Subject Area: Economics
Level: CSEC
Curriculum Topic: **Financial Sector**
CSEC Economics Section 5 Objective 1

Key teaching points:

- Explain the concept of the financial sector
- Discuss the role of the financial sector
- Discuss the concept of money

Activity 1 (30 minutes)

Read the following passage and answer the questions that follow.

The financial sector is the complex mix or network of markets, households, businesses, governments, laws and institutions interacting with one another. The informal financial sector refers to economic activities that are not officially regulated and which take place outside the formal norms of business transactions. The financial sector mobilises and makes loanable funds available from savers to spenders for consumption and investment purposes.

Part of the interaction in the financial sector involves the use of money. Money is an item considered acceptable to be used as payment for goods and services and for settling debts. However, the financial sector operated even before the introduction of money. Since the beginning of known history, humans have directly exchanged goods and services with one another in a trading system called bartering. Barter refers to the exchange of one type of good or service for another, without the use of money.

For barter to be successful each participant must want what the other has. The limitations of barter are often explained in terms of its inefficiencies in facilitating exchange in comparison to money. It is said that barter is 'inefficient' because there needs to be a 'double coincidence of wants'. For barter to occur between two parties, both parties need to have what the other wants. Also, there is no common measure of value. In a monetary economy, money plays the role of a measure of value of all goods, so their values can be assessed against each other; this role may be absent in a barter economy. If a person wants to buy a certain amount of another's goods, but only has for payment one indivisible unit of another good which is worth more than what the person wants to obtain, a barter transaction cannot occur. Another problem lies with the function of money as a standard for deferred payments. This is related to the absence of a common measure of value, although if the debt is denominated in units of the good that will eventually be used in payment, it is not a problem. If a society relies exclusively on perishable goods, storing wealth for the future may be impractical. However, some barter economies rely on durable goods like sheep or cattle for this purpose.

(a) Define the following terms:
  a. financial sector
  b. money
  c. barter
(b) Differentiate between the formal and informal financial sector.
(c) Discuss the role of the financial sector.
(d) Evaluate how money has overcome the deficiencies of the barter system.

Answer Key

(a) a. The financial sector is the complex mix or network of markets, households, businesses, governments, laws and institutions interacting with one another.

b. Money is an item considered acceptable to be used as payment for goods and services and for settling debts.

c. Barter refers to the exchange of one type of good or service for another, without the use of money.

(b) The formal financial sector refers to economic activities among households, businesses, governments, and institutions that are officially regulated. The informal financial sector refers to economic activities that are not officially regulated and which take place outside the formal norms of business transactions.

(c) The financial sector mobilises and makes loanable funds available from savers to spenders for consumption and investment purposes.

(d)

Deficiencies in Barter System	Money System
Lack of 'double coincidence of wants'. For barter to occur between two parties, both parties need to have what the other wants.	Money can be used to pay each person regardless of what each wants.
There is no common measure of value.	In a monetary economy, money plays the role of a measure of value of all goods, so their values can be assessed against each other
If a person wants to buy a certain amount of another's goods, but only has for payment, one indivisible unit of another good which is worth more than what the person wants to obtain, a barter transaction cannot occur.	Money is divisible into smaller units.
Barter cannot be used as a standard for deferred payments. If a society relies exclusively on perishable goods, storing wealth for the future may be impractical.	Money is non-perishable and can be used for future payments.