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The Role of Money in the Capitalist Economy and the Monetary Policies

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INTRODUCTION TO MONEY

Money is any commodity that simplifies exchange. During the barter system, goods were exchange for goods.it was very difficult to find someone who is ready to exchange for what you have. For a commodity to be called money, it should be provided by the government which should be legally accepted in the society as the only means of payment, bank deposit and it should be backed. Once a commodity is accepted and been called money and serving as the only medium of exchange, it should also have these features, it should serve as a record keeping device, tangible and intangible. “The issue of currency came under exclusive control of central banks by the 20th century” (Watson 2010. P.33). Government has put measures to control the paper supply of money into the society with the banks having the major role in managing the economy electronic money supply. Capitalist economy is one in which consumers, producers and resource owner is engaged in economic activity with a large measure of economic freedom. Individual economic actions are governed by the instruction of private property, profit motive, freedom of enterprise and consumers sovereignty.

Monetary policies are the action of the central banks to set policies to control interest rates and the money supply in the economy. The central bank has demonstrated that it is not to control the quantity of money. This is due to the fact that the quantity of money is determined by the demand from economic agents.

Workers get their wages on the role, contributions and the nature of work done by them. Money facilitates specialisation and division of labour in modern production. This has motivated workers to work which has increase production and also help in the growth of industries. All inputs like raw materials, labour, machinery, etc. are purchased with money and all output is sold in exchange for money.

MONEY AS A RECORD-KEEPING DEVICE

In the barter system, it was difficult to quantify what was been exchange for the other. Money has helped solved problem and now you can record whatever has been sold for a specify period of time.it was difficult to monitor what has been sold by the individual. Money has helped monitor the transactions of trade for the past." the economic function of money is to serve as a record-keeping device specifically, the monetary object serves as a cost-efficient substitute for the information that might otherwise have been gathered and recorded". (Watson 2010. P.38) Money has made trading more attrative.it has helped and motivated people to work. Money serving as a recording keeping device has facilitated good and attractive trading system.it was difficult to keep what has been sold by customers in the past since it was difficult to quantify in money terms.

WHY MONEY IS ACCEPTED

Money is a medium of exchange because it serves as the efficient way through which people can perform transactions.

The introduction of money has helped resolved the major problems that people were facing during the barter systems.it has also eliminated the double coincidence of wants. Money has been accepted as the only medium to facilitate transaction because it is provided by the government as the only means of payments. No other person or organisation is allowed to issue money. It has been accepted by the society as the only medium to accept bank deposit. All transactions by the banks is done through money. Commodity been called money should be backed and unbacked within the economy. Money makes it easy and efficient to carry any trading activities.it acts as the only way to facilitate good trading transactions. Individuals having money can buy and sell anything they want. In a general terms money has made exchange process more accurate and efficient.

MONEY AS AN INSTITUTION

Money as an institution is applied to customs and behaviour patterns important to the society as well as particular formal organisation of government and public service. Through creation of money banks are able to accept payments and it has helped individuals, society and government to get loan to expand and diversify investment. Individual are able to get loan to facilitate transactions. Government are able to get loans for government expenditure to increase productivity.

GOVERNMENT MONEY

Government use its legislation power to print unback money to finance government expenditure which create natural monopoly. This process results in inflation. This will lead to increase in prices of goods and services that there will lead to more money chasing fewer goods. “The resulting inflation acts like a tax on money holding and for this reason it sometimes called inflation tax” (Watson 2010. P.41). This prevents people

to hold much money when the inflation is high. This does not motivate people to invest because they will not get their value of money invested.

BANK RUNS

Bank runs is a situation where for some reasons everyone wants to withdraw their money from the bank at the same time. The bank will not be in a better situation to meet all the expectation of its customers because there is no money in the reserve. The only way the bank can raised money is to sell its assets to pay off the debt, it is rather difficult to sell the assets of the because the bank will have to wait for a long time before getting someone who is ready to pay full amount.

This creates a loss of confidence the society have for the bank because all the customers will withdraw their deposit. When this happens it discourage people to deposit money at the banks which will intend reduces deposit and it will lead the bank to insolvency. Rise the interest rate in the economy.

Lack of cash leads to the banks selling their assets to settle their debt which intend reduce the confidence the individual, society and the government have on the banks

MONEY AS THE BASIS OF CREDIT

The high expansionary rate and high productivity of modern business is based on credit and credit is based on the help of money. Credit has also increase the rate of investment in the capitalist economy on basis of public saving lying in bank deposits and helps in maintaining a circular flow of income. All monetary transactions consist of cheques, drafts, bills of exchange are credit instruments which are not money. It is the bank deposits that are money. Credit creation plays an important role in transferring funds from depositors to investors.

CAPITALIST ECONOMY

In capitalist economy, individuals has the right to invest in any business without any restrictions from the government. It helps individual to contribute to the society in the best that creates a source of benefit to the society. Individuals are free to make decision on how to invest. Capitalist economy needs government intervention to protect investors within the society.

MONEY IN NATIONAL AND INTERNATIONAL TRADE

Money has promoted both national and international trade. The use of money as a medium of exchange, as a store of value and as a transfer of value has made it possible to sell products within a country and international level to facilitate trade, The exchange rate between the different countries and their currencies can be fluctuate or fixed, central bank intervene directly in the financial markets to keep the nominal exchange rate at a certain level so that international business can be attractive and effective to encourage more transactions.it is necessary to take note of the price levels in others countries and try to stabilised the exchange rate to promote good international relations money has helped in establishing capital markets. There are banks, financial institutions, stock exchanges, product exchanges, international financial institutions, etc. which operate on the basis of the money economy and they help in both national and international trade. This has promoted good inter relationship between countries due to international trade. Trade relations among different countries have led to international cooperation. Developed countries have been helping the growth of under developed countries by giving grants and technical assistance. This has been made possible because the value of foreign aid received and its repayment by the developing countries is measured in money.

MONEY AND CAPITALISM

In the tradition economy, the work that has been done by someone is settled by tradition. In the tradition economy someone give orders on how production should be done and other will obey what has been said. The most essential role of money lies in the operation of the price mechanism. The price system functions through prices of goods and services. Prices determine the production of an immeasurable number of goods and services. They organise production and help in the distribution of goods and services. Prices are expressed in money and the price mechanism under capitalism cannot function without money. In a capitalist economy, means of production are owned privately and production is also carried out by private enterprise. Money performs important function for solving the central problems of an economy. The price mechanism operates without any direction and control by the government. The central problems of a capitalist economy is how much, and how and for whom to produce are solved through the price mechanism.. Profit is the difference between expenditure and receipt of a firm. The size of profit depends upon prices of commodities. The larger the difference between price and costs, the higher is the profit. At the higher the prices, it motivate producers to produce the different types of commodities in different quantities. It is also the consumer's choices which determine what to produce, how much to produce, how to produce and for what type of consumers. These are all base on consumer taste and preference.

MONETARY POLICY

Central banks use certain control measures to stabilise the economy general price level that is to control inflation or deflation and to promote maximum level of output and employment.

High real policy rate will reduce banks' lending rate reduce money supply and reduce inflation. This also will also lead to a decline in investment projects. Low real rate will motivate investors to lend money for investment projects, increase money supply in the economy. In order for the government to increase productivity, the government must increase spending, reduce taxes. The more safe monetary policy is to stabilise the real policy rate at a low but still remain positive level. The man goals of the monetary policy are to maintain balance in a country's international trade, preserving stability in its financial markets, and fostering increased capital investment so as to enhance its economic growth over time. Central banks monetary policies operations take place exclusively in the financial markets. For monetary policy to be effective it requires some process by which the purely financial actions taken by the central bank influence the non-financial decisions of households and firm.

MAINTAINING PRICE STABILITY

Prices of good and service offered in the market place either change very slowly or do not change at all. This means both internal and external stability in the price level. Price fluctuations of a larger degree are always unwelcome. Sustained increase in price level has a destabilizing effect on the economy. A falling price level has more destabilizing influence on the economy. In other words, both inflation and deflation must be controlled so that benefits of economic development are reaped. Price stability prevents not only economic fluctuations but also helps in the attainment of a steady growth of an economy.

Monetary policies also have the objective of upholding external stability in prices. External instability hampers the smooth flow of trade between nations. It also erodes the confidence of the currency. Thus, what is needed is a stable

exchange rate. It is to be posted out here that a conflict may arise between internal stability and external stability. Maintenance of external stability is no longer considered the main monetary policy objective. A monetary policy must aim at preventing or correcting internal price movements.

ECONOMIC GROWTH

Growth is a predominant aim of monetary policy. An appropriate monetary policy by adjusting money supply to the needs of growth, directing the flow of funds in keeping with the overall economic priorities, and providing institutional facilities for credit in specific areas of economic activity, all combined creates a favourable climate for economic growth.

By economic growth we mean an increase in per capita output. In a market economy, economic growth is conditioned by the productive capacity or capital stock of the economy. Economic growth requires an increase in saving and investment. Monetary policy can contribute towards economic growth by raising saving-income ratio.

There are various ways of raising the aggregate saving rate. A high rate of interest is conducive to higher saving propensities. However, a high rate of interest discourages investment. Further, a high rate of interest may encourage inflation to develop. Thus, a high rate of interest may not necessarily increase aggregate saving rate.

But monetary policy can boost aggregate saving rate by expanding banking facilities in under-banked and unbanked areas. Commercial banks can mobilize savings of the people in such a way that savings are channelized into productive investment.

BORROWING AND EXPECTATION

Interest rate transmits a greater impact on the aggregate demand in different ways. High interest rate reduce the power of the individuals, firms and other organisations to go for loans which in the long- run reduce the willingness of investors to invest in any project or buy any financial securities in the economy. Low interest rate also has a greater effect on investment. When the interest rate is low, it left to the firm to decide whether to invest or not. When the central banks keep the interest rate at very low it serve as a motivator to firms to borrow money for investment. A fall in rates will tend to increase the profitability of firms and they may pay higher dividends to shareholders. This can trigger an increase in household spending. Similarly, a rate fall makes savings less attractive and property more attractive, increasing the value of property and household wealth.

Finally, interest rates may affect the exchange rate, which can also influence export demands. For example, a rise in interest rates may raise the exchange rate, pushing up export prices and reducing overseas demand. Changes in the exchange rate also affect the price of imports, which also affect the inflation rate.

CONCLUSION

From the discussion above, it show that the term money should be used to include anything which performs the functions of money, that is medium of exchange, measure of value, unit of account, etc. Since general acceptability is the fundamental characteristic of money, therefore, money may be defined as 'anything which is generally acceptable by the people in exchange of goods and services or in repayment of debts.

Money has simplify transactions and made trading both national and international more effective and attractive.

Central bank policy has helped in bringing down inflation and also put measures to control interest rate and money supply but the central bank should not be responsible for regulating economic cycles and inflation. Central bank is inefficient in fighting inflation.

In order to stabilize the economy, the government can use either monetary policy or fiscal policy. But neither monetary policy nor fiscal policy should be considered as a precise means of controlling aggregate demand. Each policy has its own strengths and weaknesses. In view of this, both monetary and fiscal policies are simultaneously employed in every economy.

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