Isn’t Green Your Favorite Color Too?

Money, what a precious commodity! Money is not income. Your monthly income is paid in money. Money is not wealth either. The price of your house is measured in money. A credit card is not money. When you use your card, you borrow money from a third party and agree to pay it back with interest. So, what is money?

Money is anything that is generally accepted as a medium of exchange. Without money, barter is very difficult, as it requires the double coincidence of wants: what you want to sell must be exactly what I want to buy and vice versa. The use of money makes trade much easier: you sell what you have for money and use it to pay for what you want to buy.

There are two kinds of money:

- **Commodity money** is the money that has some intrinsic value of its own, like gold or silver coins that the ancient people used in market transactions, or cigarettes that POWs used in trade (e.g., two cigarettes for an apple).

- **Token money** is the money that is intrinsically worthless on its own including coins, bills, and checks. The value of token money is the buying power embodied in it. For example, the cost of printing a $1 bill or a $100 bill is only 4¢; the value of each bill is the amount of goods and services you can buy with it. Of course, you prefer a $100 bill to a $1 bill because you can buy a lot more goods and services with it.

Token money performs three important functions:

- **Medium of exchange** - You use money to pay for goods and services you buy and receive money for goods and services you sell.

- **Store of value** - You can transport the buying power of money across time and space. You save money today to spend tomorrow; you ask your bank to wire money to a friend in Japan.

- **Unit of account** - Prices are quoted in money, books are kept in money, and debts are calculated in money.
In addition to performing these functions, *token money* must be

- Limited in supply
- Widely accepted
- Uniform
- Durable
- Portable
- Divisible

The dollar, or the *green back*, is the *legal tender* of the United States (i.e., *token money* established by a government decree). It performs all functions of money and satisfies all requirements of money. How many *green backs* must be in circulation? Well, this is a hard question to answer, as there are various measurements of the money supply.

The *narrow* money supply is called **M1**, which consists of currency (coins and bills), demand deposits, travelers’ checks, and other checkable deposits. **M1** is the most liquid form of money because it directly pays for transactions. At the end of October 2010, **M1** totaled $1.8 trillion, of which $1.4 trillion were in currency and demand deposits (C & DD).

The *broad* money supply is named **M2**, which is **M1** plus saving deposits of less then $100,000, money market accounts, and retail money funds. At the end of October 2010, **M2** totaled $8.8 trillion. If you have more than $100,000 in your saving account, then your money is counted in **M3**, which totaled $10.3 trillion.

Because money is used in virtually all business transactions, it has a powerful effect on the economy. An increase in the money supply will lower the rate of interest on business and consumer loans, thus stimulating demands for capital and consumer
durable goods. With increased business and consumer spending, the economy would expand. On the other hand, when there are too much money chase too few goods in the market, then prices would rise.

Money is in high demand because it gives us the power to buy goods and services now and in the future. Having more money may not make you happier, but it surely enable you to buy more goods and services. This is why green is everyone’s favorite color!