

Chapter 1

MONEY AND BANKING



LEARNING OBJECTIVES:

After studying this chapter you will be able to understand:

- Money as a medium of exchange
- Modern forms of Money
- Concept of a bank and types of bank deposits
- How to open and operate a savings bank account
- Credit & loan facilities of a bank
- Role of post office in savings

MONEY AS A MEDIUM OF EXCHANGE

When we look around in our everyday life, we find that there are numerous transactions where goods are being bought and sold with the use of money. Sometimes instead of goods, services are being exchanged with money. Did it ever come to our mind why all exchange transactions are made in money. The reason is quite simple, a person having money can easily exchange it for any other commodity, goods or service that he or she wants. The word “money” generates a lot of interest. In today’s busy life, money has occupied a very important role. We need money to buy various types of goods in order to satisfy our wants. Similarly, we need money to avail various services such as- transport, communication, education, health, entertainment, home deliveries and so on. As a buyer, we pay money to buy goods and services and as a seller, we receive money by selling them.

Activity box : 1

Enact a role play in the class showing ancient barter system of exchanging goods for goods.

As human beings we all have basic needs like food, shelter, clothes etc. Along with these basic needs we have multiplicity of wants. Take the case of a clothes merchant. He wants to sell Clothes and buy Rice. The clothes merchant will first exchange Clothes to sell for money and then exchange the money for Rice. However to obtain money, first he has to find a rice growing farmer who is willing to sell him rice. Imagine how much more difficult it would be for the cloth merchant if he had to exchange clothes directly for Rice without the use of Money. He would have to find a rice growing farmer who would be willing to sell him rice in exchange for clothes. To put it simple both parties have to agree to buy and sell commodities to each other. This problem is known as **double coincidence of wants**. Double coincidence in nutshell means “what a person

desires to sell is exactly what the other wishes to buy”. In earlier times, such kinds of problems were solved by a system known as Barter System. Under Barter System goods were exchanged for goods. Long before money was invented, people exchanged services and goods for other services and goods in return.

Did you know that

The term “money” is derived from the latin word “moneta”



Fig 1: Barter system

The main problem which is faced in double coincidence of want is to search for the persons with required excess and need. Such kind of problem was resolved by identification of a common medium of exchange which is acceptable to all. This common medium of exchange acceptable to all is termed as **Money**. Money as medium plays an important and crucial intermediate step and in turn eliminates the need for double coincidence of want. With the introduction of money as medium of exchange it is no longer necessary for cloth producer to search for a person with the excess for exchange. The cloth producer will now be able to sell clothes in the market against money (as common medium of exchange) and in turn will be able to buy food against money. Since money acts as an intermediate in the exchange process, it is called a medium of exchange. To put it simply, Money is any medium that can be

exchanged for goods and services , or “Anything which is widely accepted in payments for goods or in discharge of other kinds of obligations is money” . Money is legal tender that means legally none can refuse its exchange.

Evolution of Money

The development of money has passed through various stages in accordance with time, place and circumstances with the progress of economic civilization of mankind. The stages of the evolution of money are

Animal Money:

In the primitive hunting stage animals were used as a common medium of exchange. As per historical records cattle occupied a place of pride. Even at present in some of the tribes of Africa and some part of Asia cattle are considered as the most precious asset to help them in the barter exchange.

Commodity Money:

In certain communities in its crudest sense, also took the form of commodity money. A large number of commodities from axes to yarn have been adopted as money. The particular commodity chosen to serve as money depended upon various factors like location of the community, climatic environment of the region, culture and economic standard of society African people used ivory and tiger jaws as money. The precious stones, rice, tea, tobacco have also been used during the primitive days of human civilization.

Metallic Money:

The discovery of gold, silver, copper and bronze gradually replaced commodity money as a medium of exchange. Use of metals as money in the course of time paved the way for the development of coinage system in India. Minting of coins removed imperfection of the metallic money in size, shape and weight.

Paper Money:

In the 17th and 18th centuries paper currency emerged as a modern form of money. it was easy to carry and was convertible.



Fig 2: Commodity money



Fig 3: Metallic money



Fig 4: Paper money

MODERN FORMS OF MONEY

Having discussed the concept of money as a medium of exchange, let us understand the modern concept of money as we know it today. Before the introduction of coins, a variety of

objects were used as money. Ancient Indians have used grain and cattle as money, thereafter came the use of metallic coins –gold, silver, copper, which continued for centuries before giving way to paper currency. The modern forms of money include Currency, Demand Deposits, Plastic money (Debit cards, Credit cards).

Currency

How does money look like? What is the form of money? Over the years the form of money has changed. You must have read in history that during the days of Kings, people used to trade by using gold coins, silver coins, copper coins etc. Before that, in the ancient days, in some places people used to hold money in the form of cattle, salt. Paper money at present has occupied very important place in the monetary system of all countries. The paper money is used to refer to the government notes i.e. note issued by the central bank of a country. Have you ever wondered why paper notes are accepted as a medium of exchange,

the answer is simple because it is authorised by the government of our country. In India currency notes and coins are issued by the Reserve Bank of India on behalf of the government. No person or organisation is allowed to issue currency. Moreover no person in India can legally refuse a payment made in rupees. Hence, the rupee is a universally accepted medium of exchange in India. Remember that currency notes and coins of India are valid only in India and not in other countries. Every country has its own currency. If you visit other countries, then you have to exchange Indian currency with the currency of that country. For instance if you visit United States of America, you have to exchange the Indian Rupee with Dollar American currency having symbol \$. The European currency is called euro having symbol €.

Activity box: 2

Make a list giving names of the currencies of France, Germany, China, Brazil



Fig 5 : Indian Currency.

Deposits with banks

Sometimes when we need only certain amount of money for our day to day needs, we need to keep our extra cash at a safe place. This means that apart from our currency as a form of holding money, the other form in which people hold money can be as deposits with banks. A Bank is an institution that deals in money. In simple words, bank means an institution which receives funds from the Public and gives loan to those who need them. The important function of Bank is collection of the savings of public. The bank does so by accepting deposits from its customers. The deposits are life line of the Banks. People deposit their extra money in the bank by opening a bank account in their name. Banks accept deposits

from the public and also pay some interest on the deposits. In this manner, people feel their money is safe and also earns them some extra amount called **interest**.

Type of deposit	Description
Saving account	<ul style="list-style-type: none"> The simplest form of bank account opened by individual
	<ul style="list-style-type: none"> Interest is given to the depositor
Current Account	<ul style="list-style-type: none"> generally maintained by businessmen, traders and firms
	<ul style="list-style-type: none"> No interest is given to the depositor
Recurring Deposits	<ul style="list-style-type: none"> Money in these accounts is deposited in monthly instalment for fixed period .
Fixed Deposits	<ul style="list-style-type: none"> Deposits in fixed account are time deposits.
	<ul style="list-style-type: none"> These accounts give highest rate of interest to the depositor.

Fig 6 : Deposits with Commercial Bank

Plastic money

Every country has their own printed currency, however paper money can easily be spoiled and has no durability. Therefore, the use of Plastic money has started and found world wide acceptance. Plastic refers to the hard plastic cards which we use everyday in place of actual bank notes. They can come in many different forms such as cash cards, credit cards, debit cards, pre-paid cash cards and store cards.

A **Debit card** also known as a bank card is a plastic card that provides the cardholder electronic access to his or her bank account .

The card, where accepted, can be used instead of cash when making purchases. Mostly the debit card is used for ATM (automated teller machine) transactions.

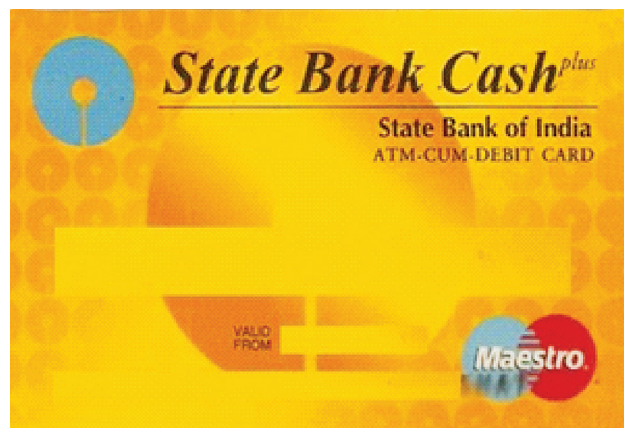


Fig 6 : ATM cum debit card

A **Credit Card** allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card creates a revolving account and grants a limit of credit to the consumer (or the user) from which the user can borrow money for payment to a seller as a cash advance to the user.



Fig 7 : Credit card

BANKING & COMMON MAN

Once you open a bank account you can also withdraw your money as and when it is required.

A Saving account is the simplest form of bank account which can be opened by any individual for encouraging savings. In the saving account interest is given to the depositor.

Since the deposits with the bank can be withdrawn anytime on demand, these deposits are known as Demand Deposits. Demand deposits share the essential features of money. The facility of cheques against demand deposits makes it possible to directly settle payments without the use of cash.

The most common form of payments being made instead of cash is a bank instrument called a **Cheque**. A **Cheque** is a paper instructing the bank to pay a specific amount from the persons account to the person in whose name the cheque has been issued. The maker of a cheque is called the 'drawer', and the person directed to pay is the 'drawee'. The person named in the instrument, to whom or to whose order the money is, by the instrument directed, to be paid, is called the 'payee'. The facility of cheques against demand deposits make it directly possible to settle payments without the use of cash.

Format of a Cheque –

1. Branch address with IFSC code printed on top of the cheque
2. Date in dd/mm/yyyy format with boxes
3. Printers name with CTS-2010 in left side

The image shows a sample of a State Bank of India (SBI) Multi-City Cheque. The form includes the following fields and instructions:

- Branch Address:** (11724) KARAMANA, KARAIKAL PLAZA, 16-17, KARAMANA, THIRUVANANTHAPURAM-695002, IFSC CODE: SBIN0011724.
- Date:** DDMMYY (Date in dd/mm/yyyy format with boxes).
- Amount:** Rupees (₹) and a field for the amount in words.
- Signature:** A box for the signature with the instruction "Please sign above".
- MICR Line:** A line of numbers at the bottom: *950020* 695002032* 002860* 31.

Fig 8 : Sample of a Cheque

of cheque

4. A pantograph which shows void/copy while taking photocopy of the cheque below the account number
5. New rupee symbol instead of bilingual format
6. "Please sign above" is mentioned on bottom right of the cheque

The **Demand Draft** is a pre-paid negotiable Instrument, wherein the drawee bank undertakes to make payment in full when the instrument is presented by the payee for payment. The demand draft is made payable on a specified branch of a bank at a specified centre. This is also called a "remotely created check".

Activity box : 3

Paste a specimen of a form used to deposit and withdraw money from a bank in your scrap book.

Types of Banks

Based on their nature of activities banks can broadly be classified into four types-

- Commercial Bank
- Central Bank
- Co operative Bank
- Specialized Banks.

A commercial Bank accepts deposits of money from the people and also uses money with it for lending purposes i.e. loan. There are some PublicSectorcommercial banks for example-State Bank of India (SBI), Punjab National Bank (PNB), Bank of India (BOI), Indian Bank,

Canara Bank, Bank of Baroda (BOB) etc. There are other Private Sector commercial banks which are under private sector such as- ICICI Bank, J&K Bank, HDFC Bank etc.

The **Central Bank** is an apex financial institution of a country. It issues (prints) notes controls and regulates monetary policy of the country. In India the name of the central Bank is RBI (Reserve Bank of India).



Fig 9 : Central Bank of India

In India there are many banks which are run by cooperative societies and are governed by the laws of the state in which they are operating. Such banks are called Cooperative Banks and are of two types - agricultural (or rural) and non - agricultural (or urban). In rural areas cooperative banks provide credit for farming, cattle, fishery etc. In urban areas the cooperative banks provide credit for self employment activities, small scale industry, purchase of durable goods such as television, refrigerator etc. and personal finance.

LOAN AND CREDIT ACTIVITIES OF A BANK

Understanding banking a little more, the people deposit their surplus funds with the banks and Banks besides providing security, pay interest to the depositors. The Bank keeps only a small portion of their deposits as cash with themselves. The balance of deposits is lent out to those who

are in need of money. To make things simple, let us think that there is only one bank in the economy. Let the banking authority has decided that the cash reserve ratio is 20 percent. So, the bank must keep 20 percent of its current deposit in the form of cash to make cash payments to persons who come to withdraw money.

Step 1

A person called A, deposits Rs.100 in the bank. As a result the bank's deposits increase by Rs.100. As per rule the bank keeps 20% of 100 as cash. This comes out to be Rs.20. So the bank keeps Rs.20 to make cash payments. Now deduct 20 from 100. $100 - 20 = 80$. So the bank can lend out Rs.80 in the form of loan.

Step 2

A person called B approaches the bank to take a loan of Rs.80. After the bank gives this loan, it can claim the amount from B in future. This means that by giving loan to person B, the bank can create another deposit of Rs.80. Now calculate the total deposit with the bank. First, person A deposited Rs.100. By giving loan to B, the bank is able to claim Rs.80. So after two steps the bank has total deposit of Rs.180. i.e. $100 + 80 = 180$

Step 3

Another person called C wants a loan from the bank. How much amount of money the bank can give as loan to C? In the previous step we saw that, the bank could increase its deposit by Rs.80 by claiming the amount from B. As per rule it has to keep 20% of 80 as cash before giving further loan to anybody. $20\% \text{ of } 80 = 16$. So the bank will now keep Rs.16 as cash and give the rest of the amount as loan. $80 - 16 = 64$. So the bank can give Rs.64 as loan to C. Again by claiming this amount from C, the bank can create another deposit of Rs.64 in step 3. Continuing from the previous two steps, we can say that, after three steps the total deposits with the bank has increased

upto $180 + 64 = 244$. Or $100 + 80 + 64 = 244$

So commercial Banks advances loans against some approved security (collateral). In India, these days banks hold about 15 per cent of their deposits as cash. This money is kept to pay depositors who may want to withdraw their money on any day as free will. Majority of the deposits are used to extend loan facility to customers. This **credit (Loan)** facility refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment. It serves two purposes –

- Banks work as intermediaries between those who have surplus money (depositors) and those people who are in need of money (borrowers).
- Banks Charge higher Interest on the loans as compared to the interest paid to the deposit. The difference between two rates is the bank's profit.

Aamir's dream house

Aamir has taken a loan of Rs 5 lakhs from the bank to purchase his dream house. The annual interest rate on the loan is 12 per cent and the loan is to be repaid in 10 years in monthly instalments. Aamir had to submit to the bank, documents showing his employment records and salary before the bank agreed to give him the loan. The bank retained as collateral the papers of the new house, which will be returned to Aamir only when he repays the entire loan with interest. So with the help of loan credit from the Bank, Aamir has fulfilled his dream of owning a house of his own.

Every loan agreement specifies a rate of interest at which the borrower must pay to the lender alongwith the repayment of principal amount. In addition, banks sometimes demand collateral security against loans.

Collateral is a asset that the borrower owns (Land, Business asset, House, Vehicle, Livestocks, Deposits with banks) and is kept with the lender/bank as a gurantee till the loan is repaid in full. If the borrower fails to repay the loan, the lender has the right to sell the collateral to obtain payment. The interest rate of the loan, collateral and documentation required for obtaining loan alongwith the mode of repayment together comprise the **terms of credit**.

Activity box :4

Paste pictures in your scrap book of some assets/collateral that can be kept by banks while lending a loan

Loan facility usually allows an individual / business to meet the working capital need of production, to buy a house, to fulfill marriage or children education needs. However when loan repayment becomes impossible due to certain reasons, in this case loans push the borrower into a situation where recovery is very painful. This is usually called a debt trap.

A commercial Bank is one of the important financial institutions serving the common man in his day to day activities. As mentioned before in the chapter, a Savings Bank Account is one of the easiest way to start the habit of Saving. These may include: opening of a bank account, depositing cash in bank and withdrawing cash from the bank.

OPENING OF SAVING ACCOUNTS IN A BANK

Following points should be considered for opening a bank account:

1. Choose a bank in which you want to open an account: This step involves choosing or selecting a bank with which a person wants to open an account. Presently we have many banks operational in our state Jammu and Kashmir. The leading bank of our state is Jammu and Kashmir Bank Ltd. popularly known as J K Bank.

2 Fill up the prescribed application form:

Every bank has a prescribed application form to be filled up for opening an account. The application involves information regarding name, residence and space for fixing a photograph.

3 Submit the filled up application form:

The filled up application form is to be submitted to the bank officer. It must be kept in mind that the bank may ask for necessary relevant documents like proof of residence, proof of identity. After scrutiny of the same the bank may issue an account number.

4 Receive necessary documents from the bank:

After completion and successful submission of the form, the bank issues an account number. Bank also provides a small book known as passbook which contains particulars of the account holder. The entries regarding cash deposit and withdrawal are also entered in this book from time to time. The passbook serves as an important documentary link between bank and account holder. The Bank may also issue ATM Card.

Depositing money in a Savings Bank Account

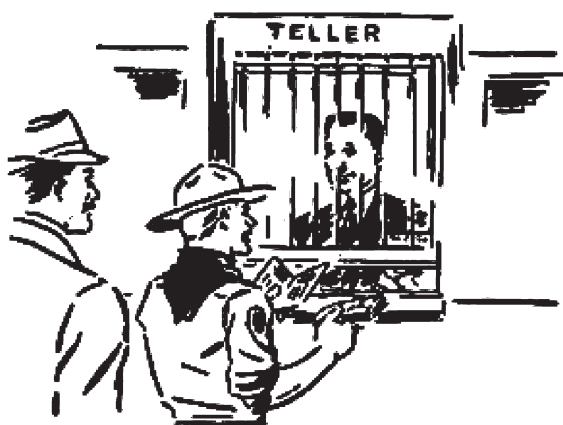


Fig 10 : depositing cash in the bank

For depositing cash in the bank the following steps should be adopted:

1 Approach the bank where you have to deposit the cash:

First of all a person should identify the bank and the branch where the cash is to be deposited.

2 Fill up the pay-in-slip:

The bank needs a person to fill up the pay-in-slip. Pay in slip contains information particulars like name of account holder, account number, date of deposit, amount to be deposited (both in figures and words), signature of the depositor, phone number etc. The reverse side of the pay in slip contains the information like number of currency notes deposited for each denomination. The pay-in-slip is to be filled in duplicate. One part will be retained by the bank while one will be returned to the depositor.

3 Approach the Receipts Counter:

Once you have filled the pay-in-slip, you have to approach the receipts counter. Receipt counter is the counter maintained by the bank for receiving the cash of the depositor. In a disciplined manner, if a queue stands for the counter one has to wait for his turn.

4 Take the receipt:

As the process of depositing cash has been completed, one should take the properly stamped and signed receipt from the same counter. The receipt is the part of the pay-in-slip as has been discussed in point 2 above.

5 Keep the receipt at safe place:

Once the proper receipt has been acquired, it should be kept at safe and secure place. The safety and security of the receipt is necessary for

any future reference. The receipt acts as documentary evidence.

Withdrawing money from Saving accounts in Bank



Fig 11 : Withdraw Money through Bank



Fig 12: Withdraw money through ATM



Fig 13: ATM Machine

The cash can be withdrawn by two procedures:

I. By visiting the branch

- (a) By filling withdrawal form: The person has to present himself personally and fill up the withdrawal form. The bank official will identify the person through passbook, photograph and Signature on withdrawal form.
- (b) By Cheque: The cheques can be signed and issued by the account holder on the concerned bank. The bank will issue cash against such cheque. The account holder can himself also withdraw cash through such cheque. The person whose name is written on such cheque can also withdraw cash. With the help of cheques the amount can be transferred from account to account.

II. By using ATM (Automated Teller Machine)

It is a machine controlled procedure. A person, on opening an account, is provided with a card which can be used to withdraw cash by inserting in ATM and following few steps. The machine, after inserting the card, will ask for pin (electronic key) to proceed. After that the machine will ask for options like amount to be drawn etc. At the end of transaction the machine will provide slip showing amount withdrawn and balance remaining with the bank.

ROLE OF POST OFFICE IN SAVINGS



Fig 14: India post

The post offices which are found round the corner of the country are located in remote village as well as in modern city centres of the country. The Post Office savings bank is the oldest and by far the largest banking system in the country, serving the investment need of both urban and rural clientele. These services are offered as an agency service for the Ministry of Finance, Government of India. The India Post network with over 155,000 branches is twice as large as the outreach of commercial banks in India put together.

Various Post office Schemes

Post Office Savings Account

5-Year Post Office Recurring Deposit

Post Office Monthly Income Scheme

Senior Citizen Savings Scheme

15 year Public Provident Fund Account

5 Years National Savings Certificate (VIII Issue)

10 Years National Savings Certificate (IX Issue)

What you have learnt

In this chapter you have learnt about the concept of money as a medium of exchange. We have looked at the modern forms of money and how they are linked with the banking system. On one side are the depositors who keep their money in the banks and on the other side are the borrowers who take loans from these banks. We have also learnt how to Open a Savings Bank Account, Deposit/Withdraw money from our account and the role that the Post Offices can play in generating savings. Economic activities require loans or credit. Credit, as we saw can have a positive impact, or in certain situations make the borrower worse off.

Fig 15 : Post Office Savings Schemes

EXERCISES

Project /Activity

- Go to the local bank and ask them to give a demo of how to operate an ATM
- Go to the local post master and request them to deliver a lecture on various post office savings schemes in your school.
- Collect the pictures/logos of any 2 Commercial banks and our Central bank and paste in your scrap Book.

A. Fill in the blanks:

- issues currency notes on behalf of the Central Government.
- Banks charge a higher interest rate on loans than what they offer on -----
- is an asset that the borrower owns and uses as a guarantee until the loan is repaid to the lender.
- A ----- is the simplest form of bank account which can be opened by any individual for encouraging savings .
- The most common form of payments being made instead of cash is a bank instrument called a -----.
- This is also called a "remotely created check,-----.

B. One word Answers :

- The central bank of India,
- One nationalized Bank of India ,
- One privately owned bank in India ,
- One post office savings scheme,

- One cooperative bank in rural India giving loans to farmers.....

C. Very short /short Answer Type Questions

- What is double coincidence of wants?? Explain with an example of your own.
- Can you think of some examples of goods/ services being exchanged or wages being paid through barter?
- Why is money called a medium of exchange?
- What are the different forms of modern currency?
- Who is authorized to issue currency in India.
- Why can no one refuse to accept payment in rupees?
- Why are the deposits in the bank account called deposits?
- How do banks mediate between those who have surplus money and those who need money?
- Define a Cheque .
- Define a Loan .
- Why do lenders ask for collateral while lending?

D. Long Answer Type Questions

- What are the various forms of modern money?
- What is the procedure of opening a Savings Bank account?
- How can you withdraw money from a Savings Bank account?
- What are the various forms of Plastic money ?
- Explain the various credit and loan activities of Banks with an example?