Economics Class 12 Important Question Chapter 3 Money And Banking

Q1. Define money.

Ans. Money may be defined as anything which is acceptable as a medium of exchange.

Q2. What determines money multiplier?

Ans. Legal reserve ratio

Q3. State any two components of M1 measure of money supply.

Ans. Currency with public and demand deposits with banks.

Q4. What are demand deposits?

Ans. Demand deposits are the deposits which are payable by the banks on the demand by the customers at any time.

Q5. Define Barter system.

Ans: Barter system of exchange is a system in which goods are exchanged for goods.

Q6. What is meant by double coincidence of wants?

Ans: Double coincidence of wants means that goods in possession of two different persons must be useful and needed by each other.

Q7. Define commercial bank.

Ans: Commercial bank is a financial institution which performs the functions of accepting deposits from the public and making loans and investments, with the motive of earning profit.

Q8. Define money multiplier/credit multiplier/deposit multiplier.

Ans: When the primary cash deposit in the banking system leads to multiple expansion in the total deposits, it is known as money multiplier or credit multiplier.

Q9. Define central bank.

Ans: The central bank is the apex institution of a country's monetary system. The design and the control of the country's monetary policy is its main responsibility. India's central bank is the Reserve Bank of India.

Q10. What will be the effect of a rise in bank rate on the money supply?

Ans: Money supply will reduce.

Q11. Calculate the value money multiplier and the total deposit created if initial deposit is Rs. 500 crores and LRR is 10%.

Ans: Value of money multiplier = 1/LRR which is equal to 1/0.1 = 10

Initial deposit was Rs. 500 crores

Hence,

Total Deposit will be Initial Deposit × Money Multiplier

= 500 ×10

= 5000 Crores

Thus, the total deposit is 5000 crores.

Q12. Calculate LRR, if initial deposit of Rs. 200 crores lead to creation of total deposits of Rs. 1600 crores.

Ans: Money Multiplier = Total Deposits / Initial Deposits

= 1600 / 200 = 8

Hence Money Multiplier = 1/LRR

8 = 1/LRR

LRR = 1.25 or 12.5

18. If total deposits created by commercial banks are Rs. 12,000, LRR is 25%, calculate initial deposit.

Ans: Money Multiplier = 1/LRR = 1/025 = 4

Initial Deposit = Total Deposit / Money Multiplier

= 12000 / 4

= Rs. 3000

Thus, the initial deposit is Rs. 3000.

Q13. **What do you mean by high powered money?**

Ans: It is the money that the RBI and the government have generated, in which the public holds the currency and banks keep the cash reserves. Money varies from cash reserves in that money is made up of demand deposits, whereas cash reserves are used to create demand deposits.

The equation is:

H = C + R

Where H = High Powered Money

C = Currency with the public (Paper money + coins)

R = Government and bank deposits with RBI

Thus, the sum total of money deposited with the public and the funds of banks are termed as powerful money. It is mainly created by the central bank.

Q14. Bring out the role of Central Bank as the controller or money supply or credit.

Ans: The Central Bank will hike the bank rate if it wants to regulate lending. Market rates and other loan rates on the money market will increase as a result of this. Borrowing will be frowned upon. The expansion of credit will be hampered by a rise in the bank rate. Likewise, a decrease in the bank rate significantly decreases money market lending rates, which in turn stimulates commercial and industrial activity, requiring more credit from banks. As a result, the volume of bank credit will increase.

Long Answer Questions (6 marks)

Q15. Explain the following functions of the Central Bank of India.

1. Bank of Issue

Ans: 1. Bank of Issue: The central bank of a country, whose tasks include currency issuance, monetary policy administration, open market activities, and engaging in transactions that promote healthy business connections. For example, the Reserve Bank of India, the Bank of England, and the Federal Reserve banks of the United States. Simply put, a bank with the formal right to manufacture currency, which can include both paper money and coins. The Reserve Bank of India is the sole authority in India for issuing banknotes. The Reserve Bank, like other central banks across the world, periodically modifies the design of banknotes. Since 1996, the Reserve Bank has released banknotes of the Mahatma Gandhi Series, which include denominations of Rs. 5, Rs. 10, Rs. 20, Rs. 50, Rs. 100, Rs. 200, and Rs. 500.

2. Banker's bank: A bankers' bank is a type of bank formed by a collection of larger, more well-established banks. Bankers' banks exist to provide services to the charter banks that established them. These institutions are created to help community banks, even though their financial services are not normally open to the public in any way. Commercial banks have a current account with the central bank and are able to borrow money in the short term. As a result, banks that need to provide banknotes to their customers either over the counter or through automated teller machines get them from the central bank, which has a monopoly on issuing banknotes. In India, the Reserve Bank of India (RBI) serves as the banker's bank. This bank requires all commercial banks in India to maintain a cash reserve ratio. Credit is created by commercial banks. The RBI's role is to regulate credit via the CRR, bank rate, and open market activities.

Q16. Explain the leading functions of commercial banks.

Ans: The most essential components of the banking system are commercial banks. A commercial bank is a profit-driven financial organisation that provides loans, accepts deposits, and provides other financial services like overdrafts and electronic fund transfers. According to Culbertson, "Commercial Banks are the entities that establish short-term bans on business and create money in the process."

Commercial banks have divided their functionality into two sections, as seen in the diagram above: primary and secondary functions.

a. **Primary Functions:** The term "primary functions" refers to the basic functions of commercial banks, which include:

i. Accepting Deposits suggests that commercial banks rely on public deposits for the majority of their funding. Demand and time deposits are the two forms of deposits. Demand deposits are those that can be easily withdrawn by individuals without giving the bank prior notice. Deposits made for a specific length of time are known as time deposits. On these deposits, banks pay a greater rate of interest.

ii. Advancing Loans refers to the utilisation of public deposits by commercial banks to make loans to individuals and enterprises. Overdrafts, cash credit, and discounting bills of exchange are all examples of commercial bank loans.

b. **Secondary Functions:** The term "secondary functions" usually refers to critical activities performed by commercial banks. Agency functions, general utility functions, and other functions are the three types of secondary functions that can be classified.

i. Agency Function – Commercial banks act as agents for their customers by collecting checks, collecting income, and paying expenses, among other things.

ii. Providing Locker Facilities, Issuing Traveller's Checks, Dealing in Foreign Exchange, and Transferring Funds are examples of general utility functions.

iii. Other tasks include lending money to individuals and opening demand deposits, as well as electronic banking, which encompasses services such as debit cards, credit cards, and Internet banking, among others.

Q17. State the functions of money.

Ans: Money is typically described in terms of the three functions or services it provides. Money functions as a means of exchange, a store of value, and a monetary unit. It is a current means of trade in the form of coins and banknotes (together, coins and banknotes). In the words of Prof. Walker, "Money is as money does."

The following are the primary purposes of money:

i. Money as a Medium of Exchange: The basic or primary function of money is to serve as a medium of exchange. The medium of money is used to exchange commodities and services. Money serves as both a medium of commerce and a means of payment. Money has no value on its own. It's only a stepping stone.

ii. Money as a Unit of Account or Measure of Value: Money is used to represent a unit of account or a measure of value. Money serves as the yardstick by which the value of other goods and services is measured and expressed in monetary terms.

iii. Money as a Deferred Payments Standard: Deferred payments are payments that are made at a later date. Debts are typically expressed in terms of account money. Loans are taken out and repaid in monetary terms.

iv. Money as a Store of Value: Money can be used to store wealth for the future. It is used to store the worth of liquid items. We can receive any commodity in the future by spending it. This is a function of money that Keynes emphasises a lot. Because money can be quickly transformed into other things, it is akin to having a reserve of liquid assets.

v. Money's Liquidity: Money is entirely liquid. Liquidity refers to a currency's ability to be converted into cash. Liquidity of asset refers to the ability to turn an asset into money rapidly and without losing value. Modern economics places a premium on money availability.

Q18. How does money overcome the problems of barter system?

Ans: i. By separating the acts of sale and purchase, money, as a medium of exchange, resolves the problem of bartering's lack of double coincidence of wants.

ii. The absence of a common measure of value is solved by using money as a measure or unit of value or a unit of account. Money serves as a unit of account and a yardstick for determining the exchange value of all goods.

iii. Money as a store of value solves the challenge of storing wealth that plagues barter. It broadened people's purchasing power.

iv. Using money as a deferred payment standard helps to alleviate the barter problem of a lack of deferred payment standards. It also aids in the formation of contracts involving future payments.

v. The use of money allowed people to sell their excess commodities in exchange for cash and utilise the cash to purchase their necessities. Currency was invented during ancient wars because it was too difficult for warriors to carry chickens and beans around to exchange for what they needed.

vi. The indivisibility of goods was a significant issue. A severe problem of indivisibility of certain items arose under barter. Some articles were tough to break down into manageable chunks. As a result, one of the trade parties was forced to give up his entire indivisible thing in return for the other's goods.

vii. A major issue at the time was the difficulty in transferring wealth. The problem of transferring a person's wealth under barter emerges. When he wants to move his money, such as his house, property, or car from one location to another, it's nearly impossible to find someone in another location who can trade his property or wealth.

Q19. Why only a fraction of deposits is kept as Cash Reserves?

Ans: Deposits are accepted by banks, while loans are disbursed to lenders. As a result, banks can lend some of their depositors' money while having enough on hand to cover daily withdrawals. The fractional-reserve banking system is what it's called. Cash Reserves are a portion of deposits held by banks. Any seasoned banker knows two things based on his or her experience. For starters, depositors do not all go to the bank at the same time to withdraw money, nor do they withdraw the entire amount at once. Second, new deposits will continue to flow into banks on a daily basis.