UNIT 5

Monetary Economics

INTRODUCTION

MEANING OF MONEY

Money is anything which is generally accepted as medium of exchange, measure of value, store of value and as means of standard of deferred payment.

FUNCTIONS OF MONEY

Functions of money can be classified into Primary and Secondary

Primary/Basic functions

- **Medium of Exchange:** - It can be used in making payments for all transactions of goods and services.
- **Measure /Unit of value:** - It helps in measuring the value of goods and services. The value is usually called as price. After knowing the value of goods in single unit (price) exchanges become easy.

Secondary functions:-

- **Standard of deferred payments:-** Deferred payments referred to those payments which are to be made in near future.

MONEY ACTS AS A STANDARD DEFERRED PAYMENT DUE TO THE FOLLOWING REASONS:

- Value of money remains more or less constant compared to other commodities.
- Money has the merit of general acceptability.
- Money is more durable compare to other commodity.
- Store of value: Money can be stored and does not lose value

MONEY ACTS AS A STORE OF VALUE DUE TO THE FOLLOWING REASONS:

- It is easy and economical to store.
- Money has the merit of general acceptability.
- Value of money remains relatively constant

MONEY HAS OVER COME THE DRAW BACKS OF BARTER SYSTEM:

- Medium of Exchange: Money has removed the major difficulty of the double coincidence of wants.

- Measure of value: Money has become measuring rod to measure the value of goods and services and is expressed in terms of price.
- Store of value: It is very convenient, easy and economical to store the value and has got general acceptability which was lacking in the barter system.

RBI publishes information for four alternative measures of Money supply, namely M1,M2,M3 and M4.

- M1 = Currency, coins and demand deposits
- M2 = M1 + Savings deposits with post office savings banks
- M3 = M2 + Time deposits of all commercial and cooperative banks
- M4 = M3 + Total deposits with Post offices.
- M1 and M2 are known as narrow money
- M3 and M4 are known as broad money

QUANTITY THEORY OF MONEY

- In monetary economics, the quantity theory of money is the theory that money supply has a direct, positive relationship with the price level.
- The theory was challenged by Keynesian economics, but updated and reinvigorated by the monetarist school of economics.
- This approach first emerged in Fisher's book The Purchasing Power of Money (1911).
- For most economists of that period, money was viewed solely as a means of exchange. The only reason for holding money was to facilitate transactions.
- Fisher's analysis commences with a simple identity (a statement that is by definition true), sometimes referred to as the equation of exchange.

MV = PT where

- M = Money Supply
- V = Transactions Velocity of Circulation of money (the number of times the money stock changes hands per period).
- P = Price level.
- T = The number of Transactions undertaken per period

NOTE THAT

MV = money stock * number of times the money stock is spent per period
= total spending per period.
PT = Price of goods & services * volume of goods & services bought per period

= total expenditure per period.

Fisher restated his equation of exchange to incorporate the banking sector. Thus,

PT = MV + M'V'

Where M is quantity of currency (termed primary money by Fisher)

V is the velocity of circulation of currency

M' is the quantity of bank deposits

and V' is the velocity of circulation of deposit money

CAMBRIDGE APPROACH (CASH BALANCES APPROACH)

I) MARSHALL'S EQUATION

The Marshall equation is expressed as:

M = KPY

Where

M is the quantity of money

Y is the aggregate real income of the community

P is Purchasing Power of money

K represents the fraction of the real income which the public desires to hold in the form of money.

Thus, the price level P = M/KY or the value of money (The reciprocal of price level) is 1/P = KY/M

II) KEYNES' EQUATION

Keynes equation is expressed as:

n = pk (or) p = n / k

Where

nis the total supply of money

pis the general price level of consumption goods

kis the total quantity of consumption units the people decide to keep in the form of cash,

Keynes indicates that K is a real balance, because it is measured in terms of consumer goods.

MEANING OF INFLATION

Inflation is a consistent and appreciable rise in the general price level. In other words, inflation is the rate at which the general level of prices for goods and services is rising and consequently the purchasing power of currency is falling.

TYPES OF INFLATION ON THE BASIS OF SPEED

(i) Creeping inflation (ii) Walking inflation (iii) Running inflation and (iv) Galloping inflation or Hyper inflation.

DEMAND-PULL VS COST-PUSH INFLATION I) DEMAND-PULL INFLATION:

- ❖ Demand and supply play a crucial role in deciding the inflation levels in the society at all points of time.
- ❖ When the cost of raw materials and other inputsrises inflation results. Increase in wages paid to labour also leads to inflation.

IS INFLATION GOOD FOR THE ECONOMY?

- ❖ Yes and No.
- ❖ Yes because Inflation helps producers realize better margins.
- ❖ This incites them to do better and produce more. No because it reduces the buying power of the consumer in real terms.

DEFLATION

- ❖ The essential feature of deflation is falling prices, reduced money supply and unemployment. Though falling prices are desirable at the time of inflation, such a fall should not lead to the fall in the level of production and employment.

MEANING OF TRADE CYCLE

- ❖ A Trade cycle refers to oscillations in aggregate economic activity particularly in employment, output, income, etc. It is due to the inherent contraction and expansion of the elements which energize the economic activities of the nation.

PHASES OF TRADE CYCLE

- ❖ The four different phases of trade cycle is referred to as (i) Boom (ii) Recession (iii) Depression and (iv) Recovery

BOOK EXERCISE QUESTIONS - MULTIPLE CHOICE QUESTIONS

PART - A

1. The RBI Headquarters is located at

a) Delhi b) Chennai
c) Mumbai d) Bengaluru

2. Money is

a) acceptable only when it has intrinsic value
b) constant in purchasing power
c) the most liquid of all assets
d) needed for allocation of resources

3. Paper currency system is managed by the

a) Central Monetary authority
b) State Government
c) Central Government
d) Banks

4. The basic distinction between M1 and M2 is with regard to

a) post office deposits
b) time deposits of banks
c) saving deposits of banks
d) currency

5. Irving Fisher's Quantity Theory of Money was popularized in

a) 1908 b) 1910 c) 1911 d) 1914

6. MV stands for

a) demand for money
b) supply of legal tender money
c) Supply of bank money
d) Total supply of money

7. Inflation means

a) Prices are rising
b) Prices are falling
c) Value of money is increasing
d) Prices are remaining the same

8. __________ inflation results in a serious depreciation of the value of money.

a) Creeping b) Walking
c) running d) Hyper

9. __________ inflation occurs when general prices of commodities increases due to increase in production costs such as wages and raw materials.

a) Cost-push b) demand pull
c) running d) galloping

10. During inflation, who are the gainers?

a) Debtors
b) Creditors
c) Wage and salary earners
d) Government

11. ____________ is a decrease in the rate of inflation.

a) Disinflation b) Deflation
c) Stagflation d) Depression

12. Stagflation combines the rate of inflation with

a) Stagnation b) employment
c) output d) price

13. The study of alternating fluctuations in business activity is referred to in Economics as

a) Boom b) Recession
c) Recovery d) Trade cycle

14. During depression the level of economic activity becomes extremely

a) high b) bad
c) low d) good'

15. "Money can be anything that is generally acceptable as a means of exchange and that thesame time acts as a measure and a store of value", This definition was given by

a) Crowther b) A.C.Pigou

c) F.A.Walker d) Francis Bacon

16. Debit card is an example of

a) currency b)paper currency

c) plastic money d) money

17. Fisher's Quantity Theory of money is based on the essential function of money as

a) measure of value

b) store of value

c) medium of exchange

d) standard of deferred payment

18. V in MV = PT equation stands for

a) Volume of trade

b) Velocity of circulation of money

c) Volume of transaction

d) Volume of bank and credit money

19. When prices rise slowly, we call it

a) galloping inflation

b) mild inflation

c) hyper inflation

d) deflation

20. ___________ inflation is in no way dangerous to the economy.

a) walking b) running

c) creeping d) galloping

Answers

1	2	3	4	5	6	7	8	9	10
c	c	a	b	c	b	a	d	a	a
11	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**
a	a	d	c	a	c	c	b	b	c

PART - B

Answer the following questions in one or two sentences

21. Define Money.

Definitions of Walker and Crowther are given below

❖ "Money is, what money does" - Walker.

❖ "Money can be anything that is generally acceptable as a means of exchange and atthe same time acts as a measure and a store of value". –Crowther.

22. What is barter?

❖ Exchange of goods for goods is known as "Barter Exchange" or "Barter System".

❖ In a barter system, the commodities and services were directly exchanged for other commodities and services.

❖ Goods like furs, skins, salt, rice, wheat, utensils, weapons, etc. were commonly used as money.

23. What is commodity money?

❖ In the past, most societies used a commodity with some intrinsic value for money.

❖ In order to function as money, the commodity had to be widely acceptable, which means that everyone had to be willing to accept it as a payment for goods or services.

❖ **Examples :** They have been popular commodity monies because they could be used for various purposes – jewellery, dental fillings etc. - as well as for transactions.

24. What is gold standard?

❖ Gold Standard is a system in which the value of the monetary unit or the standard currency is directly linked with gold.

❖ The monetary unit is defined in terms of a certain weight of gold.

25. What is plastic money? Give example.

❖ The latest type of money is plastic money.

❖ Plastic money is a term that is used predominantly in reference to the hard plastic cards used every day in place of actual bank notes.

❖ Plastic money can come in many different forms such as Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards.

26. Define inflation.

Definitions of Coulbourn and Gregorye are given below,

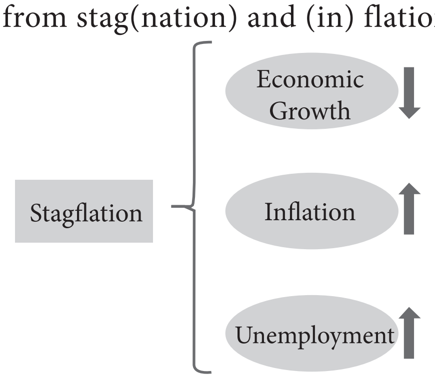
❖ " Too much of Money chasing too few goods" - Coulbourn

❖ "A state of abnormal increase in the quantity of purchasing power"- Gregorye

27. What is Stagflation?

❖ Stagflation is a combination of stagnant economic growth, high unemployment and high inflation.

❖ It is the co-existence of a high rate of unemployment and inflation. (derived from stag(nation) and (in) flation).



Answer the following questions in one Paragraph.

28. Write a note on metallic money.

❖ Under metallic standard, some kind of metal either gold or silver is used to determine the standard value of the money and currency.

❖ Standard coins made out of the metal are the principal coins used under the metallic standard.

❖ These standard coins are full bodied or full weighted legal tender. Their face value is equal to their intrinsic metal value.

29. What is money supply?

❖ Money supply means the total amount of money in an economy.

❖ It refers to the amount of money which is in circulation in an economy at any given time.

❖ Money supply plays a crucial role in the determination of price level and interest rates.

❖ Money supply viewed at a given point of time is a stock and over a period of time it is a flow.

30. What are the determinants of money supply?

1. Currency Deposit Ratio (CDR); It is the ratio of money held by the public in currency to that they hold in bank deposits.
2. Reserve deposit Ratio (RDR); Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.
3. Cash Reserve Ratio (CRR); It is the fraction of the deposits the banks must keep with RBI.
4. Statutory Liquidity Ratio (SLR); It is the

fraction of the total demand and time deposits of the commercial banks is the form of specified liquid assets.

31. Write the types of inflation.

On the basis of speed:

(i) Creeping inflation

(ii) Walking inflation

(iii) Running inflation and

(iv) Galloping inflation or Hyper-inflation.

On the basis of demand and cost:

(i) Demand-Pull Inflation

(ii) Cost-Push Inflation

On The Basis Of Inducement:

(i) Currency inflation

(ii) Credit inflation

(iii) Deficit induced inflation

(iv) Profit induced inflation

(v) Scarcity induced inflation

(vi) Tax induced inflation

32. Explain Demand-pull and Cost push inflation.

(i) Demand-Pull Inflation:

❖ Demand and supply play a crucial role in deciding the inflation levels in the society at all points of time. For instance, if the demand is high for a product and supply is low, the price of the products increases.

(ii) Cost-Push Inflation:

❖ When the cost of raw materials and other inputsrises inflation results. Increase in wages paid to labour also leads to inflation.

33. State Cambridge equations of value of money.

i) Marshall's Equation

The Marshall equation is expressed as:

$$\boxed{M = KPY}$$

Where

M is the quantity of money

Y is the aggregate real income of the community

P is Purchasing Power of money

K represents the fraction of the real income which the public desires to hold in the form of money.

Thus, the price level P = M/KY or the value of money (The reciprocal of price level) is 1/P = KY/M

ii) Keynes' Equation

Keynes equation is expressed as:

n = pk (or) p = n / k

Where

n is the total supply of money

p is the general price level of consumption goods

k is the total quantity of consumption units the people decide to keep in the form of cash,

Keynes indicates that **K** is a real balance, because it is measured in terms of consumer goods.

34. Explain disinflation.

i. Disinflation is the slowing down the rate of inflation by controlling the amount of credit (bank loan, hire purchase) available to consumers without causing more unemployment.

ii. Disinflation may be defined as the process of reversing inflation without creating unemployment or reducing output in the economy.

PART - D

Answer the following questions in about a page.

35. Illustrate Fisher's Quantity theory of money.

Introduction:

- The credit for popularizing this theory in recent years rightly belongs to the well-known American economist, Irving Fisher who published his book, 'The Purchasing Power of Money" in 1911.
- He gave it a quantitative form in terms of his famous "Equation of Exchange".

The general form of equation given by Fisher:

$$MV = PT$$

Fisher points out that in a country during any given period of time, the total quantity of money (MV) will be equal to the total value of all goods and services bought and sold (PT).

MV = PT

Supply of Money = Demand for Money

This equation is referred to as "Cash Transaction Equation".

Where M = Money Supply/quantity of Money

V = Velocity of Money

P = Price level

T = Volume of Transaction.

It is expressed as P = MV / T which implies that the quantity of money determines the price level and the price level in its turn varies directly with the quantity of money, provided 'V' and 'T' remain constant.

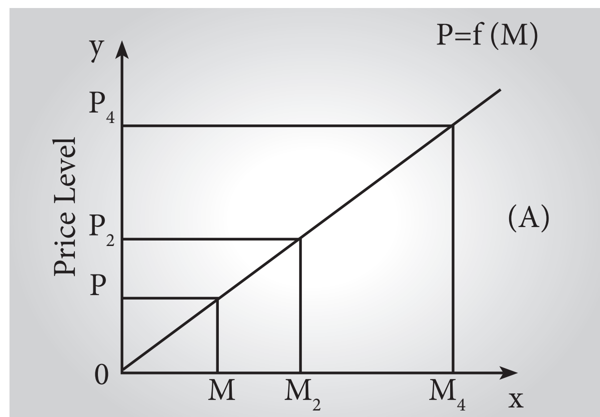
Extended Form of equation

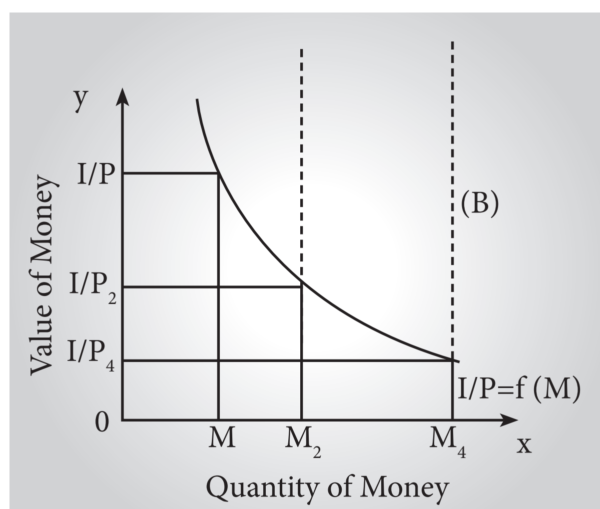
Fisher extended his original equation of exchange to include bank deposits M1 and its velocity V1. The revised equation was:

$$PT = MV + M^1V^1$$

$$P = \frac{MV + M^1V^1}{T}$$

From the revised equation, it is evident, that the price level is determined by (a) the quantity of money in circulation 'M' (b) the velocity of circulation of money 'V' (c) the volume of bank credit money M1 (d) the velocity of circulation of credit money V1 and the volume of trade (T)





i. Figure (A) shows the effect of changes in the quantity of money on the price level. When the quantity of money is 0M, the price level is 0P.

ii. When the quantity of money is doubled to 0M2 , the price level is also doubled to 0P2.

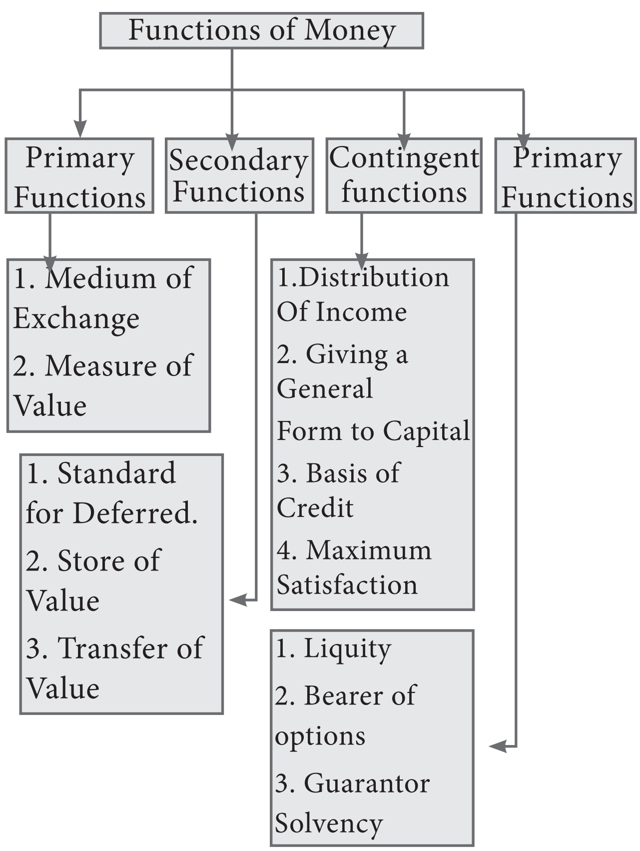
iii. Further, when the quantity of money is increased four-fold to 0M4 , the price level also increases by four times to 0P4.

iv. **Figure (B)** shows the inverse relation between the quantity of money and the value of money, where the value of money is taken on the vertical axis.

v. With the quantity of money increasing by four-fold to 0M4, the value of money is reduced by 0I / P4.

vi. This inverse relationship between the quantity of money and the value of money is shown by downward sloping curve 1 / 0P = f(M).

36. Explain the functions of money.



1. Primary Functions

i) **Money as a medium of exchange:** This is considered as the basic function of money. Money has the quality of general acceptability, and all exchanges take place in terms of money.

ii) **Money as a measure of value:** The second important function of money is that it measures the value of goods and services.

2. Secondary Functions:

i) **Money as a Store of value:** Savings done in terms of commodities were not permanent. But, with the invention of money, this difficulty has now disappeared and savings are now done in terms of money.

ii) **Money as a Standard of Deferred Payments:** Borrowing and lending were difficult problems under the barter system. In the absence of money, the borrowed amount could be returned only in terms of goods and services.

iii) **Money as a Means of Transferring Purchasing Power:** The field of exchange also went on extending with growing economic development. The exchange of goods is now extended to distant lands.

3. Contingent Functions:

i) **Basis of the Credit System:** Money is the basis of the Credit System. Business transactions are either in cash or on credit.

ii) **Money facilitates distribution of National Income:** The task of distribution of national income was exceedingly complex under the barter system.

iii) **Money helps to Equalize Marginal Utilities and Marginal Productivities:** Consumer can obtain maximum utility only if he incurs expenditure on various commodities in such a manner as to equalize marginal utilities accruing from them.

iv) **Money Increases Productivity of Capital:** Money is the most liquid form of capital. In other words, capital in the form of money can be put to any use.

4. Other Functions:

i) **Money helps to maintain Repayment Capacity:** Money possesses the quality of general acceptability. To maintain its repayment capacity, every firm has to keep assets in the form of liquid cash.

ii) **Money represents Generalized Purchasing Power:** Purchasing power kept in terms of money can be put to any use.

iii) **Money gives liquidity to Capital:** Money is the most liquid form of capital. It can be put to any use.

37. What are the causes and effects of inflation on the economy?

Meaning of Inflation

Inflation is the rate at which the general level of prices for goods and services is rising and consequently the purchasing power of currency is falling.

The main causes of inflation in India are as follows:

i) Increase in Money Supply: Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand.

ii) Increase in Disposable Income: When the disposable income of the people increases, it raises their demand for goods and services.

iii) Increase in Public Expenditure: Government activities have been expanding due to developmental activities and social welfare programmes.

iv) Increase in Consumer Spending: The demand for goods and services increases when they are given credit to buy goods on hire-purchase and installment basis.

v) Cheap Monetary Policy: Cheap monetary policy or the policy of credit expansion also leads to increase in the money supply

vi) Deficit Financing: In order to meet its mounting expenses, the government resorts to deficit financing by borrowing from the public and even by printing more notes.

vii) Black Assets, Activities and Money: The existence of black money and black assests due to corruption, tax evasion etc., increase the aggregate demand. People spend such money, lavishly.

viii) Repayment of Public Debt: Whenever the government repays its past internal debt tothe public, it leads to increase in the money supply with the public.

ix) Increase in Exports: When exports are encouraged, domestic supply of goods decline. So prices rise.

Effects of Inflation

The effects of inflation can be classified into two heads:

(1) Effects on Production and

(2) Effects on Distribution.

1. Effects on Production:

When the inflation is very moderate, it acts as an incentive to traders and producers. The profit due to rising prices encourages and induces business class to increase their investments in production, leading to generation of employment and income.

i) However, hyper-inflation results in a serious depreciation of the value of money and it discourages savings

ii) When the value of money undergoes considerable depreciation, this may even drain out the foreign capital

iii) With reduced capital accumulation, the investment will suffer a serious set-back which may have an adverse effect on the volume of production

iv) Inflation also leads to hoarding of essential goods both by the traders as well as the consumers and thus leading to still higher inflation rate.

v) Inflation encourages investment in speculative activities rather than productive purposes.

2. Effects on Distribution

i) **Debtors and Creditors:** During inflation, debtors are the gainers while the creditors are losers.

ii) **Fixed-income Groups:** The fixed income groups are the worst hit during inflation because their incomes being fixed do not bear any relationship with the rising cost of living.

iii) **Entrepreneurs:** Inflation is the boon to the entrepreneurs whether they are manufacturers, traders, merchants or businessmen, because it serves as a tonic for business enterprise.

iv. **Investors:** The investors, who generally invest in fixed interest yielding bonds and securities have much to lose during inflation.

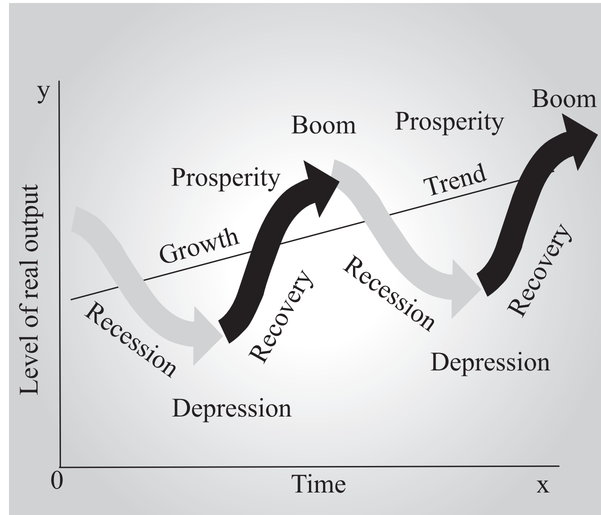
38. What are the causes and effects of inflation on the economy?

Meaning of Trade Cycle

A Trade cycle refers to oscillations in aggregate economic activity particularly in employment, output, income, etc.

Phases of Trade Cycle

The four different phases of trade cycle is referred to as (i) Boom (ii) Recession (iii) Depression and (iv) Recovery.



i) **Boom or Prosperity Phase:** The full employment and the movement of the economy beyond full employment is characterized as boom period. During this period, there is hectic activity in economy. Money wages rise, profits increase and interest rates go up.

ii) **Recession:** The turning point from boom condition is called recession. This happens at higher rate, than what was earlier. Generally, the failure of a company or bank bursts the boom and brings a phase of recession.

iii) **Depression:** During depression the level of economic activity becomes extremely low. Firms incur losses and closure of business becomes a commonfeature and the ultimate result is unemployment. Interest prices, profits and wages are low.

iv. **Recovery:** After a period of depression, recovery sets in. This is the turning point from depression to revival towards upswing. It begins with the revival of demand for capital goods. Autonomous investments boost the activity. The demand slowly picks up andin due course the activity is directed towards the upswing with more production, profit, income, wages and employment.

Additional One marks

1. ……………………..is a branch of economics that provides a framework for analyzing money.

   a. Fiscal Economics

   b. Micro Economics

   c. Monetary Economics

   d. International Economics

2. " ……………. can be anything that is generally acceptable as a means of exchange and atthe same time acts as a measure and a store of value". What Crowther denotes as 'anything' in the definition given?

   a. Money b. Assets

   c. Gold d. Vehicles

3. Which of the following is not an example of barter system?

   a. furs, skins, utensils, weapons

   b. furs, skins, utensils, but not weapons

   c. automated teller machine

   d. none of the above

4. Gold Standard is a system in which the value of the monetary unit or the standard currency is ………….. linked with gold

   a. directly b. indirectly

   c. positively d. negatively

5. ……………. is a monetary arrangement in which a country's Government allows conversion of its currency into fixed amount of silver.

   a. The Gold Standard

   b. The silver standard

   c. The Metallic standard

   d. None of the above

6. Which of the following is note an example of Plastic money?

   a. Credit cards

   b. Debit cards

   c. Pre-paid Cash cards

   d. Bonds

7. Identify anexample of digital currency.

   a. crypto currencies

   b. ATM

   c. Legal Tender Money

   d. None of the above

8. Assertion (A)Money has the quality of general acceptability, and all exchanges take place in terms of money.

   Reason (R) On account of the use of money, the transaction has now come to be divided into two parts.

   a. Both (A) and (R) are true and (R) is the correct explanation of (A).

   b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).

   c. (A) is true, but (R) is false.

   d. (A) is false, but (R) is true.

9. What is the basis of the Credit System.?

   a. State b. Computer

   c. PAYTM d. Money

10. In India, ……………...are issued by the Reserve Bank of India (RBI) and …………are issued by the Ministry of Finance, Government of India (GOI).

    a. coins and currency notes

    b. currency notes and coins

    c. currency notes and pass books

    d. none of the above

11. Match the items in the List – I with items in List – II. Select the correct answer from the code given below :

List – I		List – II
I.	M1	1. Currency, coins and demand deposits
II.	M2	2. M1 + Savings deposits with post office savings banks
III.	M3	3. M2 + Time deposits of all commercial and cooperative banks
IV.	M4	4. M3 + Total deposits with Post offices.

Codes :

	I	II	III	IV
a.	3	2	1	4
b.	2	4	1	3
c.	2	3	4	1
d.	**1**	**2**	**3**	**4**

12. ………….and ………………. are known as narrow money.

a. M2 and M3 b. M3 and M4
c. M1 and M2 d. M1 and M4

13. ………………. and ……………. are known as broad money.

a. M2 and M3 b. M3 and M4
c. M1 and M2 d. M1 and M4

14. The new symbol designed by D.Udaya Kumar, a post graduate of IIT Bombay was finally selected by the Union cabinet on ……………

a. 15th July, 2010 b. 16th July, 2010
c. 15th July, 2011 d. 25th July, 2010

15. The new symbol of Rupee is an amalgamation of Devanagri 'Ra' and the ………….without the stem.

a. Arial 'R' b. Roman 'R'
c. Italian 'R' d. Greek Script 'R'

16. The symbol of India rupee came into use on ………?

a. 25th July, 2010 b. 16th July, 2010
c. 15th July,2010 d. None of the above

17. Which of following country do not to accept a unique currency symbol?

a. China b. America
c. Britain d. Japan

18. Expand the CDR.

a. Cash Deposit Ratio (CDR)
b. Currency Digital Ratio (CDR)
c. Currency Deposit Ratio (CDR)
d. Currency Deposit Ration (CDR)

19. Expand the RDR

a. Renew deposit Ratio (RDR)
b. Reserve development Ratio (RDR)
c. Rational deposit Ratio (RDR)
d. Reserve deposit Ratio (RDR)

20. Expand the CRR

a. Capital Reserve Ratio (CRR)
b. Cash Reserve Ratio (CRR)
c. Government Reserve Ratio (CRR)
d. Cash Revised Ratio (CRR)

21. Expand the SLR

a. Statutory Liquidity Ratio (SLR)
b. State Liquidity Ratio (SLR)
c. Small Liquidity Ratio (SLR)
d. Statutory Liquid Ratio (SLR)

22. What is SLR?

a. It is the fraction of the total demand and time deposits of the commercial banks is the form of specified liquid assets.
b. Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.

c. It is the fraction of the deposits the banks must keep with RBI.

d. It is the ratio of money held by the public in currency to that they hold in bank deposits.

23. Who published the book, 'The Purchasing Power of Money" in 1911

a. Arthur b. Hicks

c. Irving Fisher d. Pigou

24. Who gave a quantitative form in terms of his famous "Equation of Exchange"?

a. Irving Fisher b. J.M.Keynes

c. J.A. Schumpeter d. R.F.Kahn

25. Given the equation , V1 represents ...?PT = MV + M^1V^1

(a) the quantity of money in circulation

(b) the velocity of circulation of money

(c) the volume of bank credit money

(d)the velocity of circulation of credit money

26. What is the other name of Cambridge Approach?

a. Quantity theory of money

b. Cash Balances Approach

c. Modern theory of Money Approach

d. Classical Approach

27. Given the equation, M = KPY, which is wrongly denoted?

a. M is the quantity of money

b. Y is the aggregate real income of the community

c. K represents the fraction of the real income which the public desires to hold in the form of money.

d. None of the above

28. According to Marshall's equation, the value of money is influenced not only by changes in M, but also by changes in

a. K b. P c. Kl d. Pl

29. In Keynes' extended equation: n = p (k + rk') or p = n/(k + rk'), which one is wrongly denoted?

a. n = total money supply

b. p = price level of consumer goods

c. k = peoples' desire to hold money in hand (in terms of consumer goods) in the total income of them

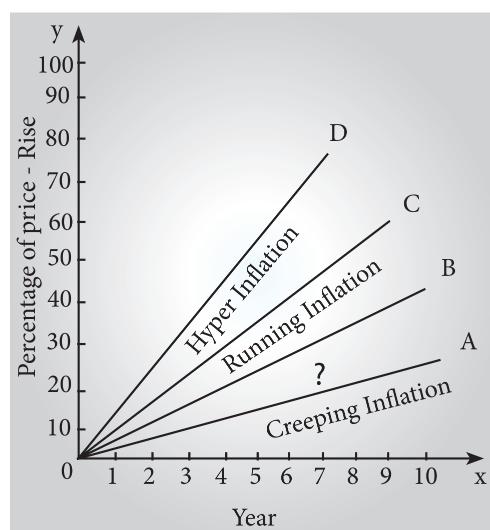
d. r = community's total money deposit in banks, in terms of consumers goods.

30. Who said the following statement? "A state of abnormal increase in the quantity of purchasing power"

a. Fisher b. Gregorye

c. Marshall d. Keynes

31. Find the missing type of inflation



a. Walking Inflation

b. Running Inflation

c. Creeping Inflation

d. Hyper Inflation

32. ………………….. is also known as mild inflation or moderate inflation.

a. Walking Inflation
b. Running Inflation
c. Creeping Inflation
d. Hyper Inflation

33. …………………… can be possible When prices rise moderately and the annual inflation rate is a single digit (3% - 9%).

a. Walking Inflation
b. Running Inflation
c. Creeping Inflation
d. Hyper Inflation

34. When prices rise rapidly like the running of a horse at a rate of speed of …………. per annum, it is called running inflation.

a. 1% - 2 % b. 100% - 200 %
c. 10% - 20% d. None of the above

35. By Galloping inflation, the percentage of the same is almost ……….. from an overall perspective.

a. 1% - 2 % b. 100% - 200 %
c. 10% - 20% d. 20% to 100%

36. In which country the first hyper inflation of the 21st century took place?

a. Zimbabwe b. Namibia
c. Venezuela d. India

37. Scarcity induced inflation has happened in Venezula of the year ……….

a. 2017 b. 2018
c. 2016 d. 2008

38. Assertion (A) : Reduced capital accumulation may discourage entrepreneurs and business men from taking business risk.

Reason (R) With reduced capital accumulation, the investment will suffer a serious set-back which may have an adverse effect on the volume of production in the country.

a. Both (A) and (R) are true and (R) is the correct explanation of (A).
b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).
c. (A) is true, but (R) is false.
d. (A) is false, but (R) is true.

39. Find which is not a an example of Fixed-income Groups?

a. wages b. salary
c. pension d. organization

40. Which is not a major anti-inflationary fiscal measures: are the following

a. Reduction of Government Expenditure
b. Public Borrowing
c. Augmenting Foreign Investment
d. Enhancing taxation.

41. Stagflation is a combination of stagnant economic growth, high unemployment and high inflation…………?

a. high inflation b. low inflation
c. no inflation d. disinflation

42. After a period of depression…………… sets in.

a. recovery b. prosperity
c. boom d. trough

43. Assertion (A) : When the disposable income of the people increases, it raises their demand for goods and services.

Reason (R) : Disposable income may increase with the rise in national income or reduction in taxes or reduction in the saving of the people.

a. Both (A) and (R) are true and (R) is the correct explanation of (A).
b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).
c. (A) is true, but (R) is false.
d. (A) is false, but (R) is true.

44. Equation of exchange is associated with:

a. Pigou b. J.B.Say
c. Marshall d. Irving Fisher

45. The theory explaining the direct relationship between the price level and quantity of money is known as :

a. Quantity theory of money
b. Say's law of markets
c. Real theory of interest
d. None of these

46. Equation of exchange is converted into the quantity theory of money by assuming the following variables as constants:

a. V and T b. M and V
c. M and P d. V and P

47. Fisher's Equation of quantity theory states that :

a. P varies directly with income
b. P varies directly with M
c. P and M are constants
d. None of the above

48. In the Cambridge equation of M = kPY, the value of k is:

a. M/V
b. 1/V
c. V in Fisher's equation
d. None of these

49. In the Fisher's extended equation of exchange MI VI represents:

a. Credit money
b. Primary money
c. Both primary and credit money
d. General price level

50. In Fisher's transaction velocity model, one of the following is not an assumption:

a. Velocity of circulation of money is constant
b. The volume of transactions is constant
c. Full employment
d. P is considered as an active factor

51. In the equation MV+ MI VI = PT, 'M 'denotes:

a. Velocity of money
b. Money in circulation
c. Bank deposit
d. None of these

52. The Cambridge version of the quantity theory of money was developed by:

a. Fisher b. Alfred Marshall
c. Pigou d. Keynes

53. In Fisher's equation of exchange MV=PT, the variation of which produces a proportional change in price:

a. M b. V c. P d. T

54. In MV=PT, if M doubles and V and T remain constant, then P will:

a. Double b. 1/2 c. 1 d. 4

55. Assertion (A) : Gold Standard is a system in which the value of the monetary unit or the standard currency is directly linked with gold.

Reason (R) :The monetary unit is defined in terms of a certain weight of gold.

a. Both A and R are true and R is the correct explanation of A.
b. Both A and R are true but R is not the correct explanation of A.
c. A is true but R is false.
d. A is false but R is true.

56. Assertion (A) : Fisher extended his original equation of exchange to include bank deposits M1 and its velocity V1.

Reason (R) : In a modern economy, bank's demand deposits or credit money and its velocity play a vital part in business.

a. Both A and R are true and R is the correct explanation of A.

b. Both A and R are true but R is not the correct explanation of A.

c. A is true but R is false.

d. A is false but R is true.

57. Assertion (A) : When the disposable income of the people decreases, it raises their demand for goods and services.

Reason (R) : Disposable income may increase with the rise in national income or reduction in taxes or reduction in the saving of the people.

a. Both A and R are true and R is the correct explanation of A.

b. Both A and R are true but R is not the correct explanation of A.

c. A is true but R is false.

d. A is false but R is true.

58. Assertion (A) :During inflation, debtors are the gainers while the creditors are losers.

Reason (R) : The debtors had borrowed when the purchasing power of money was high and now repay the loans when the purchasing power of money is low due to falling prices.

a. Both A and R are true and R is the correct explanation of A.

b. Both A and R are true but R is not the correct explanation of A.

c. A is true but R is false.

d. A is false but R is true.

59. Money is

a. Backed by gold in Fort Knox

b. The same as income.

c. The value of all coins and currency in circulation at any time.

d. Anything that is generally accepted as a medium of exchange.

60. The development of money as a medium of exchange has facilitated the expansion of trade because

a. Holding money increases people's income

b. No other mediums of exchange are available

c. Money eliminates the "double coincidence of wants" problem

d. Holding money increases people's wealth

61. A recession is:

a. A period of declining unemployment.

b. A period of declining prices

c. A period during which aggregate output declines

d. A period of very rapidly declining prices.

62. Inflation is measured by the

I. consumer price index (CPI).

II. GDP deflator.

III. current account.

IV. depreciation.

a. I and II only.

b. I and III only.

c. III and IV only.

d. I, II and III.

63. During stagflation

I. an increase in aggregate spending will eliminate the recession.

II. a decrease in aggregate spending will reduce inflation.

III. government faces contradictory goals.

IV . The central bank decreases money supply to reduce inflation.

a. I and II only.

b. III and IV only.

c. I, II and III only.

d. I, II, III and IV.

64. Which of the following are costs of inflation?

I. Inflation weakens the creation of credit and capital markets.

II. Inflation distorts business behavior, especially investment behavior.

III. Inflation increases the prices of foreign goods relative to domestic goods.

IV. Inflation imposes a tax on the holders of money.

a. I and II only.

b. III and IV only.

c. I, II and IV only.

d. I, II and III only.

65. Demand pull inflation results from

a. demand for government spending on public goods goes down due to lack of financial backup through tax collection.

b. consumer, business, and government demand for goods and services in excess of an economy's capacity to produce.

c. a shortage of demand for good and services in excess of supply during depression.

d. demand for public goods is greater than demand for consumer goods.

66. What problems are we most likely to see at which stage of the business cycle?

a. High inflation during recessions.

b. High unemployment during booms.

c. Low inflation during booms.

d. High unemployment during recessions.

67. Match the correct codes

1	Gold Standard	i	Refers to the monetary system in which the paper currency notes issued by the Treasury or the Central Bank or both circulate as unlimited legal tender.
2	The silver standard	ii	Such as Bitcoin now provide an outlet for Personal Wealth that is beyond restriction and confiscation
3	The paper currency standard	iii	A monetary system in which the standard economic unit of account is a fixed weight of silver.
4	Decentralised crypto currencies	iv	A system in which the value of the monetary unit or the standard currency is directly linked with gold.

Codes

a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)

b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)

c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)

d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

68. Match the correct codes

1	It is the ratio of money held by the public in currency to that they hold in bank deposits	i	CRR
2	Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI	ii	SLR
3	It is the fraction of the deposits the banks must keep with RBI	iii	RDR
4	It is the fraction of the total demand and time deposits of the commercial banks is the form of specified liquid assests	iv	CDR

Codes

a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

69. Match the correct codes

1	MV = PT	i	Fisher's Quantity Theory of Money:
2	Revised equation of fisher	ii	PT = MV + M1V1
3	Marshall's Equation	iii	M = KPY
4	Keynes equation	iv	n = pk (or) p = n / k

Codes

a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
d. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)

70. Match the correct codes

1	"Too much of Money chasing too few goods"	i	Walker
2	"A state of abnormal increase in the quantity of purchasing power"	ii	Crowther
3	" Money is, what money does"	iii	Gregorye
4	"Money can be anything that is generally acceptable…"	iv	Coulbourn

Codes

a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

71. Match the correct codes

1	Creeping inflation	i	Points out to unmanageably high inflation rates that run into two or three digits.
2	Walking or trolling inflation	ii	Slow-moving and very mild.
3	Running inflation	iii	When prices rise moderately and the annual inflation rate is a single digit 3% - 9%)
4	Galloping inflation or hyper inflation	iv	When prices rise rapidly like the running of a horse at a rate of speed of 10% - 20% per annum,

Codes

a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

Answers

1	2	3	4	5	6	7	8	9	10
c	a	c	a	b	d	a	a	d	b
11	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**
d	c	b	a	b	d	a	c	d	b
21	**22**	**23**	**24**	**25**	**26**	**27**	**28**	**29**	**30**
a	a	c	a	d	b	d	b	d	b
31	**32**	**33**	**34**	**35**	**36**	**37**	**38**	**39**	**40**
a	c	a	c	d	a	b	a	d	c
41	**42**	**43**	**44**	**45**	**46**	**47**	**48**	**49**	**50**
a	a	b	c	a	a	b	b	a	d
51	**52**	**53**	**54**	**55**	**56**	**57**	**58**	**59**	**60**
b	c	a	a	b	a	d	c	d	c
61	**62**	**63**	**64**	**65**	**66**	**67**	**68**	**69**	**70**
c	a	d	c	b	d	c	c	a	c
71									
b									

Additional Two Marks

1. What is Monetary Economics?

❖ Monetary Economics is a branch of economics that provides a framework for analyzing money and its functions as a medium of exchange, store of value and unit of account.

2. Write a brief history of barter system

i. Barter system was introduced by Mesopotamia tribes.

ii. Phoenicians adopted bartering of goods with various other cities across oceans.

iii. Babyloninan's also developed an improved barter system, where goods were exchanged for goods.

3. Write a short note on silver standard.

❖ The silver standard is a monetary system in which the standard economic unit of account is a fixed weight of silver.

❖ The silver standard is a monetary arrangement in which a country's Government allows conversion of its currency into fixed amount of silver.

4. Define paper currency.

The paper currency standard refers to the monetary system in which the paper currency notes issued by the Treasury or the Central Bank or both circulate as unlimited legal tender.

5. What do you know about crypto currencies?

Decentralised crypto currencies such as Bitcoin now provide an outlet for Personal Wealth that is beyond restriction and confiscation.

6. Write about"Money as a Standard of Deferred Payments" in short.

❖ Borrowing and lending were difficult problems under the barter system.

❖ In the absence of money, the borrowed amount could be returned only in terms of goods and services.

❖ But the modern money-economy has greatly facilitated the borrowing and lending processes.

7. Write about Money as a Means of Transferring Purchasing Power in short.

❖ The field of exchange also went on extending with growing economic development.

❖ The exchange of goods is now extended to distant lands.

8. Write about Money Increases Productivity of Capital in short.

Money is the most liquid form of capital. In other words, capital in the form of money can be put to any use.

9. Mention the components of Money Supply in India.

M1 = Currency, coins and demand deposits

M2 = M1 + Savings deposits with post office savings banks

M3 = M2 + Time deposits of all commercial and cooperative banks

M4 = M3 + Total deposits with Post offices.

10. What are the other names for M1, M2, M3 nd M4 Money?

- M1 and M2 are known as narrow money
- M3 and M4 are known as broad money

11. Write a note on "New Rupee on India"

- The new symbol, is an amalgamation of Devanagri 'Ra' and the Roman 'R' without the stem.
- The symbol of India rupee came into use on 15thJuly,2010.
- After America, Britain, Japan, Europe Union. India is the 5th country to accept a unique currency symbol.

12. What is Currency Deposit Ratio (CDR)?

It is the ratio of money held by the public in currency to that they hold in bank deposits.

13. What is the meaning of Cash Reserve Ratio (CRR)?

It is the fraction of the deposits the banks must keep with RBI.

14. What is Reserve deposit Ratio (RDR)?

Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.

15.Define the "Statutory Liquidity Ratio"?

SLR or "Statutory Liquidity Ratio"is the fraction of the total demand and time deposits of the commercial banks is the form of specified liquid assests.

16. State the terms of "MV = PT"

Fisher points out that in a country during any given period of time, the total quantity of money (MV) will be equal to the total value of all goods and services bought and sold (PT).

$$\boxed{MV = PT}$$

Supply of Money = Demand for Money

This equation is referred to as "Cash Transaction Equation".

17. Write the Fisher's Extended Form of equation

Fisher extended his original equation of exchange to include bank deposits M1 and its velocity V1. The revised equation was:

$$\boxed{\frac{PT = MV + M^{1}V^{1}}{T}}$$

18. Express the terms of Marshall's Equation.

The Marshall equation is expressed as:

$$\boxed{M = KPY}$$

Where

M is the quantity of money

Y is the aggregate real income of the community

P is Purchasing Power of money

K represents the fraction of the real income which the public desires to hold in the form of money.

19. Present the version of Keynes extended equation.

Keynes extended his equation in the following form:

$$\boxed{n = p\,(k + rk') \text{ or } p = n/(k + rk')}$$

Where,

n = total money supply

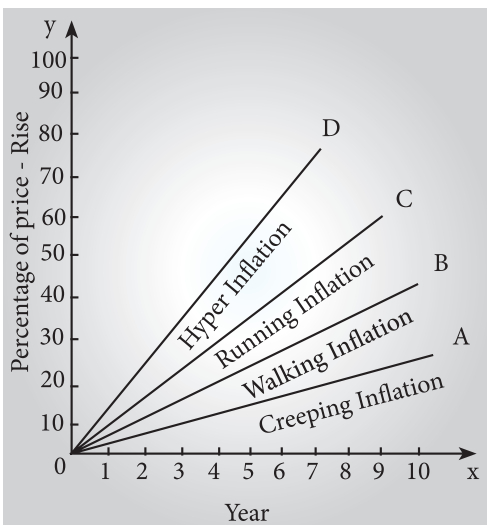
p = price level of consumer goods

k = peoples' desire to hold money in hand (in terms of consumer goods) in the total income of them

r = cash reserve ratio

k' = community's total money deposit in banks, in terms of consumers goods

20. Draw the diagram of inflation on the basis of speed.



21. Write the meaning of Galloping inflation.

❖ Galloping inflation or hyper inflation points out to unmanageably high inflation rates that run into two or three digits.

❖ By high inflation the percentage of the same is almost 20% to 100% from an overall perspective.

22. What is "Wage-Price Spiral"?

Wage-price spiral is used to explain the cause and effect relationship between rising wages and rising prices or inflation.

23. Write a note on Scarcity induced inflation.

❖ Scarcity of goods happens either due to fall in production (eg. farm goods) or due to hoarding and black marketing.

❖ This also pushes up the price.

❖ This has happened is Venezula in the year 2018.

24. Write a note on Tax induced inflation.

Increase in indirect taxes like excise duty, custom duty and sales tax may lead to rise in price (eg. petrol and diesel). This is also called taxflation.

25.State the Monetary Measures for Inflation.

i. These measures are adopted by the Central Bank of the country.

ii. They are (i) Increase in Bankrate (ii) Sale of Government Securities in the Open Market (iii) Higher Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) (iv) Consumer Credit Control and (v) Higher margin requirements (vi) Higher Repo Rate and Reverse Repo Rate.

26. State the Fiscal Measures for Inflation.

❖ Fiscal policy is now recognized as an important instrument to tackle an inflationary situation.

❖ The major anti-inflationary fiscal measures are the following: Reduction of Government Expenditure and Public Borrowing and Enhancing taxation.

27. What is deflation?

❖ The essential feature of deflation is falling prices, reduced money supply and unemployment.

❖ Though falling prices are desirable at the time of inflation, such a fall should not lead to the fall in the level of production and employment.

28. Write the meaning of Depression.

- ❖ During depression the level of economic activity becomes extremely low.
- ❖ Firms incur losses and closure of business becomes a common feature and the ultimate result is unemployment. Interest prices, profits and wages are low.
- ❖ The agricultural class and wage earners would be worst hit.

29. Compare and contrast fiat money and commodity money.

- ❖ Fiat money includes items that are designated as money that are intrinsically worthless.
- ❖ Commodity money are things like gold or silver which have alternative uses other than money.
- ❖ They can be used in dental fillings or as jewelry.

30. Answer the questions below using the following information:

All figures are in billions of dollars.

Currency held outside banks	Rs.800
Demand Deposits	1000
Traveler's Checks	100
Other checkable deposits	200
Savings accounts	300
Money market accounts	100
Other near monies	200

a. What is the value of M1?

b. What is the value of M2?

Answers:

a. Value of M1 = 800 + 1000 + 100 + 200 = Rs.2100 billion.

b. Value of M2 = 2100 (M1) + 300 + 100 + 200 = Rs.2700 billion.

31. What is Token money?

Token money is a form of money in which the metallic value of which is much less than itsreal value (or face value). Rupees and all other coins in India are all token money.

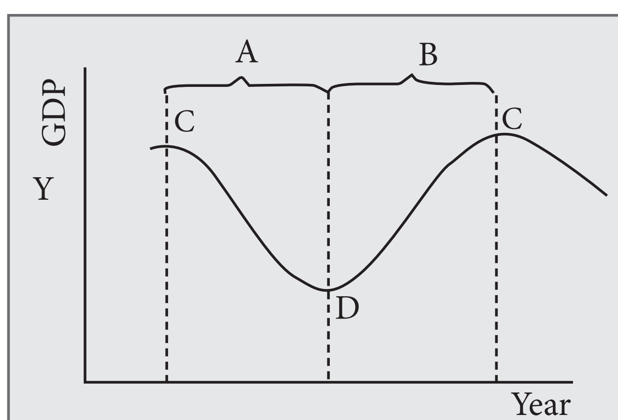
32. Write Fisher's words on money and its effect on economy.

- ❖ According to Fisher, "other things remaining the same, as the quantity of money in circulation increases, the price level also increases in direct proportion and the value of money decreases and vice versa".
- ❖ If the quantity of money doubled, the price level also double and the value of money will be one half.

33. Explain the term "Demand for Money"

- ❖ Demand for money means the demand to hold money, that is, to keep one's resources in liquid form instead of in some form of investment.
- ❖ It means the desire to hold money in liquid cash as against spending the money.

34. Use the graph below to answer the following questions:



a. Mention the phases of the "points mentioned" in business cycle graph.

A: ____________ B:____________
C: ____________ D: ____________

Answers:

A: Recession B: Recovery
C: Prosperity D: Depression

Additional Three Marks

1. Write a note on Metallic Money.

- After the barter system and commodity money system, modern money systems evolved. Among these, metallic standard is the premier one.
- Under metallic standard, some kind of metal either gold or silver is used to determine the standard value of the money and currency.
- Standard coins made out of the metal are the principal coins used under the metallic standard.
- These standard coins are full bodied or full weighted legal tender. Their face value is equal to their intrinsic metal value.

2. Explain the concept of Plastic Money.

- The latest type of money is plastic money.
- Plastic money is one of the most evolved forms of financial products. Plastic money is an alternative to the cash or the standard "money".
- Plastic money is a term that is used predominantly in reference to the hard plastic cards used every day in place of actual bank notes.
- Plastic money can come in many different forms such as Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards. They aim at removing the need for carrying cash to make transactions.

3. Explain the primary function of money.

1.Primary Functions

i) **Money as a medium of exchange:** This is considered as the basic function of money. Money has the quality of general acceptability, and all exchanges take place in terms of money.

ii) **Money as a measure of value:** The second important function of money is that it measures the value of goods and services.

4. Explain the three secondary function of money.

i) **Money as a Store of value:** Savings done in terms of commodities were not permanent. But, with the invention of money, this difficulty has now disappeared and savings are now done in terms of money.

ii) **Money as a Standard of Deferred Payments:** Borrowing and lending were difficult problems under the barter system. In the absence of money, the borrowed amount could be returned only in terms of goods and services.

iii) **Money as a Means of Transferring Purchasing Power:** The field of exchange also went on extending with growing economic development. The exchange of goods is now extended to distant lands.

5. What are the Contingent Functions?

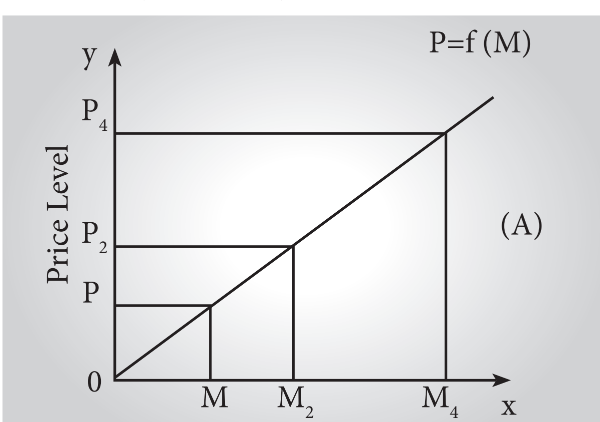
i. **Basis of the Credit System:** Money is the basis of the Credit System. Business transactions are either in cash or on credit.

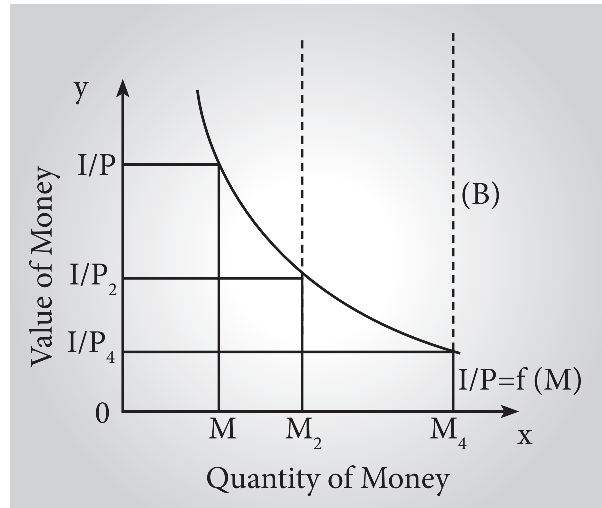
ii) **Money facilitates distribution of National Income:** The task of distribution of national income was exceedingly complex under the barter system.

iii) **Money helps to Equalize Marginal Utilities and Marginal Productivities:** Consumer can obtain maximum utility only if he incurs expenditure on various commodities in such a manner as to equalize marginal utilities accruing from them.

iv) **Money Increases Productivity of Capital:** Money is the most liquid form of capital. In other words, capital in the form of money can be put to any use.

6. Draw the diagram of Fisher's Quantity theory of money.





7. Explain "The Keynes Equation" Keynes equation is expressed as:

$$\boxed{n = pk \text{ (or) } p = n / k}$$

Where

n is the total supply of money

p is the general price level of consumption goods

k is the total quantity of consumption units the people decide to keep in the form of cash,

Keynes indicates that **K** is a real balance, because it is measured in terms of consumer goods.

According to Keynes, peoples' desire to hold money is unaltered by monetary authority. So, price level and value of money can be stabilized through regulating quantity of money (n) by the monetary authority.

Later, Keynes extended his equation in the following form:

$$\boxed{n = p\,(k + rk') \text{ or } p = n/(k + rk')}$$

Where,

n = total money supply

p = price level of consumer goods

k = peoples' desire to hold money in hand (in terms of consumer goods) in the total income of them

r = cash reserve ratio

k' = community's total money deposit in banks, in terms of consumers goods.

8. Explain any three main causes of inflation in India.

i) Increase in Money Supply: Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand.

ii) Increase in Disposable Income: When the disposable income of the people increases, it raises their demand for goods and services.

iii) Increase in Public Expenditure: Government activities have been expanding due to developmental activities and social welfare programmes.

9. Explain Effects on Production of Inflation.

When the inflation is very moderate, it acts as an incentive to traders and producers. The profit due to rising prices encourages and induces business class to increase their investments in production, leading to generation of employment and income.

i) However, hyper-inflation results in a serious depreciation of the value of money and it discourages savings

ii) When the value of money undergoes considerable depreciation, this may even drain out the foreign capital

iii) With reduced capital accumulation, the investment will suffer a serious set-back which may have an adverse effect on the volume of production

10. What is money? Explain the three functions that money performs. Which one is the primary function of money?

i) Money is anything that is generally accepted as a medium of exchange.

ii. Money must be able to act as a medium of exchange, a store of value, and a unit of account. For money to act as a medium of exchange, sellers must generally accept and buyers must generally use it to pay for goods and services.

iii. For money to serve as a store of value, it can be used to transport purchasing power from one period of time to another.

iv. For money to serve as a unit of account, it must function as a consistent way of quoting prices.

v. The primary function of money is to serve as a medium of exchange.

10. Fill in the following table by indicating whether the proposed Central Bank action will increase or decrease the money supply. If the action is not a Central Bank power then write not applicable.

Action	Effect on money supply
A decrease in central spending	
A decrease in the required reserve ratio	
A sale of government debt	
A lowering of the discount rate	
Buying government debt	
A decrease in taxes	

Answers	
Action	**Effect on money supply**
A decrease in central spending	**not applicable**
A decrease in the required reserve ratio	**increase**
A sale of government debt	**decrease**
A lowering of the discount rate	**increase**
Buying government debt	**increase**
A decrease in taxes	**not applicable**

Additional Five Mark

1. Compare and contrast inflation and deflation.

BASIS FOR COMPARISON	INFLATION	DEFLATION
Meaning	When the value of money decreases in the international market, then this situation is termed as inflation.	Deflation is a situation, when the value of money increases in the international market.
Effects	Increase in the general price level	Decrease in the general price level
National income	Does not declines	Declines
Gold prices	Falls	Rises
Classification	Demand pull inflation, cost push inflation and stagflation.	Debt deflation, money supply side deflation, credit deflation.
Good for	Producers	Consumers
Consequences	Unequal distribution of income.	Rise in the level of unemployment
Which is Good?	A little bit of inflation is a symbol of economic growth of the country.	Deflation is not good for an economy.

2. Explain the evolution of money.

BARTER SYSTEM

- ❖ Exchange of goods for goods was known as "Barter Exchange" or "Barter System".
- ❖ In a barter system, the commodities and services were directly exchanged for other commodities and services.
- ❖ Goods like furs, skins, salt, rice, wheat, utensils, weapons, etc. were commonly used as money.

METALLIC MONEY

- ❖ Under metallic standard, some kind of metal either gold or silver is used to determine the standard value of the money and currency.
- ❖ Standard coins made out of the metal are the principal coins used under the metallic standard.
- ❖ These standard coins are full bodied or full weighted legal tender.
- ❖ Their face value is equal to their intrinsic metal value.

GOLD STANDARD

- ❖ Gold Standard is a system in which

the value of the monetary unit or the standard currency is directly linked with gold.

- ❖ The monetary unit is defined in terms of a certain weight of gold.

SILVER STANDARD

- ❖ The silver standard is a monetary system in which the standard economic unit of account is a fixed weight of silver.
- ❖ The silver standard is a monetary arrangement in which a country's Government allows conversion of its currency into fixed amount of silver.

PAPER CURRENCY

The paper currency standard refers to the monetary system in which the paper currency notes issued by the Treasury or the Central Bank or both circulate as unlimited legal tender.

PLASTIC MONEY

- ❖ The latest type of money is plastic money.
- ❖ Plastic money is a term that is used predominantly in reference to the hard plastic cards used every day in place of actual bank notes.
- ❖ Plastic money can come in many different forms such as Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards.

CRYPTO CURRENCIES

- ❖ Decentralised crypto currencies such as Bitcoin now provide an outlet for Personal Wealth that is beyond restriction and confiscation.

3. Explain the supply of Money and determinants of money supply in India.

Money Supply in India

Money supply is a stock variable. RBI publishes information for four alternative measures of Money supply, namely M1,M2,M3 and M4.

M1 = Currency, coins and demand deposits

M2 = M1 + Savings deposits with post office savings banks

M3 = M2 + Time deposits of all commercial and cooperative banks

M4 = M3 + Total deposits with Post offices.

M1 and M2 are known as narrow money

M3 and M4 are known as broad money

Determinants of Money Supply

1. Currency Deposit Ratio (CDR); It is the ratio of money held by the public in currency to that they hold in bank deposits.
2. Reserve deposit Ratio (RDR); Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.
3. Cash Reserve Ratio (CRR); It is the fraction of the deposits the banks must keep with RBI.
4. Statutory Liquidity Ratio (SLR); It is the fraction of the total demand and time deposits of the commercial banks is the form of specified liquid assets.

4. Explain Measures to Control Inflation

Keynes and Milton Friedman together suggested three measures to prevent and control of inflation.

(1) Monetary measures,

(2) Fiscal measures (J.M. Keynes) and

(3) Other measures.

1. Monetary Measures: These measures are adopted by the Central Bank of the country. They are (i) Increase in Bankrate (ii) Sale of Government Securities in the Open Market (iii) Higher Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) (iv) Consumer Credit Control and (v) Higher margin requirements (vi) Higher Repo Rate and Reverse Repo Rate.

2. **Fiscal Measures:** Fiscal policy is now recognized as an important instrument to tackle an inflationary situation. The major anti-inflationary fiscal measures are the following: Reduction of Government Expenditure and Public Borrowing and Enhancing taxation.

3. **Other Measures:** These measures can be divided broadly into short-term and long-term measures.

i) **Short-term measures** can be in regard to public distribution of scarce essential commodities through fair price shops (Rationing). In India whenever shortage of basic goods has been felt, the government has resorted to import so that inflation may not get triggered.

ii) **Long-term measures** will require accelerating economic growth especially of the wage goods which have a direct bearing on the general price and the cost of living. Some restrictions on present consumption may help in improving saving and investment which may be necessary for accelerating the rate of economic growth in the long run.

5. **List the problems in defining Money Supply**

i. First, in an advanced and more important an evolving-financial system, it was not possible to define the tock of Money in an unambiguous way

ii. At least there were a number of different but equally valid definitions of the money supply and there was no strong reason for choosing one in preference to any other.

iii. As we have seen, money can be defined either narrowly or broadly.

iv. However, there are or have been within the some institutional context a number of different definitions of the money supply.

v. The definitions change frequently as does the popularity of one measure over another which partly illustrates the difficulty in trying to pin down the concept.

6. **Distinguish between Fisher's and Cambridge Equation.**

Base of difference	Fisher's Equation	Cambridge's Equaiton
1.Flow and stock of Money	Fishers's equation gives importance to flow of money.	Cambridge's equation stress on stock of money.
2. Natural of Price Level	P represents the average price level of all goods and services.	P represents the price of consumer goods.
3. Stress on Demand Supply	Firsher's view point stress on supply of money	Cambridge's view point stresses on demand of money
4. Time	It is associated with period of time	Ii is associated with point of time

Base of difference	Fisher's Equation	Cambridge's Equaiton
5. Demand of Money	Assording to Fisher., the Demand of money is for actual transactions.	According to Cambridge ideology, demand of money is for storage of meoney.

7. **Consider M = Rs. 1000. M' = Rs. 500, V = 3, V' = 2, T = 4000 goods and Find the value of money using Fisher's quantity theory of**

$$P = \frac{MV + M^1V^1}{T}$$

$$P = \frac{(1000 \times 3) + (500 \times 2)}{4000}$$

$$= \text{Re. 1 Per good}$$

Value of money (1/p) = 1

If the supply of money is doubled

$$P = \frac{(2000 \times 3) + (1000 \times 2)}{4000}$$

$$= \text{Rs. 2 Per good}$$

Value of money (1/p) = 1/2

Thus, when money supply in doubled, i.e., increases from Rs. 4000 to 8000, the price level is doubled. i.e., from Re. 1 per good to Rs. 2 per good and the value of money is halved, i.e., from 1 to 1/2.

$$P = \frac{(500\times 3) + (250 \times 2)}{4000}$$

$$= \text{Rs. 1 Per good}$$

Value of money (1/p) = 1/2

Thus, when money supply is halved, i.e., decreases from Rs. 4000 to 2000, the price level is halved, i.e., from 1 to 1/2, and the value of money is doubled, i.e., from 1 to

8. **Solve and discuss the following using Marshall "Cash Balance Approach". Suppose money supply in cash and bank deposits (M) = Rs. 1,000.(ii) The total annual national income (R) = 10,000 units.(iii) The goods (income) which the community wants to hold in money (K), say one-fifth of Y = 2,000 units**

Marshall's Equation

The Marshall equation is expressed as:

$$\boxed{M = KPY}$$

the price level P = M/KY or

the value of money = The reciprocal of price level is 1/P = KY/M

the value of money (one rupee) = 2,000 units

= (KY /M)= two units of goods, or

Prices level P = (M/KY)

= 1/2 = 0.50 paise per unit.

It is, therefore, clear that the value of money (its purchasing power) is found by dividing the total amount of goods, which the community wants to hold out of the total income (KY), by the amount of the supply of the money held by the public (M), and the price level (P) is found out by dividing the money supply (M) by the amount of goods which the community wants to hold (KY), as the price level is the opposite of the value of money.