supermarkets also accept credit cards. Debit cards and credit cards are now becoming faster to use than cash, because the usage of cards is not complicated.

At most supermarkets, you can swipe your debit card through the card reader at the checkout station, press a button, and the amount of your purchases is deducted from your bank account.

2. Reference list:

Mishkin, F. S. 2013. The Economics of money, banking, and financial markets. Tenth Edition. New York: Pearson. We especially reference to: pp. 94-106.

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