MONEY

According to Kent money is anything which is Commonly used and generally Accepted as a ~~median~~ medium of exchange Or as a Standard of Value

OR

Money may be defined as anything which is generally accepted by all the people in exchange of goods and Services or in repayment of debts

FUNCTION OF MONEY

Primary
- Medium of Exchange
- Measure of Value

Secondary
- Transfer of Value
- Store of Value
- Standard of Deffered Payments

Contingent
- Equalisation of Marginal Utilities
- Distribution of National Income
- Basis of Credit
- Liquidity
- Bearer of Option

Prof. Kinley has classified the function of Money into three Group.

(I) Primary

(II) Secondary

(III) Contingent

PRIMARY FUNCTION

It includes those function of Money which its perform in an Economic System under all Cir-cum stonces. These function include the following:-

① Medium of Exchonge: Money is used as a medium of exchonge or meons of Payment. All Kind of Tronsaction of Goods and Services are conducted with the help of Money. Transaction of Vorious goods could be conducted independently, i.e. the purchose of one good does not require the Simyntoneously Value of another. Money has thus relived us from all difficulties that were being foced under the barter System of Exchonge.

② Measure of Value: Money act as a standard of Value or unit of account. As unit of account it measures the value of all Kinds of goods and Services if we pay Rs.10 for a pen, have a measure of Value in term of basic unit of account which is rupee.

SECONDARY FUNCTION

① Standard of deffered Payments: Money Serves as a standard of debt or deffered Payments. Money is preferred as a standard of deffered Payments because it Value remain stable overtime. It means a payment to be made in future Can be stated in money terms. other goods are perishable and their value get less overtime.

(2) Store of Value : Money Serve as a store of Value. wealth Can be stored in the form of other asseats as well but money is the best form of holding assets. It because it is most Liquid form of all assets.

(3) Transfer of Value : It helps in the transfer of Value from one place to another place. It is difficult to transfer fixed assets. however by Converting them into money their Value can easily be transferred from one place to another.

CONTINGENT FUNCTION

(1) Equalisation of Marginal utilities : A Consumer can maximise his satisfaction by spending his money income Acc. to the law of equilibrium marginal Utility. This enable a Consumer to maximise his satisfaction.

② **Distribution of National Income**: Barter System did not offer proper solution to the problem of distribution of National Income. It is easier to measure the Contribution of the various factor of pro-duction to the national income in term of money.

③ **Basis of Credits**: Credit is the Life blood of modern business. Legal tender money the basic for Credit. Banks Create Credit on the basis of their primary deposits.

④ **Liquidity**: It is the most liquid Asset. It Can easily converted into type of Assets without loss of Value and time. Hetrogeneous, assets could be expressed in identical assets with the help of money.

⑤ **Bearer of option**: Money Serve as a bearer of option. Man can Command any Commodity or Services in the world if he has sufficient money to purchase it. Thus money helps people to satisfy their multiple and divergent want.

Ques What is money Supply? Describe alternative use measure of money supply as used by RBI in india?

Ans Total stock of all the forms of money [Paper, coin, bank deposit). which are held by the public at any particular point of time

OR

It refer to the Volume of Money held by the people in the Country for transaction or for Settlement of debts.

Measure of money Supply or money stock

In India RBI uses four alternative measures of money Supply Called as M1, M2, M3 & M4. Each measures is breifly explained below:

1) M1 :⇒ Currency note and coin with the public [excluding Cash in hand of all Commercial bank] + Demand Deposit (excluding inter bank deposits) of all Commercial bank and Co-operative banks + Other deposits held with the RBI.

2) M2 :⇒ M1 + Post Office Saving deposits.

3) M3 :⇒ M1 + Time deposits of all Commercial

and Co-operative Banks (excluding inter bank time deposits)

4) M4 :⇒ M3 + Total deposit with the post office Saving Organisation [excluding National Saving Certificate]

Infact a great deal of debate is still going on as to what Constitutes money Supply. M1 and M2 are may be treated as a measure of narrow money whereas M3 & M4 as measure of broad money. In practise M3 is widely used as measure of money Supply which is also Called Aggregate monetory resources of the Society. All the Above four measure of represent different degree of Liquidity with M1 being the most Liquid and M4 being Least Liquid. It may be noted that Liquidity means ability to Convent an assets into money quickly and without Loss of Value.

BARTER SYSTEM

Ques 1. What is Barter System?

Ans. Direct exchange of Goods against goods is Called Barter Exchange or System.

For example, when weaver gives cloth to the farmer in the return for getting wheat from the farmer, this is Called Barter System or Exchange.

Ques 2 State the inconvience or draw backs of Barter Exchange?

Ans Inconvience or Drawbacks of Barter Exchange

1. Lack of double Coincidence of wants: fulfillmit of mutual wants of the Sellers and buyers is Known as double coincidence of wants. There is a lack of double Coincidence in the wants of buyers and Sellers in barter Exchange.

2. Absence of Common measure of Value: In barter System. there is no common measure of Value Even if buyer and Seller of each other Commodity

Ques Explain the process of Credit Creation by Commercial Bank?

Ans Credit plays a Crucial role in the modern monetary and business System. According to Prof. Cole Credit is purchasing power not derived from income but created by financial institutions either to offset the total ideal income held by depositors in the bank or as a net addition to amount of purchasing power.

Basis of Credit Creation :- Commercial banks do not create Credit out of thin air, There is a set procedure that bank follow to Create Credit, Banks create Credit on the basis of the primary deposits. i.e. the deposits of household and firms held with the banks. Credit or deposits Created by the Commercial bank are Known as derivative deposits.

Process of Credit Creation :- Commercial banks Create Credit on the basis of deposits that they recieve from the public. A bank Cannot lend more than what it recieves from the public. Through the procen of multiple expansion of deposits banks can multiply their deposits.

SINGLE BANKING

Where there is one banking system in Economy

There is only one bank 'X' in our Economy which recieves a primary deposits of Rs. 1000. Further Suppose that the bank has to Keep a minimum reserve of 10% of the total deposits to meet the oblization of the depositor.
In Other Words, the bank has to maintain a minimum reserve of Rs. 100 and it has excess reserve of R. 900 that it Can offer as loan to the needy borrowers.

ROUND	EXCESS RESERVES	NEW CREDIT	Increase in Minimum Reser.
I	+1000	+1000	–
II	+ 900	+ 900	100
III	+ 810	+ 810	90
IV	+ 729	+ 729	81
–	–	–	–
–	–	–	–
Total		10,000	1,000

Table Shows that an initial deposits of Rs. 1000 helps Bank X to Create total deposits of Rs. 10,000. At What rate the deposits will grow depend upon the Value of deposits Multiplier. Deposit multiplier is the reciprocal of the ratio of Cash reserves to deposits and it defined as follows

$$K \Rightarrow \frac{1}{R}$$

Where,

$K \Rightarrow$ Deposit Multiplier

$R \Rightarrow$ Ratio of Cash reserve to deposits.

In Our illustration, the Value of R is percent or 0.1 therefore, the Value of deposits multiplii

$$K \Rightarrow \frac{1}{R} \Rightarrow \frac{1}{0.1} \Rightarrow 10$$

It means that the initial deposits will grow 10 times of its value i.e. Rs. 1000 X10 $\Rightarrow$ 10,000. The higher the Cash reserve ratio, the lower will be the Value of deposits multiplier and vice-versa.

Ques How do banks Create Credit? Are there any Limitations of the power of banks to Create Credit?

OR

Explain the process of Credit Creation by Commercial Bank?

Ans Credit Creation by Bank: Credit Creation is Considered as important function of a modern bank.

Keynes has Classified bank deposits into two Groups: primary deposits and derivative deposits. Primary deposits are also known as Cash deposits made by a person or a firm in a cheque able account In, on the Contrary in order to given loan to a person the banks Create his account by a Certain amount, a derivative deposit is Created.

PROCESS OF CREDIT CREATION: The process of Credit Creation Can be analysed in two Way:

I. Credit Creation by a Single Bank and,

II Credit Creation by the banking System as a whole.

MULTIPLE BANKING SYSTEM

In the real world there are many banks in existance comprising multiple banking System.

The Process of Multiple Credit Can be explained with the help of an example Suppose the initial primary deposits of Rs. 10,000 and the Cash reserve ratio 20% bank 'A' has initial excess reserve of Rs. 8,000 (i.e. 10,000 - 20% of 10,000 ⇒ 8,000) The bank Creates derivative deposit equal to its initial excess reserve of Rs. 8,000 by Granting loans to the borrowers: The borrower make payments of Rs. 8,000 by cheque to other people, who are the Customer of Banks B. The Cash reserve ratio being 20% the excess reserve of Bank B are 6,400 which it Converts into derivative deposits by giving loan to borrowers

This process will Continue untill the primary deposits of Rs. 10,000 with a bank A, lead to the Creation of total deposits of Rs. 50,000 and the initial excess reserve of Rs. 8,000 in bank leads to the multiple expansion of total derivate deposits of Rs. 40,000 in the entire banking System. The Credit Creation or the Creation of derivate deposits (DD) by the banking System will be Rs. 8,000 + 6400 + 5120 ..... Rs. 40,000. i.e. 5 times of the intial excess reserve of Rs. 8,000.

Banks	PRIMARY DEPOSITS	CASH RESERVE	CREDIT CREATION
A	10,000 (initial Primary Deposits)	2,000	8000
B	8,000	1,600	6400
C	6,400	1,280	5120
D	5,120	1,024	3,996
	⁝	⁝	⁝
Total	50,000	10,000	40,000

It make clear the following points (A) Initial Primary deposits of Rs. 10,000 in bank A leads to the expansion of total deposits of Rs. 50,000 (B) initial excess reserve of Rs. 8,000 Create multiple derivative deposits of Rs. 40,000 (C) Credit Creation (i.e. 40,000 is five times the initial access Reserve

$$K \Rightarrow \frac{\text{Total Derivate Deposit}}{\Delta R}$$

LIMITATION OF CREATE CREDIT OR CREDIT CREATION

① TOTAL CASH RESERVE IN THE COUNTRY :- If the total cash reserve in the country more the bank create credit more and vice - versa.

② CASH RESERVE RATIO : Banks have to maintained a minimum level of Cash reserves to meet day to day Oblizations of the depositores. The Smaller the ratio of Cash reserve to total deposits, the more will be the power of the bank to Create Credit.

③ BUSINESS CONDITION : During A period of busines prosperity the demand for loans & Advances by the ~~by~~ business Commity increases therefore the power of banks to Create Credit also increases on the other hand during depression the Credit Creating power of the bank decreases.

④ MONITARY POLICY OF CENTRAL BANKS : The Central bank of Country has absolute power to Control the Volume of Credit. If the Central Bank employess

Strict measure to Control Credit the power of Banks to Create Credit gets restricted.

(5) BANKING HABBITS OF PEOPLE: If the people in a Country frequently used Cheques, drafts, bill of exchange etc. to fulfill their business Obligations the banks will require lesser Cash reserve to meet their business Obligations and their power to Create Credit increases.

(6) Nature of the Security Offered: The banks offers Credit facility to the borrowers only when they offer good security or assets, The Credit Creating power of the banking institution is limited by the risky and doubtfull Securities.