UNIT III

- MONEY – DEFINITIONS
- FUNCTIONS OF MONEY
- DEMAND FOR MONEY
- SUPPLY OF MONEY
- FUNCTIONS OF COMMERCIAL BANKS
- FUNCTIONS OF CENTRAL BANK

MONEY

According to John Hicks, “money is defined by its functions: anything is money which is used as money: ‘money is what money does.”

Professor Coulborn defines money as “the means of valuation and of payment; as both the unit of account and the generally acceptable medium of exchange.”

By money Friedman means “literally the number of dollars people are carrying around in their pockets, the number of dollars they have to their credit at banks in the form of demand deposits and commercial bank time deposits”.

FUNCTIONS OF MONEY

- PRIMARY FUNCTIONS
  - Medium of exchange
  - Measure of Value
  - Store of value
- SECONDARY FUNCTIONS
  - Standard of deferred payments
  - Transfer of value
  - Basis for credit system

PRIMARY FUNCTIONS

- Medium of exchange: The transaction of sale and purchase of goods and services are carried out with money. As a medium of exchange, it is the most acceptable medium for transactions. The market mechanism thrives on money.
- Measure of Value: Money is the standard unit of measuring the value of goods and services just like meters to cloth and litres to liquid. There can be no pricing without the unit of measurement.

- Store of Value: Wealth and assets can be kept intact because money acts as a store of value and does not deteriorate over long period of time. It can be used at times of emergencies just in case like precautionary motive. It can also ne used to pay credit.

SECONDARY FUNCTIONS

- Standard of deferred payments: The lending and borrowing of money is an example for standard of deferred payment. Payment on a later date is possible with money.

- Transfer of value: Transfer of money from one place to another is possible today. Money helps to transfer purchasing power from one country to another.
- Basis for credit system: The credit system in an economy depends on money only. Without money credit purchase and sale is not possible. Therefore the basis for credit system is money.

These are the secondary functions of money in an economy.

DEMAND FOR MONEY

The demand for money is the quantity of cash people wish to hold. The liquidity preference theory propounded by J. M. Keynes. The three reasons for holding cash are:

- Transaction motive: The transactions motive for demanding money arises from the fact that most transactions involve an exchange of money. Because it is necessary to have money available for transactions, money will be demanded. The total number of transactions made in an economy tends to increase over time as income rises.

- Precautionary motive: People often demand money as a precaution against an uncertain future. Unexpected expenses, such as medical or car repair bills, often require immediate payment.
- Speculative motive: The demand for an asset depends on both its rate of return and its opportunity cost. The speculative motive for demanding money arises in situations where holding money is perceived to be less risky than the alternative of lending the money or investing it in some other asset.

The demand for money is determined by factors like income, rate of interest and inflation.

SUPPLY OF MONEY

There are many definitions of the supply of money. *M*1 is most commonly used and includes all currency (notes and coins) in circulation, savings deposits held at banks (bank money), and traveller's cheques. A broader measure of the supply of money is *M*2, which includes all of M1 plus savings and time deposits held at banks. The third measure of the money supply is *M*3, which includes all of *M*2 plus large denomination, long-term time deposits.

FUNCTIONS OF COMMERCIAL BANKS

- PRIMARY FUNCTIONS

1. Accepting deposits from the public: Savings deposit, recurring deposit, fixed deposit and current deposit are accepted from the public. They are the liabilities of the banks.
2. Advancing loans: The main function of the commercial banks is to advance short term and long term loans, secured and unsecured loans to public and organisations. They earn interest and profits out of this. It is the asset of the bank.

FUNCTIONS OF COMMERCIAL BANKS: PRIMARY FUNCTIONS

3. Creation of credit: Banks create credit and transfer loans to businesses and commercial organisation at the same time instead of dealing with cash all the time.

- SECONDARY FUNCTIONS

1. Locker facilities: Banks provide locker facilities to store valuables which are risky storing at home.
2. Overdraft facilities: Commercial banks also provide overdraft facilities.
3. Dealing foreign exchange: Foreign exchange for individuals and organisations are provided by commercial banks. They are authorised to do so.

FUNCTIONS OF COMMERCIAL BANKS: SECONDARY FUNCTIONS

- Discounting bills of exchange: The Bank purchases trade bill before its payment term at a price less the amount of discount interest. The Bank discounts bills submitted by the drawee which is creditor of the principal amount and holds a settlement account at the Bank.

- Bank acts as agents: They facilitate agents for tax returns and refunds; paying loans of other institutions; premium payments; trustees for organisations; processor of cheques, bills etc.

FUNCTIONS OF RESERVE BANK OF INDIA

- ISSUE OF CURRENCY

RBI is authorised to issue currency in India. Printing of rupee notes is the authority of RBI in India.

- BANKER TO THE GOVERNMENT

RBI is the banker to the government. The finances of the government of India and monetary policy authority is RBI

- BANKER TO BANKS

They are bankers to the other commercial banks. Reserve ratios of the commercial banks is kept by RBI.

- CREDIT CONTROLLER

Credit control operations like bank rate policy, variable cash reserve ratio, open market operations are carried out by RBI.

- MANAGING FOREIGN EXCHANGE

Central bank is the custodian of foreign exchange reserves in India.

- ISSUE DIRECTIVES

The authority to issue directives on the monetary aspects of the Government. Clearing house activities;

- PROMOTIONAL FUNCTIONS

Refinancing exports, agricultural financing, industrial financing, helping cooperative sector

- REGULATIONS AND SUPERVISION

Granting license to banks; Control over NBFIs; Periodical review of the working of the commercial banks.

- LENDER OF LAST RESORT

A lender of last resort is whoever you turn to when you urgently need funds and you've exhausted all your other options. Banks typically turn to their lender of last resort when they cannot get the funding they need for their daily business.

- PUBLICATIONS

RBI bulletin, working papers, occasional papers, reports, handbook of statistics etc.,