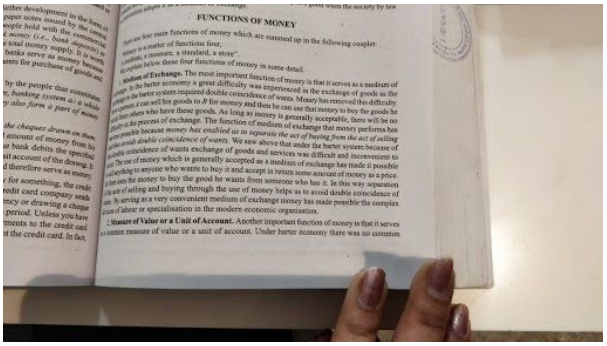


FUNCTIONS OF MONEY

There are four main functions of money which are summed up in the following couplet:

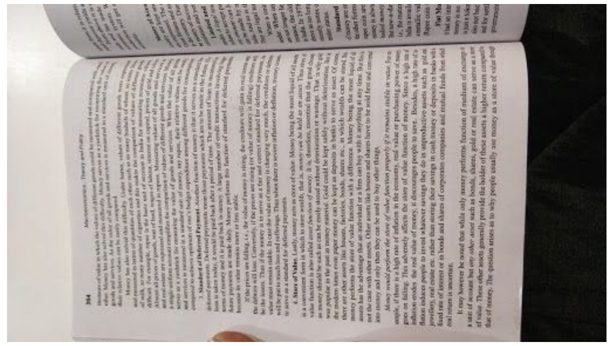
"Money is a matter of functions four,

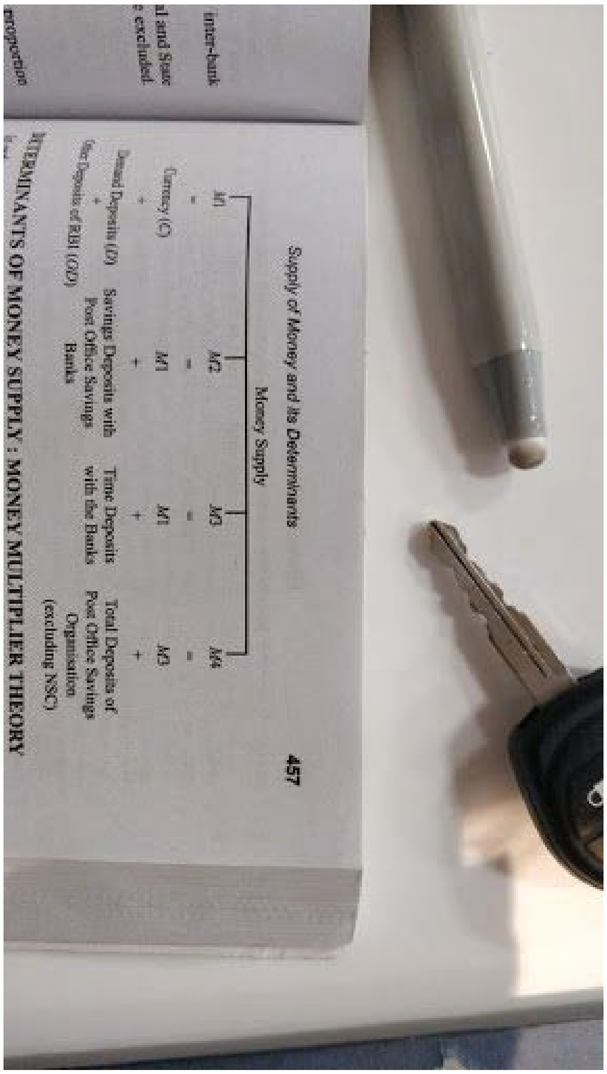
A medium, a measure, a standard, a store".

We explain below these four functions of money in some detail.

1. **Medium of Exchange.** The most important function of money is that it serves as a medium of exchange. In the barter economy a great difficulty was experienced in the exchange of goods as the exchange in the barter system required double coincidence of wants. Money has removed this difficulty. Now a person *A* can sell his goods to *B* for money and then he can use that money to buy the goods he wants from others who have these goods. As long as money is generally acceptable, there will be no difficulty in the process of exchange. The function of medium of exchange that money performs has become possible because *money has enabled us to separate the act of buying from the act of selling and thus avoids double coincidence of wants*. We saw above that under the barter system because of lack of double coincidence of wants exchange of goods and services was difficult and inconvenient to arrange. The use of money which is generally accepted as a medium of exchange has made it possible to sell anything to anyone who wants to buy it and accept in return some amount of money as a price. He then uses the money to buy the good he wants from someone who has it. In this way separation of the acts of selling and buying through the use of money helps us to avoid double coincidence of wants. By serving as a very convenient medium of exchange money has made possible the complex division of labour or specialisation in the modern economic organisation.

2. **Measure of Value or a Unit of Account.** Another important function of money is that it serves as a common measure of value or a unit of account. Under barter economy there was no common





Money Supply

M1	M2	M3	M4
=	=	=	=
Currency (C)	M1	M1	M3
+	+	+	+
Demand Deposits (D) + Other Deposits of RBI (OD)	Savings Deposits with Post Office Savings Banks	Time Deposits with the Banks	Total Deposits of Post Office Savings Organisation (excluding NSC)

DETERMINANTS OF MONEY SUPPLY : MONEY MULTIPLIER THEORY

MODULE 5 DEMAND AND SUPPLY OF MONEY (VERY EASY MODULE)

DEFINITION OF MONEY: PROFESSOR D H ROBERTSON DEFINES MONEY AS "ANYTHING WHICH IS WIDELY ACCEPTED IN THE PAYMENT OF GOODS OR IN DISCHARGE OF OTHER KINDS OF BUSINESS OBLIGATION"
ACCORDING TO CROCHETER"MONEY CAN BE DEFINED AS ANYTHING THAT IS GENUINELY ACCEPTABLE AS MEANS OF EXCHANGE AND THAT AT SAME TIME ACTS AS A MEASURE AND A STORE OF VALUE" (IMP)
2 IMP THINGS ABOUT MONEY EMERGE FROM ABOVE DEFINITION

1. MONEY HAS BEEN DEFINED IN TERMS OF FUNCTIONS IT PERFORMS
2. AN ESSENTIAL REQUIREMENT OF ANY KIND OF MONEY IS THAT IT MUST BE GENERALLY ACCEPTABLE TO EVERY MEMBER OF SOCIETY

FUNCTIONS OF MONEY

ANS: REFER TO THE GROUP

SUPPLY OF MONEY

BY MONEY SUPPLY WE MEAN THE TOTAL STOCK OF MONETARY MEDIA OF EXCHANGE AVAILABLE TO A SOCIETY FOR USE IN THE CONNECTION WITH THE ECONOMIC ACTIVITY IN THE COUNTRY. ACCORDING TO THE STANDARD CONCEPT OF MONEY SUPPLY IT IS COMPOSED OF FOLLOWING TWO ELEMENTS
1. CURRENCY WITH THE PUBLIC :
2. DEMAND DEPOSIT WITH THE PUBLIC :
TWO THINGS MUST BE NOTED WITH REGARD TO MONEY SUPPLY IN THE ECONOMY

1. THE MONEY SUPPLY REFERS TO THE TOTAL SUM OF MONEY AVAILABLE TO THE PUBLIC IN THE ECONOMY AT A POINT OF TIME ,i.e, MONEY SUPPLY IS THE STOCK CONCEPT IN SHARP CONTRAST TO THE NATIONAL INCOME WHICH IS A FLOW CONCEPT
2. MONEY SUPPLY ALWAYS REFERS TO THE AMOUNT OF MONEY HELD BY THE PUBLIC. THE TERM PUBLIC INCLUDES HOUSEHOLDS, FIRMS, INSTITUTIONS OTHER THAN BANK AND GOVERNMENT

MEASURES OF MONEY SUPPLY

1. MONEY SUPPLY(M1) OR NARROW MONEY : THIS IS THE NARROW MEASURE OF MONEY SUPPLY AND IS COMPOSED OF FOLLOWING ITEMS :

$$M1 = C + DD + OD$$

C = CURRENCY WITH PUBLIC
DD = DEMAND DEPOSIT WITH THE PUBLIC IN COMMERCIAL AND COOPERATIVE BANKS
OD = OTHER DEPOSITS HELD BY PUBLIC WITH RBI
C CONSIST OF FOLLOWING
I. NOTES IN THE CIRCULATION
II. CIRCULATION OF RUPEE COIN AND SMALL COIN
III. CASH RESERVE ON HANDS WITH ALL BANKS
IN MEASURING DD WITH PUBLIC IN BANKS, INTER BANKS DEPOSITS .i.e, DEPOSITS HELD BY A BANK IN OTHER BANKS ARE EXCLUDED FROM THESE MEASURE

OTHER DEPOSITS WITH RBI INCLUDE
I. DEPOSITS WITH INSTITUTIONS LIKE UPI, IDBI, IFCI, NABARD ETC.
II. DEMAND DEPOSITS OF FOREIGN CENTRAL BANKS AND FOREIGN GOVT
III. DEMAND DEPOSITS FROM IMF AND WORLD BANK

2. MONEY SUPPLY(M2)

M2 = M1 + SAVING DEPOSIT WITH POST OFFICE SAVING BANKS

THE REASON WHY MONEY SUPPLY M2 HAS BEEN DISTINGUISHED FROM M1 IS THAT SAVING DEPOSITS WITH POST OFFICE SAVING BANKS ARE NOT AS LIQUID AS DEMAND DEPOSIT WITH COMMERCIAL AND COOPERATIVE BANKS AS THEY ARE NOT CHEQUABLE ACCOUNTS

3. MONEY SUPPLY (M3) OR BROAD MONEY

M3 IS A BROAD CONCEPT OF MONEY SUPPLY

M3 = M1 + TIME DEPOSITS WITH BANKS (FD)

IT IS GENERALLY THOUGHT THAT TIME DEPOSITS SERVE AS STORE OF VALUE AND REPRESENTS SAVING OF THE PEOPLE AND ARE NOT LIQUID AS THEY CANNOT BE WITHDRAWN THROUGH DRAWING CHEQUE ON THEM . HOWEVER SINCE LOANS FROM BANKS CAN BE EASILY OBTAINED AGAINST THIS TIME DEPOSITS , THEY CAN BE USED IF FOUND NECESSARY FOR TRANSACTION PURPOSES . FURTHER THEY CAN BE WITHDRAWN AT ANY TIME BY FORGOING SOME INTEREST EARNED ON THEM

4. MONEY SUPPLY (M4)

M4 = M3 + TOTAL DEPOSITS WITH POST OFFICE SAVINGS ORGANISATION

INSTRUMENTS OF MONETARY POLICY

THE CENTRAL BANK OF A COUNTRY HAS THE RESPONSIBILITY OF CONTROLLING THE VOLUME AND DIRECTION OF CREDIT IN THE COUNTRY THERE ARE 2 TYPES OF TOOLS OR INSTRUMENTS OF MONETARY POLICY OF CONTROLLING CREDIT

1. QUANTITATIVE TOOLS
2. QUALITATIVE OR SELECTIVE TOOLS

QUANTITATIVE MEASURES

1. BANK RATE POLICY

BANK RATE IS THE MINIMUM RATE AT WHICH THE CENTRAL BANK OF THE COUNTRY PROVIDES LOANS TO THE COMMERCIAL BANK OF THE COUNTRY
BANK RATE IS ALSO CALLED AS DISCOUNT RATE BECAUSE IN THE EARLIER DAYS CENTRAL BANK USED TO PROVIDE FINANCE TO THE COMMERCIAL BANKS BY RE DISCOUNTING BILLS OF EXCHANGE WHEN THE CENTRAL BANK RAISES THE BANK RATE THE COST OF BORROWINGS BY THE COMMERCIAL BANKS FROM THEIR CENTRAL BANK WOULD RISE THIS WOULD DISCOURAGE THE COMMERCIAL BANKS TO BORROW FROM THE CENTRAL BANK FURTHER WHEN THE BANK RATE IS RAISED , THE COMMERCIAL BANKS ALSO RAISE THEIR LENDING RATES. WHEN THE LENDING RATES OF INTEREST CHARGED BY THE COMMERCIAL BANKS ARE HIGHER , BUSINESSMAN AND INDUSTRIALIST WOULD FEEL DISCOURAGED TO BORROW FROM COMMERCIAL BANKS. THIS WOULD TEND TO CONTRACT BANK CREDIT AND HENCE WOULD RESULT IN THE REDUCTION OF MONEY SUPPLY IN THE ECONOMY. THE REDUCTION IN MONEY SUPPLY WOULD REDUCE AGGREGATE DEMAND OF GOODS AND SERVICES . THIS WOULD REDUCE PRICES AND CHECK INFLATION IN THE

ECONOMY .
ON THE OTHER HAND WHEN THERE IS RECESSION OR DEPRESSION IN THE ECONOMY THE BANK RATE IS LOWERED. A FALL IN THE BANK RATE WILL CAUSE THE REDUCTION IN LENDING INTEREST RATES OF THE COMMERCIAL BANKS . WITH CREDIT OR LOANS FROM BANKS BECOMING CHEAPER, BUSINESSMEN WOULD BORROW MORE FROM THE COMMERCIAL BANKS FOR INVESTMENT THIS WOULD LEAD TO THE INCREASE IN AGGREGATE DEMAND FOR GOODS AND SERVICES AND HELP IN OVERCOMING RECESSION AND BRINGING ABOUT RECOVERY IN THE ECONOMY

2. OPEN MARKET OPERATIONS

OMO REFERS TO THE PURCHASE AND SALE OF GOVT SECURITIES BY RBI FROM / TO MARKET. THE OBJECTIVE OF OMO IS TO ADJUST THE RUPEE LIQUIDITY CONDITIONS IN THE ECONOMY ON A DURABLE BASES

WHEN RBI SELLS GOVT SECURITIES IN THE MARKETS THE BANKS PURCHASE THEM . WHEN THE BANKS PURCHASE G SEC [GOVT SECURITIES] THEY HAVE A REDUCED ABILITY TO LEND TO INDUSTRIAL HOUSES OR OTHER COMMERCIAL SECTORS THIS REDUCE SURPLUS CASH , CONTRACTS THE RUPEE LIQUIDITY AND CONSEQUENTLY CREDIT CREATION. WHEN RBI PURCHASES THE SECURITIES THE COMMERCIAL BANKS FIND THEM WITH MORE SURPLUS CASH AND THIS WOULD CREATE MORE CREDIT IN THE SYSTEM

3. CASH RESERVE RATIO

CRR IS THE AMOUNT OF FUNDS THAT THE BANKS ARE BOUND TO KEEP WITH RBI AS A PORTION OF THEIR ***NET DEMAND AND TIME LIABILITIES***

IMPACTS OF REDUCING CRR

WHEN CRR IS REDUCED MORE FUNDS ARE AVAILABLE TO BANKS FOR LENDING . THIS MEANS THAT THE BANKS WOULD HAVE MORE MONEY TO PLAY AND THIS LEADS TO REDUCTION OF INTEREST RATES ON LOANS PROVIDED BY THE BANKS

IMPACTS OF INCREASING CRR

WHEN RBI INCREASES CRR LESS FUNDS ARE AVAILABLE WITH BANKS AS THEY HAVE TO KEEP LARGER PORTION OF THEIR CASH IN HAND WITH RBI . THE BANKS THE INCREASE THE INTEREST RATES

4. STATUTORY LIQUIDITY RATIO

SLR REFERS TO THAT PORTION OF DEPOSITS WITH THE BANKS WHICH IT HAS TO KEEP WITH ITSELF AS LIQUID ASSETS SUCH AS CASH,GOLD, GOVT SECURITIES ETC

QUALITATIVE OR SELECTIVE MEASURES

1. MARGIN REQUIREMENTS

THIS REFERS TO THE DIFFERENCE BETWEEN THE SECURITIES OFFERED AND AMOUNT BORROWED BY THE BANKS

2. CONSUMER CREDIT REGULATION

THIS REFERS TO ISSUING RULES REGARDING DOWN PAYMENT AND MAXIMUM MATURITY IF INSTALLMENT CREDIT FOR PURCHASE OF GOODS

3. RBI GUIDELINES

RBI ISSUES ORAL, WRITTEN STATEMENTS , APPEALS, GUIDELINES, WARNINGS TO THE BANKS

4. RATIONING OF CREDIT

THE RBI CONTROLS THE CREDIT GRANTED BY COMMERCIAL BANKS

5. MORAL SUASION

PSYCHOLOGY MEANS AND INFORMAL MEANS OF SELECTIVE CREDIT CONTROL

6. DIRECT ACTION

THIS STEP IS TAKEN BY THE RBI AGAINST BANKS THAT DON'T FULFILL CONDITIONS OR REQUIREMENTS . RBI MAY REFUSE TO RE DISCOUNT THEIR PAPERS OR MAY GIVE EXCESS CREDITS OR CHARGE A PENAL RATE OF INTEREST FOR NON COMPLIANCE

IS LM MODEL MOST PREFERRED AND IMP

https://www.masterclass.com/articles/what-is-the-is-lm-model-in-economics#breaking-down-islm

https://www.investopedia.com/terms/i/islmmodel.asp