

# 4.3 Definition, Measurement, and Functions of Money

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Name: \_\_\_\_\_ Class: \_\_\_\_\_ Date: \_\_\_\_\_

Total: 10 marks

## Objective

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Build the skills to answer exam questions on **the definition, measurement, and functions of money**.

You must be able to:

- state the three **functions of money** 货币的职能: medium of exchange, store of value, unit of account
- compare the money-supply measures **M1** and **M2** by liquidity
- distinguish **commodity money** 商品货币 from **fiat money** 法定货币

## 1 Worked examples

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Study these first. Each one shows the method for a question type used later.

### ■ Three functions of money

- **Medium of exchange** —accepted in trade.
- **Store of value** —holds worth over time.
- **Unit of account** —a common measure of prices.

### ■ M1 and M2

**M1** is the most liquid (cash and chequing deposits); **M2** adds slightly less liquid savings and small time deposits.

### ■ Commodity vs fiat

**Commodity money** has intrinsic value (e.g. gold); **fiat money** has value because the government declares it legal tender.

## 2 Practice

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2.1 State the three functions of money.

[2]

2.2 State which is more liquid, M1 or M2. [1]

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2.3 State the difference between commodity money and fiat money. [2]

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### 3 Exam-style questions

3.1 Using money as a "unit of account" means it is used to [1]

- A store wealth over time
- B measure and compare prices
- C earn interest
- D back the currency with gold

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3.2 Fiat money has value because [1]

- A it is made of gold
- B the government declares it legal tender
- C it is naturally rare
- D it earns interest

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3.3 A shopkeeper prices goods, accepts cash for them, and keeps takings in a savings account.

(a) Name the money function used in **pricing** goods. [1]

(b) Name the function used in **accepting cash**. [1]

(c) Name the function used in **saving**. [1]

### 4 Go further

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- work through the **4.3 Definition, Measurement, and Functions of Money** lesson on the **Learn** page;
  - read the **Financial Sector** section of the AP Macroeconomics handout on the **Know** page.

## Solutions

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**2.1** medium of exchange, store of value, unit of account.

**2.2** M1.

**2.3** commodity money has intrinsic value of its own; fiat money has value only because the government declares it legal tender.

**3.1** B.

**3.2** B.

**3.3** (a) unit of account. (b) medium of exchange. (c) store of value.