5 Money and Economy

Have you ever thought how many exchanges of goods and services are taking place in the economy every day? These exchanges of goods and services between individuals, and between production units became easier with the advent of money.

Fig 5.1

Anything accepted in the exchange of goods and services can generally be called money. It is money that made the exchange of goods and services faster and made specialization possible. For example, rubber farmers are able to focus solely on their production because they can convert their product, which is rubber, into money and use that money to buy other goods and services he needs.

Forms of money change day by day but we cannot think of an economy without money. This is because money influences human life at different levels such as consumers, producers, and suppliers. Banks play a major role in facilitating the activities of money in the economy. Let's examine this in the context of the functions of money.

Fig 5.2

Fig 5.3

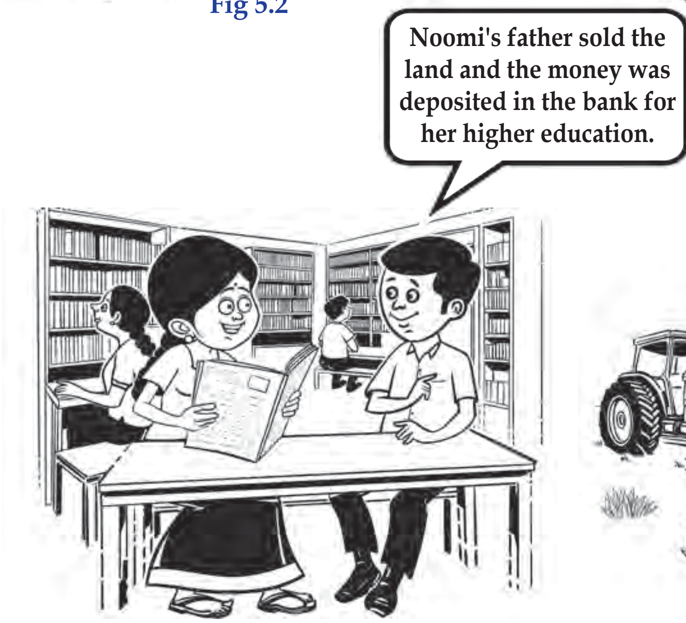


Fig 5.4

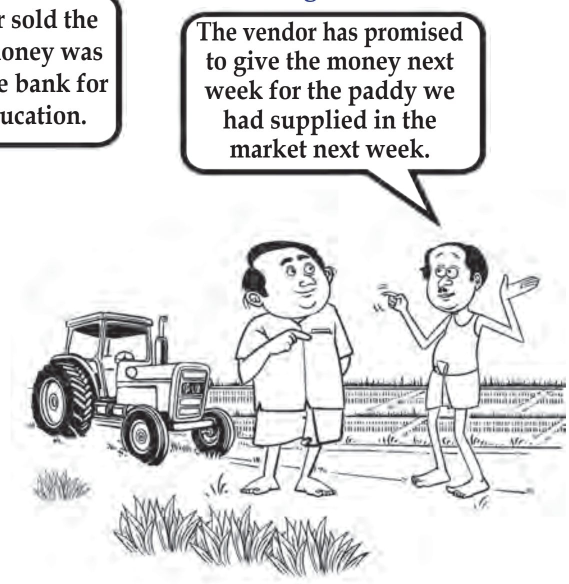


Fig 5.5

Observe the pictures. Picture 5.2 shows that money is used to buy goods. Similarly, all the pictures show the various activities that money does. Discuss with your friends and explain pictures 5.3, 5.4 and 5.5.

The above pictures indicate the various roles money plays in the economy. Money helps people to buy and sell goods and services, compare the prices of different goods and services, store the value of savings and assets, and lend and borrow money.

What were the transactions of goods and services using money in your household in the past month? Prepare a list in consultation with your parents.

General Functions of Money

Medium of Exchange: Goods and services can be sold for money, and the money can be used to purchase the goods and services that are needed. For example, labour can be supplied and its reward can be received in the form of money. The same money can be used to purchase goods and services. In this way money is crucial for making countless transactions in the economy.

Measure of value: The value of all goods can be expressed in monetary terms. In the barter system, it was not easy to compare the value of one good with the value of another. Money made it easy to compare the values of two goods. The value of a good is the price that is assigned to it in the transaction process.

Fig 5.6

Just as the value of good is measured in monetary terms, the value of money can also be expressed in terms of other goods. The value of money is its purchasing power. When the price of goods increases, the purchasing power of money will decrease, and when the price of goods decreases, the purchasing power of money will increase. Changes in the purchasing power of money are keenly felt when there is inflation or deflation in the economy.

Store of Value: When money became something that was acceptable to everyone, it had become possible to store the value of any good in the form of money. This was not possible in the barter system. Through this it is possible to convert the value of goods, including that of perishable items, into money or asset and it can be used in the future.

Means of Deferred Payments: In the modern times many business activities are carried out with ease because of the advantage of settling the financial transactions at a later date. Both buyers and sellers generally agree that the cash settlement of the transactions of goods and services can be cleared later. It is possible to measure the value of borrowing and lending in the form of money. This is very helpful for short and long-term business transactions.

Characteristics of Money

A key characteristic of money is that it is generally recognised and accepted. What other characteristics should money possess? Discuss and complete the list.

- Generally accepted
- Durable
-
-

Write down the various functions of money.

How does money work in the economy?

It is money that moves the economy and speeds up its functioning. Let's look at an example of how it stimulates the economic activities of production, distribution and consumption and strengthens the economy by making the transactions faster.

Rice production is an economic activity in the primary sector. A farmer who produces rice may need fertilizers, seeds, pesticides, machinery, and labour. When money is spent on fertilizers and machinery, it becomes a source of income for the producers in the industrial sector. When the rice producers depend upon transportation facilities to get the rice to the market, it becomes a source of income for service providers.

Fig 5.7

The money received as income by the industrial and service sectors is pumped back into the economy. In this way, each currency spent in the economy changes hands again and again. As the number of exchanges increase, the transactions in the economy also increase.

My trail

I am a hundred rupee note. At 9 am today, a student took me to a shop and bought two notebooks worth Rs. 50 each.

Using your imagination, complete my journey by writing down how many transactions I would have undergone by 5 pm, fully utilising my value. How many transactions have taken place in my journey according to you? What is the total value of these transactions?

The number of times a unit of money is exchanged in a given period of time is known as the velocity of circulation of money. An increase in the velocity of circulation money indicates an acceleration in economic growth, while a decrease in the velocity of circulation money indicates a slowdown in economic growth. In the economies where growth rate is high, producers and consumers have more chances to spend money, while in the economies where growth rate is low, producers and consumers have limited chances to spend money.

As mentioned, banks and financial institutions play a major role in facilitating money transactions and also in regulating the economic activities. Every country has its own banking system. Let's get acquainted with the banking system in India.

Money and the Central Bank

What is the source of currencies and coins in circulation in our country? Who is the ultimate authority of all this money?

In each country, the respective central banks will be the ultimate authority of this money. The Reserve Bank of India (RBI) is the central bank of India and it is headed by its Governor. It was established on 1 April 1935 in Kolkata under the Reserve Bank of India Act, 1934. In 1937, the headquarters of the Reserve Bank was shifted to Mumbai. It was nationalized in 1949.

Fig 5.8

The central bank regulates and coordinates the activities of banks and non-banking financial institutions in the economy. Let's see the functions of the Reserve Bank of India.

Functions of the Reserve Bank of India

Printing and Issuing Currency

As per the Reserve Bank of India Act 1934, only the Reserve Bank of India has the power to print and issue all currencies except coins and one rupee notes. The coins and one rupee notes are printed and issued by the Ministry of Finance, Government of India. The Reserve Bank of India is responsible for designing, incorporating the security features, printing, and distributing the currency. Currency notes are printed at the Government of India's printing presses at Nasik (Maharashtra) and Dewas (Madhya Pradesh). It is also printed at two presses at Mysore (Karnataka) and Salboni (West Bengal) by Bharatiya Reserve Bank Note Mudran Limited (BRBNML), owned by RBI. Coins are minted at the Government of India's mints at Mumbai, Hyderabad, Kolkata and Noida. Based on the government's instructions, the Reserve Bank of India can withdraw the currency notes in circulation. This is known as demonetization.


Fig 5.9

Demonetization

The most recent demonetization was implemented in India was effected on 8 November 2016. The aim was to prevent corruption, black money, terrorism, and counterfeit currencies. The existing currency notes of Rs 500 and Rs 1,000 were declared as no longer legal tender. New currency notes of Rs 500 and Rs 2,000 were printed. The public had the opportunity to deposit old currency notes, without declaration till 31 December 2016 in banks and with declaration till 31 March 2017 in the RBI.

Who prints one rupee note and coins?

Before 1835, the rupee, coins and other forms of money were used in India.

There are historical reasons why the Government of India prints one rupee note and coins. The historical convention of 1835 allowed the East India Company, on the basis of Paper Currency Act of 1835, to print paper currency in British India. The intention was to facilitate trade and commerce. The Coinage Act of 1906 and the Coinage Act of 2011 gave the central government the power to mint coins. The Government of India retains this power and therefore prints one rupee note and coins.

Bankers' Bank

The Reserve Bank acts as the bankers' bank. It provides emergency loans to banks in the times of crisis, maintains the reserves of banks, and helps to settle transactions between banks.

Controls the supply of money and credit

When the supply of money increases and the production of goods and services does not increase proportionately, there arises a situation where there are fewer goods and services and more money in the economy. This causes the prices of goods and services to rise. An increase in the general price level of goods and services is known as inflation.

Inflation in India is measured using the Consumer Price Index (CPI), which is prepared by the National Statistical Office under the Ministry of Statistics and Programme Implementation (MOSPI).

Fig 5.10

Find some news stories related to inflation and present them before the class. List the causes mentioned in each news story.

If inflation increases in the economy without any control, it causes a decrease in the purchasing power of money. It adversely affects economic growth and production. Therefore, inflation must be controlled. One of the reasons behind inflation is the increase in the quantity of money supply.

Inflation based on the General Consumer Price Index in August 2023 and September 2023 is given below.

	August 2023			September 2023		
	Urban	Rural	Total	Urban	Rural	Total
India	7.02	6.59	6.83	5.33	4.65	5.02
Kerala	6.40	6.08	6.26	4.59	4.93	4.72

Source: Kerala Economic Review 2023

- What was the change in inflation in September 2023 compared to the inflation rate in August 2023?

Have you ever wondered what will be the total amount of money in an economy? Wouldn't it be the total amount of money held by the public and the money held by banks and non-banking financial institutions in an economy?

The Reserve Bank sees the total amount of money in our economy in the form of M1, M2, M3 and M4. Let's see what they are.

M1 = Coins and currency notes held by the public and the savings deposits in commercial banks

M2 = M1 + savings deposits in post office savings banks

M3 = M1 + net fixed deposits in commercial banks

M4 = M3 + total deposits in post offices (excluding National Savings Certificates)

where M1 and M2 are known as narrow money and M3 and M4 are known as broad money.

Uncontrolled lending by banks leads to the increase in the money supply in the economy and also inflation. This needs to be controlled. RBI uses quantitative and qualitative measures to control credit.

Credit Control Measures

- **Quantitative measures**
  - **Change in bank rates**
  - **Change in reserve rates**
  - **Open market operations**
- **Qualitative measures**
  - **Margin requirement**
  - **Moral suasion**

Let's see how inflation is controlled by changing bank rates and changing the reserve ratio, by RBI. The important bank rates are the repo rate and the reverse repo.

> **Repo Rate**
>
> The rate of interest charged by the Reserve Bank of India on the loans taken by commercial banks from the RBI.
>
> **Reverse Repo Rate**
>
> The rate of interest given by the Reserve Bank of India on the deposits by the commercial banks.

For example when inflation increases unchecked, RBI increases repo rate and reverse repo rate.

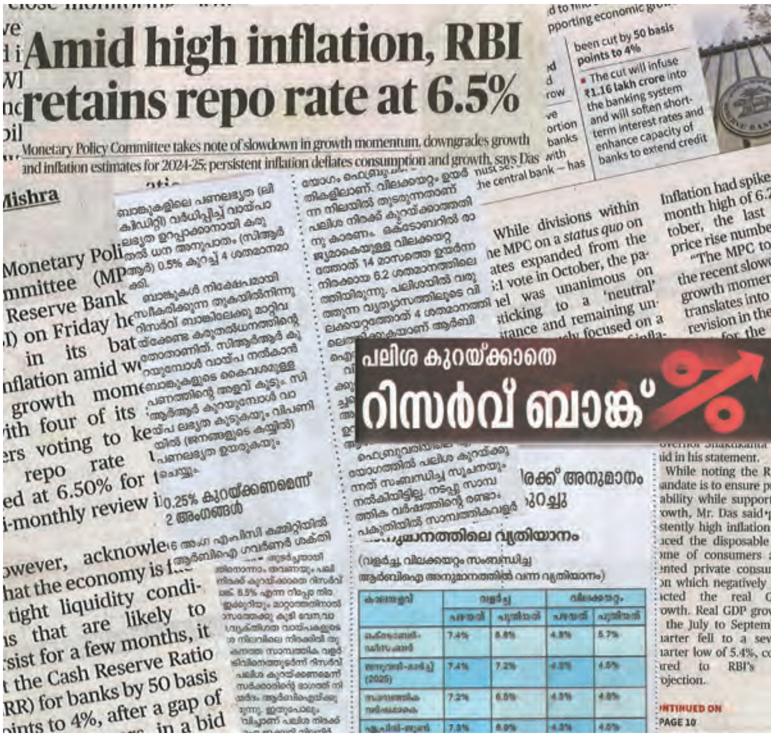
When RBI increases these rates, the commercial banks also change these rates. When these rates are increased, the money available with the commercial banks for lending fall because at a higher rate of interest the commercial banks will take less loans from RBI and deposit more in the RBI. In the same way the loan taken by the public will also be less. So the money available in the economy also would be less. When the rate of interest is high, people will prefer to save more money rather than spend, because the reward for not consuming is greater. The money held by the public flows to commercial banks and from there to the Reserve Bank. The amount of money in the economy decreases and the inflation comes under control.

The repo rates for different periods are given below

June	2022	4.90%
December	2022	6.25%
September	2023	6.50%

- Find out the trend in the repo rate.
- Discuss how the repo rate affected the credit and savings in the period from June 2022 to December 2022.

Reserve Bank of India controls the credit and supply of money by changing the Cash Reserve Ratio (CRR). This is the amount of money the banks must keep as reserves with the Reserve Bank out of the money they receive as deposits. When the reserve ratio decreases, the amount of money available with banks to lend increases and the availability of credit increases. This increases the money available with the people. However, when the reserve ratio increases, amount of money available with banks to lend will decrease. This reduces the availability of credit and reduces the amount of money people have.



Amid high inflation, RBI retains repo rate at 6.5%

Monetary Policy Committee takes note of slowdown in growth momentum, downgrades growth and inflation estimates for 2024-25; persistent inflation deflates consumption and growth, says Das

പലിശ കുറയ്ക്കാതെ
റിസർവ് ബാങ്ക്

Fig 5.11

Acts as the government's bank

The Reserve Bank of India is responsible for maintaining government accounts, providing banking services, and implementing financial management. It also advises the government on matters such as fiscal and monetary policy.

Fiscal policy

Fiscal policy is the policy regarding taxation and government spending.

Monetary policy

Monetary policy is the policy regarding the supply of money and the rate of interest.

Visit the Reserve Bank of India website and find out the current repo rate, reverse repo rate, and cash reserve ratio and present them in the class.

Custodian of foreign exchange reserves

The foreign exchange reserves of our economy are the sum total of foreign currencies and gold reserves. RBI is the custodian of all these.

Fig 5.12

Publication of Reports

RBI publishes various reports at different periods such as Banking Trends in India, Monetary Policy Reports, Consumer Surveys, RBI Bulletin and Statistical Supplements.

Analyze the functions of the Reserve Bank and explain how it regulates economic activities in India.

Fig 5.13

Banks and Non-Banking Financial Institutions

Banks and non-banking financial institutions are institutions that provide financial services to individuals, organizations, and businesses in the economy. Banks can be broadly classified into commercial banks and cooperative banks.

While the operations of commercial banks are controlled by shareholders, the ownership of cooperative banks is vested with the members of the cooperative societies. Kerala Bank is an example of a cooperative bank.

Commercial banks

Commercial banks are licensed by the RBI to provide banking services and are included in the Second Schedule of the RBI Act, 1934. Public sector banks, private sector banks, small finance banks, payment banks, specialized banks, regional rural banks, and foreign banks are some examples of commercial banks.

Fig 5.14

Commercial banks that were allowed to operate in India after the financial reforms of the 1990s are known as new generation banks. Examples include Axis Bank, Mahindra Bank, Yes Bank and Indus Bank.

Find out which banks operate in your area and list the category they fall into.

Functions of Commercial Banks

The main functions of commercial banks are to accept deposits from the public and to provide loans. Banks act as a safe haven for savings. They are able to convert the money deposited in banks into various types of loans and make them available to entrepreneurs.

Accepting Deposits

Let's get acquainted with the various types of deposit accounts offered to the public by commercial banks.

- **Savings Deposit:** This is a deposit that instills the habit of saving in individuals and allows them to withdraw money according to their needs. The depositor has the opportunity to withdraw money from such deposits, subject to restrictions. The number of times money can be withdrawn within a period and the limit on the amount that can be withdrawn varies from bank to bank. Banks often offer low interest rates on savings deposits.

- **Current Deposit:** A current account is an account intended for business transactions. There is no limit to the number of transactions that can be made from such accounts in a single day. Banks do not pay interest on the money in this account. Overdraft facility is provided for this account. An overdraft is a system that allows you to withdraw more than the amount in the current account within a predetermined limit.

- **Term Deposit or Fixed Deposit Account:** Money that is not needed to be withdrawn immediately can be deposited in such accounts. Banks pay more interest on such deposits than on money in a savings bank account. If money is withdrawn from these deposits before the maturity period, the interest rate received by the depositors may be reduced. The interest can be withdrawn upon maturity along with the deposits, or at various periods determined by the depositor.

- **Recurring Deposits:** Recurring deposits are deposits of a fixed amount of money at regular intervals for a specific period of time. Such deposits earn higher interest rates than savings deposits. However, they are lower than the interest rates on fixed deposits. At the end of the tenure, the accumulated amount can be withdrawn along with interest.

Why do banks offer higher interest rates on fixed deposits than on savings deposits?

Anu and Manu are students of Class 9. Anu won a prize of Rs. 25,000 in a state-level elocution competition. Manu receives National Merit-cum-Means Scholarship of Rs. 12,000 every year from Class 9 to 12. Both of them want to deposit this money in a bank for their higher education. Which bank accounts would you suggest for Anu and Manu to deposit this money?

Lending Loans

It is the Commercial banks that provide various loans to individuals and institutions for various financial activities. Commercial banks act as intermediaries between depositors and borrowers. Banks keep a portion of the deposits received as reserves and lend the rest to entrepreneurs. Commercial banks charge interest on the various loans they provide to their customers.

The interest rate charged to borrowers is higher than the interest rate paid to depositors. The difference between the interest paid to depositors and the interest charged from borrowers is the income of banks. This is known as the spread. Banks provide loans by accepting various collaterals. They accept gold, land documents, salary certificates, etc. as collateral.

Identify and prepare notes on various loans offered by commercial banks.

Other functions

- Providing various services

Commercial banks provide various banking services to the public.

- Credit Card ,Debit Card
- ATM Services
- Locker Facility

Visit three banks in your area and find out the rates they charge as interest for various loans and complete the table.

Item	Bank Name	Bank Name	Bank Name ....
Home Loan			
Agricultural Loan			
Personal Loan			

- Identify the type of loan for which banks charge the lowest rate of interest.
- List the collateral that the banks accept for various loans.

How do commercial banks influence economic activity?

Banks and Technology

Technology is helpful in increasing the speed of transactions. With the advent of mobile banking and online banking, customers have been able to access various banking services using smartphones and computers. Online banking is a system where bank transactions are available through the internet. Banking services that were available only at certain times and days are now available 365 days a year, anywhere in the world, due to the intervention of technology. Let's get acquainted with some of the payment systems that have emerged in the banking sector as a result of technology.

- **National Electronic Fund Transfer System (NEFT)**

This is a system introduced by the Reserve Bank of India to make bank transactions between account holders easier and faster. Funds are transferred using the Indian Financial System Code (IFSC).

- **Real Time Gross Settlement (RTGS)**

RTGS is a system introduced by the RBI to transfer large amounts of money between account holders. The feature of this is that transactions can be completed in a very short time.

- **Core Banking**

Core banking is a system that enables an account holder of a bank to carry out financial transactions from any of its branches. There is no need to go to the specific branch where the customer holds the account for the bank transactions. It is convenient for the customers.

- **Universal Payment Interface (UPI)**

UPI is a payment system developed by the National Payments Corporation of India (NPCI). It enables real-time money transfers between bank accounts. Users can connect their various bank accounts through a mobile application and make simple and secure transactions. Some of the popular UPI apps are Google Pay, Paytm, Phone Pay, BIM UPI, and Amazon Pay.

Fig 5.15

The use of cyber technology can help deliver personalized services and reduce costs, but it also poses significant challenges to security.

Organize an interview with a bank official to create awareness about the possible frauds that can occur while using banking services online and the steps we need to take against it. Prepare a questionnaire for this purpose.

Non-banking financial institutions

These are financial institutions that operate in the banking sector but perform only some of the functions of a bank. Unlike banks, non-banking financial institutions cannot accept savings and deposits from the public. Money cannot be withdrawn by using cheques from such financial institutions.

KSFE

KSFE is a non-banking financial company in Kerala. It was established in 1969 to provide financial services to the people of Kerala. It provides various services like gold loans, personal loans, business loans, vehicle loans, housing loans, microfinance and chits. through its various branches. KSFE has a strong presence in Kerala through its network of branches and the strong support of its customers.

Non-banking financial institutions are regulated by institutions such as the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDA), and National Housing Bank (NHB).

Insurance companies (e.g. LIC, GIC), mutual fund companies (e.g. UTI), and non-banking financial institutions (e.g. KSFE) are all examples of non-banking financial institutions.

Sources of Credit in India

Entrepreneurs need money to start new ventures, to expand existing ventures and to enable firms to adopt new technologies. A large percentage of this comes from banks and non-banking financial institutions. Credit can be considered as the main source for the financing of development activities. Sources of credit in India can be classified into formal and informal sources of credit. Formal sources of credit are the organized, institutionalized and regulated systems. Informal sources of credit are the unorganized and non-institutionalized systems. The mutual coexistence and operational success of both are necessary for the growth of the economy.

Sources of Credit

Formal Sources of Credit

- Banks
- Non-Banking Financial Institutions
- Self-Help Groups
- Microfinance Institutions

Informal Sources of Credit

- Local Money Lenders
- Friends, Relatives
- Other Methods

The sources of credit in Kerala during various periods are given in the table.

Source/Period	2019 January-April	2020 January-April	2021 January-April
Banks	68.55	48.77	44.51
Non-bank financial institutions, Microfinance institutions	6.29	21.8	13.33
Self-help groups	8.8	17.43	41.53
Local moneylenders	8.04	3.65	4.43
Friends, relatives	7.85	6.79	2.99

Source: Kerala Economy 2023 Vol.4 No.1

- Find out the reason for the decrease in loan share from banks and increase in loan share from SHGs during 2019-21.
- Discuss the influence of local moneylenders on the credit system in Kerala.

Credit Deposit Ratio

Credit Deposit Ratio measures the proportion of a bank's deposits that are used for loans. It is monitored by the RBI. A high credit deposit ratio indicates that banks have lent out a large portion of the deposits they have received. But what does a low credit deposit ratio indicate?

What are the different sources of credit in India?

Discuss in class how they function in the economy.

Credit deposit ratio in public sector banks in various states is given.

States	March 2021	March 2022	March 2023
Andhra Pradesh	136.20	145.62	155.40
Assam	37.69	42.98	47.27
Tamil Nadu	103.05	99.76	104.79
Kerala	64.74	65.85	72.05
Panjab	44.56	43.68	41.92

Source: Kerala Economic Review 2023

- Find out the reasons why the credit deposit ratio is high in some states and low in others.
- Examine the credit deposit ratio from March 2021 to March 2023.

Financial Inclusion

Have you noticed the steps taken by the country to bring benefits of functioning of money and financial institutions to everyone? Financial inclusion and inclusive economic growth accelerate when banking services reach the common man, the rural population and the marginalised people. Let's see what steps the government has taken for this.

Nationalization of Banks

In order to bring the functioning of banks to different parts of the country and to more people, 14 banks were nationalized in 1969 and 6 banks, in 1980. The main objectives of bank nationalization are given below.

- To expand banking facilities in rural areas
- To provide credit to farmers at lower rates
- To ensure equitable distribution of credit
- To prevent the concentration of economic power in a few people.

Co-operative Banking Systems

Co-operative banks play a crucial role in activating the rural economy by providing banking facilities to villagers and ordinary farmers. They operate on the principles of co-operation, self-help and mutual assistance. The objectives of co-operative banks are to inculcate the habit of saving among the villagers, to protect the common people from private moneylenders, and to provide low-cost loans to farmers and small businessmen.

Kerala Bank

The history of Kerala Bank starts with the registration of Thiruvananthapuram Central Co-operative Bank in 1915 through the Travancore co-operative society regulation act of His Highness Sree Moolam Thirunal in 1914. It started functioning as a bank on 18 January 1916. It was included in the Second Schedule of the Reserve Bank of India Act in July 1966. In 2019, the thirteen district co-operative banks of Kerala were merged into the Kerala State Co-operative Bank and became known as Kerala Bank. Kerala Bank operates in all 14 districts of Kerala with 823 branches.

The main objectives of Kerala Bank are to provide better banking services, ensure financial inclusion and to accelerate the economic development of the state.

Social commitment, rural development and providing support to the marginalized community are also the objectives of the bank. 40% of the bank's shares are held by the Government of Kerala, 30% by District Co-operative Bank and 30% by others. Kerala Bank provides many banking services to its beneficiaries. This includes accepting deposits, providing loans and making other monetary transactions. The bank provides many facilities to its customers with ATM services across Kerala, modern banking technology and digital platform.

Microfinance

Microfinance aims to provide financial services to low-income individuals, families, and businesses who do not have access to conventional banking services.

Poverty alleviation, empowerment of women and the marginalized, promotion of entrepreneurship and ensuring job creation, and improvement of quality of life are all goals set by microfinance.

The Grameen Bank, founded by Professor Muhammad Yunus in Bangladesh in 1983, is a good example of microfinance. Kudumbashree in Kerala works on the concept of microfinance. The work done by Kudumbashree in Kerala for poverty alleviation and women empowerment has repeatedly attracted world attention. These systems work by accepting small deposits through Neighborhood Groups and Self Help Groups (NHGS, SHGS) and by providing loans as per the need.

Jan Dhan Account

The Prime Minister Jan Dhan Account is a scheme to open an account for all those who do not have a bank account in the country. Its aim is to bring all the people of the country under the ambit of banking services. Zero minimum balance account is the special feature of this scheme. It also aims to provide financial services to the low-income group, promote financial literacy and inculcate the banking habit.

Digital currency has been the latest trend in financial transactions. The government is also promoting Aadhaar-based payment system, e-wallet and National Finance Switch to reduce the use of physical currencies and increase the use of digital currencies, thus moving towards a cashless economy.

Fig 5.16

What are the steps the government has taken to promote financial inclusion?

Money plays a vital role in enabling the economic activities of production, consumption and distribution. As money turned digital, the number and magnitude of the transactions also increased. New currencies are emerging, keeping in with the changes in the world order. Money channelled into the market for consumption goes directly to producers and distributors while money set aside for saving goes to the entrepreneurs as loans through banks and non-banking financial institutions. Banks and non-banking financial institutions play a significant role in accelerating economic growth rate by promoting transactions. The proliferation and use of technology has promoted cashless transactions and succeeded in bringing those remote areas that have hither to no access to banks into the banking network.

Extended Activities

1. Visit the website of Reserve Bank of India and prepare a class report on its various publications
2. Visit a commercial bank in your area and understand their various activities and services provided. Prepare a chart showing the credit deposit ratio, various loans and deposits and their interest rates.
3. Visit a production unit and prepare a report containing the following information.

- Operating sector (primary, secondary or tertiary)
- Services provided by the bank to this production unit
- Relation with other sectors