

Chapter-3

Money, Savings and Credit

Today, money plays an instrumental role in shaping economic structure. Without money, an economic system has no existence. In the present times, all activities related to production, consumption, exchange and distribution etc. are effected by money. Thus money has become an inseparable part of life. Modern society gets many advantage from money, and because of this, money has more utility. According to Marshall, "The credit for present progress goes to money. According to Truscott, "If money is not the heart of our economic system, it can certainly be considered its blood stream. Thus money is the strength of our life economy."

EVOLUTION OF MONEY-HISTORY OF MONEY

Money has an important role to play in our economic and commercial life. It is considered as the backbone of our modern economy. At the early stage of civilization, human wants were limited, and they used to satisfy their wants by producing themselves. But with the increase in population, human needs started increasing. It became difficult to satisfy all human wants by their own production. Gradually, they started satisfying their wants by exchanging goods among themselves. Today for the satisfaction of most of

the wants, people depend on other people. Usually each person is engaged in a particular activity. The income earned by them is used for purchasing other goods. Thus, the importance of exchange has increased today.

Forms of exchange

- (I) **Barter system**
- (II) **Monetary system**

(i) **BARTER SYSTEM**

Barter means direct exchange of goods and services. Under barter system, both sale and purchase of goods and services takes place without the use of money. In other words, barter system of exchange is a system in which goods are exchanged for goods with the mediation of money. For example, exchange of rice is for wheat, exchange of oils for vegetable, exchange of curd for milk etc. This system was prevalent in old days. Practically because of this system, people suffered a lot of problems,

Difficulties of Barter system:

People suffered following difficulties due to the barter system,

1. Lack of double coincidence of wants:

The barter system requires a double coincidence of wants on the part of those who want to exchange goods and services. It is necessary for a person who wishes to trade his goods and services to find some other person who is not only working to buy his goods and services, but also possesses that goods which the farmer wants. Such a double coincidence is a rare possibility. This can be explained with the help of an example. Lieutenant Cameron wanted to cross the river in Africa, but the boatman used to ask for the teeth of elephant for helping him in crossing the river which he did not have

Cameron came to know about the person who wanted to exchange elephant teeth for cloth, but Cameron had no cloth. After some times, he knew about a third person who had cloth and wanted to exchange it for wire. Fortunately, Cameron had wire. He exchange wire for cloth and cloth for elephant teeth, and ultimately crossed the river by paying elephant teeth. But his time was wasted because of lack of double coincidence of wants.

Difficulties of barter system :

1. Lack of double coincidence
2. Lack of common measure of value
3. Lack of store of value
4. Lack of divisibility
5. Difficulty of future payment
6. Problem of transfer of value

2. Lack of common measure of value:-

another major difficulty of barter system is related with common measure of value. There was lack of a common measure of value to measure the price of goods and services. For example, what will be quantity of ghee required for one kilo of rice? How will it be determined as to how many goods are required for a cow etc?

3. Lack of store of value :

In barter system, there was difficulty of storing the produced goods. Because store of purchasing power for future cannot be made due to perishable in nature of most of the goods. It was difficult to store perishable goods for example fish, fruit, vegetables etc. for long time.

4. Lack of Divisibility:

some of the goods are of such nature that cannot be divided. If divided, the utility is lost e. g. Living animals. This difficulty related to lack of divisibility occurs when a person has a cow and he wants three or four things which are available from different persons. In this situation, a cow cannot

be divided into three or four pieces because it will destroy the utility of a cow. Exchange was difficult in this situation.

5. **Difficulty of future payment:**

in barter system, lending and borrowing was difficult. For example, a man lends his cow to the other man for two years.

In these two years, the other man is availing the cow's milk and using the cow dung as fuel. So, it was found that the lender is in loss and the borrower has advantage.

6. **Problem of transfer of value:**

Barter system faces the problem of transfer of value because in many situations, it was difficult to shift the static asset from one place to another place. The problem was more critical when a person was migrating from one place to another. In this condition, he had to leave his asset because it was difficult to sell them. For e.g., a person living in Allahabad is shifting to Agra, could not exchange his house for another one in Agra. But with the development of money, he can sell his house in Allahabad and can buy one in Agra.

MONETARY SYSTEM

Revolution of market is the outcome of human needs. Difficulties in barter system gave birth to money. With the invention of money, the transaction of goods and services between the buyer and seller became quite easy. Invention of money made merchandising easier. Invention of money is a great achievement for human civilization. Renowned author Crothers has said, "As in mechanics wheel is important, in science fire and in politics democracy has its own place, the same place money has in economic life of a man." Money is one of the most fundamental of all man's invention.

In monetary system, the man first sells his goods or services and earns money and then spends the money to buy other goods of his need. So, this system is known as the monetary system. The development of money, in a way, an epitome of the history of human civilization.

World's Currencies :

In the following table no.3.1, various currencies across the world are mentioned.

Table 3.1 : World's Currencies

Country	Currency
1. India	Rupee
2. Pakistan	Rupee
3. Bangladesh	Taka
4. Nepal	Rupee
5. America	Dollar
6. England	Pound
7. Russia	Ruble
8. Singapore	Dollar
9. Afghanistan	Afghani
10. Iran	Riyal
11. Iraq	Dinar
12. Sweden	Crona

Functions of money

In the modern era, money has become an important instrument to lead life and its importance in one's life is increasing day to day. The four basic

functions of money are:

1. Medium of exchange
2. Measure of value
3. Standard of deferred payment
4. Store of value

These four functions of money can be explained through this little poem.

*Money is a matter of functions four;
A medium, a measure, a standard, a store.*

In recent years, economists have given various functions of money. In short, the main functions of money are discussed below:

1. Medium of exchange:

Money is a medium of exchange, money acts as a medium for selling and purchasing of goods in market. It serves as a standard medium of exchange by removing the difficulties of barter system and acts as a convenience of making transactions. It acts as a legal tender, so its noted value and its cognizable features facilitate money's universal acceptability as means of payment.

2. Measures of value:

Money acts as a unit of measure of value. In other words, it acts as a yardstick of standard measure of value to which all other things can be measured. Evolution of money has removed the difficulties of measuring value of goods. In modern times, the value of every commodity can be measured in money. With the use of money, the value of exchange has become easier and economic calculation for measuring value have been simplified.

3. Standard of deferred payment:

In modern era, much of the economic activities are carried on credit, payment is done in future. In other words, money in modern era has helped the people deal effectively with credit transaction. For e.g. Ram has lend Rs. 100 to Shyam for one year. After one year, Shyam can return Rs.100 to Ram. Money functions as a standard of deferred payments settling the doubts and future transactions. In modern business credit acts as a backbone and money has made it easier. Barter system was found limited to this facility of lending and borrowing.

4. State of value:

Human being has tendency to save a part of his income for future to fulfil his future requirements. Money has special feature of being stored and held future purpose. In barter system, there was difficulty of storing and holding goods because goods can get perished. Money can be stored for longer periods of time. Utility of money is never lost, it can be used in future for purchasing goods and services.

5. Transfer of purchasing power:

Money is a liquid means of exchange. Hence purchasing power of money can be transferred from one place to the other. Because of this unique characteristic of money, buying and selling process has become easier and can be done at the global level. Goods can be purchased and sold from one place to another and can be taken from one place to another because money has been accepted as a mode of exchange across the world. Money has made lending and borrowing easier, people can sell their assets and properties and can move to other place and purchase new things because money has become the best means of transferring the value of money.

6. Basis of credit:

In present times, credit is used as money. On the basis of money, credit is given. Bank or financial institutions create credit on the basis of money. Various credit notes are created on the basis of money such as cheque, Hundi, draft etc. for e.g. Cheque can be issued or used only if the person has account in the bank. Commercial bank provides credit on the cash reserve basis. If amount of money is more, credit will be small. Thus money is the basis of credit.

WHAT IS MONEY?

In practical life, every moment, money has its own importance and its use. In general times, if we talk about money, people think it as a thing made of metal or paper used for buying and selling of goods. For having a clear money we need to analyze day to day activities which include purchasing and selling of across the country or in foreign countries. During early civilization, things like goat, cow, wheat skin etc. were used as mode of exchange. With the development of civilization, skin, stones, beads, gold, silver and paper money came into existence. Nowadays, payment is done through paper money and cheque. In general terms, money is understood as metallic coins. The terms 'money' is also used as a sign of stamp. That's only anything with government stamp on sign is considered as money. In economics, money has been defined in various ways by various authors. Some of these definitions are broader in concept while some of these are based on other facts.

Prof. Hartley Withers says, "Money is what money does." Coulborn has defined money as "money may be defined as the means of valuation of payment". According to Knapp, "Anything which is declared money by the state becomes money." According to Aeligmaw, "money is one thing that possesses general acceptability." It can be concluded that anything with general acceptability, independent in nature, used as exchange as a means of nature, has a standard for payment is considered as money. Money is that

commodity which is generally accepted by the people as a medium of exchange, measure of nature, store of nature and transfer of value.

In present days of Globalisation and with the race for economic development, paper money, cheque etc. are used as a medium of exchange. Today exchange is possible even with plastic money which is known as ATM-cm-Debit card and credit card. Because of the facility of core banking in this present age of computer, guaranteed transfer of money from one place to another within the country is possible in few minutes.

Development of money has been described in table 3.1

Table 3.1 : Development of Money

1. Barter	2. Commodity Money	3. Mettalic Money	4. Coins	5. Paper Money	6. Credit Money
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Table 3.1 describes these things:

1. Barter:

It involves exchange of goods for goods.

2. Commodity money:

In primitive age, any particular commodity was used as money. In hunting age animal skin, in pastoral age commodities such as animals like

cows and goats, during agrarian age goods like wheat, maize, rice etc. were used as generally accepted medium of exchange.

3. **Metallic money:**

Because of the use of commodity money, people faced a lot of difficulties and so the use of metals started. Metallic money refers to coins prepared out of various metals like gold, silver, bronze, nickel etc.

4. **Coins:**

The use of metallic money was getting difficult day by day, so it gave birth to coins on full-bodied money, which refers to coins. Goods prepared out of various metals like gold, silver, bronze, nickel etc. With value certified by an exclusive monopoly of the state came to be known as coins. Various types of coins are shown in the figure below.



Pict. 3.1 : Coins

5. **Paper money:**

It was very difficult to transfer coins from one place to another. Eventually paper money came into existence. At present, generally in all

countries of the world, paper money is in vogue. Notes made of paper generated by government and central bank of the country are known as paper money. In India, denomination of one rupee or more are issued by reserve bank of India of the country. Thus central govt. issues one rupee notes and reserve bank of India issues rupees of denomination 2, 5, 10, 20, 50, 100, 500 and 1000. Smples of some notes used in India and America are shown below:



Pict. 3.2 : Indian Paper Currency

6. Credit money:

With the economic development, use of credit money started. Mostly cheque, hundis and other types of credit money are used as money. These are

known as credit money. International transaction, credit money for e.g. Cheques and hundis are mostly used in comparison to metal or paper money.

Plastic money : Today plastic money is widely used. ATM-cum-debit card and credit card are famous plastic money.

(i) **ATM-cum-debit card-** During the process of economic development, banking institutions started using a small piece of plastic as money. ATM is one type of plastic money. The meaning of ATM is automatic teller machine. This machine provides service of withdrawal and deposits through 24 hours. In India, all these services are provided to the customers through all commercial banks for example-state bank, Allahabad bank, ICICI etc. ATM of state bank of India is shown below.



Pict. 3.4 : ATM centre

In the above picture we see an ATM centre. ATM-cum-debit card is required for withdrawal of money from ATM.



Pict. 3.4 : ATM Card

ATM-cum-debit card is shown in picture 3.4. A secret pin is required for the operation through ATM-cum-debit card. How we draw money from ATM machine is shown in picture 3.5.



Pict. 3.5 : ATM Machine

(II) Credit card:

Credit card is also a type of plastic money. UISA, Master card, America express etc. are mostly used credit card. Bank limits the amount of credit of its customer under credit card, after considering customer's financial situation. Customers usually buy goods and services through the medium of credit cards within the fixed limit of money. Credit card is shown in picture 3.6.



Pict. 3.6 : Credit card

Economic Importance of money:

Money has its own importance in modern and economic system. Our economic system would collapse without money in modern society. Economic progress of different countries of the world was not possible without money. During the process of economic development, money has an important role to play in socialist economy or capitalist economy and even in mixed economy. A famous economist Truscott is of the opinion regarding economic importance of money, "money is necessarily a source of blood, if not the heart of the economy." Today

economic system cannot operate even for a minute without money. Therefore Prof. Marshall is of the opinion that "Money is the pivot around which the whole economic service clusters." Crowther throws light on the importance of money and says that "every branch of knowledge has its own important invention for example, wheel in mechanics, fire in science, and vote in political success. In the same manner, in the economic and commercial life of people, money is the most useful invention, which is the basis of complete system. Infact money is an important invention of human bird. The following lines explain the importance of money.

"money ! money!! Money!!!

Brighter than sunshine

Sweeter than honey."

Thus it is clear that each aspect of modern life is affected by money. Prof. Pigeon has rightly said, "In the modern world, industry is closely unfolded in the garment of money.

Advantage of Money:

Money is most useful for us. The whole society is affected by money positively. Money has an important place in all divisions of economics for e.g. consumption, production, exchange, distribution and public finance. Some of the important advantages of money are a follow:

1. Money has facilitated consumers: The invention of money is most profitable. Each consumer purchases goods according to his or

her choice. This facility was not possible under faster system. Money is the base of demand of consumers. The person with more money demands more goods and services. Scarcity of money decreases the demand.

2. Money has facilitated production:

Money has facilitated production. Producers can assemble appropriate quantity of factors of production, purchase and store of raw materials and arrange capital on credit with the help of money time to time. It is impossible to know the cost of production, expected price of the good and expected amount of profit without money.

3. Money and Credit:

Credit system is possible only because of money and credit money: The structure of modern business is based on credit. Banks promote small savings of people and provide money on credit & industries. Thus money is the basis of credit.

4. Removal of Barter difficulties:

The money has removed the inconvenience of barter and exchange has become easier due to money.

5. Liquidity of money and capital:

People accept capital, as money provides liquidity to capital. Capital can be used in the form of money. A person with money can buy things according to his necessity and satisfy his wants.

6. Mobility of money and capital:

Money makes capital mobile. With the use of money, capital can be transferred not only from one place to another but also from one country to another. It has made the development of business and trade successful.

7. Money and capital formation:

Money is an important source of capital formation. People save money and transfer it to productive uses. It accelerates capital formation. Thus, money is an important source of capital formation.

8. Money and large scale industries:

It is because of money production that establishment of industries is possible on large scale.

9. Money and economic progress:

Money is an index of economic progress.

10. Money and social welfare:

Money is a measure of National Income and per capita income of any country. Increasing per capita income of any country promotes economic welfare of the country. Social welfare can be measured with the help of money.

Importance of money can be understood after going through all the above-mentioned advantages. It is an important source of satisfying human wants not only of labourers, farmers, doctors, professors, engineers, politicians and socialists but also saints. Money has provided many services in economic life. So, it is rightly said, "Money is a good servant"

Advantage of Money

- Benefit to consumer
- Benefit to production
- Money and Credit
- Removal of Barter facilities
- Liquidity of money and capital
- Mobility of money and capital
- Money and capital formation
- Money and large scale industries
- Money and economic progress
- Money and social welfare

What is saving?

The whole income of the society is spent on goods and services. Goods are of two types:

- i. There are some goods which are used immediately or purchasable. These are known as current goods.
- ii. There are some goods which are used in productive activity. These are known as durable goods.

The whole income of the society is spent on these two types of commodities. That part of total income which is spent on current goods is known as consumption and that part of income which is spent on durable goods is known as saving. Thus it is clear that saving is the difference between income and consumption.

$$\text{Saving} = \text{Income} - \text{Consumption}$$

Saving is of two types:

- i) Saving in cash
- ii) Saving in goods

That part of income is known as saving in cash which is not spent on any type of commodities while saving in goods is known as investment. According to Crowther, "A man's saving is that part of his income which is not spent on consumption goods." Economists are of the view that for development and stability of an economy, saving and investment are equally important. This can be expressed with the help of formulae:

$$S = I \text{ or } \text{Saving} = \text{Investment}$$

Credit:

The meaning of credit is faith and confidence. Having more faith in a person means his credit is more. In economics, credit means faith in the ability of payment of debt. We say that if the credit worthiness of Arun is more in market, this means that people have more faith in his ability of debt-repayment. On the basis of this creditworthiness, each person or institution gives credit to another person or institution. According to Gide, "Credit is an exchange which is complete after the expiry of a certain period of time after payment."

There are two sides of credit: (i) Creditor (ii) Debtor

Creditor gives money and goods on credit and payment is deferred. This is done on the basis of faith. The money borrowed from him is repaid after some time. The repayment of goods and services is also done in the same manner. The basis of credit is faith and confidence on debtor. It is impossible to make transaction without faith and confidence. Thus it is clear that debtor borrows money, goods and services on the basis of faith at a particular time and promises to repay the amount with interest after a stipulated period of time.

Basis of Credit

The main basis of credit are as follows:

1. Confidence:

The main basis of credit is confidence. Creditor pays money on credit only when he has confidence on debtor that he will repay the same on time.

2. Character:

Character of debtor is also an important basis of credit. If the debtor is honest and having good character, he easily gets debt. The credit worthiness of characterless people is low and nobody wants to give them debt.

3. **Capacity to repay:**

Repayment capacity and ability of a person also affects his credit worthiness. Creditor advances money or debt only when he has confidence on the repayment capacity of the person. So, repaying worthiness of characterless people is low and nobody wants to give them debt.

4. **Capacity to repay:**

Repayment capacity and ability of a person also affects his credit worthiness. Creditor advances money or debt only when he has confidence on the repayment capacity of the person. So, repaying capacity of a person also affects his credit worthiness.

5. **Period of loan:**

The amount of loan also depends on the period of loan. Creditors hesitate in advancing loan for a long period because of the change in character, economic situation and capacity to pay the customer. This is the reason creditor always takes to advance loans for a short period of time.

Thus, all the above mentioned bases are essential elements of credit. These elements can be expressed in the following manner: "A person's credit depends on four C's: Confidence, Character, Capacity and Capital."

Credit paper:

Credit paper relate to all those resources which are used as credit money. Exchange of credit or debt is possible on the basis of credit-paper. These work as a medium of exchange in the transactions of goods and services. Credit paper functions as money. But there is a difference between money and credit paper, that is, money is legal tender and credit paper is not accepted legally. So, nobody can be forced to accept credit paper in the transaction.

These are of various types:

1. Cheque
2. Bill of exchange
3. Bank draft
4. Hundi
5. Promissory note
6. Traveler's cheque
7. Book credit
8. Credit proof paper

1. Cheque:

Cheque is the most common form of credit paper. It is a type of written order given by the depositor to the particular bank for the payment of written amount to written payee. The format of cheque is shown in the picture 3.7.



Pic. 3.7 : Cheque

1. Bank Draft:

Bank draft is a paper which is an order of a particular bank to its other branch or other banks for the payment of written amount to indicated person concerned on it. It is less costly to transfer from one place to another through bank draft. Bank draft is of two types, i.e. national and international. The format of bank draft is shown in fig. 3.8



Pic. 3.8 : Bank Draft

3. Travelers cheque:

Travelers cheque is issued by banks for the convenience of passengers. Any passenger can obtain traveler's cheque by depositing a fixed amount in bank. A fixed amount is printed in every traveler's cheque. Any other person cannot use this cheque because specimen signature of the concerned traveler is indicated on it.

4. Promissory note:

This is also a type of credit paper. A legal document between a lender and a borrower whereby the latter agrees to certain conditions for the repayment of the sum of money borrowed.

Today credit and credit papers are becoming more important.

Summary

- Money is an indispensable part of our life. The credit goes to money for the progress of modern age.
- The development of money is in a way an epitome of history of human civilization.
- There are two types of exchange :
(i) Barter system and (ii) Monetary system
- There were lots of difficulties in barter system for the removal of the difficulties of barter system, money was invented. The invention of money solved all the difficulties of barter system.
- Money is a matter of functions four — A medium, a measure, a standard, a store.
- Anything which possesses general acceptability as a legal tender and independent in nature, used as a medium of exchange, measure of value, standard of deferred payment and as a measure of value, is known as money.

- In India, one rupee note and coins are issued by finance department of central government, and rupees of denomination two or more are issued by Reserve Bank of India.
- Today, plastic money is more popular. ATM-cum-Debit card and credit card are most popular among plastic money. This has made exchange easier.
- Money is the pivot around which the whole economic science clusters

Money! Money!! Money!!!

Brighter than sunshine

Sweeter than Honey!

- The difference between income and consumption is saving.
- Credit is the exchange activity which is completed with repayment within stipulated period of time.
- Credit papers denote all those resources which are used in the form of credit money.
- Credit paper is of different types — Cheque, Bill of exchange, Bank draft, Hundi, Promissory note, Traveler's cheque, Book credit, Credit proof.
- Credit paper functions as money but there is one basic difference between them. Money is a legal tender while credit paper is not accepted legally.

Questions

Objective questions:

Fill up the blanks:

1. The credit goes to _____ for the progress of modern age.
2. Money is _____ of an economy.
3. The history of development of money is _____ human civilization.
4. An exchange of goods is known as _____ system.

5. Invention of money is the greatest _____ of human beings.
6. Money is a _____ of exchange
7. Due to plastic money, the exchange has become _____.
8. Money is a good _____.
9. Difference between income and expenditure is known as _____.
10. The base of credit is _____.

Short Answer type questions:

1. What is Barter system?
2. What is monetary system?
3. Define Money.
4. What is ATM?
5. What is credit card?
6. What is saving?
7. What is credit?

Long Answer type questions:

1. Explain the difficulties of barter system.
2. Explain the functions of money.
3. Discuss the economic importance of money.
4. Explain the development of money.
5. What is credit? Explain some important credit papers.

Answer of Objective Questions:

1. Money 2. Strength of life 3. History 4. Barter
5. Achievement 6. Medium 7. Easy 8. Servant
9. Saving 10. Confidence

