

12.1: Why It Matters- Money and Banking

Why explain the role of money and banking in an economy?



Figure 1. Cowrie Shell or Money? Is this an image of a cowrie shell or money? The answer is: Both. For centuries, the extremely durable cowrie shell was used as a medium of exchange in various parts of the world. (Credit: modification of work by “prilfish”/Flickr Creative Commons).

This is another practical module. Have you ever made a purchase, saved some of your paycheck, or taken out a loan? If so, this module is for you, and you probably know at least some of what the module has to say. If not, it’s time you learned this real life knowledge.



Figure 2. Bank Collage. TDBank, Bank of America, and Wells Fargo by Mike Mozart, CC-BY.

It’s a bit ironic that after all you have studied in this course about buying, selling, producing and consuming, it’s only now that we introduce money and the financial side of the economy. In an important sense, this module is similar to the previous one on budgets and fiscal policy. In this module, like the last one, we start with practical stuff:

- What is money?
- What are banks?
- How does credit work?
- What is the difference between a credit card and a debit card?

Understanding how these things work will provide a solid foundation for understanding the ways in which the government intervenes in the macroeconomy through monetary policy and bank regulations, which we’ll investigate in another module.

THE MANY DISGUISES OF MONEY: FROM COWRIES TO BITCOINS

Here is a trivia question: In the history of the world, what item was used for money over the broadest geographic area and for the longest period of time? The answer is not gold, silver, or any precious metal. It is the cowrie, a mollusk shell found mainly off the Maldives Islands in the Indian Ocean. Cowries served as money as early as 700 B.C. in China. By the 1500s, they were in widespread use across India and Africa. For several centuries after that, cowries were used in markets including southern Europe, western Africa, India, and China for a wide range of purchases: everything from buying lunch or a ferry ride to paying for a shipload of silk or rice. Cowries were still acceptable as a way of paying taxes in certain African nations in the early twentieth century.

What made cowries work so well as money? First, they are extremely durable—lasting a century or more. As the late economic historian Karl Polyani put it, they can be “poured, sacked, shoveled, hoarded in heaps” while remaining “clean, dainty, stainless, polished, and milk-white.” Second, parties could use cowries either by counting shells of a certain size, or—for large purchases—by measuring the weight or volume of the total shells to be exchanged. Third, it was impossible to counterfeit a cowrie shell, but gold or silver coins could be counterfeited by making copies with cheaper metals. Finally, in the heyday of cowrie money, from the 1500s into the 1800s, the collection of cowries was tightly controlled, first by the Portuguese and later by the Dutch and the English. As a result, the supply of cowries was allowed to grow quickly enough to serve the needs of commerce, but not so quickly that they were no longer scarce. Money throughout the ages has taken many different forms and continues to evolve even today. What do you think money is?

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