4.3 Definition, Measurement, and Functions of Money

Name: ____________ Class: ________ Date: __________ **Total: 10 marks**

KEY WORDS unit of account 记账单位 • fiat money 法定货币 • functions of money 货币的职能 • medium of exchange 交换媒介 • store of value 价值储藏

Objective

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

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

2.1 State the three functions of money. [2]

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

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

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

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

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]

Solutions

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.