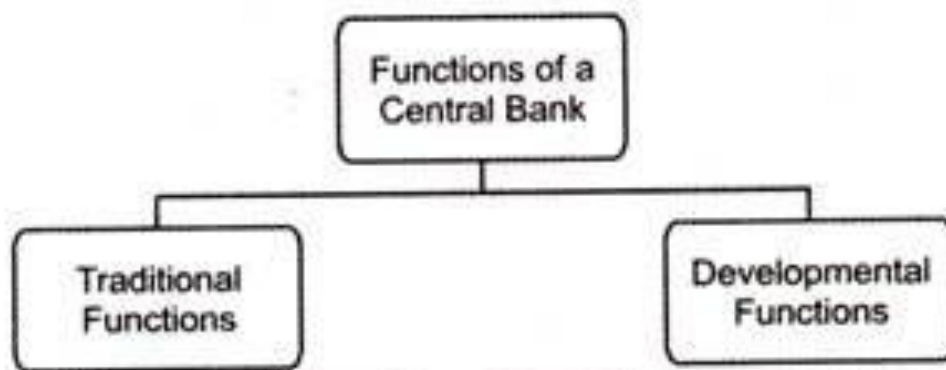


FUNCTIONS OF CENTRAL BANK



(a)Traditional Functions:

Refer to functions that are common to all central banks in the world.

1.Issue of Currency:

The central bank is given the sole monopoly of issuing currency in order to secure control over volume of currency and credit. These notes circulate throughout the country as legal tender money. It has to keep a reserve in the form of gold and foreign securities as per statutory rules against the notes issued by it.

It may be noted that RBI issues all currency notes in India except one rupee note. Again, it is under the directions of RBI that one rupee notes and small coins are issued by government mints.

2.Holder of Cash Reserves

One of the most crucial functions of the Central Bank is that they are the custodians of cash. Moreover, banks in every country reserve some percentage of their deposits with the central bank. This makes the central bank, the legal and the most safest holder of cash reserves.

3.Banker, Agent and Adviser to the Government:

Central bank, everywhere, performs the functions of banker, agent and adviser to the government.

As banker to the government, it makes and receives payments on behalf of the government. It advances short-term loans to the government to tide over difficulties.

As an adviser to the government it advises the government on all monetary and economic matters. The central bank also acts as an agent to the government where general exchange control is in force.

4. Lender of Last Resort:

When commercial banks have exhausted all resources to supplement their funds at times of liquidity crisis, they approach central bank as a last resort. As lender of last resort, central bank guarantees solvency and provides financial accommodation to commercial banks (i) by rediscounting their eligible securities and bills of exchange and (ii) by providing loans against their securities. This saves banks from possible failure and banking system from a possible breakdown.

5. Custodian of Foreign Exchange or Balances:

It has been mentioned above that a central bank is the custodian of foreign exchange reserves and nation's gold. It keeps a close watch on external value of its currency and undertakes exchange management control. All the foreign currency received by the citizens has to be deposited with the central bank; and if citizens want to make payment in foreign currency, they have to apply to the central bank.

6. Credit Controller

The commercial banks create a lot of credit during their course of operations. However, this credit can be one of the most critical and leading reasons for the emergence of inflation in an economy.

In such a case, a governing body is required to monitor the credit rates. Therefore, the central bank works on the control and modification of credit rates and the control of inflation.

7. Clearing House Function:

Banks receive cheques drawn on the other banks from their customers which they have to realize from drawee banks. Similarly, cheques on a particular bank are drawn and passed into the hands of other banks which have to realize them from the drawee banks. Independent and separate

realization to each cheque would take a lot of time and, therefore, central bank provides clearing facilities, i.e., facilities for banks to come together every day and set off their chequing claims.

(b) Developmental Functions:

Refer to the functions that are related to the promotion of banking system and economic development of the country. These are not compulsory functions of the central bank.

1. Developing specialized financial institutions:

Refer to the primary functions of the central bank for the economic development of a country. The central bank establishes institutions that serve credit requirements of the agriculture sector and other rural businesses.

Some of these financial institutions include Industrial Development Bank of India (IDBI) and National Bank for Agriculture and Rural Development (NABARD).

2. Influencing money market and capital market:

Implies that central bank helps in controlling the financial markets. Money market deals in short term credit and capital market deals in long term credit. The central bank maintains the country's economic growth by controlling the activities of these markets.

3. Collection and Publication of Data:

It has also been entrusted with the task of collection and compilation of statistical information relating to banking and other financial sectors of the economy. The data is quite helpful for researchers, policymakers, and economists.