CHAPTER-1

MONEY AND BANKING

KEY POINTS

- Barter System and its disadvantages
- Evolution of Money
- Money– its concept, characteristics, functions, classification, role and disadvantages.
- Bank– its concept, origin, classification and function.
- Non Banking Financial Institutions.

'Every time you spend money, you're casting a vote for the kind of world you want' *–Anna Lappe*

1.01. What is barter?

Barter is the direct exchange of commodities against commodities. No individual is self-sufficient. No individual can produce all the goods and services that the individual needs to satisfy various wants. Therefore, individuals are inter-dependent. Interdependence leads to barter. Individual A produces rice but does not produce sugarcane. Individual B produces sugarcane but does not produce rice. Individual A depends on B for sugarcane; individual B depends on A for rice. There is direct exchange of the two commodities, rice and sugarcane, between A and B. What is true of individuals is also true of countries. Lack of self-sufficiency leads to interdependence. Interdependence gives rise to exchange at the international level.

1.02 Disadvantages of the barter system:

At the dawn of civilisation the barter system did not have any serious problem. Population was less. Life was simple. Wants were few.

Jonbeel Mela where the traditional barter system still prevails.

The size of the market was small. However, as time rolled by serious problems began to emerge in the barter system. These problems have finally led to the breakdown of the barter system. There are four major disadvantages of the barter system.

First, the barter system does not work when there is lack of double coincidence of wants. The exchange between A and B, in our example, takes place because there is double coincidence of wants. A has rice. She needs sugar cane. B has sugarcane and B needs rice. So there is exchange between A and B. The problem will arise when B, for example, needs fish which A does not produce. Let us suppose that C produces fish but C does not want sugarcane. There is lack of double coincidence of wants.

Secondly, the barter system lacks a common unit of account. The value of each commodity has to be expressed in terms of the value of another commodity. For example, one apple is exchanged against three guavas. Similarly for other commodities to be exchanged in the market it is impossible for the consumer to keep in mind innumerable rates of exchanges. Money economy replaces the barter economy and removes this problem. Money becomes the common unit of account. The value of each commodity in the market is expressed in terms of money. In fact, value-in-exchange is the price of the commodity.

Thirdly, the barter ceases to operate when commodities are indivisible. Can the elephant be exchanged against a piece of bread? The value of a piece of bread is low and the value of the elephant is high. But the elephant is not divisible! The money economy removes this problem of indivisibility. Money is divisible. Money can settle even a small value transaction. A thousand rupee note can be converted into five hundred rupee notes, five hundred rupee notes into hundred rupee notes and so on right down to small coins. The required amount of money is available for every transaction be it a high value or an extremely low value transaction.

Fourthly, the barter system lacks a store of value of goods and services. Value is stored up in the sense that commodities are stored up so that the stored up commodity may be exchanged against other commodities as and when such a transaction is required to take place. But the problem is that commodities are perishable. Some perish earlier (e,g, egg, fish, milk etc.) and others somewhat later (e,g, cloth, rice etc). Beyond a point of time commodities can no longer be stored up. That makes saving difficult in the barter system. Saving has to be done in the form of commodities only. In a money economy, the problem is solved. Money is durable. It can be stored up. Naturally saving will be done in the form of money. An individual may keep these savings with the banks as well. He or she may withdraw savings from the bank as and when necessary.

1.03 Evolution of Money : a brief account

Money as we know has not developed overnight. There is a certain process of evolution of money. There are five stages in the evolution of money. They are – (1) Barter System (2) Animal Standard (3) Metallic Standard (4) Coinage (5) Paper Money.

Barter system may be taken as the first stage in the evolution of money. It is true that there was no use of money in the barter system. But there was commodity money as commodities act as the medium of exchange in that system. However, the barter system broke down because of its inherent deficiencies.

In the second stage of evolution of money animals were used as money. It was the stage of animal standard. In particular goats were used as medium of exchange. However, this stage ran into two serious difficulties. First, the animal used as medium of exchange was not homogenous. Some animals were healthy, some sickly, some white, some black and so on so that it was a problem of choice for the users. It was a question of selection and rejection (eg. the white one selected and the black one rejected). Such a situation made the process of exchange hazy and uncertain. Secondly, during epidemics goats die in large numbers which would mean a sharp reduction in the supply of money, goat being money and money being goat. The monetary system would then suffer from the shortage of money. Similarly, during the breeding season, the number of goats would increase which would mean an increase in the supply of money. Over supply of money would bring down the value of money. Thirdly, indivisibility is another limitation of animal standard. Because of these problems the animal standard broke down.

The third stage in the evolution of money is the metallic standard. Gold and silver were used as money. Gold and silver, being valuable metals, were acceptable as the medium of exchange. However, metallic standard also ran into problems. First, everytime there was a transaction it was neccessary to ascertain whether it was real gold and silver or fake gold and silver. Secondly, it was not considered to be safe to carry valuable metals from one place to another because of the security risk.

Thus came the fourth stage in the evolution of money. This is the stage of coinage. Gold and silver coins were minted out of the gold and silver bars. But the problem was the inelastic supply of metals. Unless there was an increase in the supply of gold and silver it was not possible to increase the number of coins. Secondly, as trade and commerce began to spread far and wide, it became inconvenient to carry large amounts of such coins from one place to another.

Because of these problems, coinage had to yield place to paper money. Paper money heralded the fifth stage in the evolution of money. Paper money again has evolved out of two stages. In stage one, paper money was convertible into gold or silver of equivalent value. It was then convertible or representative (representing gold or silver) paper money. In stage two, paper money itself came to be accepted as money. It was no longer a claim against gold or silver. This paper money is inconvertible or non-representative paper money. Today's paper money comes under this category.

It is noteworthy that cheque is being increasingly used today in the developed as well as the developing countries. But cheque is not money as it does not have general acceptability as the medium of exchange. So also is the case with credit and debit cards.

1.04 What is money?

According to Geoffrey Crowther anything that is generally acceptable as a medium of exchange is money. General acceptability means acceptability by one and all. It is backed up by the law of the land. In other words, general acceptability has a legal basis.

1.05 Characteristics of money:

Money has a number of characteristics. These are explained below.

1. **Money must have general acceptability.** It must be acceptable as a medium of exchange. This is the most important characteristic of money.
2. **Money must have cognizability.** There should be absolutely no difficulty in identifying money. If money is not easily recognisable, transactions will naturally be problematic.
3. **Money must have durability.** Fish, egg, milk etc. can not be a money. Because these are perishable commodities. If money is perishable, money cannot be stored up. In that case, there will be no store of value. Saving will be impossible.
4. **Money must have homogeneity.** In other words, money of equivalent value must be identical in all respects. If one ten rupee note is like a ribbon in size and another is as big as the size of a register book, there will be problems of selection and rejection. The bigger one may be rejected and the smaller one accepted. Therefore, all ten rupee notes must be perfectly identical in all respects. Similarly for money of other denominations.
5. **Money must have liquidity.** Liquidity of money means direct and immediate convertibility of money into goods and services that the holder of money wants. In fact, compared to other assets, the degree of liquidity is the maximum in case of money. Land, gold, silver other assets also have liquidity but their liquidity is less than that of money as these are not directly and immediately convertible into goods and services. For example, a plot of land cannot be instantly converted into goods and services. The plot of land has to be sold out and the money earned will be used to buy goods and services. Same is the case with gold, silver and other assets. The case is different with money.

6. **Money must have transferability.** The volume of trade and commerce is expanding over time. The area of the market is being extended. It will be difficult to settle transactions, if money lacks transferability. In today's monetary and banking system it is not even necessary to physically transfer money to settle transactions. Payment may be made through adjustment of bank accounts. Credit cards and debit cards are being increasingly used to settle transactions. Core banking facilities or on-line payment may also be made to settle transactions.

7. **Money must have divisibility.** High value money may be converted into low value money. There is money to settle transactions of all values, high or low. Lack of divisibility of commodity money was another major problem of the barter system. Money can settle a transaction of 50 paise or a transaction of ₹ 50 crore.

8. **Money must have stability of value.** If the value of money continues to fall all the time, money will fail to act as the store of value. In Germany when the value of money fell sharply or the price level rose quite rapidly, people eventually refused to accept German money and a new currency had to be introduced.

It is to be noted that the characteristics of money are not substitutes for one another. Money must have all the characteristics simultaneously.

1.06 Functions of money:

Money performs four different functions. There is a couplet which runs as follows : "Money is a matter of functions four– a medium, a measure, a standard and a store."

1. **Money performs the function of a medium of exchange.** In the barter system commodities are directly exchanged against commodities; in a money economy commodities are indirectly exchanged through money. A single transaction in the barter system is splitted into two transactions in a money economy. The person producing rice will sell rice (first transaction) and the money thus earned will be used to buy cloth (second transaction). Money thus becomes the medium of exchange.

2. **Money acts as a standard of measurement of values of goods and services.** All economic goods have prices. The value in exchange expressed in terms of money is price. Money is the common unit of measurement. The value of all economic goods and services are expressed in prices only.

3. **Money acts as a standard of deferred payments.** Deferred payments are payments made later on and not at the point of time when the product or the service is delivered to the customer. It is taking commodities on credit. Accounts of all such payments are expressed in terms of money. The transactions between the creditors and debtors similarly do not involve instantaneous payments; there are cases of deferred payments. The debtor takes the loan today but repays it later on. The account of the transaction is maintained in the form of money.
4. **Money functions as the store of value.** Commodity money cannot be stored up as it does not have durability. Saving cannot be done in the form of commodity money. Durability is one of the characteristics of money. Value of goods and services may be stored up in the form of money. As and when the goods and services are needed, money can be easily converted into those goods and services. However, money will continue to act as a store of value as long as its own value does not fall rapidly. If and when the value of money falls rapidly, money may be replaced by gold or silver or land as a store of value.

The first two functions of money are known as the primary functions of money and the last two as the secondary functions of money. Apart from these four functions there are also certain contingent functions of money. For example, money transferred from the rich may be utlised for the benefit of the poor thereby reducing economic inequalities.

1.07 Types or classification or kinds of money:

In a broad sense money is of two types– money-of-account and money proper. Money-of-account is merely a concept, an abstract idea. It does not undergo a change. Money proper changes its form from time to time. What is money proper today will not remain as money proper tomorrow. Whatever is the form of money proper it will always act as money of account. Money of account is like the Office of the Prime Minister of India; money proper is like the person who happens to be the Prime Minister at any given point of time. Commodity money, animal money, metallic money and paper money were money proper at different points of time and at the same time they were also money-of-account. Independent India has seen so many personalities as Prime Ministers at different points of time but there is a common thread running through all of them – they all held the office of the Prime Minister of India!

Money proper has different types. These are :

(1) Commodity money
(2) Animal money
(3) Metallic money
(4) Paper money
(5) Legal tender money
(6) Non-legal tender money
(7) Fiat money
(8) Token money
(9) Cheque money
(10) Standard money
(11) Hot money
(12) Dear money
(13) Easy money
(14) Black money
(15) High power money

(1) Commodity money : In the barter system commodity was the medium of exchange. It was both money of account and money proper. Accounts were kept in the form of commodity.

(2) Animal money : Animals were used as money, particularly goats. Goat was the medium of exchange. It was money proper as well as money of account.

(3) Metallic money : In course of time, gold and silver came to be used as the medium of exchange. It was the stage of metallic money. It was also money of account.

(4) Paper money : Paper money has replaced metallic money as it is easy to carry. Earlier on, paper money was convertible or representative paper money as it was convertible into gold or silver of equivalent value. Today's paper money, however is inconvertible or non-representative paper money as it is no longer convertible into gold or silver. It is no longer a claim against gold or silver; it is money in its own right. It is used as the medium of exchange and accounts are also maintained in the form of paper money. Thus, it is also both money of account and money proper.

(5) Legal tender money : When the general acceptability of money as a medium of exchange is supported by the law of the land it is legal tender money. Refusal to accept it as the medium will be violation of the law. Legal tender money is of two types, limited legal tender and unlimited legal tender. Limited legal tender money is money which is acceptable upto a given value of a transaction. Transactions may be low value or high value transactions. For high value transactions it will be cumbersome to use small coins. For example, a person has sold his plot of land worth Rs. 10 lakh. If the buyer of the plot of land pays Rs. 10 lakh all in small coins, the transaction will be too cumbersome. On the other hand, unlimited legal tender money is money which can be used as a medium of exchange for transactions of any value– Rs. 10 lakh, Rs. 10 crore, Rs. 100 crore and so on. Whether limited or unlimited, legal tender money is both money proper and money of account.

(6) Non-legal tender money : When the general acceptability of money as a medium of exchange has no legal support it becomes non-legal tender money. Refusal to accept this money will not mean any violation of the law of the land. (for example, cheque money).

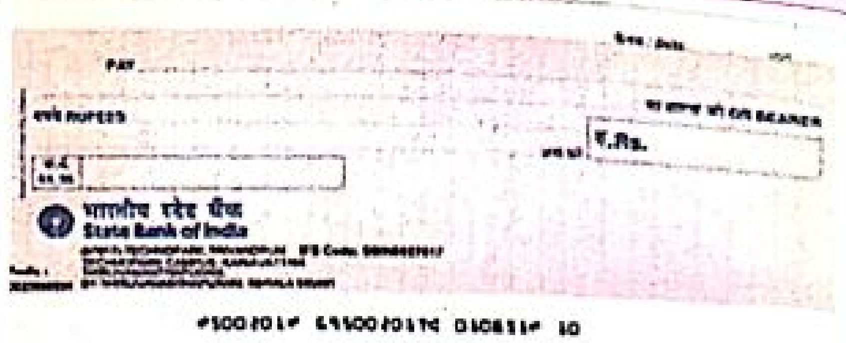
(7) Fiat money : Fiat means the authority or the power of the state. Money supported by the fiat of the state is fiat money. Like all other types of money it is money proper and also money of account.

(8) Token money : When the face value or written value or embossed value of money is higher than its intrinsic or metallic value, it becomes token money. For example, take a hundred rupee note. The word hundred is written on that currency. That is the face value. The currency is made of paper. The value of the paper used is much less than the written value. It is token money. Similarly, take a five rupee coin. The word five is embosed on the coin. But the value of the metal out of which the coin has been made is much less. It's also an example of token money. The money that we are using today are all examples of token money.

(9) Cheque money : A cheque is not legal tender money. An individual may refuse to accept payment in cheque. There is no violation of the law of the land. A cheque is a claim against money. A cheque is encashed at the counter of the bank. Although cheque is not money yet the fact remains that cheque is being increasingly used as a means of payment not only in

Token Money

the developed but also in the developing countries.



Cheque

(10) Standard money : Standard money is a unit of money. The value of other units of money are related to it. In India, the Rupee is the standard money. One paise is a unit and it is one percent of 100 paise.

(11) Hot money : Money that goes out of the country in the face of socio-economic disorder and uncertainty in the country is hot money. It is affected by speculation. It is money on the wings. It is also known as nervous money.

(12) Dear money : Dear money results from central banking action. When for example, India's Central Bank, the Reserve Bank of India (RBI) raises its rate of interest the member banks will borrow less from the RBI. In their turn, the member banks will raise their rates of interest as a result of which the borrowers will borrow less from the member banks. Money thus becomes dearer. It is the dear money policy.

(13) Easy or cheap money : When the Central Bank reduces the interest rate the member banks borrow more from the Central Bank and lend more to their borrowers. Money thus becomes cheaper. It is cheap money policy.

(14) Black money : Black money is not a distinct type of money. Any money can become black money when it is generated through economic offence. For example, tax evasion is an economic offence. Let us suppose that after all deductions and rebates from his gross annual income an individual has to pay income tax of ₹ 5 lakh (taxable income). But, the individual manipulates his tax statement in such a way that his taxable income is shown as 1 lakh. Therefore, the amount of money which should have gone to the Government Treasury, (i.e. ₹ 5-1) 4 lakhs, stays with the individual. This amount of money is black money or unaccounted money. It is the product of an economic offence.

(15) High power money : Out of the total money supply in the country that part which is under the direct control of the country's Central Bank is high-power money. By means of this money the Central Bank can increase or decrease the money supply in the country.

1.08 Role of Money:

1. Money makes exchange easier. It has removed the difficulties of the barter system.
2. The price system is an important characteristic of a market centered or even a market friendly economy. The price system is dependent on the supply of money. [A market centred economy is one where the demand and supply forces determine the output and the price of commodities and services.]
3. Even in a system where the administrative decisions of the government determine the price and output of commodities and services, and not their demand and supply, the value of output in that system is expressed in terms of money. Without money, no economic system can operate.

1.09 Drawbacks of money:

1. When money lacks stability of value, quite a number of problems will arise in the economy. For example, when the value of money continues to fall (or which is the same thing as saying that the price level continues to rise) the consumers will have to spend more money to buy the same amount of goods and services from the market. People whose income is limited and fixed suffer the most under such circumstances. Similarly, when the value of money continues to rise (the price level continues to fall), the producers face losses because of which they may decide to cut down the level of production. As and when that happens, employment opportunities will also shrink.
2. Money may be used as one of the instruments to facilitate the concentration of economic power and wealth. In an economy where money is everything money can easily become a means to acquire economic power.
3. Weakness for money may well be the cause of the erosion of the social value system. Corruption, irregularities, injustice of all types are the end results of degrading values.
4. When money takes the form of black money, the economy suffers in many different ways. For instance, the government loses considerable amount of revenue due to large scale tax evasion.

1.10 What is a bank?

Bank is a financial institution that deals in loans. Bank collects the savings from savers and offers these savings, baring a small part, to the borrowers. Farmers, industrialists, consumers, students and many other sections of people borrow from the bank. Such a business brings profit to the bank. Those who borrow from the bank have to return the principal to the bank alongwith a rate of interest. This rate of interest collected by the bank is higher than the rate of interest paid by the bank to the savers. The difference is the profit earned by the bank.

1.11 Origin of banking:

According to Geoffrey Crowther, the monetary economist, the businessmen, the gold merchants and the money lenders are the ancestors of banks. In the Middle Ages, when the Bank of Venice was set up in Italy, the word bank, began to gain wide publicity. As there was constant warfare among the city states in Italy the states were in need of finance. To mobilise resources the states appointed commissioners. These commissioners were known as Monte. During those days large areas in Italy were under the Germans. The Germans used the term 'Banck' in place of Monte. In Italy, this word was banco; in France, banke and in England, bank. The **Bank of Hindustan** the first bank in India was set up in 1770. The first bank in Assam that was set up entirely on local capital mobilisation was the **Gauhati Bank.** This bank was set up in 1926.

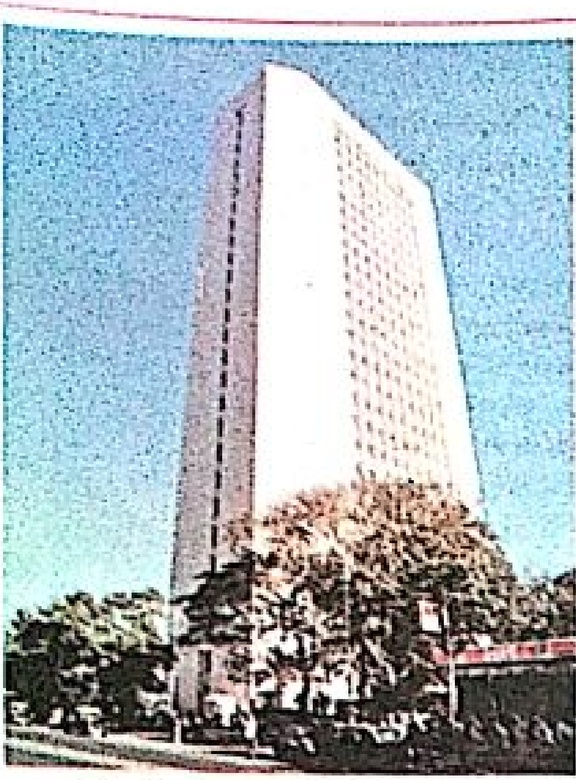
1.12 Classification or Kinds and Functions of Banks:

There are different types of banks. Among these, at this stage we discuss the functions of six banks. These are–

(i) The Central Bank, (ii) The Commercial Bank, (iii) Regional Rural Banks (RRB), (iv) Industrial Development Bank of India (IDBI), (v) Small Industries Development Bank of India (SIDBI) and (vi) National Bank for Agriculture and Rural Development (NABARD). Besides these banks there are many other banks like Asian Development Bank, the World Bank and on. At this stage it is not necessary to go into all these banks.

1. The functions of Central Bank :

The Central Bank is the head of all the banks in a country. All the banks are to operate as per instructions issued by the Central Bank. The Riksbank of Sweden is the world's oldest Central Bank. This bank was set up in 1656. India's Central Bank is the Reserve Bank of India. This bank was set up in 1935. The Central Bank performs a number of functions.



The Headquater of RBI, Mumbai

RBI Office at Guwahati

These are as follows–

(i) **The Central bank issues currency.** This is the monopoly right of the central bank as no other bank in the country enjoys this right.

(ii) **The Central bank controls the volume of credit.** Credit money constitutes a big chunk of total money supply. The quantity of credit money depends on the lending capacity of the commercial banks. The Central bank adopts credit control measures to regulate the lending capacity of the commercial banks.

(iii) **The Central bank is the bankers bank.** The Central bank examines the account of all the member banks. The Central bank is also the friend in need to all other banks. Whenever the banks are in a financial crisis, it is the Central bank that comes to their help.

(iv) **The Central bank is the financier, advisor and agent to the government.** The Central bank is the financier to the government. The government faces a budgetary deficit when the aggregate expenditure shown in the budget exceeds the aggregate revenue to be earned by the government. This deficit is removed when the Central bank prints new money and makes it available to the central government. (Deficits in state budget is not removed in this manner). The Central bank is the adviser to the government. The bank offers its own suggestions to the government to make the income policy, tax policy, trade policy and the like more effective and realistic. The Central bank is also the agent to the government. It maintains the accounts of income and expenditure of the government.

(v) **The Central bank is the custodian of the foreign exchange reserves of the country.** Foreign exchange may flow into the country in many different ways like export earnings, foreign investment and so on. The Central bank fixes the official rate of exchange. Rate of exchange is the rate at which the currency of a country is exchanged against the currency of another country. In a free enterprise economy where the state central over the economy is the minimum, the rate of exchange is basically determined by the market forces of demand for and supply of foreign currency.

(vi) **The Central bank functions as the clearing house of the member banks.** There is inter-bank lending and borrowing. The Central bank maintains the accounts of all member banks. All transactions between the lending and borrowing banks are cleared at the Central banking level.

(vii) **The Central bank has a promotional role to play.** It promotes socio-economic development as it releases funds to the priority sectors in the economy (like agriculture in India). At present, priority sector lending in India has been fixed at 40 per cent of the total deposits of the banks.

(viii) **There are miscellaneous functions which are performed by the Central bank.** The bank reviews the economic situation of the country from time to time. It supplies loans to the cooperative bank and other banks. It operates a welfare fund for educational and social purposes and so on.

2. The functions of Commercial Banks :

The banks which provide service to the public directly or indirectly by conducting activities related to savings, credit, trade etc., under the direction of Central Bank, are generally called Commercial Banks. Presently the areas of activities of these banks are increasing day by day. The functions of commercial banks are discussed below:

(I) **The commercial bank mobilises savings.** Savings are of three types : (a) current savings or deposit, (b) fixed savings or time deposit and (c) savings deposit. Current savings or deposit may be withdrawn by the saver or depositor at any time. Fixed or time deposits cannot be withdrawn like current deposits; the depositor has to give prior intimation to the bank before he or she withdraws the savings. In case of savings deposit a part can be withdrawn as and when necessary but the other part can be withdrawn only with the banks permission.

In India, according to Census 2001, only 36 per cent of India's total population had bank accounts. In 2011, it increased to 59 per cent. By 2014 (August) 210.5 million Indians had bank accounts. The number is still rising.

(ii) The commercial bank offers loans. Farmers, artisans, industrialists, thelawallahs, rickshawpullers and others receive loans.

The proper utilisation of bank loans improves the economic status of the people.

Generally, the commercial bank does not offer long term loans. Long term loans mean that the bank has to part with savings for a longer period of time. This may create a problem for the bank. The bank will not be in a position to release the savings to the depositor when he or she comes to withdraw money. People may lose confidence in the bank. Ultimately, the bank may even fail or go bankrupt.

(iii) The commercial banks as a whole can create credit money. On the basis of the primary or passive deposits the banks can create derivative or active deposits. The savings deposited with the bank by a saver is the primary or passive deposit. It is passive because it is the saver who takes the first step, the bank is passive. On the contrary, derivative or active deposits are created by the commercial banks. A part of the primary or passive deposits is retained by the bank. The banks offer the other part as loans to different sections of people in the society. The proces of credit creation starts as soon as the banks begin to offer loans.

Bank's Counter

Let us take an example. Let us suppose that A, the depositor deposits ₹ 1000 with the bank. This will be the primary or passive deposit. Let us assume that 20 per cent of this amount is kept by the bank and the rest is offered as loan. The amount of the loan, therefore, will be ₹ 800. The bank keeps 20 per cent to enable it to meet the demands of the customer at any point of time. The bank cannot offer the entire ₹ 1000 as loan. Now, let us suppose that the individual who has taken the loan of ₹ 800 from the bank pays the money to another individual who deposits the money with another bank. The second bank similarly keeps 20 per cent of ₹ 800 with itself and offers the rest i.e., ₹ 640 as loan. For the second bank ₹ 800 will be the primary or passive deposit and ₹ 640 will be the derivative or active deposit. Now, ₹ 640 is put into the third bank (primary or passive deposits) out of which 20 per cent is retained by this bank and the rest is offered as loan (derivative or active deposit). And so on. At the end of this process the total amount of deposits will be ₹ 1000 + ₹ 800 + ₹ 640 + ₹ 512 + ... 0 = ₹ 5000. Thus, on the basis of the primary or passive deposit of ₹ 1000 initially the commercial banks have created ₹ 5000. This is five times of the original amount. This is the process of creation of credit by the commercial banks.

(iv) The commercial banks also perform certain miscellaneous functions. Valuable ornaments, important documents etc. may be kept in the lockers of the bank for safe custody. Some of the banks also function as the trustee of the property of the customer or depositor.

3. The Industrial Development Bank of India (IDBI) :

The IDBI was set up in the year 1964. This bank has two primary functions (a) to offer financial assistance to the industries and (b) to develop the institutions that are related to industrial development of the country. The bank offers direct loan to the various industries. It also offers indirect loan for industrial development. For example, the IDBI gives financial assistance to the State Financial Corporation, Industrial Development Corporation, the commercial banks and such other institutions and, in their turn, these institutions offers loan to the various industries. Thus the loan from the IDBI does not come directly to the industries but through these institutions.

Another important function of the IDBI is to offer industrial loans at concessional rate of interest to industries in the backward regions of the country.

Yet another function of the IDBI is to take the initiative in creating entrepreneurship through various training programmes.

4. Regional Rural Banks (RRBs) :

Five RRBs were set up for the first time in 1975. These banks perform two main functions : (i) to provide loans at low rate of interest to the villagers and liberate them from the clutches of the private money lenders who charge extremely high rate of interest and (2) to mobilise rural savings and invest these in various productive activities. In 2014, the number of RRBs in India was 57.

5. National Bank for Agriculture and Rural Development (NABARD):

NABARD was established in the year 1982. The functions performed by the Reserve Bank of India in the field of rural credit have all been transfered to NABARD. The main functions of NABARD are:

(i) NABARD is the apex financial institution among all the institutions related to investment and production in the rural areas;

(ii) NABARD streamlines the process of offering loans, monitors and evaluates the progress of various rural schemes and organises training programmes for the beneficiaries;

(iii) NABARD coordinates the various schemes for rural development initiated by the central government, the state governments, the Reserve Bank of India and so on.

The Headquarter of NABARD in Mumbai

6. Small Industries Development Bank of India (SIDBI) :

The Bill to set up SIDBI was passed in 1989 and SIDBI started its operations from 1990. The Headquarter of SIDBI is at Lucknow. The main functions of SIDBI are :

(i) to promote modernisation and application of improved technology in small industries;

(ii) to create markets for the products of the small industries;

(iii) to create more employment opportunities in the small industries in semi urban areas and check the migration of population from these areas to the towns and cities and

(iv) to offer financial assistance to the State Financial Corporation, Industrial Corporation, commercial banks, cooperative banks and regional rural banks so as to enable these institutions to offer loans to the small industries.

SIDBI

1.13. Non Banking Financial Institutions (NBFIs):

Like the banks NBFIs also collect savings from the savers and advances these savings as loans to various people. But there are two main differences between the banks and the NBFIs. First, the depositors can withdraw money from the banks through cheque; NBFI depositors cannot do that. Secondly, in case of banks there is the Deposit Insurance Scheme to cover the risk of the depositors; NBFIs do not have such schemes.

NBFIs are required to be registered with the Reserve Bank of India. Many NBFIs not registered with the RBI cheat the depositors as they suddenly vanish leaving no trace of their existence.

SUMMARY

The story of evolution of money is interesting. Any commodity or substance cannot be money. Money must have certain characteristics. Because of these characteristics money can perform certain functions. There are different types of money. Money plays an important role in the economic system. Money has removed the inconveniences of the barter system. Of course, money also has its own problems. The banking system creates money. The Central bank is the head of all the banks. Reserve Bank of India is the central bank of India. There are different types of banks, each with specific functions. There are certain financial institutions outside the banking system of the country. These are known as the Non Banking Financial Institutions or Intermediaries. There are differences between banks and NBFIs.

EXERCISE

Very short answer type questions :

1. What is barter?
2. What is money?
3. Mention one important function of money.
4. Give an example of non-legal tender money
5. What is representative paper money?
6. What is a bank?
7. In which year was the Reserve Bank of India set up?
8. What is current deposit?

Short answer type questions :

1. How does the lack of double coincidence of wants create problems in the barter system?
2. What is meant by store of value?
3. Which characteristic of money is the most important one and why?
4. What is liquidity of money?
5. 'Money is the common unit of measurement of the value of goods and services.' Explain.
6. What is the difference between limited and unlimited legal tender?
7. What are the functions of the Regional Rural Banks?
8. How are the Non Banking Financail Institutions different from the banks?

Long answer type questions :

1. Explain four demerits of the barter system.
2. Explain any four characteristics of money.
3. Explain four major functions of money.
4. Is cheque money? Give reasons for your answer.
5. Mention four problems associated with money.
6. Explain any four functions of the Central Bank.
7. Explain any two major functions of the commercial banks.
8. Briefly explain any two functions of each of the following :

   (i) IDBI, (ii) RRBs, (iii) NABARD, (iv) SIDBI