MONEY AND CREDIT (Module -1)

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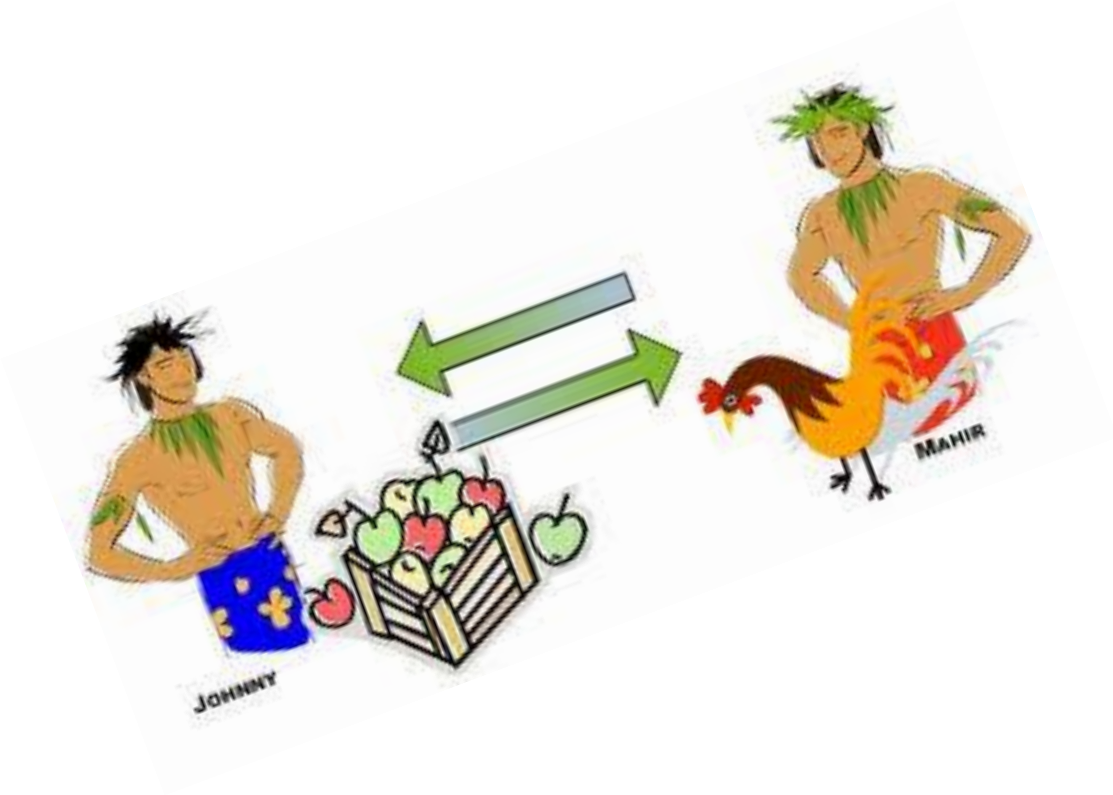
MEDIUM OF EXCHANGE

Barter System: Before the advent of money, people used to follow the barter system of exchange. Suppose somebody has surplus vegetables and he needs wheat in lieu of that then he could find a person who has surplus wheat and needs vegetables.



Barter system

Double Coincidence of wants: The major feature or rather drawback of the barter system was the coincidence of wants. It used to be difficult to find a person who can fulfill the coincidence of wants. Moreover, it was impractical and difficult to carry heavy goods for barter. This restricted the economic activity.

MONEY

In the historical period coins of precious metals started getting used as medium of exchange and this was the birth of money. As precious metals were difficult to procure so slowly paper money or currency notes began to replace them. Now the government or government authorized body in a country issues currency notes for circulation.

In India, the Reserve Bank of India issues currency notes. On the currency note you can observe the statement promising a particular amount to be paid to the bearer of the currency note.

Money removed the coincidence of wants factor and smoothened exchange facilitating economic activity.

MONEY

OTHER FORMS OF MONEY

Deposits with Banks: The other form in which people hold money is as deposits with banks. At a point of time, people need only some currency for their day-to-day needs. Banks accept the deposits and also pay an interest rate on the deposits. In this way people's money is safe with the banks and it earns an interest. People also have the provision to withdraw the money as and when they require. Since the deposits in the bank accounts can be withdrawn on demand, these deposits are called **demand deposits**. The facility of cheques against demand deposits makes it possible to directly settle payments without the use of cash. Since demand deposits are accepted widely as a means of payment, along with currency, they constitute money in the modern economy.

EVERY CURRENCY NOTE IS MADE IN RBI
AND IT IS KEPT THERE WITH FULL SECURITY.

DEPOSITS WITH BANKS

Credit: Banks keep only a small proportion of their deposits as cash with themselves. For example, banks in India these days hold about 15 per cent of their deposits as cash. This is kept as provision to pay the depositors who might come to withdraw money from the bank on any given day. Since, on any particular day, only some of its many depositors come to withdraw cash, the bank is able to manage with this cash. Banks use the major portion of the deposits to extend loans. There is a huge demand for loans for various economic activities.

Banks make use of the deposits to meet the loan requirements of the people. In this way, banks mediate between those who have surplus funds (the depositors) and those who are in need of these funds (the borrowers).

Banks charge a higher interest rate on loans than what they offer on deposits. The difference between what is charged from borrowers and what is paid to depositors is their main source of income.

A large number of transactions in our day-to-day activities involve credit in some form or the other. Credit (loan) refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment.