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Role of Money in a Developing Economy

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ABSTRACT:

Money plays a vital and all-pervading role in the smooth and efficient functioning of the economic system. It is not only facilitates the automatic working of the market mechanism, but also provides necessary motivation for economic progress. Economic development is generally believed to be dependent on the growth of real factors such as capital accumulation, technological progress and increase in quality and skills of labour force. This view does not adequately stress the role of money in the process of economic development. Mixed economy, which has been regarded as a golden mean between capitalism and socialism, is a compromise between these two opposite economic systems. The rational for such a compromise is to integrate the good feature of capitalism and socialism, i.e. to take advantage of the market forces while keeping its bad effects under check.

KEYWORDS: Economy, Mobilising, Financing, Investible, Dualism, Resources, Capitalism.

INTRODUCTION: Apart from performing the conventional functions i.e. as a medium of exchange, as a measure of value, as a standard of deferred payments and as a store of value, money, through the expansion of monetary economy and the development of money market, plays an active and developmental role in a developing and mixed economy. Money acts as a great mobilizing agent in these economies in a number of ways by

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increasing resources, generating new resources and channelizing resources into productive uses. It is said that money is a mere veil and intrinsically unimportant. What matters is the real goods and productive factors which money buys. However, this extreme view about the unimportance of money as such is no longer believed. Not only is money an important factor without which modern complex economic organization is impossible, but it is also an important factor for promoting economic development.

Money is one of the most fundamental inventions of mankind. Every branch of knowledge has its fundamental discovery. In mechanics, it is the wheel; in science fire; in politics the vote. Similarly, in economics, in the whole commercial side of man's social existence, money is the essential invention on which all the rest is based. Money is indispensable in an economy, whether it is capitalistic or socialistic. Price mechanism plays a vital role in capitalism. Production, distribution, and consumption are influenced to a great extent by prices, and prices are measured in money. Even a socialist economy, where the price system does not play so important a role as under capitalism, cannot do without money. For a while, the socialists talked of ending money, i.e., abolishing money itself, because they considered money as an invention of the capitalists to suppress the working class. But later on they found that even under a system of planning, economic accounting would be impossible without the help of money.

DYNAMIC ROLE OF MONEY: Money plays an important part in the daily life of a person whether he is a consumer, a producer, a businessman, an academician, a politician or an administrator. Besides, it influences the economy in a number of ways.

1. **To the Consumer:** Money possesses much significance for the consumer. The consumer receives his income in the form of money rather than in goods and services. With money in hands, he can get any commodity and service he likes, in whatever equaliser of marginal utilities for the

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consumer. The main aim of a consumer is to maximise his satisfaction by spending his limited income on different goods which he wants to purchase.

2. **To the Producer:** Money is of equal importance to the producer. He keeps his account of the values of inputs and outputs in money. The raw materials purchased, the wages paid to workers, the capital borrowed, the rent paid, the expenses on advertisements, etc. are all expenses of production which are entered in his account books. The sale of products in money terms are his sale proceeds. The difference between the two gives him profit. Thus a producer easily calculates not only his costs of production and receipts but also profit with the help of money.

3. **In Specialisation and Divisions of Labour:** Money plays an important role in large scale specialisation and division of labour in modern production. Money helps the capitalist today wages to a large number of worker engaged in specialised jobs on the basis of division of labour. Each worker is paid money wages in accordance with the nature of work done by him. Thus money facilitates specialisation and division of labour in modern production. These, in turn, help in the growth of industries. It is, in fact, through money that production on a large scale is possible.

4. **As the Basis of Credit:** The entire modern business is based on credit and credit is based on money. All monetary transactions consist of cheques, drafts, bills of exchange etc. These are credit instruments which are not money. It is the bank deposits that are money. Banks issue such credit instruments and create credit. Credit creation, in turn, plays a major role in transferring funds from depositors to investors. Thus credit expands investment on the basis of public

saving lying in bank deposits and helps in maintaining a circular flow of income within the economy.

5. **As a Means to capital Formation:** By transforming savings into investment, money acts as a means to capital formation. Money is a liquid asset which can be stored and storing of money implies savings, and savings are kept in bank deposits to earn interest on them. Banks, in turn, lend these savings to businessmen for investment in capital equipment, buying of raw materials, labour, etc. from different sources and places. This makes capital mobile and leads to capital formation and economic growth.
6. **As an Index of Economic Growth:** Money is also an index of economic growth. The various indicators of growth are national income, per capita income and economic welfare. These are calculated and measured in money terms. Changes in the value of money or prices also reflect the growth of an economy. Fall in the value of money (or rise in prices) means that the economy is not progressing in real terms. On the other hand, a continuous rise in the value of money (or fall in prices) reflects retardation of the economy. Somewhat stable prices imply a growing economy. Thus money is an index of economic growth.
7. **In the Distribution and Calculation of Income:** The rewards to the various factors of production in a modern economy are paid in money. A worker gets his wages, capitalist his interest, a landlord his rent, and an entrepreneur his profit. But all are paid their rewards in money. An organiser is able to calculate the marginal productivity of each factor in terms of money and pay it accordingly. For this, he equalises the marginal productivity of each factor with its price. Its price is, in fact, its marginal productivity expressed in terms of money. As payments are made to various factors of production in money, the

calculation of national income becomes easy.

8. **In National and International Trade:** Money facilitates 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 commodities not only within a country but also internationally. To facilitate trade, money has helped in establishing money and capital markets. There are banks, financial institutions, stock exchanges, produce exchanges, international financial institutions, etc. which operate on the basis of the money economy and they help in both national and international trade.
9. **In Solving the Central Problems of an Economy:** Money helps in solving the central problems of an economy; what to produce, for whom to produce, how to produce and in what quantities. This is because on the basis of its functions money facilitates the flow of goods and services among consumers, producers and the government.
10. **To the Government:** Money is of immense importance to the government. Money facilitates the buying and collection of taxes, fines, fees and prices of services rendered by the government to the people. It simplifies the floating and management of public debt and government expenditure on development and non-developmental activities. It would be impossible for modern governments to carry on their functions without the use of money. Not only this, modern governments are welfare states which aim at improving the standard of living of the people by removing poverty, inequalities and unemployment, and achieving growth with stability. Money helps in achieving these goals of economic policy through its various instruments.
11. **To the Society:** Money confers many social advantages. It is on the basis

of money that the superstructure of credit is built in the society which simplifies consumption, production, exchange and distribution. It promotes national unity when people use the same currency in every nook and corner of the country. It acts as a lubricant for the social life of the people, and oils the wheels of material progress. Money is at the back of social prestige and political power.

FINANCIAL DUALISM:

Most of the developing economies are characterised by financial dualism. In other words, the money market in these economies may be divided into organized and unorganized once. The organized sector mostly includes the central bank, the commercial banks, co-operatives, other financial institutions, e.g. development banks, agricultural and industrial finance corporations, insurance companies. The unorganized sector chiefly includes the money lenders, the indigenous bankers, the pawnbrokers, traders and merchants, friends and relatives, etc.

The existence of unorganized money market restricts the implementation of the policies of the monetary authority and adversely affects the process of economic growth in many ways like:

- Restricts the use of bank cheques.
- Encourages non-monetary transactions.
- Discourages capital formation.
- Perpetuates age-old practices, like hoarding of gold.

CONCLUSION: Money is a good servant but a bad master. Money is not an unmixed blessing. Total dependence or misuse of money may lead to undesirable and harmful results. What is required is the proper regulation of money supply through a wisely formulated monetary policy to ensure the efficient working of the economic system and to achieve the socio-economic objectives of the economy. Money acts as a great wheel of circulation and a great instrument of exchange. The use of money makes it possible to carry specialization to its fullest extent, thereby, resulting in economic progress. The basic difference between a monetary and a barter economy is the use and non-use of money.

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