CHAPTER 3: MONEY AND BANKING

₹ $ ¥ €

WHAT IS MONEY?

Money is anything which is generally used as a medium of exchange, measure of value, store of value and means of standard deferred payment.

It covers all types of money: coins, paper notes, cheques, digital money, plastic money etc…. It can be used to buy anything as it is legally accepted by everyone. It removes the problem of double coincidence of wants as anyone can buy anything he needs.

Barter Exchange:

It is a trade in which one product or service is exchanged for another.

It is the oldest form of commerce.

A barter system refers to the

exchange of goods & services with two or more parties without the use of money.

In other words,

the exchange of one good or service from a party in return for a Good or Service by another party. This exchange is also known as "C-C Transactions" (C stands for Commodity).

DISADVANTAGES OF BARTER EXCHANGE:

1. A lack of a standardised means of measuring value.
2. There is a lack of desire for duplication. (Lack of double coincidence of wants)
3. A scarcity of common value measures.
4. Inadequate store of value.

5. Deferred payment standards are lacking.	
6. Inability to divide.	

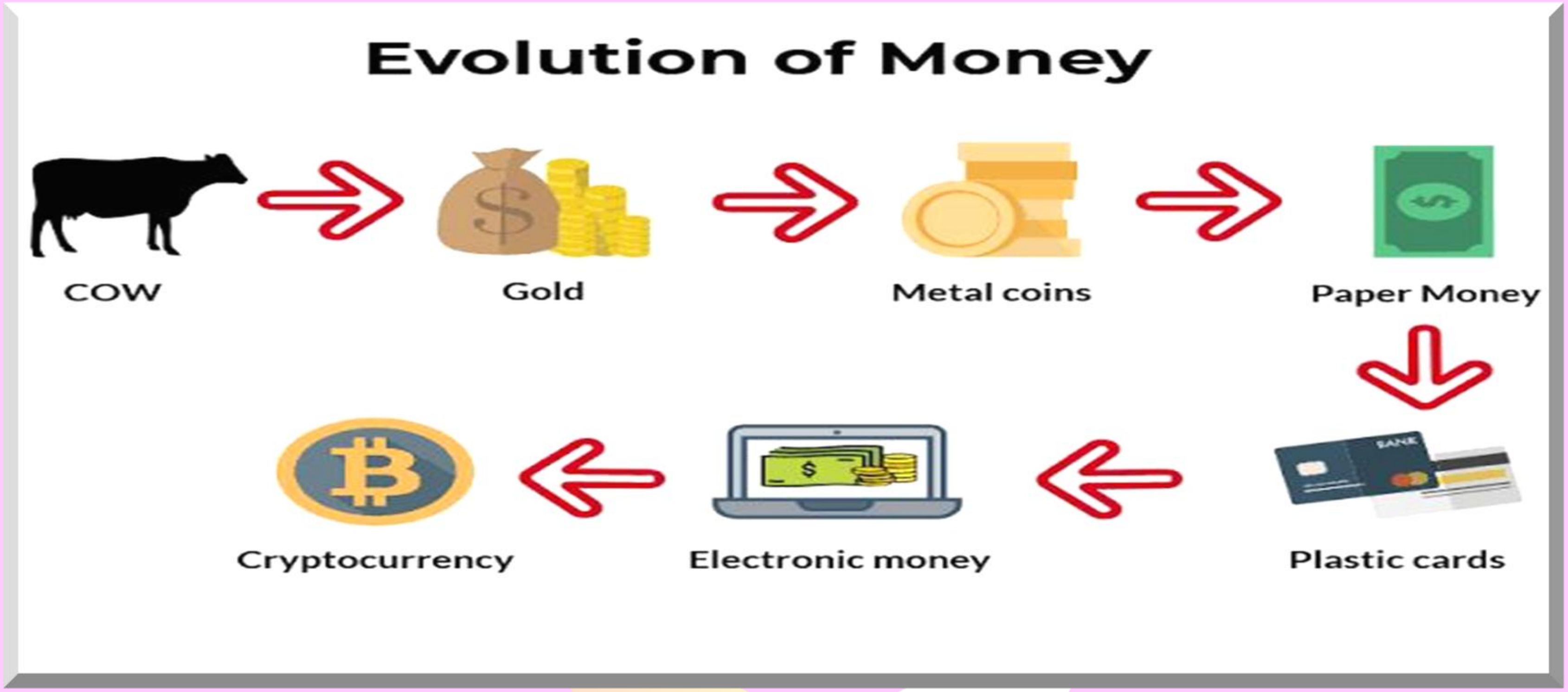
Evaluation of Money (₹, 💰)

5 Stages of Evolution of Money

Some of the major stages through which money has evolved are as follows:

(i) Commodity Money
(ii) Metallic Money
(iii) Paper Money
(iv) Credit Money
(v) Plastic Money.

Money has evolved through different stages according to the time, place and circumstances.



(i) Commodity Money:

In the earliest period of human civilization, any commodity that was generally demanded and chosen by common consent was used as money.

Goods like furs, skins, salt, rice, wheat, utensils, weapons etc. Were commonly used as money. Such exchange of goods for goods was known as 'Barter Exchange'.

(ii) Metallic Money:

With progress of human civilization, commodity money changed into metallic money. Metals like gold, silver, copper, etc. Were used as they could be easily handled and their quantity can be easily ascertained. It was the main form of money throughout the major portion of recorded history.

(iii) Paper Money

Invention of paper money marked a very important stage in the development of money. Paper money is regulated and controlled by Central bank of the country (RBI in India). At present, a very large part of money consists mainly of currency notes or paper money issued by the central bank.

(iv) Credit Money:

Emergence of credit money took place almost side by side with that of paper money. People keep a part of their cash as deposits with banks, which they can withdraw at their convenience through cheques. The cheque (known as credit money or bank money), itself, is not money, but it performs the same functions as money.

(v) Plastic Money:

The latest type of money is plastic money in the form of Credit cards and Debit cards. They aim at removing the need for carrying cash to make transactions.

DEFINITIONS OF MONEY:

Legal definition of money:

(a) Legally, money is anything proclaimed by law as a medium of exchange.

(b) Paper notes and coins (together called currency) is money as a matter of law.

Functional definition of money:

Functional definition of money refers to money as anything that performs four basic functions,

(a) It serves as a medium of exchange.

(b) It serves as a standard unit of value.

(c) It serves as a means for future / contractual payments or standard of deferred payments.

(d) It serves as a store of value.

According to this, definition of money includes both notes and coins as well as cheque able deposits with the banks.

Narrow definition of money:

Functional definition of money is a narrow definition of money. It includes only notes, coins and demand deposits as money. In other words, in its narrow definition, money includes only those things that function as money in terms of:

(a) Medium of exchange.

(b) Measure of value.

(c) Standard of future/Deferred payments.

(d) Store of value.

Broad definition of money:

These deposits can be converted into demand deposits on a short notice, and are "Near money assets". Money assets and near money assets together make up a definition of money.

Characteristics or features of money:

(a) **Durability**:

Money must be durable and not likely to deteriorate rapidly with Frequent handling. Currency notes and coins are being used repeatedly and shall Continue to do so for many years.

(b) Medium of exchange:

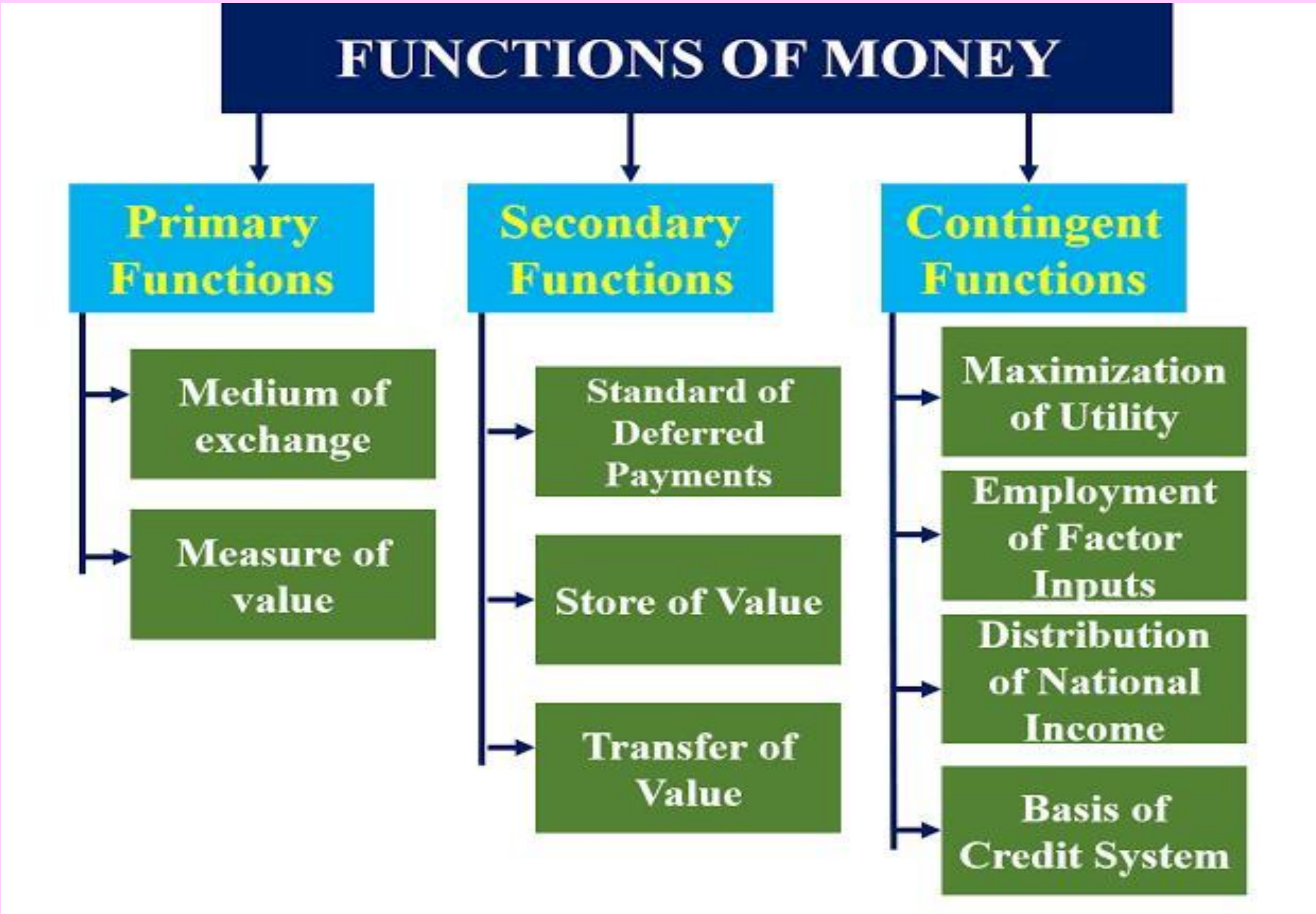
Money is the thing that acts as a medium of exchange for the sale and purchase of goods and services.

(c) **Weight**:

Money must be light in weight. Paper money is better than metal coins because it is light in weight.

(d) Measure of value:

It not only serves as medium of exchange but also acts as a measure of value. The value of all the goods and services is expressed in terms of money


FUNCTIONS OF MONEY
Primary Functions
Secondary Functions
Contingent Functions
Medium of exchange
Measure of value
Standard of Deferred Payments
Store of Value
Transfer of Value
Maximization of Utility
Employment of Factor Inputs
Distribution of National Income
Basis of Credit System

Primary function or Main function:

Primary function includes the most important functions of money, which it must perform in an economic system irrespective of time and place. The following two functions are included under this category.

(a) Medium of exchange
• Money when used as a medium of exchange helps to eliminate the basic limitation of barter trade, that is, the lack of double coincidence of wants.
• Individuals can exchange their goods and services for money and then can use this money to buy other goods and services according to their needs and convenience.
• The ease at which money is converted into other goods and services is called “liquidity of money”.
(b) Measure of Value /unit of account
• As Geoffrey Crowther puts it, “Money acts as a standard measure of value to which all other things can be compared.” Money measures the value of economic goods.
• Money works as a common denominator into which the values of all goods and services are expressed.

Secondary Functions

(i) Standard of deferred payments

- The debtors make a promise that they will make payments on some future date. In those situations, money acts as a standard of deferred payments.
- It has become possible because money has general acceptability, its value is stable, it is durable and homogeneous.

(ii) Store of value

- Wealth can be conveniently stored in the form of money. Money can be stored without loss in value.
- Savings are secured and can be used whenever there is a need.
- In this way, money acts as a bridge between the present and the future.

iii) Transfer of value:

Money also serves for transfer of value. It facilitates buying and selling of goods not only in the domestic country but also in other parts of the world.

TYPES OF MONEY

Legal Tender Money:

Money which can be legally used to make payments for some obliged debt is known as legal tender money. It is of two types-

Limited legal tender money: It is that form of legal money which is used to make payments for the debts up to a certain amount. For example; coins.

Unlimited legal tender money: It is that form of legal money which can be used to make payment of debts up to any amount. There is no limit fixed. For example; paper/ currency notes.

Full Bodied Money:

It is that form of money in which face value is equal to intrinsic value of money. It means commodity value= money value. For example: gold and silver coins.

Representative Full-Bodied Money:

It is that form of full-bodied money in which intrinsic value is less than face value of money. It means commodity value< money value. For example: paper notes.

Credit Money:

It is that form of money whose intrinsic value is lower than its face value. It means that money value> commodity value. For example: credit cards, bank deposits etc....

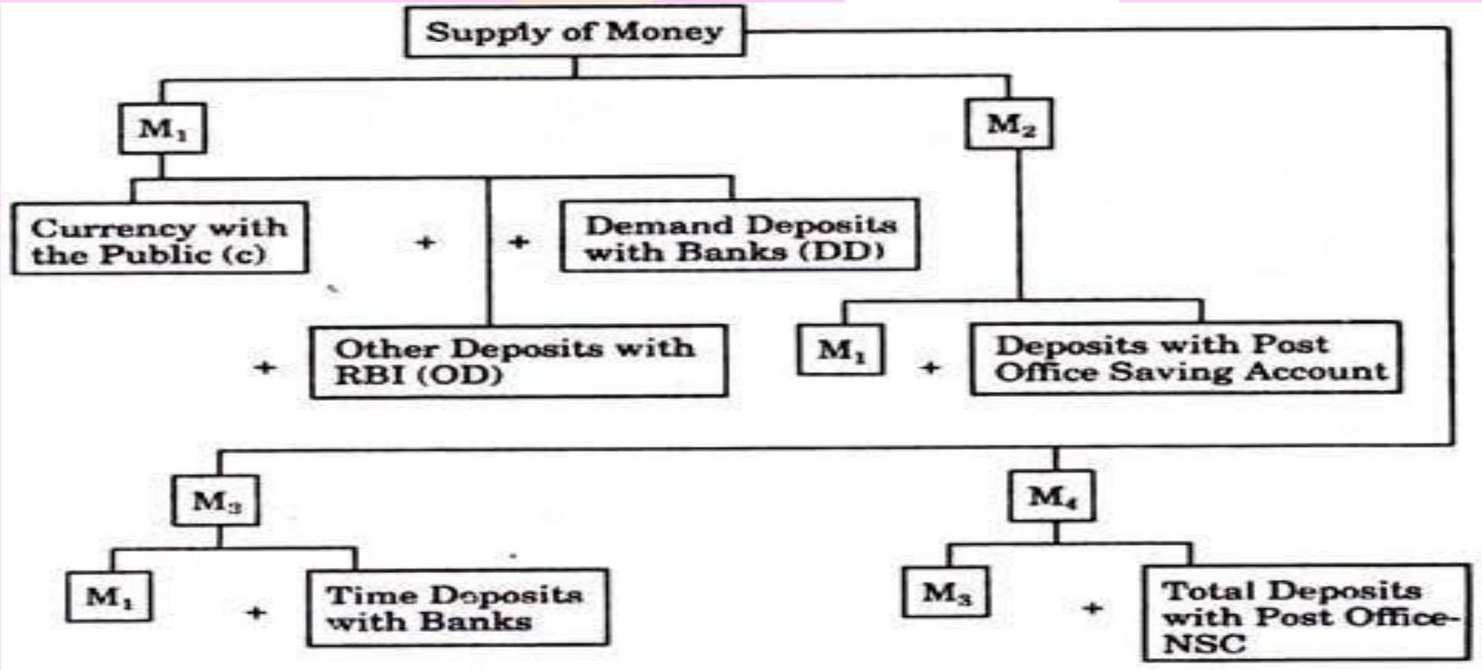
MONEY SUPPLY

Money supply refers to the total money held by public at a particular point of time in an economy.

It includes money only held by the "public" not the government or banking system. Money supply is a "Stock" concept.

There are 4 measures of money supply.

MEASURES OF MONEY SUPPLY



(i) M1:

It is the first and basic measure of money supply. It includes currency held by the public, demand deposits of commercial banks and other deposits with the RBI.

M1= Currency and coins with public+ Demand deposits with commercial banks+ Other deposits with RBI

(ii) M2:

It is a broader concept of money supply as compared to M1. It also includes savings deposits with the post office saving bank.

M2 = M1 + Savings deposit with Post office saving bank

(iii) M3:

It also includes net time deposits in addition to M1 measure of money supply.

M3 = M1 + Net time deposits with banks

(iv) M4:

It includes total deposits with post office savings bank in addition to M3 measure of money supply.

M4 = M3 + Total deposits with post office saving bank

HIGH POWERED MONE

High powered money is the money produced by RBI and the government.

It includes currency held by the public and the cash reserves held by the banks.

It is denoted by symbol (H).

It is different from money because money consists of demand deposits while it includes cash reserves which act as a base for generating demand deposits.

Commercial Banks

A commercial bank is a financial organisation that accepts deposits, provides checking account services, makes different loans, and provides basic financial products to people and small companies such as certificates of deposit (CDs) and savings accounts. Most individuals conduct their banking at a commercial bank.

Types of commercial bank

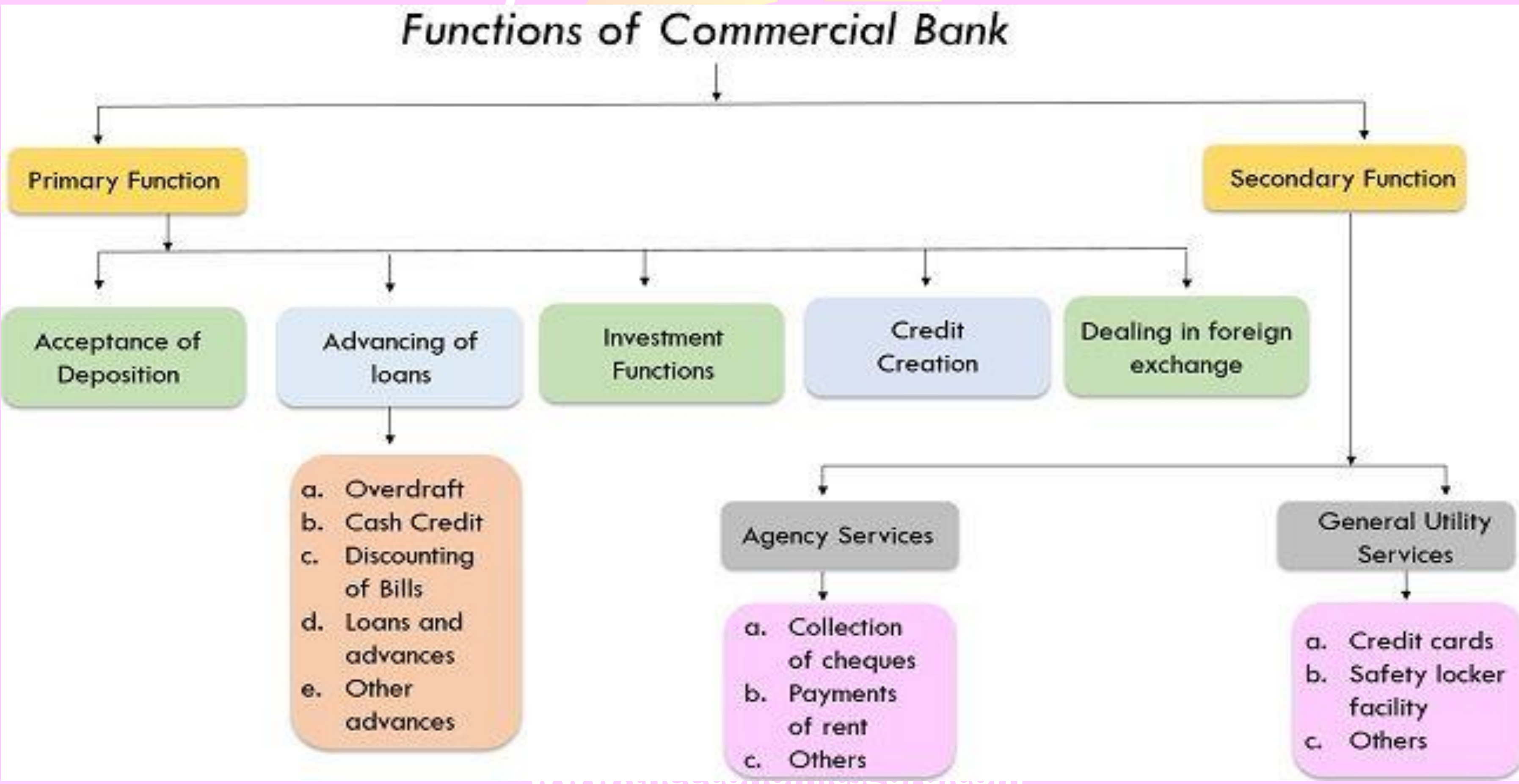
Commercial banks come in three main varieties.

Private banks are a subset of commercial banks where the majority of the share capital is owned by private persons and companies. All private banks are listed as limited liability firms. Examples of such banks are Industrial Credit and Investment Corporation of India (ICICI) Bank, Yes Bank, and Housing Development Finance Corporation (HDFC) Bank.

Public bank: This category of bank is nationalised, and the government owns a substantial portion of it. For instance, Bank of Baroda, Punjab National Bank, Dena Bank, Corporation Bank, and State Bank of India (SBI).

Foreign bank: These financial institutions were founded in other nations and have branches there. Examples of such banks are American Express Bank, Citibank, Standard & Chartered Bank, and Hong Kong and Shanghai Banking Corporation (HSBC).

Functions of Commercial Banks



Primary Functions

Accepting Deposits –

Commercial banks accept deposits from their customers in the form of saving, fixed, and current deposits.

Savings Deposits

Savings deposits allow a customer to credit funds towards their accounts for up to a certain limit. These deposits are preferred by individuals with a fixed income, utilized to create savings over time.

Fixed Deposits –

Fixed deposits come with a predetermined lock-in period. Fixed deposits are also referred to as time deposits as the funds are deposited for a specific time frame.

Current Deposits –

Current deposits allow account holders to deposit and withdraw money whenever necessary. In some cases, current accounts also offer overdrafts until a pre-specified limit to individuals and businesses.

Providing Loans –

One of the main functions of commercial banks is providing credit to organizations and individuals, and profit from the earned interest. Usually, banks retain a small reserve for their expenses while offering the remaining amount to customers as various types of short and long-term credits.

Credit Creation –

A unique function of commercial banks is credit creation. Instead of offering liquid cash, banks create a line of credit and transfer the loan to a business or commercial body all at once.

Categories of Secured and Unsecured Loans provided by Commercial Banks

Cash Credit –

Commercial Banks and their Functions include extending advances to individuals and organizations against bonds, inventories, and other types of securities. This facility, commonly known as cash credit, provides a more substantial sum when compared to other forms of credit.

Short-Term Credits –

Short-term loans are usually pledged without any security, offering a smaller loan amount and repayment tenor. These are also referred to as personal loans.

Secondary Functions

The following can be considered as the secondary functions of commercial banks –

Providing locker Facilities –

Commercial banks provide locker facilities to customers who want to store valuables safely. Locker facilities eliminate the impending risk of theft or loss, which prevail when kept at home.

Dealing in Foreign Exchange –

Commercial banks help provide foreign exchange to individuals and organizations that export or import goods from overseas. However, only certain banks which have the license to deal in foreign exchange are eligible for such transactions.

Exchange of Securities –

Another function of commercial banks is to trade in bonds and securities. Customers can purchase or sell the units from the financial institution itself, which offers more convenience than alternate approaches.

Discounting Bills of Exchange –

The main function of a commercial bank in today's date is to discount bills of businesses. Bill discounting is considered a profitable investment for banks. Bills create a steady flow of funds, while not becoming a risky venture during payment as it is considered as a negotiable instrument. These also do not involve the financial institution in any litigation.

Bank as an Agent –

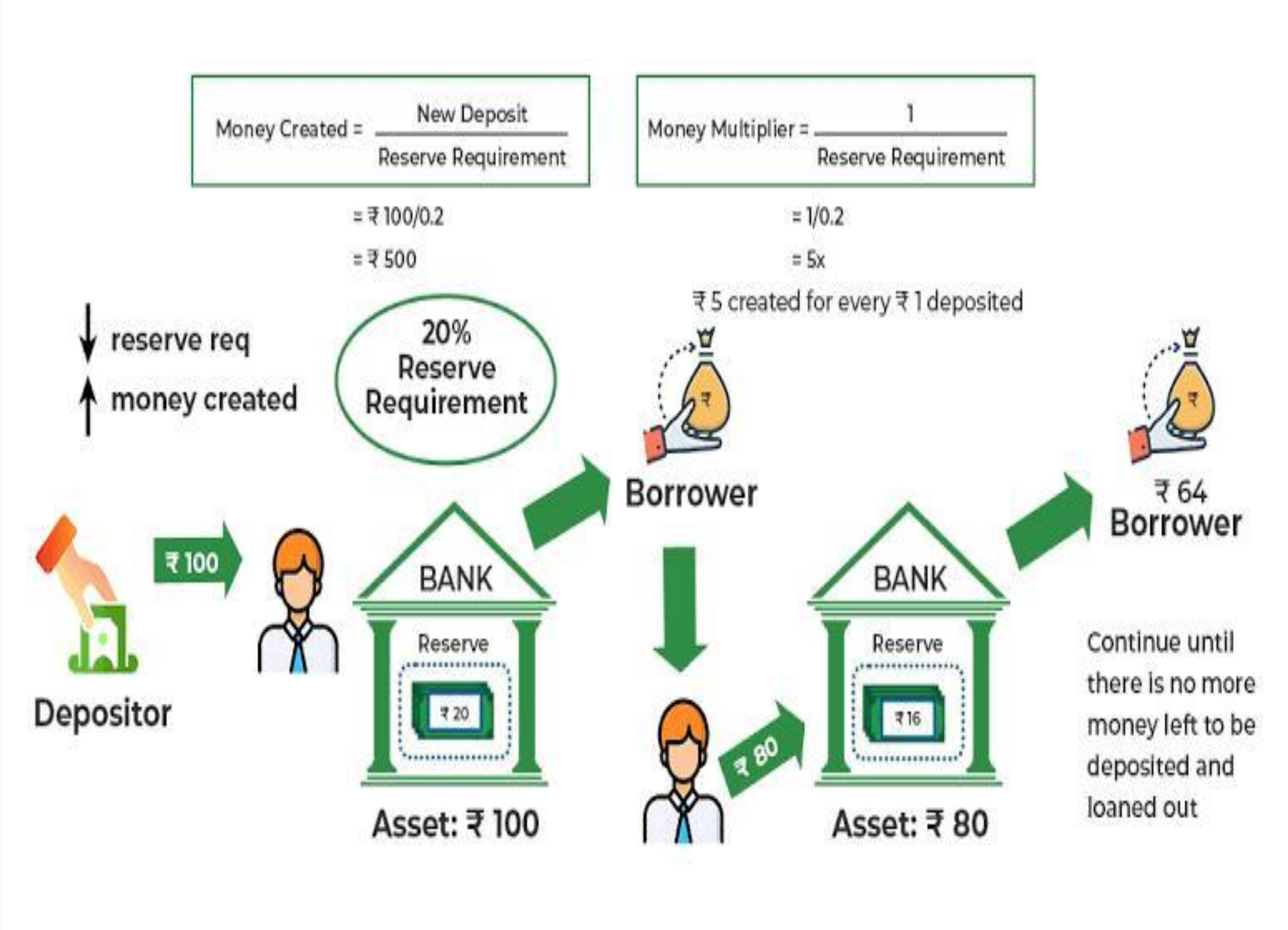
Commercial Bank and its Function also require them to provide finance-related services to customers, fulfilling the role of an agent. These services usually include –

- **Acting as an administrator, trustee, or executor of a customer-owned estate.**
- **Assisting customers with tax returns, tax refunds, and other similar tasks.**
- **Serving as a platform to pay premiums, repay loan instalments, etc.**
- **Offering a platform for electronic transaction of funds, processing of cheques, drafts, bills, etc.**

CREDIT CREATION BY COMMERCIAL BANKS

A commercial bank is a dealer of credit. It creates money based on cash deposits. Further, it issues new money through its loan operations and creates credit or expands the monetary base of a country.

Therefore, this process of credit creation leads depositors to believe that they have money with the bank. Also, borrowers believe that they owe a certain amount of money to the bank. Let's understand credit creation through an example.


Money Created = New Deposit / Reserve Requirement
= ₹ 100/0.2
= ₹ 500
Money Multiplier = 1 / Reserve Requirement
= 1/0.2
= 5x
₹ 5 created for every ₹ 1 deposited
↓ reserve req
↑ money created
20% Reserve Requirement
Borrower
₹ 64
Borrower
₹ 100
Depositor
BANK
Reserve
₹ 20
Asset: ₹ 100
₹ 80
BANK
Reserve
₹ 16
Asset: ₹ 80
Continue until there is no more money left to be deposited and loaned out

The following formula can be used to determine the total credit creation.

Total credit creation = Original deposit × Credit multiplier coefficient

Where,

Credit multiplier coefficient = 1/r

R = Cash reserve requirement also known as cash reserve ratio (CRR)

Let us understand this with an example.

If the money deposited in a bank is ₹10,000 and the bank has a CRR of 10%, then what will be the credit multiplier coefficient?

Credit multiplier coefficient = 1/10%

= 1/0.1 = 10

Total credit creation = 10,000 × 10 = 1,00,000

Similarly, if CRR = 20%

Then,

Credit multiplier coefficient = 1/20%

= 1/0.2 = 5

Therefore, total credit creation = 10,000 × 5 = 50,000

From the given values we can understand that, a low CRR value results in high credit creation and a high CRR results in low credit creation. Therefore, with the help of credit creation, the money gets multiplied in the economy.

Mechanism of Credit Creation-

Table 2 : Multiple Credit Creation by Banking System

Banks	Primary Deposits	Cash Reserves (r = 20%)	Credit Creation or Derivative Deposits (ΔD)
A	Rs. 1000 (Initial primary deposits)	Rs. 200	Rs. 800 (Initial excess reserves ΔR)
B	800	160	640
C	640	128	512
D	512	102	410
.	.	.	.
.	.	.	.
Total	5000	1000	4000

Central Banks

Central bank is regarded as an apex financial institution in the banking system. It is considered as an integral part of the economic and financial system of a nation. The central bank functions as an independent authority and is responsible for controlling, regulating and stabilising the monetary and banking structure of the country.

In India, the Reserve Bank of India is regarded as the central bank. It was set up in 1935. Central banks are responsible for maintaining the financial stability and economic sovereignty of the country.

The functions of a central bank can be discussed as follows:

1. **Currency regulator or bank of issue**
2. **Bank to the government**
3. **Custodian of Cash reserves**
4. **Custodian of International currency**
5. **Lender of last resort**
6. **Clearing house for transfer and settlement**
7. **Controller of credit**
8. **Protecting depositors' interests**

Currency regulator or bank of issue:

Central banks possess the exclusive right to manufacture notes in an economy. All the central banks across the world are involved in issuing notes to the economy.

This is one of the most important functions of the central bank in an economy and due to this the central bank is also known as the bank of issue.

Bank to the government:

The central bank accepts deposits and issues funds to the government. It is also involved in making and receiving payments for the government. Central banks also offer short term loans to the government in order to recover from bad phases in the economy.

It acts as an advisor and agent of the government by providing advice to the government in areas of economic policy, capital market, money market and loans from the government.

Custodian of Cash reserves:

It is a practice of the commercial banks of a country to keep a part of their cash balances in the form of deposits with the central bank. The commercial banks can draw that balance when the requirement for cash is high and pay back the same when there is less requirement of cash.

Lender to the Last Resort:

The central bank is referred to as the lender of last resort as it saves banks from possible failure and the banking system from a possible breakdown. In case commercial banks fail to meet their financial requirements from other sources, they can approach the central bank for a loan as a last resort.

Clearing house for transfer and settlement:

Central bank acts as a clearing house of the commercial banks and helps in settling of mutual indebtedness of the commercial banks. In a clearing house, the representatives of different banks meet and settle the interbank payments.

Controller of credit:

Central banks also function as the controller of credit in the economy. It happens that commercial banks create a lot of credit in the economy that increases the inflation.

The central bank controls the way credit creation by commercial banks is done by engaging in open market operations or bringing about a change in the CRR to control the process of credit creation by commercial banks.

Protecting depositors' interests:

Central bank also needs to keep an eye on the functioning of the commercial banks in order to protect the interests of depositors.

Examples of Central Banks

Some of the well-known central banks across the world are:

1. **Federal Reserve (USA)**
2. **Reserve Bank of India (India)**
3. **People's Bank of China (China)**
4. **Bank of England (UK)**
5. **European Central Bank (EU or European Union)**

Credit Control by Central Banks

Credit Control

↓

Control of money supply

↓

Monetary Policy

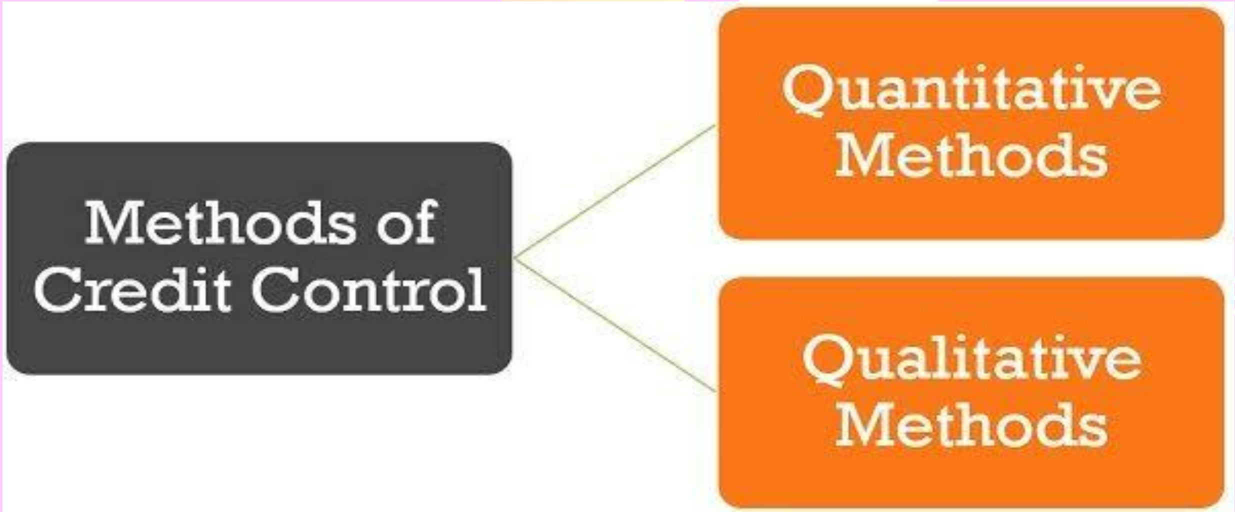
Definition:

Credit Control is a function performed by the Central Bank (Reserve Bank of India), to control the credit, i.e. the demand and supply of money or say liquidity in the economy. With this function, the central bank regulates the credit granted by the commercial banks to its customers. It aims to achieve economic development with stability as well as to manage the inflationary and deflationary pressure.

The basic objectives of credit control are:

- **To attain stability in the internal price level.**
- **To obtain stability in the foreign exchange rates, which maintains the external value of the currency.**
- **To maintain stability in the money market through liquidity control measures.**
- **To promote overall economic growth and development, by maximizing income, employment and output.**
- **To promote national interest.**

Methods of Credit Control



Quantitative Credit Control

Quantitative measures of credit control are those which affect the overall supply of money in an economy. These measures do not restrict the flow of credit to some specific sectors of the economy.

Bank Rate Policy:

Bank rate policy is used as the main instrument of monetary control during inflation. When the Central Bank raises the bank rate, it is said to have adopted a dear money policy. The increase in bank rate increases the cost of borrowing which reduces commercial banks borrowing from the Central Bank. Consequently, the flow of money from commercial banks to the public reduces. Therefore, inflation arising because bank credit is controlled.

Cash Reserve Ratio (CRR)

The CRR is the necessary minimum percentage of a bank's total deposits that is to be kept with the Central Bank.

During inflation, the Central Bank increases the CRR, and thereby the funds for providing loans with the commercial banks decrease. In this process, the flow of credit and the aggregate demand is reduced. Thus, the process of credit creation by the commercial bank is checked and helps control inflation. On the other hand, the RBI reduces the CRR to curb the deflation situation.

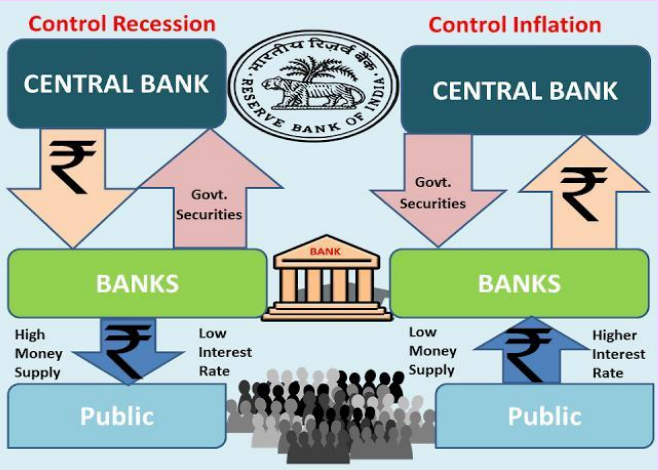
Statutory Liquidity Ratio (SLR)

SLR is the fixed percentage of assets in the form of cash or other liquid assets which a bank must maintain with the Central Bank. The Central Bank can vary the SLR between 20% and 40%.

Open Market Operation:

Open market operations refer to the sale and purchase of government securities and bonds by the Central Bank. While controlling inflation, the Central Bank sells

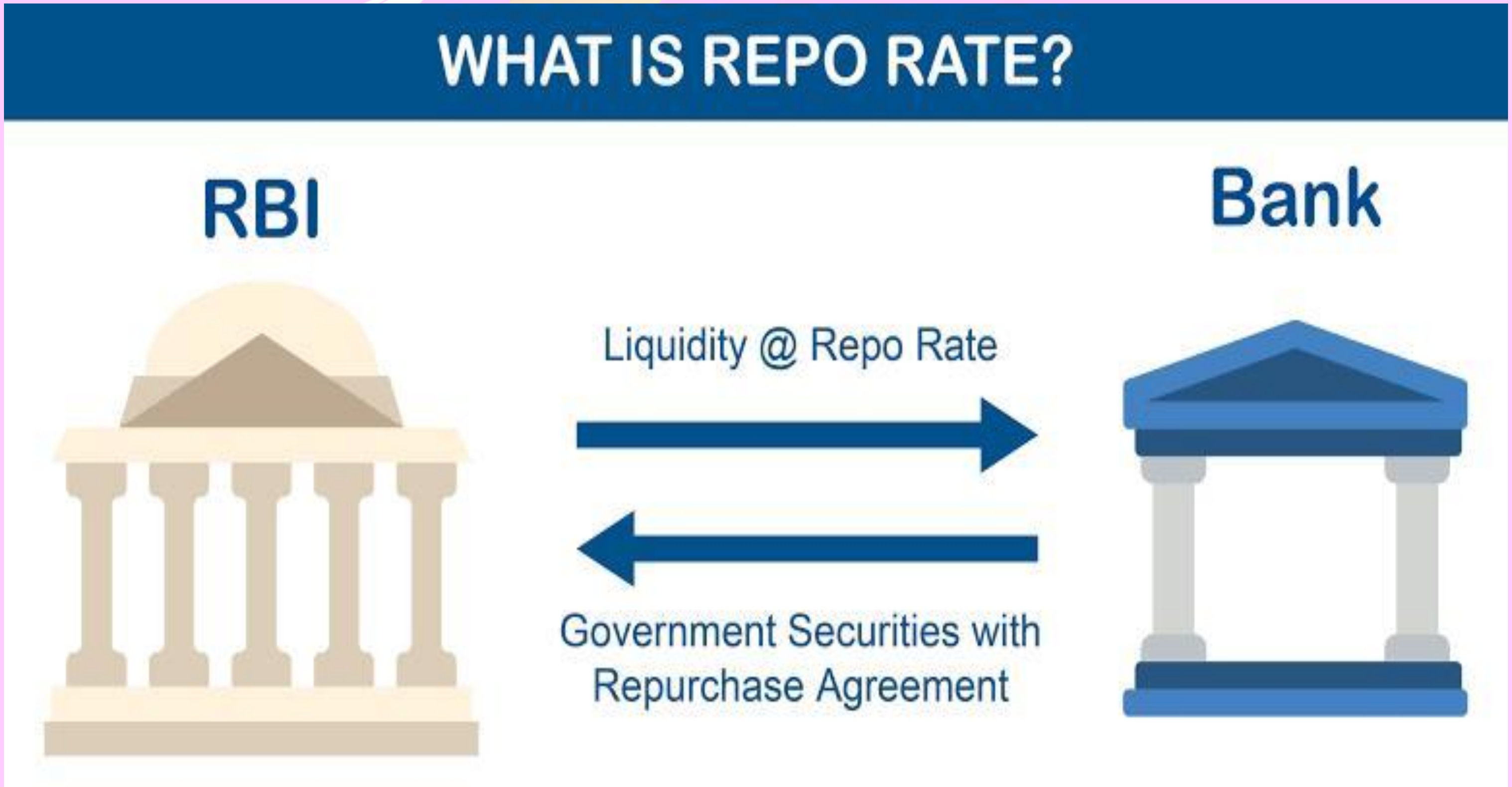
Government securities to the public through banks. This results in the transfer of a part of bank deposits to the Central Bank account and reduces the credit creation capacity of commercial banks.



Repo Rate

Commercial banks, at times of financial crunch, seek short-term funds from the central bank of a country (RBI in the case of India) to tide over the financial crisis. For providing these funds, RBI levies interest on the amount that is lent to the commercial bank. This rate of interest is better known as the repo rate.

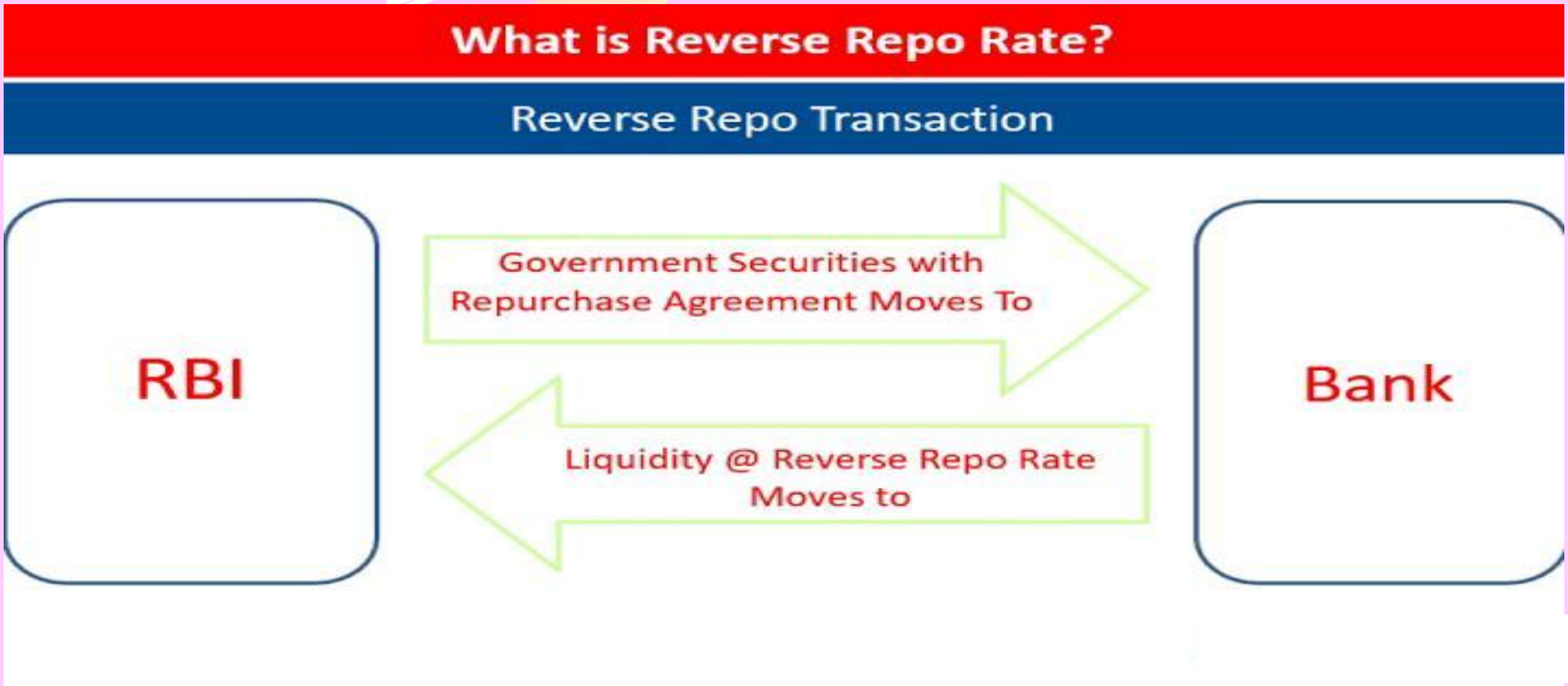
Repo rate is technically a repurchase agreement in which the commercial banks offer securities such as Treasury Bills to the RBI in return for short-term funds.



Reverse Repo Rate

Reverse Repo Rate is said to be that rate of interest at which the central bank (RBI in India) borrows money from the commercial banks for a short term. It helps the central bank to have a ready source of liquidity at the time of need. RBI offers great interest rates in return for the amount supplied by the commercial banks.

Commercial banks also keep the excess funds that they receive with RBI as it is considered safe. The added benefit is that RBI will also pay interest, which gives the banks an option to earn interest on their idle money.



Qualitative Credit Control

Qualitative measures of credit control are those which focus on the alternative uses of credit in an economy. These measures control the flow of credit to specified areas of economic activity.

Margin Money (Margin Requirements):

This implies the minimum margins to be kept by the borrowers with commercial banks while borrowing money against specific securities from commercial banks.

Credit Authorization Scheme:

This shows the ceiling on the amount of credit for certain purposes and requires the prior sanction of the RBI.

Moral Suasion:

Moral suasion is a mixture of both persuasion and pressure. The Central Bank makes an attempt to persuade commercial banks to follow its directives of monetary policy or it can pressurize them to follow its policy directives. When it fails to work, the Central Bank can use direct action which includes the non-recognition of a commercial bank.

Rationing of Credit:

The quota system was introduced in 1960. The RBI fixes credit quota for member banks. If the member bank seeks more loan than their fixed quota, they will have to pay higher interest.

Methods	To Control Money Supply	To Expand Money Supply
	(Inflation)	(Deflation)
Bank Rate	Increase	Decrease
Open Market Operations	Increase	Decrease
Cash Reserve Ratio (CRR)	Increase	Decrease
Statutory Liquidity Ratio (SLR)	Increase	Decrease
Repo Rate	Increase	Decrease
Reverse Repo Rate	Increase	Decrease
Margin Requirements	Increase	Decrease

Difference Between Commercial Bank and Central Bank

Basis	Commercial Banks	Central Bank
Definition	Central bank is the apex financial institution of the country that is concerned with formation of monetary policies and the way money should be regulated in the economy	It Is a type of financial institution that is concerned with providing banking services to the general public and businesses by facilitating deposit, offering loan facilities
Ownership	Central bank is always having public ownership	Commercial banks can be either public or private in their ownership
Number of Banks	There is only one central bank in a country	There can be many commercial banks in a country
Profit Motive	Central bank does not operate for making profit	Commercial banks operate with the motive of earning profit
Clients	Commercial banks and the government	Individuals and businesses
Policy creator	Central banks create monetary policy to regulate interest rates in an economy	Commercial banks do not create any policies that are essential for the functioning of an economy
Source of Money Supply	Central banks are the source of money supply in an economy	Commercial banks run on the deposits obtained from the individuals and hence they perform no such function

Some Important Question Answer

1. 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.

2. 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

3. . 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.

4. . 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.

5. **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.

6. Difference between a Banking Institution and Financial Institution

Ans. A financial institution will not be called a banking institution, until it performs the following two primary functions, i.e. (i) Acceptance of deposits (cheque able and non-cheque able). (ii) Providing loans.

Hence, all financial institutions are not banking institutions, but all banking institutions are financial institutions. Other financial institutions are known as non-banking financial institution, which performs some but not all functions of a bank. They can accept deposits but cannot give loans such as LIC, UTI, etc.

7. What are demand deposits?
(All India 2014,2011,2010; Delhi 2013,2012)

Ans. Demand deposits are current and savings account deposits with banks or other financial institutions, which are payable on demand. No interest payments are given on current account deposits whereas, on saving account very low rate of interest are given.

8. What are time deposits? (All India 2014,2012; Delhi 2010C; Compartment 2014)

Ans. Time deposits are fixed term and recurring deposits having a fixed period of maturity, where the term of deposit may vary. Cheques cannot be issued against them and are not payable on demand and these deposits yield interests for the depositor.

9. What is a Central Bank? (Foreign 2014; Delhi 2009C, 2008)

Ans. The Central Bank is an apex banking institution which controls the entire banking system and money supply of a country. Reserve Bank of India is the Central Bank of India.

10. Define Cash Reserve Ratio. (Delhi 2011)

Ans. The percentage of total deposits, which a commercial bank needs to keep as reserve with the Central Bank, this ratio is termed as Cash Reserve Ratio.

11. Define Statutory Liquidity Ratio. (All India 2011)

Ans. Every commercial bank is required to maintain a fixed percentage of its assets in the form of cash or other liquid assets. This is termed as Statutory Liquidity Ratio.

12. **Define bank rate. (Delhi 2009,2008C)**

Ans. The rate at which commercial banks can barrow funds from Central Bank for a period of more than 90 days is termed as bank Rate.

13. **What is commercial bank? (All India 2008)**

Ans. Commercial bank is financial institution which accepts chequeable and non-chequeable deposits from the people and offers different kind of loans for the purpose of consumption or investment.

14. **Explain the currency authority function of Central Bank. (Foreign 2014)**

Ans. Central Bank of the country has the sole authority of currency issue in the country, which gives it a monopoly in issuing currency. As in India RBI issues the currency, while currency notes are printed by the subsidies of RBI and coins are minted by the Central Government of the country, however both currency notes and coins are circulated by RBI, which gives RBI the power to control, supervise and enhance the money supply in the economy.

15. Explain lender of the last resort function of the Central Bank. (Delhi 2014,2010; All India 2013,2010)

Ans. When a commercial bank fails to accommodate its financial requirements, the Central Bank acts as the lender of last resort. The Central Bank issues loans to a commercial bank against specified and approved securities of the bank.
In this way, the Central Bank ensures the smooth functioning of commercial banks and appropriate flow of credit in the economy.

15. **Explain the banker to the government function of the Central Bank. (Delhi 2013,2010; MI India 2010)**

Ans. Central Bank acts as a banker, advisor and agent to the Central and State Governments. As the common public keep their cash balance, demand deposits and time deposits with commercial banks; the Central Bank manages the cash reserves and demand deposits of governments in current accounts. It carries out the exchange, remittance and other banking operations on behalf of the government, i.e. the Central Bank maintains same relation with the government as commercial banks has with genes.

16. **State three main functions of commercial bank. Explain any one of them. (All India 2009)**

Ans. The three main functions of commercial banks are

(i) Accepting deposits
(ii) Advancing loans
(iii) Credit/money creation

Accepting deposits, It is one of the primary function of commercial banks. It accepts cheque able and non-cheque able deposits from public in the form of demand deposits (which can be withdrawn on demand) and time deposits (which cannot be withdraws on demand).

18. Explain any two functions of a Central Bank. (Delhi 2009; All India 2009)

Ans. The two main functions of a Central Bank are

(i) Bank of Issue Note issue is the main function of a Central Bank. It has the monopoly or we can say, have a sole authority to issue currency notes.
(ii) Banker's bank Central Bank keeps the cash balances of commercial banks and issues loans to them on requirements in the same manner as the commercial bank does for its customers. A Central Bank has almost the same relation with the other commercia