Unit 7

Money, Banking and International Trade

Origin of Money

- Economic activities of primitive mankind confined only consumption and production. People were self-dependence at that time.
- With the passage of time and modernization, human wants multiplied, and started to exchange of goods/commodities.
- Exchange commodities for required commodities is called barter system and economy is called barter economy.
- In barter system, various difficulties likes matching double wants to exchange, acceptable measuring rod of goods and services were lacking,.
- For addressing various difficulties, money was invented and at initial phase various goods and commodities were worked as money (medium of exchange)

Origin of Money

- As barter system was and inconvenient method of exchange, the people were compelled to select some commodities which were most commonly accepted in that area as a medium of exchange.
- Thus large variety of goods/commodities were come as a exchange Medium or money in different time and different part of the world: Wheat, corn, tobacco, skins beads .... Cattle .
- Later metallic or metal coin were invented as a money.
- After the use of metal coin, gradual development was started and coins were replaced by paper notes for carrying convenience and easily portable purpose.

Meaning and Definition of Money

- Money is the generally acceptable means of exchange goods and services.
- Walker's definition : " Money is what money does".
- It gives the stress on the function of Money.
- Robertson definition: "*Money is commodity which is used to denote anything which is widely accepted in payment for goods and in discharge of other business obligation.*"
- Crowther definition: "*Anything that is generally accepted as a means of exchange and at the same time act as a measurement and the store of the value is called money.*"
- Thus money is any thing that is generally acceptable as a medium of exchange, common

Importance of Money

- Money plays a vital role in the smooth and efficient functioning of the economic system, so it is called life blood of the economic system.
- Role of Money are:

1. Importance in consumption: money act as medium of exchange and also represents the general purchasing power. It gives convenient to buyer to purchase the goods and services and makes easy in transaction.
2. Importance in Production: Money makes possible to producer to engage all factors of production by paying their reward in term of money.
3. Importance in Exchange: Money facilitates in exchange of goods and services. It avoids difficulties of barter system. External and internal trade becomes easy due to use of money.

Importance of Money

5. Importance in Public finance: Government receives revenues in the form of money by taxes, fees fines penalties and Government makes payment of wages, salaries, interest, in the form of money.
6. Importance in capital formation: Addition capital stock in a country likes equipments, tools, factories, transportation assets, road and other physical infrastructure can be easily possible with the help of money.
7. Importance in the measurement of National income: National income can be measured in the terms of Monetary value.
8. Importance in the price mechanism: Price can be determined on the basis of demand and

Function of Money:

- Money is important invention for economy, which has various function.

1. Primary Functions: it is the main functions of the money.

a) Medium of exchange

b) Measure of Value

2. Secondary Function:

a) Store of Value

b) Transfer of Value

c) Standard of deferred payment

3. Contingent function:

a) Basis of Credit

b) Distribution of National Income

c) Liquidity and uniformity of wealth d)

Value of Money:

- Value of money is defined as the quantity of goods and services that will be exchanged for one unit of money.
- Value of the money can be understood as purchasing power of money.
- Irving Fisher: " The purchasing power of money is the reciprocal of the levels of prices."
- There is inverse relationship between purchasing power and price level.
- Robertson: "The value of money means amount of the things will be given in exchange for a unit of money."
- Benham: " The value of money means the purchasing power of a unit of currency over things in general."

Quantity theory of Money (Fisher Equation)

- Initially, Quantity theory of Money propounded by an Italian economics **Davanzatti**. Later classical economists (Ricardo, Mills)explained the value of money in terms of quantity of money. **American economist Irving Fisher** popularized the Quantity theory of money.
- This theory states that there is positive relationship between price level and Quantity of money. If quantity of money increases, it leads to increase in price level too and vice versa.
- Assumptions
  - There is no change in transaction of trade volume (T), velocity of circulation of money(V), and bank money (V').
  - Money is only used as medium of exchange, no

Quantity theory of Money (Fisher Equation)

- Fisher: "Other thing being equal, as quantity of money in circulation increases, the price level also increases in direct proportion and the value of money decreases and vice versa"
- It means that if the quantity of money doubles the price level will also be doubled and vice-versa.
- Fisher Equation
- **MV=PT ....(1)**
- P=Price level, M= total amount of money in circulation
- V=velocity of circulation of money, the velocity of circulation of money is the number of times the money changes hands in the given period of times.

QTM

- Suppose Quantity of money(M) is Rs.100,000, Velocity in circulation of money(V) is 10 and total volume of trade transaction(T) is 10,000 then what will be the price level?

Solution:

As we know the QTM, **PT= MV**

- By putting the value from given question,
- P 10,000= 100,000 x 10
- Or P =1,000,000/10,000
- Or P=100

If suppose again that if Quantity of money is increased to Rs.200,000 and rest of all are same, what will be the price level?

P 10,000= 200,000 x 10

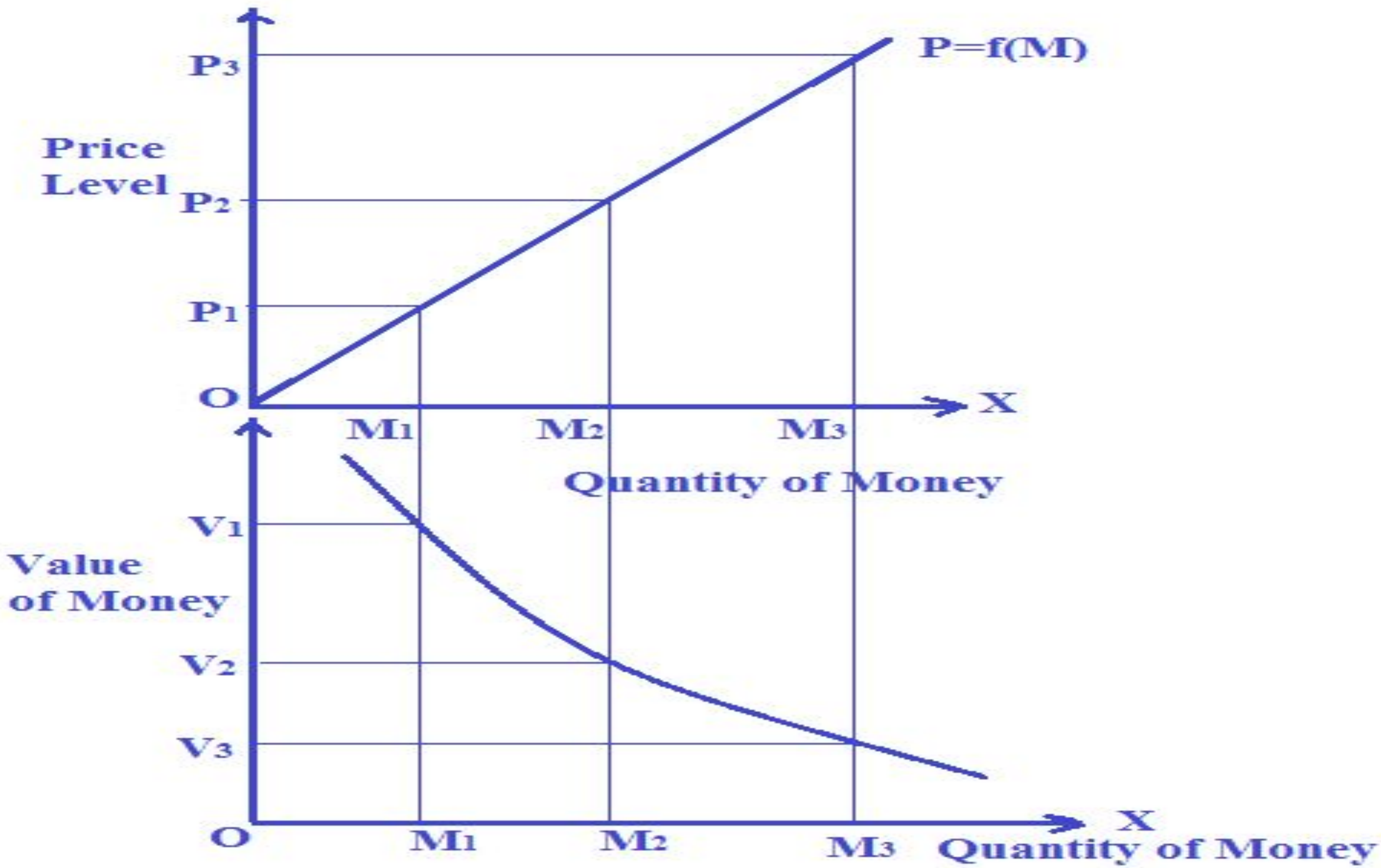
Or P = 2,000,000/10,000

Or P =200

This example showed that if quantity of money is doubled, price level is also became

Fisher's QTM in Graphical representation

Two figures show as price level increases with increases in money supply (upper par), but value of money decreases with increases of money supply(lower part).



QTM...................

- As Fisher added the bank's credit as a money the QTM, Equation (1) becomes,
- PT= MV+ M'V'.................... (2)
- Where, M'=Bank's credit as a money, and V'= Velocity of bank money.
- Criticism:
  - Based on unrealistic assumption (full employment level in long run)
  - Static theory (V,V' and T are constant)
  - Ignores other determinants of the price-level.
  - Money is not only medium of exchange.
  - Not independent variables

Money Supply

- Money supply is defined as the amount of the money in an economy at a given period of time.
- Money supply represents the stock of money at a point of time. It can be obtained by summing up the financial assets that can perform functions of money including currency in circulation.
- Money supply is the sum of currency held by public and demand deposit of public in the bank.
- Money supply is stock as well as variable.
- It is stock, which can be seen as the total quantity of money held by public in spendable form at a point of time.(variable than can be measured in a point of time is called stock)
- It is flow variable as the product of the stock of

Money Supply

- Basically, we can observe two types of monetary aggregates.
- 1.Narrow Money (M1)
- 2. Broad Money (M2)
- Narrow Money(M1) refers to the sum of currency held by the public and demand deposit held at commercial bank including other deposits held at central bank.
- i.e. $M1 = C + DD$

Where, M1= Narrow Money

C= Currency held by the public

DD= Demand deposits held at commercial banks(including othe deposits in central bank)

Broad Money (M2) is the sum of Narrow money(M1) and Time deposit.

Determinants of Money supply

- The money supply is determined by joint effort of Central bank(NRB), commercial banks and public. Basically, the role of reserve money, and money multiplier is dominant.
- Determinants of Money supply are:

1. Reserve Money (RM): RM includes currency held by public, cash held by commercial bank, Commercial bank's balances with the central bank and other deposits held at central bank. Money supply positively associated with Reserve money. Higher the RM higher will be the money supply.
2. Money Multiplier(m) = M/RM , M=total money stock, RM= reserve money, Higher the Money multiplier, higher will be the money supply.
3. Currency-demand deposit ratio (C/DD): if the public desire to hold more currency relative to

Determinants of Money supply

4.Excess reserve ratio:

5.Cash reserve ratio (CRR):

6.Time deposit Ratio:

7. Other Deposit to demand deposit Ratio:

8.Net Foreign Asset (NFA) of the monetary sector.

9 Net domestic Assets (NDA)

(a) Net claims on government (NCG)

(b) Claim on nonfinancial government enterprise (CNFGE)

(c) Claim on financial institution

(d) Claims on private sectors

(e) Other items, net (OITN)

Inflation

- Introduction to Inflation:
- Inflation is the rise in the general price level. But every rise in the general price level is not inflation. It is the persistent and appreciable rise in general price level. Inflation causes the decrease in value of money or the purchasing power of money. Hence, the cost of living increases during inflation. Some economists regarded inflation as a monetary phenomenon. They believe that inflation is a situation of "too much money chasing too few goods
- **Common View**
- ***According to Crowther,*** *"Inflation is a state in which the value of money is falling i.e. prices are falling."*

*According to **Gardner Ackley**, "Inflation is a persistent*

Inflation……………………….

- ***According to Keynes,*** *"Inflation is the result of the excess of aggregate demand over the available aggregate supply and true inflation starts only after full employment".*
- ***Monetarist's View:*** monetarist assumes that inflation is purely monetary phenomenon. It is due to excess money supply.
- **Milton Friedman**: "*Inflation is always and everywhere a monetary phenomenon.*"
- **Coulbourn** defines inflation as "*too much money chasing too a few goods.*"
- **Hawtrely** defines inflation as "*issue of too much currency.*"

The following are the main features of inflation:

1. Inflation is the rise in general price level, not a state of high price.
2. Inflation is not a small or temporary fluctuation but is a sustained and appreciable rise in general price level.

Types of Inflation:

Inflation can be classified under different categories, some of which are explained below:

A. On the basis of Speed

Inflation on the basis of speed can be classified as:

1. **Creeping:** Creeping or mild inflation occurs w2hen the price of goods and services rises by 3% or less in a year. This kind of mild inflation makes consumers expect that prices will keep going up in future so it boosts their demand.
2. **Walking:** Walking inflation occurs when the price of goods and services rises from 3-10% a year. It is harmful to the economy because producers cannot keep the production level up to the increased level of demand.
3. **Galloping:** Galloping inflation occurs when the price of goods and services rises to 10% or more. It is harmful to the economy. (10-20%)
4. **Hyperinflation:** Hyperinflation is when prices of goods and services rises by more than 20% a

Types of Inflation:

B. On the basis of Inducement

Types of inflation on the basis of inducement are as follows:

1. **Wage induced inflation:** Inflation caused by the increase in wage rate is known as wage induced inflation. One of the major causes that increases the wage rate is trade unions.
2. **Profit - induced inflation:** When Producers, due to their market power, often tend to increase profit margin, increasing price then it is known as profit – induced inflation. This leads to profit-induced inflation
3. **Scarcity induced inflation:** When the supply of goods falls on account of natural calamities it cannot meet the demand for goods and price rises then this type of inflation is termed as scarcity induced inflation.
4. **Deficit induced inflation:** When the government finances its deficit budget by printing money, it causes inflation and it is called deficit induced inflation.

Types of Inflation

C. On the basis of time

1. **Peace time inflation:** When prices rise during the peace period, it is known as Peacetime Inflation. It is due to enormous government expenditure or spending on capital projects of a long gestation (development) time. There arises a gap between the receipts of income and the availability of goods and services causing inflation.

2. **War time inflation:** During war, scant (scarce) productive resources are all diverted and prioritized to manufacture military goods and equipment. Overall it results in very limited supply and extreme shortage (low availability) of resources (raw materials) to produce essential commodities. Consequently, prices of necessary goods keep on rising in the market, resulting in Wartime Inflation.

3. **Post-war inflation:** Inflation that takes place soon after a war is a post-war inflation. After the war

Types of Inflation

D. On the basis of Scope

1. **Comprehensive inflation:** When the prices of all commodities rise in the entire economy, it is known as Comprehensive Inflation. Economy-Wide Inflation is its other name.
2. **Sporadic inflation:** When prices of only a few commodities in some regions (areas) rise, it is called Sporadic or sectoral inflation. It is sectional in nature. For example, increase in food prices due to bad monsoon.

E. On the basis of Government Reaction

1. **Open inflation:** When the government does not attempt to restrict inflation, it is known as open inflation. In a free-market economy, where prices are allowed to take its course, Open Inflation occurs.
2. **Suppressed inflation:** When the government prevents the price rise through price controls, rationing, etc., it is known as Suppressed Inflation. Repressed Inflation is it's other name.

F. On the basis of Employment

1. **Partial inflation:** When price rises with the increases in money supply before full employment, it is called partial inflation. Before full employment, output and prices rises with increases in money supply.
2. **Full inflation**: After full employment level, as price rises with increase in money supply, it is called full inflation.

G. On the basis of Causes

1. **Demand pull inflation:** inflation due to increased in Aggregate demand is called Demand pull inflation.
2. **Cost push inflation**: inflation due to increased in cost of production(i.e wage, rent profit interest) is called cost push inflation.

H. Other types

Measurement of Inflation

- There are various methods of measuring inflation: (i) Consumer Price Index (CPI), (ii) GNP Deflator, (iii)Wholesale price index (WPI) or Producer price index(PPI). But we only discuss about CPI here
- Under percentage change in Price Index Number (PIN), widely used indexes are Consumer Price Index (CPI) and Wholesale Price Index (WPI), also called Producer Price Index (PPI). WPI is used to measure the general rate of inflation and CPI is used to measure the change in the cost of living
- Consumer Price Index
- **Consumers price index (CPI)**
- Weighted average of prices of a specified basket of goods and services. which are purchased by the consumers.
- The most well-known indicator of inflation is the *Consumer Price Index (CPI)*, which measures the percentage change in the price of a basket of goods and services consumed by households. It is a weighted average of prices of a specified basket of goods and

Methods of Constructing Consumer Price Index

The CPI can be calculated in two ways:

1. **Aggregate expenditure method or weighted aggregate method:** The weight of the quantities consumed in the base year is used in this method. The following is the formula for this method: $\text{CPI} = \frac{\Sigma P_1 q_0}{\Sigma P_0 q_0} \times 100$
2. **Family budget method:** The price relatives of all commodities are calculated first, and then weighted, in this method. The following is the formula for this method:

$$\text{CPI} = \frac{\Sigma\left(\frac{P_1}{P_0} \times 100\right) P_0 q_0}{\Sigma P_0 q_0} = \frac{\Sigma P w}{\Sigma w}$$

Where,

$P = \frac{P_1}{P_0} \times 100$ (Price relative)

$w = P_0 q_0$ (Value of the commodity consumed)

Example of CPI calculation:

- Construct CPI number for the year 2022 for the data given below

Commodity	Base year 2021		p_1
	p_0	q_0	
A	20	18	30
B	24	9	43
C	12	7	10
D	7	6	5
E	21	7	19

What change in the CPI in 2022 has taken place as compared to 2021? Find inflation rate.

SOLUTION

Commodity	p_0	q_0	p_1	p_0q_0	p_1q_0
A	20	18	30	360	540
B	24	9	43	216	387
C	12	7	10	84	70
D	7	6	5	42	30
E	21	7	19	147	133
				$\Sigma p_0q_0 = 849$	$\Sigma p_1q_0 = 116$

$$\text{CPI} = \frac{\Sigma p_1q_0}{\Sigma p_0q_0} \times 100$$

$$= \frac{1{,}160}{849} \times 100$$

$$= 136.63$$

Hence, the CPI of 2022 has been increased figure (136.63 – 100) = 36.63 %

$$\text{Inflation rate} = \frac{136.63 - 100}{100} \times 100$$

$$= 36.63\%$$

Process or Steps Consumer Price Index calculation

1. **Selecting the CPI basket:** In this step a basket of goods that a typical consumer buys is selected with appropriate weight assigned to it according to its importance. The idea is to make the relative importance of the items in the CPI basket the same as for a typical consumer. For example, because people spend more on apples than on shoes, the CPI places more weight on the price of an apple than on the price of a shoe.
2. **Compute the cost of a basket:** It is the process of calculating the cost of a basket at different time periods. It is calculated by multiplying the quantity by their respective prices at different periods. Here the changes in prices are only considered constant.

$$CPI = \frac{\text{Cost of CPI basket at current year prices}}{\text{Cost of CPI basket at base year prices}} \times 100$$

3. **Choose the base x:** one year is taken as a base year to compare the changes in price and then the CPI is calculated as follows:

$$(\text{Inflation rate})_t = \frac{CPI_t - CPI_{t-1}}{CPI_{t-1}} \times 100\%$$

Calculation of Inflation

Wholesale price index calculation method

- **Wholesale Price Index/ Producers Price Index (WPI/PPI)**

The process of calculating WPI is same as in calculating WPI.

WPI is calculated as:

$$\text{WPI} = \frac{\text{Cost of WPI basket at current year prices}}{\text{Cost of WPI basket at base year prices}} \times 100$$

After calculating WPI the inflation can be calculated as below:

$$(\text{Inflation rate})_t = \frac{\text{WPI}_t - \text{WPI}_{t-1}}{\text{WPI}_{t-1}} \times 100\%$$

Where,

WPI_t = WPI for the period 't'

WPI_{t-1} = WPI for the period 't– 1'.

$(\text{Inflation rate})_t$ = inflation for the period 't'.

Example: if cost of WPI basket at current year is 3500 and cost of WPI basket at base year was 2000, calculate inflation rate.

SOLUTION

We know,

$$WPI = \frac{\text{cost of WPI basket at current year prices}}{\text{cost of WPI basket at base year prices}} \times 100$$

$$= \frac{3500}{2000} \times 100$$

$$= 175$$

After calculating WPI the inflation can be calculated as below:

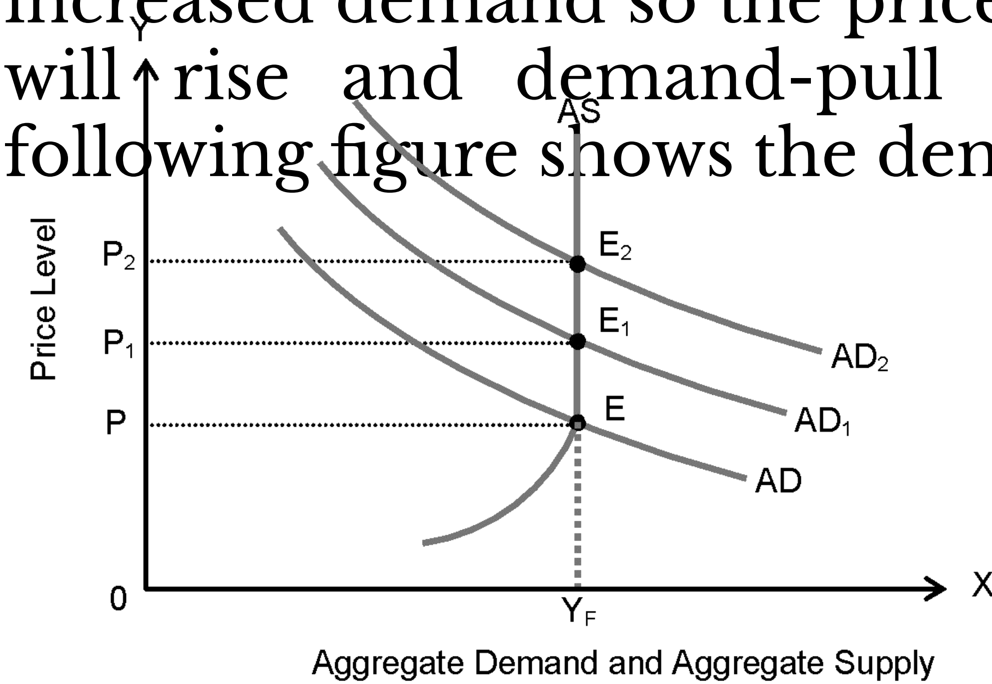
$$(\text{Inflation rate})_t = \frac{WPI_t - WPI_{t-1}}{WPI_{t-1}} \times 100\%$$

$$= \frac{175 - 100}{100} \times 100\%$$

$$= 75\%$$

On the basis of Causes of Inflation

- **Demand-Pull Inflation**
- Inflation resulting from increase in aggregate demand is called demand-pull inflation. It occurs when there is increase in aggregate demand for goods and services keeping the aggregate supply constant. When aggregate demand increases, the available aggregate supply cannot meet the increased demand so the price of goods and services will rise and demand-pull inflation occurs. The following figure shows the demand-pull inflation.



Explanation of Demand pull inflation figure

- In the **Figure**, level of income and price level are measured along the X-axis and Y-axis respectively. AD is the aggregate demand curve and AS is the aggregate supply curve. The AS curve is upward sloping in the beginning and becomes parallel to the Y-axis when full employment is reached. AD and AS curves intersect with each other at point E where the general price level is OP.
- If AD is increased and become AD1, new equilibrium will be at E1, that equilibrium shows the price level is OP1 and output is same OYf as earlier that means no change in output only price level increased after increased in AD .
- Similarly, again AD1 increased to AD2 that leads

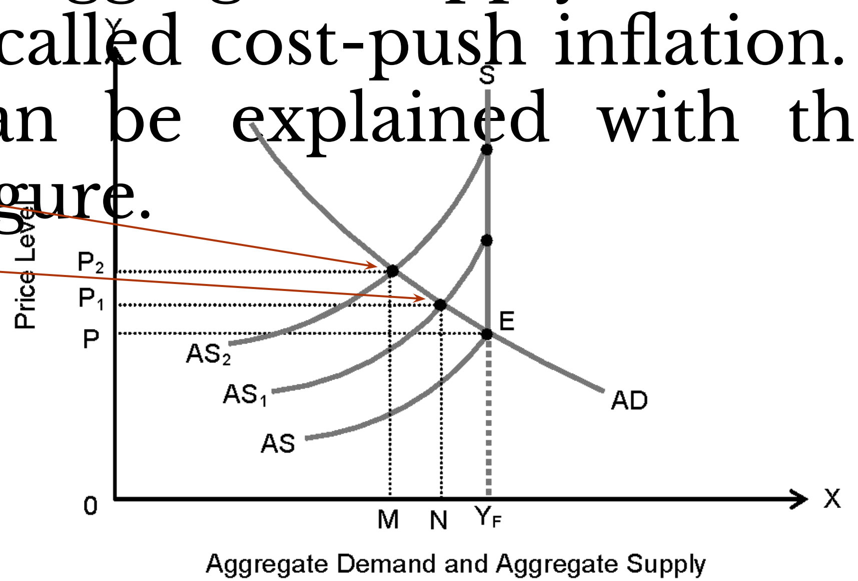
Causes of Demand Pull inflation

- **Causes of the demand-pull inflation are :**

1. **Increase in money supply and bank credit:** Due to the increase in money supply and bank credit, investment, income and consumption also increases.
2. **Decrease in interest rate:** Decrease in interest rates causes a rise in consumer spending and higher investment. This will lead to a rise in aggregate demand and inflationary pressures.
3. **Increase in government expenditure:** When there is increase in government expenditures in the form of regular and development expenditure, there will be a direct increase in demand for goods and services.
4. **Decrease in tax rate:** The low rate of taxes increases disposable income and hence the purchasing power of people which makes the aggregate demand high. This leads to demand-pull inflation.
5. **Increase in export:** Due to increase in export, there will be increase in aggregate demand. If supply of goods cannot be increased accordingly then demand-pull inflation arises.
6. **Currency devaluation:** Currency devaluation is the intentional fall in the value of the money of a nation against another currency. The main aim to devalue a currency is to increase exports relative to import.

Cost-Push Inflation:

- **Cost-Push Inflation**
- Inflation resulting from the decrease in aggregate supply due to the increase in cost of production.
- Inflation resulting from the decrease in aggregate supply due to the increase in cost of production is called cost-push inflation. When there is a rise in prices of factors of production there will be an increase in cost of production. This will lead to a decrease in aggregate supply and hence the rise in price level called cost-push inflation. The cost-push inflation can be explained with the help of the following figure.



- E2
- E1

Explanation of figure:

- In the **Figure**, aggregate demand and aggregate supply are measured along the x-axis and price level along the y-axis. AD is the aggregate demand curve and AS is the aggregate supply curve. The AS curve is upward sloping in the beginning and becomes parallel to the y-axis when full employment is reached. AD and AS curves intersect with each other at point E where the general price level is OP. if cost of production increased that leads to change in AS as AS_1 which cuts AD upper part at E_1 and Price level is OP_1 and output is decreased to ON
- Further increased in cost of production,

Causes of Cost push inflation

- The main causes of cost-push inflation are:

1. **Increase in wage:** Existence of a strong trade union exercises its union power to increase the real wage rate of the labour. The cost-push inflation originating from the increased wage rage is called wage-push inflation.
2. **Increase in profit margin:** When the producers increase their profit margin, price will definitely rise. The inflation originating from the increased profit-margin is called profit-push inflation.
3. **International reason:** The economy of a country is linked with other countries. If the price of consumer goods, raw materials and capital goods increase in foreign countries the price of goods and services also increases in the country.
4. **Natural disasters:** the occurrence of natural disasters like, earthquake, flood, and draughts has adverse effect on productivity. This reduces the output and thus reduces the supply relative to demand. Thus, the price level rises.
5. **War:** when there is war between the countries or within a country then the productive resources of a country are diverted towards the production of arms and ammunition.
6. **Hoarding**: when the wholesalers, traders, businessmen

Effect of inflation:

- Inflation is a hydra-headed monster. It creates inequalities of wealth distribution and paralyses the machinery of the whole economic system. effects of inflation is different to different people of the society as explained below:
- 1. **Effects on production:** Inflation creates uncertainty which adversely affects the production system. The effects of inflation on production activities can be listed below:

   a. **Reduction in saving:** When price increases the purchasing power decreases which means more money is needed to buy the same quantity of goods. Thus saving reduces.

   b. **Encourages hoarding:** When prices increase, hoarding of goods increases in an expectation to sell it at higher prices.

   c. **Reduces volume of production:** Volume of production decreases because of business uncertainty that discourages entrepreneurs from taking business risk in production.

   d. **Affects pattern of production:** Because of inflation producers diversify resources from producing necessary goods to luxurious goods because the rich, whose incomes increase more rapidly demand luxury goods.

   e. **Quality falls:** Since the producer's interest is higher profits and because there is higher demand during

Effect of Inflation:

2. **Effects on distribution**: During inflation, the fixed income groups like pensioners, interest and rent earners, etc. are always the losers. Similarly, salaried persons like factory workers, teachers, etc. are also the losers because incomes do not increase as fast as the prices. Inflation is unjust because it puts the economic burden on those sections of the society who are least able to bear it.
3. **Effects on society**: High rate of inflation leads to social unrest in the economy. Dissatisfaction increases among the workers. They demand higher wages to sustain their present living standard. Moreover, high rate of inflation leads to a general feeling of discomfort for the household as their purchasing power is consistently falling.
4. **Effects on moral**: Inflation adversely affects business morality and ethics. It encourages black marketing and enables the businessmen to reap wind-fall gains by undesirable men in order to increase the profit margin, the producers reduce the quality by introducing adulteration in their products.
5. **Effects on politics**: Inflation also disrupts the political life of a country. It corrupts the politicians and weakens the political discipline. The increase in inequality and moral degradation from the inflation can also lead to the loss of

Banking

- Bank word derived from Italian word “Benco”, which means bench. In Earlier time person who deals with money by sating in bench, so the place where people sating in bench for money transaction, It is called bank.
- The banking sector draws surplus money from those who are not using it and lends it to those who need it. It is also regarded as the financial wheel of the economy.
- Definition of Bank:
- A bank is the institution which accepts deposits from public and makes funds available to those who need them.
- A bank is an institution which deals with money and credit.
- **<u>Definition based on Deposit Collection:</u>**
- **World bank:** “Banks are financial institutions

Banking

- H. I. Hart: "A banker is one who in the ordinary course of his/her business, honours cheques drawn upon him/her by persons from and for whom s/he receives money on current account."
- <u>**Definitions based on Both Deposit and Loan:**</u>
- **Crowther**: "**A banker is a dealer in debts. The banker's business is then to take the debts of other people to offer his/her own in exchange and thereby to create money.**"
- **Gilbert**: "**A bank is dealer in capital, or more properly a dealer in money. He is the intermediate party between the borrower and the lender.**"
- **Kinley:** " **Bank is an establishment which makes to individuals such advances of money or other means of payments as may be required safety made and to which individuals entrust money or**

Banking

- Thus bank has following feature:
- It deals with money.
- It accepts deposits and advances loans.
- It also deals with credit and it has ability to create credit.
- It aims at earning profit.
- It manages the payment system in the economy.

Role of Banking System in the Economy

1. Mobilization of Saving
2. Capital formation
3. Monetisation of economy
4. Promotion of Employment
5. Poverty Alleviation.
6. Remittance of Money
7. Safety of wealth
8. Removal of Exploitation.
9. Development of Finance
10. Rapid economic development

Classification of Banks

- BFI in Nepal:mid-july 2023
- 1. Central Bank 1
- 2. Commercial Bank 20
- 3. Development Bank 17
- 4. Finance Companies 17
- 5. Microfinance Companies 57

bank

- **Central bank is the highest monetary authority of a country which manages monetary and banking system of a country.**
- **It is autonomous institution**
- **It works as Financial Advisor of the government and Banker's bank.**
- De Kock: " A bank which constitutes the apex of the monetary and banking structure of the country is the central bank"
- Vera Smith: " Central bank is a banking system in which as single bank has been entrusted the duty of regulating the volume of currency and credit in that country"
- Nepal Rastra Bank (NRB) is the central bank of Nepal. It was established in 2013/Baishakh 14(

Central Bank: Meaning of central bank

- **Broad objectives of NRB are**:
- *To regulate the issue of currency note of Nepal*
- *To arrange the circulation of currency throughout the country*
- *To stabilize the exchange rates of the Nepalese currency to safeguard the economic interest of the general public*
- *To development the financial structure of the country on sound lines consistently with national socio-economic objectives and policies.*

Role and Function of Central bank

1. ***Monopoly power of Note issue:***
2. ***Government's Bank:***
3. ***Banker's Bank:***
4. ***Lender of the last resort:***
5. ***Clearing house function:***
6. ***Control of Credit:***
7. ***Custodian of metallic reserve and international currency***
8. ***Development function***

Central bank play the catalyst of the economic development and economic growth

- *Some development function by NRB or central bank are:*

1. ***It provides financial assistance to the government to carry out development works.***
2. ***It helps to develop money and capital market.***
3. ***It manages short-term and long-term debts for the government.***
4. ***It collects various types of statistics by conducting surveys of the current state of the economy and publishes them.***
5. ***It helps to develop the banking system and banking habits in the country.***
6. ***It advises the government in formulation monetary and fiscal and economics policy.***
7. ***It diverts the scarce resources to the productive sectors by using credit control methods.***
8. ***It establishes a good relationship with international financial institutions like World bank, international monetary fund (IMF).***

Commercial Bank: meaning and definition

- Commercial bank is a financial institution which accepts deposits from the public, makes the fund available to those who need them and helps in the remittance of money from one place to another.
- Crowther: " A bank collect money from those who have it to spare or who are saving it out of their incomes and it lends this money to those who require it."
- World Bank: "Banks are financial institutions that accepts funds in the form of deposits repayable on demand or in short notice."
- Nepal bank limited is the first commercial bank of Nepal. This was established in 1994 BS (1937AD), Second commercial bank is

Role and function of Commercial Bank:

- **Primary Functions**

  1. Accepting Deposits:
     - i. Demand Deposit
     - ii. Saving Deposit
     - iii. Fixed deposit
  2. Providing Loans
     - i) Cash credit
     - ii) Overdraft
     - iii) Loan and advances
     - iv) Call loan

Role and function of Commercial Bank:

- **Secondary Functions**
  1. Remittance of the money
  2. Collection and payment of credit instruments
  3. Purchase and sale of securities
  4. Income receiving and payment
  5. Acting as trustee and executor
- Contingent Functions
  1. Locker facility
  2. Traveler Cheques
  3. Letter of Credit
  4. Dealing in foreign exchanges
  5. Collection of statistics

International Trade

- All the countries of the world are dependent upon each other and all them are involved in export and import of goods and services.
- Export refers to outflow of the goods and services from domestic country to foreign trade partners.
- Import refers to inflow of the goods and services from foreign country to domestic country.
- Definition:
- International trade or foreign trade is the sale and purchase of goods and services between the people of different countries. It involves export and import.
- International trade refers to exchange of goods and services between the people of different countries.

Concept of International Trade

- D.G. Luckett: “The purchase of goods and services by the citizens of one country from the citizens of another country is called international trade”
- R.G. Lipsey and K.A. Chrystal: “International trade refers to the exchange of goods and services that takes place across international boundaries.”

Importance of International Trade

- Cheaper And quality product:
- Development of Agriculture Sector
- Industrial Development :
- Development of Competitive capacity
- Improvement in Living standard of People:
- Increase in Employment Opportunities
- Increase in Government Revenue
- Expansion of the market
- Technological Progress
- Good relation with Foreign Countries.

Distinction between Internal and International Trade

Internal Trade	International Trade
1. If the exchange of Goods and services is made between the people of a country, it is called internal trade.	1. If the exchange of goods and services is made between the people of the different countries, it is called international trade.
2. It is not involve export and import of goods and services.	2. It involves export and import of goods and services.
3. Trade takes place within the boundaries of a nation	3. Trade takes place between two countries.
4. There is no trade restriction for internal trade.	4. There are different restrictions for international trade between as the two countries involved in trade have different policies with regards to trade.
5. Transportation cost is less due to take place within the boundaries of a country.	5. Transportation cost is high due to take place across the world..
It does not generate any foreign reserve.	It generates foreign reserve.

Concept of Balance of Trade:

- Balance of Trade is defined as the difference between value of export and value of import of a country.
- Balance of Trade includes only import and export of visible material goods, which have physical structure, size, shape and form.
- Balance of Trade does not include invisible or non-material good or services such as transportation, banking, insurance etc.
- Definition:
- R.R. Paul: "Balance of trade is the difference between the values of visible exports and imports."
- N.G. Mankiw: "Trade balance is the value of nation's exports minus the value of its imports."

Concept of Balance of Trade:

- **Features of Balance of Trade**

1. The elements of balance of trade are export and import.
2. It includes only visible goods.
3. Non-materials or invisible goods and services are not included in the balance of trade.

Type of Balance of Trade

1. **Trade Surplus:** If the total export of the country greater than its total import, it is called trade surplus or favourable trade balance.
2. **Trade deficit:** If the total import of the country greater than its total export, it is called trade deficit or unfavourable trade balance.

Concept of Balance of Payment

- Balance of payment (BOP) is defined as the systematic record of receipt and payment of a country with the rest of the world.
- Kindle Berger : *“ **Balance of payment of a country is a systematic record of all the economic transactions concerning goods, service and capital flow between its residents and residents of foreign country.”***
- R.G. Lipsey and K. A. Chrystal : *“ **Balance of payment is a summary of a country’s transaction involving payments and receipts of foreign exchange.”***
- Thus, BOP is the complete statement of country’s receipts and payments in foreign exchange.

Feature of Balance of Payment

1. It is a systematic record of all the economic transactions between one country and the rest of the world.
2. It includes all the transactions: Visible and invisible.
3. It is the annual statement.
4. It adopts a double booking keeping system, It has two sides: Credit side and Debit side. Receipt are recorded on the credit side and payments on the Debit side.
5. In the accounting sense, total credits and total debits in the balance of payments statement always balance.
6. When receipt are equal to payments, the balance of payment is in equilibrium, but when receipt

Type of Balance of Payment (BOP)

- There are two types of BOP accounts.

1. Favorable balance of payments: If total receipt of a county exceed its total payments, it is called favorable BOP. It is also called surplus of the BOP.

Favourable BOP= Total receipt> Total Payments

2. Unfavorable balance of Payments: : If total payments of a county exceed its total receipts, it is called favorable BOP. It is also called surplus of the BOP.

1. Unfavourable BOP= Total receipt< Total Payments

Structure or component of BOP

1. Current Account:.
2. Capital Account:
3. Cashflow Account:

Importance of BOP

- BOP is a important macro economic indicator which shows various aspects of country's international economic position.
- BoP helps to government and central bank to take decision on fiscal and monetary policies respectively.
- It also shows the dependency of a country on rest of the world to develop the country.
- Importance:

1. It is the measure of performance of the economy.
2. It shows expenses made on imported gods and services.
3. It shows foreign currency entering the country and going out of the country.
4. It evaluates the success of the country in exporting goods and services to foreign countries
5. It shows the entire picture of the total transactions of an economy with other economies of the world.
6. It is useful to formulate economic policies: monetary, fiscal and exchange rate policy

Difference between Balance of Trade and Balance of Payment

Basis of Difference	Balance of Trade	Balance of Payment
1. Definition	It is the difference between total volume of export and import of visible items of a country with the rest of the world	It is the systematic record of receipt and payments of a country with the rest of the world.
2. Visible and invisible	It includes only visible goods.	It includes both visible and invisible goods and services.
3.Economic performance	It cannot show the entire economic performance of a country	It show the entire economic performance of a country.
4. Narrow and broad concept	It is a narrow concept	It is a broad concept