Chapter 3

Money and Inflation

GSEB Class 12 Economics — Complete Board Exam Notes

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INTRODUCTION

Money is at the centre of all economic activities in a modern world. To satisfy her/his needs, an individual requires money to buy goods and services. Money is not only the medium of exchange but it is also used as the store of value. People save money for their future needs.

Human wants are unlimited and a person cannot satisfy all wants by one's own produce. Thus a person tries to satisfy maximum possible wants by way of **mutual exchange of goods and services**.

In ancient times, human beings used to satisfy their wants by exchanging goods and services among themselves. Such a system of exchange for satisfying wants was called a **barter system**.

3.1 MEANING OF A BARTER SYSTEM

Barter system is a system of exchange where goods or services are **directly exchanged for other goods or services without using a medium of exchange, such as money**.

In the earlier years, individuals lived a simple village life, had fewer needs and carried out agricultural exchange of goods and services which was sufficient for their sustenance.

Examples of Barter: A farmer cultivating wheat would store the required stock and exchange the remaining wheat to get rice, clothes, or shoes. The shoemaker would get clothes, food, and ghee by exchanging the shoes he made. Teachers used to get food in exchange for knowledge and artists would be patronized for their entertaining art.

Increasing population and socio-economic development resulted in an increase and change in demands, making them more specific. Industrialization, Urbanization, division of labour, and Specialization made the Barter system limited and less applicable. The mutual exchanges decreased and personal needs increased.

3.1.1 LIMITATIONS OF A BARTER SYSTEM

The prominent limitations of the barter system are as follows:

3.1.1.1 Problem of Mutual Adjustment of Wants

With socio-economic development, the needs of human beings increased and the economic structure became more complicated. The core problem of barter is the need for a **'double coincidence of wants'** — both parties must want exactly what the other has to offer, at the same time.

Example: Those who had rice to exchange for wheat did not always need wheat but wanted clothes instead. While those who had clothes did not want rice but wanted ghee in exchange for their clothes.

Thus, there was a **difficulty in establishing a need for each other's goods or services** to make the barter possible. This made it a challenge to establish a barter between indivisible and divisible goods. For example, if someone wants to exchange half a cow for some rice — dividing a cow is not possible.

> ■ **Key Term: 'Double Coincidence of Wants' — Barter requires that both parties must want exactly what the other person has to offer. This is very rare and makes barter impractical.**

3.1.1.2 Difficulty in Storing of Value

There was an increasing problem in **storing value** under the barter system. Here, 'value' means exchange value.

A farmer may exchange wheat for a pair of shoes or cloth. But when productivity rises and he produces more wheat, there arises a problem of **strong surplus wheat**. If wheat can be stored for a long period, then at a future date such stock of wheat can be exchanged for a new pair of shoes or cloths or rice. But the question arises: **how to store wheat for a long time?**

When an individual produced on a large scale through one's own efforts, she/he had to exchange this produce **instantaneously** for other goods and services. It was otherwise difficult to store the surplus goods or store the exchange value of those goods. Perishable goods like food items could not be stored long-term — their value simply decayed.

3.1.1.3 Problem of Measurement of Value

With the introduction of **division of labour and specialization** in an industry-driven economy, the issue of measuring the value of goods and services emerged.

Exchanging wheat for rice was simple in earlier times. But now a large number of goods became available for exchange against wheat — rice, textile, ghee, shoes, etc. Hence it became difficult to **determine and maintain the exchange value of wheat**.

Example: If 20 kg of wheat = 40 kg of rice = 10 meters of textile = 1 kg of ghee. In a modern structure, measurement questions arise: how much textile can exchange for 1 kg of ghee? Or how much rice can exchange for 1 kg of ghee? It became very difficult to determine such exchange rates.

This led to a need for a **universally acceptable measuring rod** for value. This eventually led to the origin of money, which became a **standard measure of value and a common denomination of trade**.

Limitation	Problem	Result
Mutual Adjustment of Wants	Double coincidence of wants — both parties must want what the other has	Barter becomes extremely difficult to arrange
Difficulty in Storing Value	Surplus goods (esp. perishable) cannot be stored long-term	Cannot save wealth for future needs
Problem of Measurement of Value	No common measuring rod; exchange rates between many goods become complex	Cannot easily compare or assess the value of different goods

Summary: Three Limitations of the Barter System

3.2 ORIGIN AND DEVELOPMENT OF THE CONCEPT OF MONEY

Evolution of Money

In order to simplify the procedure of exchange and to introduce a universally acceptable medium which satisfies the store of value function, under the barter system, **commodities and animals were used as a medium of exchange in India**.

Agriculture being the major sector of the economy, there was large production of crops. The required stock was stored; the rest of the crops were sold to buy animals. When required, the animals could be sold to get goods, services, or crops in return. In this way, **animals like horse, cow, and buffalo became the means of exchange values for money and trade**.

The use of animals as a standard measure and a common medium of trade also became a limitation and caused difficulties. **Animals are mortal** — they get sick and die. Therefore, the storage of wealth in the form of animals was not advisable. Thus, **valuable minerals and stones were used instead of animals**.

At the onset of imperialism, the **use of coins started** as a means of trade and exchange of goods and services in the kingdom. The only limitation was that they were used in limited societies and regions.

Democracy and Industrialization inspired the need for **modern money** as a means of exchange. By the support of central government, money became widely accepted as a means of exchange of goods and services. Money also succeeded in overcoming the limitation of storage of value. The advent of **banking system** made it easier to transfer and store money.

Stage	Medium Used	Limitation / Why It Changed
Stage 1	Barter (Goods for Goods)	Double coincidence of wants; storage problem; no common measure of value
Stage 2	Commodities & Animals (cow, horse, buffalo)	Animals are mortal, get sick and die; not reliable store of value
Stage 3	Valuable Minerals and Stones	Limited to certain societies and regions
Stage 4	Coins (Metal Money)	Used in limited kingdoms and regions; not universally accepted
Stage 5	Paper Money + Central Government backing	Universal acceptance; easy to store; banking system made transfer easy
Stage 6	Banking System, Credit Cards, e-Banking	Further convenience; invisible/digital money (e-money)

Evolution of Money — From Barter to Modern Banking

3.3 MEANING OF MONEY AND FUNCTIONS OF MONEY

In order to understand money, it is necessary to understand the functions of money. That which performs the functions of money is called money.

> ***"Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place."***
>
> **— Marshall**

> ***"What is accepted universally in exchange of goods or services is money."***
>
> **— Robertson**

■ Key Idea: The best way to understand money is through its functions. Anything that performs the three main functions of money IS money.

FUNCTIONS OF MONEY

3.3.1 Money as a Medium of Exchange

The **most important function** of money is to act as a medium of exchange and trade. It **removes the limitation of the lack of 'double coincidence of wants'** and makes exchanges easier.

How it works: The farmer can get money in exchange for wheat and then from that money he can buy clothes, rice, ghee, etc. An individual can spend money to satisfy present demands for goods and services, and also save the money for future to satisfy future needs.

Basically, money is used as a medium to satisfy the needs of an individual by buying goods or services. It **separates the act of buying from the act of selling** — you don't need to find someone who wants exactly what you have. You sell for money and buy what you want separately.

■ **This function directly solves Limitation 1 of Barter — the 'double coincidence of wants' problem. Money acts as a universal intermediary.**

3.3.2 Money as a Store of Value

Another function of money is that **'Money is a store of value'**. If a person produced goods and services in exchange for other goods and services but saving wealth for future needs was difficult before the use of money.

Animals were mortal and long-term saving of values was not possible using them. This made money **the most successful means of storage of value in terms of time**. It is easy to have money as storage of value. It became possible to get money in exchange for crops and save the money for future needs to buy goods or services.

Another advantage of using money as store of value was that it could be used as a **standard of deferred payment**. This characteristic of money became an important basis for the entire systems of credit, hire-purchase and instalment payments.

■ **This function directly solves Limitation 2 of Barter — 'Difficulty in Storing Value'. Money can be stored indefinitely without losing its exchange value (unless inflation occurs).**

3.3.3 Money as a Measure of Value

Money plays an important role as a **measure of value**. In the Barter-exchange system it was difficult to remember the exchange rates and values of each of the goods or services — for example: 20 kg of wheat = how much kg of rice? = how much meter of cloths? = how much kg of ghee?

Money makes this easier by allowing the values of different goods or services to be **compared and assessed against each other**. Money implies the price system, allowing the measure of price of each good or service which can be compared to each other. It also allows faster decision making and exchanges.

■ **This function directly solves Limitation 3 of Barter — 'Problem of Measurement of Value'. Money acts as a universal unit of account — a common yardstick for all goods and services.**

Function	What It Does	Barter Limitation It Solves
Medium of Exchange	Allows buying and selling separately; removes need for double coincide	Mutual Adjustment of Wants (3.1.1.1)
Store of Value	Money can be saved for future use; standard of deferred payme	Difficulty in Storing Value (3.1.1.2)
Measure of Value	Common yardstick to compare prices of all goods and ser	Problem of Measurement of Value (3.1.1.3)

Three Functions of Money and the Barter Limitations They Solve

3.4 TYPES OF MONEY

Since the time of barter system, animals or precious stones were used as means of exchange and storage of value. Thereafter metal coins came into existence which were followed by government regulated notes and currency coins. This was succeeded by the banking system, credit card, and e-banking system.

The six types of money are:

Type	Description / Examples
(1) Commodity Money	Goods used as money in ancient times. E.g., grain (wheat, rice), salt, cloth, etc. These were actual goods w
(2) Animals Money	Animals like cow, horse, buffalo used as a medium of exchange and store of value in ancient India. Animals
(3) Metal Money	Valuable minerals, stones, and metal coins (gold, silver, copper). Coins were introduced during the era of in
(4) Paper Money	Government-regulated currency notes. Backed by the central government's authority. Became universally a

(5) Plastic Money	Credit cards and debit cards. Backed by the banking system. Easy to use for large transactions. E.g., Visa,
(6) Banking Money (Invisible / e-Money)	Digital Money through internet banking, mobile banking, UPI, NEFT, RTGS, etc. Money that exists electroni

3.5 MEANING OF INFLATION

In a simple sense, **inflation means a rise in the general price level**. Generally people consider inflation to be a rise in the prices of goods and services; but economics gives a more precise and clear meaning of inflation.

Inflation is not just any price increase. Economics defines inflation very specifically. A one-time price rise, or a price rise in only a few goods, is NOT inflation. True inflation involves a **continuous, general, and sustained rise in price levels** across all sectors of the economy, which leads to a decrease in the purchasing power of money.

Simple Meaning: Inflation = Continuous Rise in General Price Level = Decrease in Purchasing Power of Money

3.6 DEFINITION OF INFLATION

"A situation of excess demand over supply of goods is called inflation."

— Dr. A. P. Lerner

"Inflation is said to occur when monetary income rises faster than real income."

— Dr. A. C. Pigou

"The real situation of inflation is created with increase in money income beyond the level of the full employment of factors of production."

— Dr. J. M. Keynes

Explanation of the Three Definitions:

Lerner's Definition:

Lerner focuses on the demand-supply relationship. When demand for goods exceeds their supply (excess demand), prices rise. This excess demand situation = inflation. It is a simple and direct explanation: too much money chasing too few goods.

Pigou's Definition:

Pigou focuses on income. When your money income (nominal income) rises faster than your real income (actual purchasing power), you appear to be earning more but can actually buy the same or less. This gap between monetary income and real income is inflation.

Keynes' Definition:

Keynes gives the most precise definition. He says TRUE inflation starts only AFTER full employment of factors of production (land, labour, capital, enterprise). Before full employment, a rise in money supply leads to more production and employment — not inflation. But AFTER full employment, more money cannot create more output — prices simply rise. This is the real inflation situation.

■ Keynes' View is Board-Important: True inflation occurs only after full employment. Before full employment, rise in money can boost production. After full employment, rise in money only raises prices — that is real inflation.

3.7 CHARACTERISTICS OF INFLATION

According to the above definitions of inflation, the following are the various characteristics of inflation:

(1) Constant Rise in Price Levels:

Inflation involves a **continuous and constant rise in price levels** — not a one-time increase. A temporary price spike due to a festival or short supply is NOT inflation. Inflation means prices keep going up, one after another, persistently.

(2) Price Rise in All Sectors of the Economy:

Inflation is characterized by a **general rise in prices across all sectors** — agriculture, industry, and services. If only one product or one sector's prices rise, it is NOT inflation. True inflation means a widespread, economy-wide price rise.

(3) Purchasing Power Decreases (Value of Money Falls):

A constant and steady increase in price leads to a **decrease in the purchasing power of money**. If prices double, the same amount of money can now buy only half the goods. The value of money falls. This is why inflation is sometimes defined as the 'decrease in the value of money.'

(4) The Rise in Price Level After Full Employment is Inflation:

Following Keynes' view, the rise in price level after **full employment** of factors of production is called true inflation. It proves to be harmful for the economy.

Some Additional Important Points to Understand Inflation Better:

(I) Suppressed Inflation:

When government has kept control over and suppresses increase in price levels via rules, law, and subsidies, it is considered inflation even if there is no visible price rise. **It is called 'Suppressed Inflation'**. The inflation exists but is hidden by government controls.

(II) Short Period Price Rise of Limited Goods is NOT Inflation:

If in an economy, for a shorter period of time, there is an increase in the price of limited goods or services, then it is **not inflation**. Inflation must be widespread and sustained, not temporary or sector-specific.

(III) Price Rise Before Full Employment — Not Harmful Inflation:

When some factors of production are unemployed and there is a price rise, then producers get an **incentive to produce more** — so economic activity gets a boost, factors get employment, production rises, and prices eventually fall. This is a healthy, self-correcting mechanism.

- If there is unemployment in factors of production, increasing price of goods/services will encourage employment to increase production, which will decrease prices.

Therefore, the increase in price levels in ALL sectors of an economy even **after full employment** is considered inflation — and it proves to be **harmful for the economy**.

3.8 CAUSES OF INFLATION

Inflation means a constant increase in price of goods and services in all sectors of an economy. The two major factors affecting the price of goods and services are: **Demand** and **Supply**. So the major factors affecting inflation are:

Two Major Causes: (1) Increase in Demand (→ Demand-Pull Inflation) | (2) Increase in Cost of Production (→ Cost-Push Inflation)

3.8.1 Increase in Demand — DEMAND-PULL INFLATION

There is an increase in demand for a product which leads to increase in its price. If supply is not provided or if they are provided at a slower rate than the increasing demands, then there is an increase in price of the product.

If there is inflation due to increase in **aggregate demand** as compared to the aggregate supply, then it is called **'Demand-Pull Inflation'**.

■ **Demand-Pull Inflation = When total demand in the economy exceeds total supply. Too much money chasing too few goods.**

The major reasons for increase in demand are:

(1) Increase in Supply of Money:

Monetarists consider inflation as a **purely monetary phenomenon**. According to them, if there is an increase in money in a state, the individuals earn more income because of which the demands of necessities increase. Against the increasing demand, the supply remains steady, leading to increase in price and inflation.

> ***"Too much money chasing too few goods causes inflation."***
>
> **— Machlup**

This is the classic monetarist explanation: when the central bank prints more money or when credit expands, people have more money to spend. But if production has not increased, prices simply go up.

(2) Increase in Public (Government) Expenditure:

The government of developing countries like India is involved in economic development of the country. Government incurs expenditure after installing infrastructures, provision of basic utilities, or providing employment. This **increases the supply of money in the economy** — it increases the incomes and demands of the people, which leads to a rise in the general price level.

Thus, if the government circulates money in excess of the production of goods and services in the economy by increasing public expenditure, then the rise of general price level gains momentum.

(3) Over-Population:

In India there is a **2% annual increase in population**, leading to an increase in demands of individuals. The increasing population causes increase in demands for basic requirements and when supply is insufficient, the price level increases.

When population is constant but their **purchasing power increases** due to rise in their income, there is also an increase in price levels.

Thus, supply of money leads to increase in demands followed by increase in price levels of goods or services.

3.8.2 Increase in Cost of Production — COST-PUSH INFLATION

The other major factor affecting price is the **supply of goods and services**. Supply-oriented economists believe that when there is an increase in production cost, there is an increase in its price.

If there is an increase in cost of any of the following, the price of goods or services goes up:

- Raw material costs
- Machines and equipment costs
- Electricity and water rates
- Worker's wages
- Transportation costs

The inflation caused due to increase in production cost is called **'Cost-Push Inflation'** or **'Supply Shock Inflation'**.

■ **Cost-Push Inflation = When the cost of producing goods rises, producers raise prices to maintain profits. This pushes up the price level from the supply side. Also called 'Supply Shock Inflation'.**

3.8.3 Other Reasons for Inflation

The major reasons for inflation are (1) increase in demand and (2) increase in production cost. But practically there are also **other factors** which can affect inflation. Even though these are minor factors, for a short term they cause a spike in price levels. The other reasons are:

(1) Taxation Policy:

The taxation policy of the government causes inflation. The **high increase in tax rates increases the production cost** of the products, which leads to a rise in inflation. For example, if the government increases GST on petroleum products, transport costs rise, which pushes up prices of goods across all sectors.

(2) Increase in Price of Import:

In India, **70% of petroleum products are supplied via import**. If there is an increase in price of crude oil in the international market, then there will be an increase in rates of petrol and diesel. This increase also increases the price of other products (because transportation becomes expensive).

This is a classic example of imported inflation — inflation that originates outside the country and enters through higher import prices.

(3) Scarcity:

When there is a scarcity in terms of raw material, electricity, or any requirement for production, it leads to increase in price level of the goods or services. If scarcity prevails for a long period during production or is extensive in nature, it can cause inflation.

Basically there is an increase in demand and production cost that leads to inflation, but the other minor factors (taxation, import prices, scarcity) can also contribute and accelerate inflationary pressures.

Cause	Type of Inflation	Mechanism
Increase in Money Supply	Demand-Pull	More money → more demand → prices rise (Machlup: "Too much money chasing too few good
Increase in Govt. Expenditure	Demand-Pull	Govt. spending raises incomes → demand rises → price level rises
Over-Population	Demand-Pull	More people → more demand for basics → supply insufficient → prices rise
Increase in Production Cost (wages, raw materials, etc.)	Cost-Push / Supply Shock	Higher costs → producers raise prices → general price level rises
High Taxation	Other / Cost-Push	Higher taxes → higher production costs → prices rise
Increase in Import Prices	Other / Imported Inflation	70% petroleum imported in India; crude oil price rise → petrol/diesel rises → all prices rise
Scarcity (raw material, electricity)	Other / Cost-Push	Shortage of inputs → production falls → supply-demand gap → prices rise

Master Table: All Causes of Inflation

EXERCISE — QUESTIONS AND ANSWERS

Section 1 — Choose the Correct Option (MCQs)

(1) Who gave the definition "What is accepted universally in exchange of goods or services is money"?

Options: (a) Marshall (b) Keynes (c) Pigou (d) Robertson

✓ Answer: (d) Robertson

(2) What is the type of inflation called when there is an increase in demand?

Options: (a) Demand-pull (b) Cost induced (c) Salary induced (d) Profit induced

✓ Answer: (a) Demand-pull

(3) What is the value of money during constant and steady price increase?

Options: (a) Increases (b) Decreases (c) Constant (d) Does not change

✓ Answer: (b) Decreases — as prices rise, purchasing power of money falls.

(4) What is the type of inflation when the government controls inflation via rules or laws?

Options: (a) Suppressed (b) Open (c) Galloping (d) Hidden

✓ Answer: (a) Suppressed — when govt. controls prices through rules/subsidies, the underlying inflation is suppressed.

(5) Which economist believes that the true inflation is caused when there is a rise in prices even when there is full employment?

Options: (a) Marshall (b) Crowhter (c) Keynes (d) Pigou

✓ Answer: (c) Keynes

(6) What is the economic system called that allows exchange of rice instead of clothes?

Options: (a) Monetary system (b) Banking system (c) Barter system (d) Loan system

✓ Answer: (c) Barter system

(7) Which of the following can be used as the best means for storage of value?

Options: (a) Crops (b) Animals (c) Stones-minerals (d) Coins

✓ Answer: (d) Coins — among the options, coins are the most durable store of value.

Section 2 — Answer in One Line

(1) Write the meaning of barter system.

Barter system is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange such as money.

(2) Write the definition of money given by Marshall.

"Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place." — Marshall

(3) Normally what is inflation?

In a simple sense, inflation means a rise in the general price level of goods and services in all sectors of the economy, which leads to a decrease in the purchasing power of money.

(4) What is cost-push inflation?

Cost-push inflation is the inflation caused due to an increase in the cost of production (raw materials, wages, electricity, transportation etc.), which forces producers to raise prices. It is also called Supply Shock Inflation.

Section 3 — Answer in Brief

(1) Discuss the function of money as a medium of exchange.

- The most important function of money is to act as a medium of exchange and trade.

- It removes the limitation of the "double coincidence of wants" — the main problem of barter.
- A farmer can sell wheat for money and then use that money to buy rice, clothes, ghee — separately.
- Money separates the act of buying from the act of selling.
- An individual can spend money to satisfy present demands and also save for future needs.

(2) Discuss the function of money as store of value.

- Money is a successful store of value — it can be saved for future use.
- In barter, perishable goods (crops) could not be stored long-term; animals were mortal.
- Money can be stored indefinitely without losing its exchange value.
- Money can also be used as a standard of deferred payment — basis for credit, hire-purchase, EMIs.
- The banking system further made storage and transfer of value easy.

(3) State the causes of inflation.

- (A) Increase in Demand (Demand-Pull): (i) Increase in supply of money, (ii) Increase in govt. expenditure, (iii) Over-population.
- (B) Increase in Cost of Production (Cost-Push): Rise in raw material costs, wages, electricity, transportation etc.
- (C) Other Reasons: Taxation policy, increase in price of imports (70% petroleum imported in India), scarcity of raw materials.

Section 4 — Give Answers to the Point

(1) Define money and explain its functions in brief.

- DEFINITION (Marshall): "Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place."
- DEFINITION (Robertson): "What is accepted universally in exchange of goods or services is money."
- THREE FUNCTIONS:
- (a) Medium of Exchange: Removes double coincidence of wants. Farmer sells wheat for money, then buys rice. Separates buying from selling.
- (b) Store of Value: Money can be saved for future. Overcomes problem of perishability of barter goods. Basis of deferred payment / credit system.
- (c) Measure of Value: Common yardstick for all goods. Enables price comparison and faster decision-making. Overcomes the measurement problem of barter.

(2) Write a short note on the origin and evolution of money.

- Stage 1 — Barter: Goods exchanged directly for goods. Had 3 limitations: double coincidence of wants, storage problem, measurement problem.
- Stage 2 — Commodity Money: Crops and goods used as money. In India, agriculture dominated, so crops were stored and used for exchange.
- Stage 3 — Animal Money: Cow, horse, buffalo used as medium of exchange. Limitation: animals are mortal.
- Stage 4 — Minerals and Stones: Valuable minerals replaced animals. More durable.
- Stage 5 — Coins: Metal coins at the onset of imperialism. Used in kingdoms; limited to regions.
- Stage 6 — Paper Money: Democracy and industrialization led to government-backed paper money. Universal acceptance; easy to store and transfer.
- Stage 7 — Banking Money / e-Money: Credit cards, internet banking, UPI, NEFT, RTGS. Completely digital; most modern form.

(3) Explain the statement "Too much money chasing too few goods causes inflation".

- This statement is given by Machlup and explains the monetarist (demand-pull) view of inflation.
- "Too much money" — when the supply of money in the economy increases (through RBI printing money, government expenditure, or credit expansion), people have more income and purchasing power.
- "Chasing too few goods" — if the production of goods and services has NOT increased at the same rate, there is more money in the hands of consumers than there are goods to buy.
- Result — sellers realize that demand exceeds supply, so they raise prices. This is demand-pull inflation.
- Example: If the government suddenly gives everyone Rs. 10,000 extra, but the amount of rice, vegetables, and goods in the market is the same, prices will simply go up.
- Conclusion: Inflation is fundamentally a monetary phenomenon — more money without more production = higher prices. This is why RBI controls money supply to control inflation.

Section 5 — Detailed Questions

(1) Define barter system and explain the limitations of barter system.

- DEFINITION: Barter system is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange such as money.
- LIMITATION 1 — Problem of Mutual Adjustment of Wants: Barter requires "double coincidence of wants" — both parties must want exactly what the other has. Example: A person with rice must find someone who has wheat AND wants rice. As the economy became complex, this became nearly impossible to arrange. Also, indivisible goods cannot be split (e.g., half a cow).
- LIMITATION 2 — Difficulty in Storing Value: Surplus goods (especially food) are perishable and cannot be stored long-term. A farmer with surplus wheat must exchange it immediately or it will rot. There was no way to store the "exchange value" of goods for future use.
- LIMITATION 3 — Problem of Measurement of Value: With division of labour and many goods in the market, exchange rates became complex. How much wheat = how much cloth? = how much ghee? Maintaining and remembering all exchange rates became impossible. There was no common measuring rod for value.
- CONCLUSION: These three limitations of barter led to the origin and development of money as a universally accepted medium of exchange.

(2) Define inflation and explain the causes of inflation.

- DEFINITION (Lerner): "A situation of excess demand over supply of goods is called inflation."
- DEFINITION (Keynes): "The real situation of inflation is created with increase in money income beyond the level of the full employment of factors of production."
- CAUSE 1 — Demand-Pull Inflation (Increase in Demand):
    - (a) Increase in Money Supply: More money → more demand; supply unchanged → prices rise. Machlup: "Too much money chasing too few goods causes inflation."
    - (b) Increase in Govt. Expenditure: Govt. spending on infrastructure etc. raises incomes → demand rises → prices rise.
    - (c) Over-Population: India has 2% annual population growth. More people → more demand for basics → supply insufficient → prices rise.
- CAUSE 2 — Cost-Push Inflation (Increase in Cost of Production):
    - Rise in costs of raw material, machines, electricity, water rates, wages, transportation raises production cost → producers raise prices → general price level rises.
- CAUSE 3 — Other Reasons:
    - (a) Taxation Policy: High tax rates increase production costs → prices rise.

• (b) Increase in Import Prices: 70% of petroleum is imported in India. If crude oil price rises internationally → petrol/diesel prices rise → all goods become expensive.
• (c) Scarcity: Shortage of raw material, electricity etc. reduces production → supply-demand gap → prices rise.

■ BOARD EXAM QUICK REVISION — CHAPTER 3: MONEY AND INFLATION

1. Barter system = Direct exchange of goods for goods WITHOUT money as medium of exchange.

2. THREE LIMITATIONS of Barter: (1) Mutual Adjustment of Wants (Double Coincidence of Wants) (2) Difficulty in Storing Value (3) Problem of Measurement of Value.

3. Double Coincidence of Wants = Both parties must want exactly what the other has — main failure of barter.

4. EVOLUTION OF MONEY: Barter → Commodity → Animals → Minerals/Stones → Coins → Paper Money → Plastic/e-Money.

5. DEFINITION — Marshall: 'Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place.'

6. DEFINITION — Robertson: 'What is accepted universally in exchange of goods or services is money.'

7. THREE FUNCTIONS OF MONEY: (1) Medium of Exchange (2) Store of Value (3) Measure of Value.

8. Medium of Exchange solves: Double Coincidence of Wants. Store of Value solves: Storage Problem. Measure of Value solves: Measurement Problem.

9. TYPES OF MONEY (6): (1) Commodity Money (2) Animals Money (3) Metal Money (4) Paper Money (5) Plastic Money (6) Banking/Invisible/e-Money.

10. Inflation = Continuous rise in GENERAL price level in ALL sectors of economy = Decrease in Purchasing Power of Money.

11. DEFINITION — Lerner: 'A situation of excess demand over supply of goods is called inflation.'

12. DEFINITION — Pigou: 'Inflation is said to occur when monetary income rises faster than real income.'

13. DEFINITION — Keynes: 'True inflation starts when money income rises beyond FULL EMPLOYMENT level.'

14. Suppressed Inflation = When govt. controls prices through rules/subsidies — inflation exists but is hidden.

15. TWO MAJOR CAUSES: (1) Demand-Pull Inflation (increase in demand) (2) Cost-Push Inflation (increase in production cost).

16. Demand-Pull Inflation: (a) Increase in Money Supply (Machlup: 'Too much money chasing too few goods') (b) Increase in Govt. Expenditure (c) Over-population (India: 2% annual growth).

17. Cost-Push Inflation = Rise in raw materials, wages, electricity, transport → producers raise prices.

18. Other Causes: (1) Taxation Policy (high taxes raise costs) (2) Increase in Import Prices (70% petroleum imported in India) (3) Scarcity.

19. Demand-Pull = Inflation from demand side. Cost-Push = Inflation from supply/cost side.

20. Machlup quote (Board-important): 'Too much money chasing too few goods causes inflation.'

MCQ ANSWER KEY — MEMORISE THESE

"What is accepted universally..." → Robertson | Inflation when demand increases → Demand-Pull | Value of money during inflation → Decreases
Inflation controlled by govt. rules → Suppressed Inflation | True inflation after full employment → Keynes | Exchange of goods without money → Barter System
Best store of value → Coins | "Too much money chasing too few goods" → Machlup | 70% petroleum imported in India → Key fact for import inflation

Notes prepared from GSEB Class 12 Economics Textbook, Chapter 3 — Complete Board Exam Coverage | All content is textbook-accurate, line-by-line.