Unit I Money And Banking System / Financial System

* Money :-
• Medium of exchange
• Means of performing trading activities.
• Means of making payments.

* Evaluation of Money :-
• Barter System (CC economy)
• Metallic Age
→ Precious Metals
→ Non Precious Metals
• Paper currency
• Plastic Money
• E-Money

* Barter System :-
Exchange of Surplus (goods & services) among two person is known as commodity exchange.

→ Types :-
• Goods to Goods
• Goods to Services
• Services to services.

→ Demerits :-

- Double co-incidence of wants.
- Difficult to store
- Indivisible.
- Portability problem (Transfer Problem)

* Metallic Age :-

→ Precious metals :-
- Gold
- Silver

→ Non-Precious Metals :-
- Alloy
- Brass
- Steel
- Copper

→ Demerits :-
- Value depreciates
- Changes of theft
- Cannot claim
- Heavy to carry

* Paper Currency :-

→ Demerits :-
- Chances of theft
- Gets destroy
- Limited acceptability upto a domestic territory

* Plastic Money :-
- Debit Card
- Credit Card

* Money :-

Meaning :- Obtained from latin word Moneta (named after Rome goodess Juno Moneta) which means anything which is used as medium of exchange.

Definition :- → Descriptive definitions
→ Legal definition
→ General Acceptability
→ Appropriate definition.

1. Descriptive Definition :-
These definitions which includes the functions of Money.

- "Anything that is generally acceptable as a means of exchange & that at the same time acts as a measure & store of values." — Crowther in this book :- An outline of money.
- "Money may be defined as means of valuation & of paymend" — Coulborn
- "Money is anything i.e. widely used a

means of payment & is generally acceptable in settlement of debts." — Cole

2. Legal Definitions :-

Definitions that includes law & govt.

- "Anything which is defined by the state as money is money." — Professor Knap
- Professor Hartley believes that money should be legal tender.
- These are narrow definitions based on "State theory of money.". The govt. cannot force the people to accept money.

3. General Acceptability :-

These definitions favour acceptance

- "Money is anything which is commonly used & generally accepted as a medium of exchange or as a standard of value."
— Kents.
- "Money is described as "anything which is widely accepted in payment of goods or in discharge of other kinds of business

obligations". — D.H. Robertson.

- "Money is anything i.e. generally accepted in payment of goods & services or in the repayment of debts.". — E. Mishkin
- Money here, is defined as anything which has general acceptability.

4. Appropriate Definition :-

Money is anything i.e. accepted by all in Economic transactions as a medium of exchange, A unit of account & a store of value."

Characterstics / Quality of Money :-

1. General Acceptability
2. Durability
3. Portability
4. Divisibility
5. Limited in Supply
6. Stability
7. Homogeneous
8. Measures of value
9. Active Agent
10. Liquid assets
11. It is means not end.
12. Voluntary acceptability.
13. Govt. Control.

Measures of Value :-

Value of any good or service can easily be measured in terms of money. It is accepted as a measure of value.

Active Agent :-
Money is an active agent of an economic system. In modern economy, money is required in every commercial process. Process of production cannot start without the participation of money.

Liquid Assets :-
Money is highly liquid asset. It can easily be converted in goods & services. Debt, stock, & bills, etc..., are the other liquid assets but the liquidity of money is highest than the other liquid assets. One has to first get to convert other liquid assets into money, then it can be converted in desired goods or services, while money can directly be converted.

Money is a means & not an end :-
The word money is means to acquire things desired. Money itself cannot be used to satisfy. It is indirectly used to get any goods or services to satisfy human wants.

Voluntary Acceptability :-
Money is voluntarily accepted by people. There is no requirement to get legal approval. People always wish to hold money.

Government Control :-
Reserve Bank of India & Govt., of India have an authority to issue currency which is accepted as a form of money in india. No other authority can issue currency notes. Thus, the Govt. keeps control over the money supply in the country.

* **Classification of Money :-**

→ Actual money & money of account.
→ Commodity Money & representative money.
→ Money & Near-Money
→ Metallic Money & Paper money
→ Credit Money.

* **Modern forms of Money :-**
- Currency
- Deposit Money or Bank Money
- Legal Tender Money
- Near Money
- Electronic Money
- Fiat Money representative money

* Actual Money & Money of Account :-

- **Actual money** is that which actually circulates in the economy. It is used as a medium of exchange for goods & services in a country.

- **Money of account** is that form of money in terms of which the accounts of a country are maintained & transactions made.

For ex:- rupee is the money of account in India. Generally, actual money & money of account are the same for a country; however, sometimes actual money may be different from the money of account. For ex:- rupee & paisa is the money of account in India. In real practice, however; one paisa coin is nowhere visible.

* Commodity Money & Representative Money :-

- **Commodity money** is made up of a certain ... & its face value is equal to its intrinsic value. It is also referred to as full-bodied money.

- **Representative money**, on the other hand, is generally made either of cheap metals or paper notes. The intrinsic value of the representative money is less than its face value. Currency

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notes & coins are good examples of representative money in India. Representative money may or may not be converted into full-bodied money.

* Money & Near-Money :-

- **Money** is anything that possesses 100 percent liquidity. Liquidity is the quality of being immediately & always exchangeable in full value for money.

- **Near-Money** refers to those objects which can be held with little loss of liquidity. For ex, National Savings Deposits, Building Society Deposits & other similar deposits are not money because they are not generally acceptable in paying debt; these, however, could be easily & quickly exchanged for money without any loss or with minimum loss.

* Metallic Money & Paper Money :-

This classification is based upon the content of a unit of money. Money made of some metal like gold & silver is called metallic money. On the other hand, money made of paper, such as currency notes, is called paper money.

- *Metallic money* is sub-classified into :-

→ *Standard Money* :- It is one whose intrinsi[c] value is equal to its face value. It is mad[e] up of some precious metal & has free coina[ge]

→ *Token Money* :- It is that form of money wh[ose] face value is higher than its intrinsic value. Indian rupee coin is an example of token mo[ney]. Paper money comprises bank notes & govt. notes which circulate without difficulty.

- *Papper money* is classified into following pa[rts]

→ *Representative paper money*, which is 100% backed ~~by~~ precious metals & is fully redeemable in some precious metal.

→ *Convertible paper money*, which can be convert[ed] into standard coins at the option of the hold[er]. It is not fully backed by precious metals.

→ *Inconvertible paper money*, which cannot be converted into full-bodied money. Indian one rupee note is a good example of inconve[rt]-ible paper money.

→ *Fiat money*, which is issued by the govt. of the country under emergency conditions. It does not have any backing of reserve.

* *Credit Money* :-
It is also known as bank money. this consists of deposits of the people held with the banks & which are payable on demand by the depositors. Cheques, drafts, bills of exchange, etc.

* *Currency* :-
The currency is a country's unit of exchange issued by their govt. or central bank whose value is the basis for trade. Currency includes both metallic money (coins) & paper money i.e. is in public circulation.

- *Metallic Money* :- Metallic money refers to the coins which are used for small transactions. Coins are most often issued by the govt. Examples of coins are 50 paise coins, & 1, 2, 5 & 10 rupee coins.

- *Paper Money* :- It refers to paper notes & used for large transactions. Each currency note carries the legend, 'I promise to pay the bearer the sum of 50/100 rupees depending on the value of note.' The currency notes are duly signed by the govt. of RBI.

Simply, the meaning of legend is that it can be converted into other notes or coins of equal value. Examples of currency notes are 1, 2, 5, 10, 20, 50, 100, 500 & 2000 rupee notes.

☆ Deposit Money or Bank Money :–

- It refers to money deposited by people in the bank on the basis of which cheques can be drawn. Customers of the bank deposit coins & currency notes in the bank for safe-keeping, money transferring & also to get interest on the deposited money.

- This money is recorded as credit to the account of the bank's customer which can be withdrawn by him on his/her wish by cheques. Cheques are widely accepted these days because transfer of money through cheques is convenient.

☆ Legal Tender Money :–

- Legal tender money is the currency which has got legal sanction or approval by the Govt. It means that the individual is bound to accept it in exchange for goods & services; it cannot be refused in settlement of payments of any kind.

- Both coins & currency notes are legal tender. They have the backing of Govt. They serve as money

on the fiat (order) of the Govt. But a person can legally refuse to accept payment through through cheques because there is no guarantee that a cheque will be honoured by the bank in case of insufficient deposits with it.

- Currency is the most common form of legal tender. It is anything which when offered in payment extinguishes the debt. Thus, methods of payment personal cheques, credit cards, debit cards & similar non-cash methods of payment are not usually legal tenders.

- Coins & notes are usually defined as a legal tender. The Indian rupee is also legal tender in Bhutan but Bhutanese Ngultrum is not legal tender in India.

☆ Near Money :–

It is a term used for those which are not cash but highly liquid assets & can easily be converted into cash on short notice such as bank deposits & treasury bills. It does not function as a medium of exchange in everyday purchases of goods & services.

Electronic Money :-

- Electronic money (also known as e-money, electronic cash, electronic currency, digital money, digital cash or digital currency) involves computer networks to perform financial transactions electronically.

- Electronic funds transfer (EFT) & direct deposit are examples of electronic money.

- The financial institutions transfer the money from one bank account to another by means of computers & communication links.

- A country wide computer network would monitor the credits & debits of all individuals, firms, & Govt. as transactions take place in the economy.

- It exchange funds every day without the physical movement of any paper money. This would eliminate the use of cheques & reduce the need for currency.

Fiat Money :-

Fiat money is any money whose value is determined by legal means. The term fiat currency & fiat money relate to types of currency or money whose usefulness results

not from any intrinsic value or guarantee that it can be converted into gold or another currency, but from a Govt.'s order (fiat) that it must be accepted as a means of payment.

Money V/S Currency :-

The term 'currency' includes only metallic coins & paper notes which are legal tender & are in actual circulation in the country. The term 'money' however includes not only currency in circulation but also credit instruments. In other words, we may say that all currency is money but all money is not currency.

→ Currency = Notes + Coins
→ Money = Currency + Near money.

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Functions

- Static functions
  - Primary
    - Medium of exchange
    - Measure of value
  - Secondary
    - Store of Value
    - Transfer of Value
    - Deferred Payment
- Dynamic functions
  - Other function
    - Basis of credit
    - Distribution of income
    - Marginal utility
    - General form of money
    - Guarantee of solvency
    - Liquid asset.

Importance of Money :-

- Economic Importance of money
- Social Importance of Money
- Importance of Money in Capitalist Economy
- Importance of Money in Socialist Economy
- Importance of Money in Mixed Economy
- Importance of Money in Planned Economy
- Importance of Money in Modern Economy

1. Economic Importance of Money :-

- Consumption
- Production
- Exchange
- Distribution
- Public Finance
- Other economic activities

Imp. in the field of

Consumption	Production	Exchange
• Satisfaction of human wants	Collection of Resources	Simple & easy
• Consumer's Sovereignty	Store of capital	International Trade
• Consumer Equilibrium	Mobility of capital	Widened Scope
• Consumption of many Goods	Division of labour (specilization)	Deferred Payment
• Present & future Consumption	Estimation of Cost	Use of Credit
	• Optimum distribution of Resources	Price determin-ation.

Distribution	Public Finance	Economic activity
• Determination of factor payments • Making factor payments • Feeling of cooperation	Measurement of Direct tax & Measurement of indirect tax & Public debt	Measurement of Economic activity Motivational tool Development of financial & non-financial activities
• Increase social welfare	Fiscal payments	
•	Govt. Budget	

2. Social Importance of Money:-

- Social freedom
- Social awareness
- Money & political consciousness
- Money & national sentiment.

3. Importance of Money in Capitalist Economy:-

- Useful in Price Mechanism
- Distribution of National Income
- Saving & Investment decisions
- Formation of Capital
- Credit Transaction
- Basis of Deferred Payments
- Control over Economic Activities

4. Importance of Money in Socialist Economy:-

- Economic Decisions
- Economic calculations
- Basis of Valuation
- Basis of Distribution
- Formation of capital
- International Payments
- Economic Development.

5. Importance of Money in Mixed Economy:-

- Economic Decisions
- Economic Calculations
- Basis of Valuation
- Basis of Distribution
- Formation of capital
- International payments
- Economic Development
- Useful in Price Mechanism
- Distribution of National Income
- Saving & Investment decisions.
- Formation of capital
- Credit Transaction
- Basis of Deferred Payments
- Control over Economic activities.