Many people think the study of economics is all about money—but that is not the case. The job of our economy is primarily to enable the efficient production, distribution and consumption of goods and services that people in our society need and want. Money serves as a tool to help the economy do its job. So, to understand the role of money, we first need to understand the role of an economy. Let’s begin there.
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Drivers of Production—People’s Needs and Wants

People have many needs and wants—cars, tables, taxi rides, medical services, computers, doors, pens, tires, theatres—and on and on and on. A “need” is something you must have, such as a place to live or groceries. A “want” is something you would like to have to make life easier, more comfortable or more enjoyable.

Needs and wants will differ from person to person. You may want a smartphone. Someone else may feel they need a smartphone. What’s the difference? Why does the distinction matter? One reason it matters is because your feelings, and the intensity of your feelings, will affect your money decisions. If you feel that you need something, you are more likely to commit to buying it—and it is likely you will be willing to pay a higher price for it. You are also likely to be willing to trade off other things to get it.

Businesses Like It When You Feel You NEED Their Product or Service

Businesses like it when you feel you need what they are selling. Through advertising, businesses aim to inform you about their product or service—and encourage you to buy it. But they often use advertising to affect your emotions—how you feel about their product or service—to shift it from being a want to being a need. If that happens, consumers are most likely to buy, possibly on a regular basis.

The Economy’s Job Is to Respond to Needs and Wants

People need and want goods and services for two main reasons: (i) to survive, which requires such necessities as food, clothing and shelter; and (ii) to enhance the enjoyment and comfort of life, which involves things that simply make life better. The economy’s job is to try to respond to these desires—people’s needs and wants. At the same time, by producing goods and services, the economy creates opportunities for people to work and be employed by businesses, governments and other organizations. Entrepreneurs see the potential in
opportunities to start and operate businesses that respond to changing or expanding needs and wants.

**Economic Insight:** The economy’s job is to respond to people’s needs and wants with goods and services

**In Using Resources to Produce Goods and Services, Opportunities are Created to Earn Incomes**

Many of the resources used in production—land, natural resources and raw materials, capital equipment, and labour—are owned by individuals and companies. In return for the use of their resources, people can earn incomes. The incomes earned from production then enable people to buy the goods and services that are produced. If you are getting the impression of a circular flow here, you are right. Resources flow into the business sector to produce goods and services. In return, the incomes people are paid for using the resources allow them to buy the goods and services produced.

**Economic Insight:** Hopes for the economy – create more opportunity, more jobs, more incomes, improved well-being

**Growth Is Important for an Economy to Create Jobs and Incomes**

Over time, the aim is that the economy will grow and produce more goods and services; create more opportunities, jobs and incomes; and help Canadians achieve a higher level of well-being. A key role of the Bank of Canada, as we will see, is to support economic growth and the improved well-being of Canadians.

**But Other Things Are Important, Too**

At the same time, as efforts are made to achieve economic growth, several other concerns must also be addressed and assigned priority. One is fairness. As production occurs, what will affect and determine who gets those goods and services? Is the distribution of goods and services—and access to them—equitable and fair?

There is also the environment to consider. Is the current production of goods and services negatively affecting the environment? If so, can production methods be changed so that does not occur? Better yet, can the means and methods of producing goods and services help improve the environment?

Fairness and the environment are just two of the factors that can affect economic activity.
Why Can’t We Have Everything We Want?
As we noted, an economy’s job is to respond to people’s needs and wants with goods and services. But although these needs and wants may seem unlimited, people learn very early in life that they can’t have everything. The economy does not satisfy every need and want that people have. Why?

The main reason is that the resources available to use in production—our available natural resources, labour and capital (plants, factories, equipment), along with existing technology—are limited. If they weren't limited, every society could produce everything that everyone wanted. We could all have 10 computers, 5 houses, 12 cars, 3 boats and so on. But there are only so many trees, so many minerals, so many people.

Our Limited Resources Generate the Basic Economic Problem …
The limitations imposed by our resources present an economic challenge to our society. We have to decide how to use our available resources in the best way possible to produce goods and services to satisfy peoples’ needs and wants. That is the “basic economic problem.” Since we can’t have everything we want, what will we produce? And, in making those decisions, we need to consider the trade-offs. After all, if a resource is used for one purpose, it can’t be used for another. Each decision made about the use of a resource has an “opportunity cost” – the loss of the next best thing that we could have produced with that resource. Options. Decisions. Choices. Trade-offs. These are what economics is about.

… and the Three Basic Economic Questions
All of us face economic choices and trade-offs. But what are the key decisions facing an economy? The three basic economic questions are these:

1. Given the available resources and options, what goods and services will be produced?
2. Which resources will be used and how will they be combined to produce goods and services?
3. How will the goods and services produced be distributed to those who need and want them?

These three questions are sometimes summarized as “What? How? and For whom?”
How Do We Measure an Economy’s Success? Standard of Living and Quality of Life

Knowing the challenge facing an economy, we now have another question. How do we know how well an economy is doing its job? There are two common ways of measuring that. One is to look at our standard of living. The other is to consider our quality of life.

To measure our standard of living, we use math to make a calculation. We add up the total value of all the goods and services produced and divide that total by the number of people who use them to get the output—or wealth—the economy is producing per person (the expression economists use is per capita). The following shows the dollar value of output per person produced in the Canadian economy in 2015 and 2016:

2015 GDP per capita: $1,770,196
2016 GDP per capita: $1,796,178

This shows us that the total dollar value of output (or gross domestic product, GDP) produced in Canada in 2016 was higher than that in 2015. Does this mean Canadians were better off in 2016, and was Canada’s standard of living higher? The reality is, we need more information to know the answers. Why?

Prices Have to Be Considered—and Set Aside to Compare Real Information

When we add up the value of all the goods and services produced by our economy, we tend to do this according to their monetary value, that is, their price. That’s where we have to be careful. Suppose a hockey stick cost $60 in 2015. Then suppose that in 2016 that same hockey stick cost $65. If we add up the value of hockey sticks produced in 2016 and compare that with the value of sticks produced in 2015 and get a higher value, that figure may be partly due to higher prices—not to more hockey sticks being produced.

That price difference creates a challenge for us if we want to learn whether more hockey sticks are produced from one year to the next. Why do we want to know this? Well, if more sticks are produced, that means more resources are used. That could mean more labour is used, which means possibly more jobs and more income for Canadians. It could mean more wood is purchased, helping the wood manufacturers. It could mean more fibreglass is purchased, helping the fibreglass manufacturers. And so on.
So, it is important to know if more hockey sticks are produced or whether the higher value in one year is primarily, or totally, a result of higher prices. Let’s use our example for further illustration with some bigger numbers. Suppose that 500,000 hockey sticks were produced in 2015 and sold at an average price of $60 each. The total value of hockey sticks produced that year was:

\[500,000 \times 60 = 30,000,000\]

Then, suppose that 490,000 hockey sticks were produced and sold in 2016 at an average price of $65. The total value of hockey sticks produced that year was:

\[490,000 \times 65 = 31,850,000\]

If you simply looked at the total value of hockey sticks produced, you might think that more hockey sticks were produced in 2016—when, in fact, fewer were produced. The higher number was due to the higher average price. To know whether more hockey sticks were produced, you would have to exclude the change in price.

We aren’t going to do that now—but it is a very important step if you want to compare production and output from one year to another. And that applies to measuring the output of all goods and services in an economy, which we want to do if we want to see whether an economy has grown from one year to another.

**Measuring and Comparing an Economy’s Output Over Time Is Important. Here Are Two Reasons Why.**

Measuring whether an economy has grown from one year to another, and over time, helps us to see if a society’s standard of living is changing—and whether it is improving.

*Real GDP in Canada over time*

http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/econ05-eng.htm

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>1,796,178</td>
</tr>
<tr>
<td>2015</td>
<td>1,770,196</td>
</tr>
<tr>
<td>2014</td>
<td>1,753,683</td>
</tr>
<tr>
<td>2013</td>
<td>1,709,820</td>
</tr>
<tr>
<td>2012</td>
<td>1,668,524</td>
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<tr>
<td>2011</td>
<td>1,273,984</td>
</tr>
<tr>
<td>2010</td>
<td>1,248,739</td>
</tr>
</tbody>
</table>
Measuring the changes in output in an economy over time can also inform policy-makers and affect their policies. How well is the economy doing, compared with its overall ability? Over time, is more slack (the non-productive use of resources)—showing up in the economy with more and more room to grow? Or is the economy moving closer to the limits of its productive capacity? That kind of information is important to those who make policy decisions that can affect spending and output in the economy, as we will see.

Clearly, measuring an economy's level of output over time is important to policy-makers. And dividing that level of output by the population and calculating the effect of price changes provides a measure of our standard of living—which is one way of knowing how well an economy is doing its job. Is our standard of living improving over time, or is it declining?

The following chart measures Canada’s standard of living over recent decades.

<table>
<thead>
<tr>
<th>Countries GDP: GDP Annual Comparison</th>
<th>Canada GDP Annual Per Capita Evolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Date</td>
<td>GDP Mill.$</td>
</tr>
<tr>
<td>2016</td>
<td>1,529,760M.$</td>
</tr>
<tr>
<td>2015</td>
<td>1,552,808M.$</td>
</tr>
<tr>
<td>2014</td>
<td>1,792,883M.$</td>
</tr>
<tr>
<td>2013</td>
<td>1,842,627M.$</td>
</tr>
<tr>
<td>2012</td>
<td>1,824,289M.$</td>
</tr>
<tr>
<td>2011</td>
<td>1,788,647M.$</td>
</tr>
<tr>
<td>2010</td>
<td>1,613,463M.$</td>
</tr>
<tr>
<td>2009</td>
<td>1,371,152M.$</td>
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<tr>
<td>2008</td>
<td>1,549,073M.$</td>
</tr>
<tr>
<td>2007</td>
<td>1,464,978M.$</td>
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<td>2006</td>
<td>1,315,515M.$</td>
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<tr>
<td>2005</td>
<td>1,169,467M.$</td>
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<td>2004</td>
<td>1,023,170M.$</td>
</tr>
<tr>
<td>2003</td>
<td>892,498M.$</td>
</tr>
<tr>
<td>2002</td>
<td>757,981M.$</td>
</tr>
<tr>
<td>2001</td>
<td>736,425M.$</td>
</tr>
<tr>
<td>2000</td>
<td>742,319M.$</td>
</tr>
</tbody>
</table>

[https://countryeconomy.com/gdp/canada](https://countryeconomy.com/gdp/canada)
Standard of Living Tells Us Nothing About Distribution—or Fairness

It is important to remember that calculating a nation’s standard of living doesn’t tell us anything about how the wealth generated by the economy is distributed to people. In 2016, the average household income in Canada was $30,474 a year. But what does that tell us? It doesn’t mean every household earned $30,474 that year. It tells us that, on average, a Canadian household earned that amount.

It is interesting to note that, according to the Organisation for Economic Co-operation and Development (OECD), in 2016, the top 20% of income earners in Canada earned about five times more than those in the lowest 20%. The distribution of wealth and income is certainly not equal in Canada or in other countries around the world. The other question to consider is whether the distribution is fair and equitable. Societies—and the people in those societies—can face choices about whether efforts and policies should be put in place to make the distribution more equitable. This is particularly the case in democracies, where people can exercise their views by voting and choosing among policies and parties. In some nations, people do not have a say in the distribution of wealth.

Standard of Living Gives Us a Measure of Material Well-Being—but There Is More to Life Than That

There is another way of measuring how well an economy is doing. You’ve probably heard the expression “Money can't buy happiness.” This phrase says that there are other considerations in life besides material well-being. These other considerations include such things as peace, freedom, happiness, environmental quality and so on. To assess a society’s well-being in this broader sense, we need to look at something else that will give us a measure of overall quality of life.

Measuring Quality of Life Is More Difficult

Measuring the quality of life in a society is much more difficult than measuring the standard of living. Measuring the standard of living is a mathematical calculation. But how do we measure the value of feeling free, having good health, having a good education, being at peace, breathing clean air, drinking clean water, enjoying parkland and feeling happy?
1.1 THE ECONOMY: ITS ROLE

Refer to Box 1.1 to see the efforts that are being made to measure quality of life and what the statistics show about our quality of life. Certainly, compared with other countries around the world, Canadians enjoy a very high quality of life—perhaps, in some ways, the highest quality of life. That is something we can enjoy, can take pride in and need to protect.

The primary challenge for any economy, then, is to decide how to use its available resources to produce and distribute goods and services in response to needs and wants. And that’s where money can help. Let’s see how.

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**Box: 1.1**

The Organization for Economic Cooperation and Development (OECD) undertakes work to explore the quality of life in nations around the world. The OECD produces an index which compares the quality of life in various countries.

They provide access to an interactive map where the user can select their location, or one of many other locations, to explore the quality of life in that country or area.

In generating this index of quality of life, the OECD states, "There is more to life than the cold numbers of GDP and economic statistics. This Index allows you to compare well-being across countries, based on 11 topics the OECD has identified as essential, in the areas of material living conditions and quality of life."

The criteria used by the OECD to compare the quality of life among nations are as follows:

- Housing
- Income
- Jobs
- Community
- Education
- Environment
- Civic Engagement
- Health
- Life Satisfaction
- Safety
- Work-Life Balance

You can click here on the link to access the OECD's site focusing on quality of life and explore the OECD findings re quality of life in various nations.

1.2 SPECIALIZATION, TRADE, AND THE BARTER SYSTEM: SETTING THE STAGE FOR MONEY

In Early Societies, Needs Were the Priority
People in early societies were not particularly concerned with money. They were too busy worrying about survival and dealing with their basic needs for food, clothing and shelter. But, over time, societies advanced and became more developed. Initiative led to new discoveries, new technology, new resources—and the opportunity to develop and provide new goods and services. Increasingly, people benefited from these changes and could think about things they might want beyond what was needed.

Specialization of Labour Helped to Change Everything
Because of these changes, a major development occurred that helped to increase the production of goods and services—in quality, quantity and variety—and improve the efficient use of resources. That development was specialization.

What does that mean? With specialization, rather than trying to do everything independently, people became interdependent—working together—while developing certain skills, talents, jobs and careers to produce specific goods and services.
1.2 Specialization, Trade, and the Barter System: Setting the Stage for Money

As people specialized, they became better at what they did. They produced more and better goods. They offered more and better services. This helped societies to achieve improved economic development and progress.

With Specialization Came a Challenge and an Answer—Trade!

However, as specialization occurred, a challenge arose. If individuals specialized in one or a few areas of production, how were they to acquire the other things they needed and wanted—the things they didn’t produce?

For example, suppose that by deciding to specialize in farming people were able to provide food for their own use—and also a “surplus” that could be made available to others. Farming provided food—but what about all the other things a farmer needed?

The answer was to trade with others who produced a surplus of the other things the farmer needed and wanted.

If all those who specialized in an area of economic activity were able to produce a surplus beyond their own needs, the surpluses would be available for trade. A consequence of specialization, therefore, is the need for trade.

Specialization Helped to Improve Productivity

The more productive the farmer—that is, the more the farmer is able to produce using the available resources—the greater the surplus available for trade and the more the farmer can acquire from others. Specialization usually leads to people becoming more skilled and able to produce more wealth for the economy. The wheels of economic progress begin to turn. Innovation. Invention. Creativity. Hard work. Productivity. Progress.

Through specialization and trade, then, more and better goods and services can be produced, and the standard of living in a society can improve.

Specialization is associated with the concept of the division of labour. That is, rather than trying to do everything, or many things, a person concentrates his or her labour skills on one activity or on just a few activities.

As Economies Progress, More Opportunity Is Generated

In our early history, division of labour was limited because there were still relatively few producers, with a limited number of goods and services being produced. Over time, though, more and more producers and more and more goods and services have created more
opportunities. Today, we have a vast array of jobs, careers and occupations people can choose for their area of specialty.

The Benefits of Trade Preceded the Arrival of Europeans in North America
The economic advantages of specialization and trade have been recognized for a long time. Indeed, when Europeans first came to North America, they discovered that the Indigenous people were already very adept at trading. The Indigenous people were particularly good at hunting and trapping and were able to obtain furs beyond their needs. They could therefore provide furs for trade with the Europeans, who wanted to sell them in Europe, where furs were very valuable. In return for furs, the Indigenous people received goods from the Europeans, often goods they had never seen or known of before.

The Early Barter System in Canada
In those early economic days, trade took place by exchanging one or more items directly for others, that is, through barter. An economy based on this method of trade is referred to, not surprisingly, as a barter system. As long as the output of the economy is made up of relatively few goods and services, this type of system can function successfully.

However, as a society advances and a much greater volume and diversity of output is produced, bartering becomes complicated and cumbersome. Calculating the value or cost of each item in terms of every other item becomes difficult. Making the trades becomes difficult, and the economic system becomes costly. It doesn't take very many items before this happens. As the basis for an economy’s system of exchange and transaction, bartering just doesn't suit the needs of a modern, diversified economy. Note, however, that even though bartering is not the basis for our system of exchange, some bartering still goes on in the world today.

More Goods and Services, More Exchanges—and a New System of Exchange
As more goods and services were produced, the exchange process became much more complicated. An alternative system for trading one good or service for another was needed. Did I hear someone mention money?
1.3 THE ROLE OF MONEY

**Bartering Requires a Coincidence of Wants—Very Difficult for a Modern Economy**
In a barter system, a farmer who wants a television has to find someone with an extra television who wants food. Simply finding someone who has a television available isn't sufficient. The person with the television has to have a coincident want—that is, has to want the food the farmer has to trade.

In today's world, finding people with coincident wants for all the exchanges we make would be a monumental task. Suppose your chosen profession was electrician. Think about how difficult it would be if you had to trade the output of your electrician skills for a pen, a milkshake, a car, an apartment, a pair of shoes and so on.

**Money Provides a Solution to the Problem—a Common Unit of Account**
To avoid this chaos, an alternative system of exchanging goods and services evolved. It became apparent that exchanging one good or service for another would be much simpler if everyone was willing to accept some common item in a trade, that is, if each person could trade whatever he or she produced for one common thing. Something like money.

Money overcomes the problems of a barter system and the need for a coincidence of wants. With money, a set of common prices can be established. This is one of the roles of money—to serve as a unit of account. People can be paid for their services in money and earn an income paid in money. People can then use their money to buy the things they need and want.

**Money Also Serves as a Medium of Exchange**
Money has another function. It serves as a medium of exchange. The farmer can provide food to those wanting food and receive money from them in exchange. The farmer then exchanges the money for a TV at a price the farmer is willing to pay. Such a process is much simpler and saves a great deal of travel, searching and time.

Money therefore eliminates the need for a coincidence of wants. Money helps bring simplicity and organization to our economy. It is something people are willing to accept in exchange for the output they have produced. Money is our medium of exchange.
1.3 The Role of Money

Many Things Have Served as Money in the Past
Throughout history, societies have used various items as a medium of exchange, from playing cards to shells to furs to gold. For one reason or another, these items became acceptable in some societies as forms of payment for goods and services. As soon as something is readily accepted in a society as money, and people will accept it in exchange for goods and services, it can serve as a medium of exchange. That is the most important criterion for anything to serve as money—it must be readily acceptable.

Money Also Serves as a Store of Value
Money also serves a third function—to act as a store of value. Rather than using money for spending today, you can store (in other words, save) it for use in the future. If what we use as money is going to serve as a store of value, this can further limit what can serve as money. For example, suppose your income was paid in apples, but you didn't want to spend all your income right away. You wanted to save some of it to spend later. You're going to have difficulty saving some of your apple income. The apples will eventually rot, and no one is going to want rotten apples. You don't want this to happen to your money. You don't want it to lose its acceptability because you saved it.

We want our money to allow us to postpone using some of our current income today. One of our goals in saving is to ensure that the value of our savings doesn't decrease over time. In fact, we usually hope that the value of our saved funds will increase. Later on, we will look at the value of money and how this can potentially be eroded over time because of inflation. We will also learn how the value of savings can increase over time through wise investment and earning interest.

There Are a Variety of Ways to Store the Value of Money for Future Use
If you decide to save some of your money for use in the future, you might acquire other things of value—other assets—such as bonds or stocks. Or you might invest in a house. People invest in such assets with the goal or hope that they will retain or increase their value over time. Eventually, these assets will be sold and converted back to money for spending. When you sell an asset such as a bond, stock or real estate, this is referred to as liquidating an asset—that is, converting it back to money.

To summarize, money serves three key roles: (1) a medium of exchange, (2) a unit of account and (3) a store of value for future use.

Money simplifies the exchange of goods and services and allows us to save for the future. What qualifies something to serve as money?
1.4 THE CHARACTERISTICS OF MONEY

Today, shells or furs wouldn’t work particularly well as money in Canada. At an earlier time, in a simpler economy, they could, and did.

There are some characteristics for whatever serves as money in a modern economy.

**Money Is Durable**

First, to serve as an effective medium of exchange, money must be durable. Drawing upon our earlier example, we could have chosen to use apples as money. But problems arise when the apples rot. Who wants to carry around rotten apples? In addition, apples can be eaten, and nothing could erode the value of your money more quickly than having it end up in your stomach.

**Money Is Not Easily Reproduced and Is Relatively Scarce**

Second, whatever serves as money must not be easily reproduced by just anyone. And it should be relatively scarce. We could use chestnuts as money. They’re relatively scarce and last a long time. But if we did, people would start growing chestnut trees, and we wouldn’t be able to control the supply. Soon there would be so many chestnuts available that prices would rise until you’d need a truck to carry the chestnuts required to pay for bread and milk.

**Money Is Not too Scarce**

Third, although money must be relatively scarce, it can’t be too scarce. It should be available in a sufficient quantity to allow all the exchanges in our economy to take place. We could use whooping cranes. But there wouldn’t be enough of them for all the exchanges that have to take place. We would very quickly run out of money—to say nothing of the poor birds.
Money Is Easy to Transport

Fourth, money has to be easy to transport. We could use elephants. But just think of all the problems on payday if elephant money was used to provide your wage or salary. Pocket money would take on a whole, or should we say hole, new meaning.

An example of money from the past that did not meet this criterion is the yap stone. The Bank of Canada has a yap stone in its new museum. The caption from the exhibit provides a bit of background on this unique item used as money.

This impressive stone disc is actually money from the Pacific island of Yap. “Rai,” as these stones are called, range from a few centimetres high to four metres high. This is the largest-known rai outside of Yap. It likely stood upright in the ground outside its first owner’s house. When traded, a rai did not move—it simply changed ownership. Rai were quarried on the island of Palau and taken to Yap on rafts, crossing 500 kilometres of open water. The difficulties of this journey contributed to the rai’s value. Although rai are still occasionally used for culturally significant exchanges, the official currency of Yap is now the US dollar—a somewhat more portable currency.
Money Is Divisible into Fractions

Last, money must be divisible into usable quantities or fractions. Imagine the difficulties you would face when you went to purchase something that had a price of 1/50th of an elephant. Not a pleasant thought.

So, money needs to be durable, not easily reproduced by anyone, relatively scarce, not too scarce, easily transported and divisible. But, as we emphasized earlier, the most essential attribute of anything that serves as money is its acceptability. It must be readily accepted by people in the economy in the exchange of goods and services.

Apples, stones, chestnuts, elephants and whooping cranes don't satisfy the above criteria, and they aren't readily acceptable by people in return for goods and services. What is accepted today, and what do we use for money?

Two Forms of Money In Our Economy—Cash and Bank Accounts

As a medium of exchange in our economy, money takes two primary forms—cash (coins and bank notes) and bank accounts where we put our money on deposit with a financial institution—and where we can access that money in different ways.

Money in Canada is measured in dollars and cents—what we use as our unit of account. Everything in our economy is priced in dollars and cents, and we use money to acquire goods and services. But carrying money as cash is becoming less and less common. We could lose the cash, or it could be stolen. And, because cash is a “bearer instrument,” anyone who presents cash for payment can use it without proof of ownership. So, if someone takes or finds your cash, it’s easy for them to use it.

But many people still carry some cash with them. To get cash, you can go to the financial institution where your money is on deposit and withdraw it. This can be done through a person—a teller—or through an ATM (automatic teller machine) or ABM (automatic banking machine) (two names used for the same thing) using a debit card.
1.4 The Characteristics of Money

Debit Card—A means to access your money and make a payment

When you use your debit card, it tells your financial institution to transfer money from your account into the account of another person, company or government. Debit cards do this electronically and make the transfer quickly.

Typically, you will need your PIN (personal identification number) to make a debit card payment. Today, people are increasingly making payments through a tap of the card (the tap and go feature).

Cheques—Another way to access your money and make a payment

You can also use the money you have in the bank to write a cheque. By using a cheque, you instruct your financial institution to transfer money from your account someone else’s account.

The person or organization to which you are transferring your money may or may not have their money on deposit at the same financial institution. At the end of the day, all the money transferred by cheques will have to be settled among the different financial institutions. More on this later.

So, there are three primary ways we use or access our money to pay for goods and services—cash, debit cards and cheques.
Credit Cards—Accessing Someone Else’s Money to Make a Payment

There is one other form of payment used to acquire goods and services—credit cards. This brings us to an important distinction. A debit card or a cheque is an access device that allows us to use our money. Neither one is actually money—the deposits we make to the bank or financial institution are the money.

Credit cards are another access device we can use to make a payment. But when when you use a credit card, you are not accessing and transferring your own money. Instead, you are drawing on a prearranged loan you have with your financial institution. Your institution will have approved “credit” for you to use—up to a set limit. When you use a credit card, you are using all or part of the loan the institution is willing to give you to make the purchase. The credit card is the means that makes it possible for you to borrow the money.

The borrowed funds, not the credit card, are the money. The credit card is just an access device. Eventually you must use your own funds to pay back those that were borrowed using the credit card.

Quick Summary

We have seen that the primary challenge of an economy is to use relatively scarce resources to produce goods and services to satisfy the needs and wants of people in a society. The primary roles of money are to serve as a medium of exchange, a unit of account and a store of value. We also identified the characteristics of money and what we tend to use as money in Canada.

Before we examine the economy and the financial system in more detail, let’s take a little journey back into history to look at the evolution of money, both in general and particularly in Canada.