ANSWERS OF MOCK TEST

ANS 7 . Money is the most important invention of Modern Times. In ancient time salt and cattle (in ancient Rome), tobacco (in American colonies), pigs (in South sea islands), pearls, precious stones, leather, clothes, etc. were used money. Afterwards most of the countries found that metallic coins such as iron, gold, silver, copper etc. were more suited to serve as money. Later on it give the way to introduction of paper money (currency notes) along with coins made of copper, bronze or nickel etc. nowadays credit money (in the form of cheques, drafts, bills of exchange, credit cards etc) and plastic money (in the form of debit cards) are becoming more popular.

ANS 8. On the basis of relationship between the value of money as money and the value of money as commodity, money can be classified in

[i] full bodied money;

[ii] representative full bodied money;

[iii] credit money

[i] full bodied Money :- full body money is that money whose value as a commodity for non monetary purposes is as great as its value as money. Most of the earlier commodity money, such as gold, silver, cattle etc. Modern economies gold coins in Gold Standard (metallic standard money).

[ii] representative full bodied money :- this type of money usually made of paper. It is equivalent to circulating warehouse receipt for full bodied coins or their equivalent in bullion. The paper money itself has no value as a commodity it is just a piece of paper but it represent in circulation an amount of money with an commodity value equal to the value of money. The advantage of this type of money is that it is convenient to use it in those trade which require large sum of money.

[iii] credit money :- this refers to a money whose value as money is greater than the commodity value of the material, from which the money is made. Credit money is of various forms, such as token coins, representative token money, deposits at Banks, circulating promissory notes issued by central banks.

ANS 9. As the number of goods and services increases, specialisation increases, level of trade, area of trade, population increases and a progress of Civilization occurs, it creates more difficulty in barter system. The main differences are as follows:-

A] Lack of double coincidence:- barter system can only work when both of the persons are ready to exchange each other's goods. But due to increase in number of goods and services; increase in their variety and increase in population; availability of faster means of transportation, increase in area of trade, it is very difficult to find the person who is willing and able to buy the goods or services of a traders and willing and able to sell those goods or services which are trader wants. Due to this lack of double coincidence search cost was relatively was higher in barter system.

B] Lack of common measures:- under the barter system there is no common measure of goods and services. Value of each goods is Express in terms of Other goods and services. As the number of goods increases, number of exchange rates also increases. Therefore it is difficult to determine the exchange rate of goods and an the other hand it become very difficult for every person to remember the exchange value of one community in terms of the Other commodities, which result in conflict and as a result trade become more difficult. It also create the problem of accounting because of abscess of common measures.

C] Difficulty in deferred payments :- there are certain contract that occurs in economy which requires future payment or in other words these payments are delayed such as wages, salary, interest, rent, etc. In barter system future payments would be made in specific goods or services, which causes the following problems

(i)their could be disagreement about which commodity would be used for payment

(ii)their could be a disagreement about the quality of the goods or services to be paid

(iii)the value of commodity to be repaid may increase or decrease in that time period.

D] Difficulty in storage of wealth or purchasing power:- Barter system does not provide any method of storing wealth of purchasing power. In this system stock of certain commodities are stored for future use which requires relatively more space for its storage and which subjected to degraded during that time or its value increases or may decreases with the passage of time and cost of storage and maintenance is also very high.

E] Difficulty in transfer of value:- the transfer of wealth in barter system involves heavy transportation cost and during transportation good may degrade. There is also a possibility of value fluctuation because it takes time for transportation. Besides this the transfer of immovable goods (such as house, land, etc.) is impossible.

F]. Difficulty in exchange of indivisible goods:- there are many goods which are indivisible, such as horse. Suppose the exchange rate of one hours is 100 bags of weight and if a person required 10 bag of wheat than exchange will be difficult. In this case if the person has to exchange his cattle with 10 bags of weight, then he has to divide his horse which is not possible for him or he has to exchange the entire horse which will further creates the problem of double coincidence and problem related with storage of values. So in this case exchange is not possible.

G]. Difficulty in exchange of services:- the determination of exchange rate of services in the term of other services or goods is very difficult because the nature of service differs, such as exchange of services of doctors and services of teachers or accountant.

H]. High trading cost:- due to increase in the search cost and disutility of waiting, the trading cost become High day by day. The basic reason behind this is increase in number of goods and their variety.

ANS 10. (A) In the present world money act as a usful measuring rod of the value, but just like other scales it will work efficiently until its value remains constant. The value of money is its purchasing power. The purchasing power of the money is inversely related with general price level. so with the change in price level the value of money also changes, which indicates that more or less quantity of commodity can be purchased by the same unit of money. If the value of money changers just like the value of goods, then it will again create the problem of exchange.

(B). Money is called as bearer of options or generalised purchasing power because it offers freedom of choice. The owner of a particular commodity now need not to purchase the goods from those to whom he sold his goods.

ANS 11. (i) primary functions - primary functions of money includes the most important or basic function of money. it includes two functions :-

a) medium of exchange:- medium of exchange is an important function of money. money serves as a medium of exchange (medium for sale of purchase of goods and services) or medium of payments. Goods are exchanged for money and thus money can be used for buying any Other goods or services that we need as medium of trade and helps in trade. In barter system there is a compulsion of purchase with the sale or there is a compulsion of sale with the purchase. This function of money separated the act of sale and purchase of commodity. As a result exchange of goods now become easy and convenient It as remove the problem of double coincidence which exist in barter system. Therefore it saves the time, money and energy spent in barter system. This function of money served as generalised purchasing power.

b) measure of value (unit of value) :- money serve as a common measure of value or as a unit of value in terms of unit of account. Which means that value of each goods and service is expressed as a price which is the number of monetary unit for which any good for service can be exchange. It helps in measuring the exchange value of goods. The price of all the goods and services can be fixed in terms of money and the problem of expressing of the value of each community in terms of quantities of other goods and memorizing them can be avoided. It would not be possible to keep business account unless all business transaction are Express in money. Unit of value function of money makes possible of keeping business account. Due to this function accounting, calculation of cost, profit, loss, consumers of all production equilibrium, calculation of national income, per capita income,etc. now become very simple and easier.

(ii) Secondary function :- this category includes those function of money which are supplementary of primary functions. There are three secondary function of money-

a) standard of deferred payments :- money also serve as standard of deferred payment. Deferred payments refers to those payments which are made sometimes in the future. Such as payments of pensions, principal and interest on loan, salaries, etc. Future payments cannot be made in term of physical goods because the value of these goods is liable to change, whereas money serves as a measure by which the value of future payments is made because the value of money is comparatively constant. Beside this problem regarding the disagreement of commodity or disagreement about the quality of commodity does not arise in monetary system. This functions helps in expansion of trade, sales and purchase of security become easier.

b) Store of value:- money serve as a store of value. A store of value means shifting of purchasing power from present to future. Under barter system storing of values (saving) is very difficult in terms of goods. Whereas money enables people to save a part of their current income and store it for future use in a most economic and convenient way. It is used as store of value because the value of money is comparatively more stable, it is to durable, it occupies comparatively less space for storage and it will be accepted at any time for any goods or services.

c) Transfer of value :- money help us to transfer value or purchasing power from one person to another and from one place to another because money is ready acceptable, transfer of money from money is comparatively cheaper and it has the quality of liquidity. This transfer of value takes place through currency, cheques, bank drafts, pay orders, etc.

ANS 12. (A)

SRN	FIAT MONEY	FIDUCIARY MONEY
1.	Money that serves as money on the order of the government.	Money which is accepted as money on the basis of the trust that it's issuer commands.
2.	A person cannot legally refuse to take payments through Fiat money.	A person can legally refuse to take payment through fiduciary money.
3.	For eg. Currency coins and currency notes.	For eg. Cheques

(B) The supply of money refers to the volume of money held by the public in an economy at a given time. The term public includes all economic units, such as households, firms etc. (except government and banking system).

There are two approaches regarding Constituents of money supply:-

(i) Traditional approach : Money supply = coins + currency notes + demand deposit.

(ii) Modern approach : Money supply = coins + currency notes + demand deposit + time deposits + financial assets in non banking financial institutions + treasury and exchange bills + bond and shares + credit cards.

Ans 13 A]. (i) M1= C + DD + OD

C= currency notes and coins with the public.

DD= demand deposit of all commercial banks and co-operative banks.

OD= other deposit held with RBI, such as demand deposit of public financial institutions, foreign central banks and governments, IMF, World Bank, etc.

(ii) M2= M1 + Savings deposit with post office saving banks.

(iii) M3= M1 + Net time deposit of banks.

(iv) M4= M3 + Total deposit with post office saving operation (excluding NSC).

M1 and M2 are measures of narrow money, whereas M3 and M4 are measure of broad money. M3 is most widely used measure of money supply in India.

B]. (i) Money has the merit of general acceptability, which can not be found in other goods.

(ii) Value of money remains relatively stable in Comparison to other goods.

(iii) Money is more durable in comparison to other goods.

(iv) The storage of money is convenient in comparison to other goods.

(v) The storage of money is very cheaper but the storage of goods is costlier.

(vi) Money has the quality of liquidity whereas other goods may not be as liquid as money.

OR

ANS13. (i) Monetary policy of the central bank:- Central Bank can directly affect the money supply by its monetary policy. If central bank uses dearer money policy then supply of money in the economy decreases where as money supply increases if central bank uses cheaper money policy.

(ii) Commercial banks capacity and policy of credit creation credit:- creation capacity of commercial bank depends on the cash deposit in bank. If cash deposit in the commercial bank increases then the ability to create the credit also increases, which increases the money supply in the economy and vice versa. Policy of credit creation of commercial bank also affect the credit creation by bank, such as policy of interest rate, etc. which will affect the money supply in the economy.

(iii) Government Fiscal policy:- fiscal policy of government means policy related with the receipt and expenditure of government, which is also known as budgetary policy. If government follows deficit budgetary policy then money supply in the economy increases where as in surplus budgeting the money supply of the economy decrease.

(iv) Liquidity preference:- If liquidity preferences (desire to hold cash) in the economy increases then the supply of money in economy increases and vice versa.

(v) Consumption habits:- if consumption habits of the people in the economy increases (means saving habits decreases) then the supply of money in the economy also increases and vice versa.

(vi) Banking habits of the people:- if banking habits of the people in the economy increases then supply of the money in the economy also increases because now banks deposit increases which helps in more credit creation which result in increase in money supply in the economy and vice versa.

ANS. 20 Savings bank account contains the feature of both time and demand deposits. The deposits of this account is payable on demand by cheque. There are limitations on the number of cheque issued in a period of time. Interest is paid on these accounts. Therefore saving bank account is included in both these deposits. According to RBI "the average of the monthly minimum balance in the savings account on which interest is being paid shall be considered as time deposit whereas the excess amount over that is considered as demand deposits".

OR

(i) Local facility:- Bank provide local facility to their customers. The customers can keep the valuable goods and important documents in these locker for safe custody. The bank charges a very nominal charge for this.

(ii)Traveller'ons cheque:- Bank issue Travellers cheques to help their customers to travel without the fear of theft or loss of money. With this facility the customer need not to take the risk of caring cash with them during their travel.

(iii)gift cheques:- some banks issued checks of various denominations (such as rupees 11, 21, 31,51,101 etc.) to be used on auspicious occasions.

(iv) Business information:- bank provides information to their customers on economic condition of the economy and give suggestion to them on financial matters.

(v) Underwriting securities:- bank underwrite the securities issued by the government, public or private bodies. Because of its full faith in banks, the public will not hesitate in buying security carrying the signatures of bank.

ANS 21. Open market operations referred to the sale and purchase of Government Security in the open market by the government banks. If central bank sale the security of government then the deposits of commercial bank decreases and due to that the credit creation ability of the commercial bank will also decreases. Thus the credit creation by a commercial bank will also decreases.

If central bank purchase the security of government from the open market then the deposits of commercial bank increases and due to that the creation ability of the commercial banks will also increase. Thus credit creation by the commercial bank with also increases.

In the condition of inflation in the economy central bank sales the government securities and in the condition of deflation in the economy central bank purchases the government securities to control the problems.

ANS 22. (A) False. To curb the Depression, supply of money needs to be increased. Accordingly commercial banks are advised to pursue cheap money policy.

(B) True. Increase or decrease in bank rates is often followed by increase or decrease in the market rate of interest.

ANS 23. 1.**ACCEPTANCE OF DEPOSIT** commercial banks accept deposits from individuals, business enterprises and other institution in the form of deposit and in this way increases their saving habits and minimises their risk of carrying cash. Against the deposit bank provides them interest also. Banks mobilized idle reserves of public for consumption or investment purpose and in this way help in employment generation, economic growth and economic development. Bank except mainly four types of deposit from the public

A] current account deposit these accounts are usually maintain by Businessman. The depositor can deposit or withdraw money as an when they like. These deposits are terms as demand deposits. No interest is charged on these deposit. Bank charges small charges for providing some services to the account holder such as cheque facility. Bank also provide the facility of the overdraft in current account holder. There is no specific time for this account.

B] saving bank account this account is made for encouraging small savings of middle or lower class public. There is no restriction on depositing the money in this account but there is a restriction on the number of withdrawal in a period of time. These deposits are payable on demand and withdrawal by cheques. Cheque Books are issued with a certain minimum balance interest is paid on this deposit but the rate of interest is less than that of which deposit account. There is no specific time limit for this account.

C] fixed deposit accounts in this account a depositor can deposit the money once for a specified period of time. This account varies from 15 days to a few years. They are termed as Time deposits. Higher interest paid on this deposit and the rate of interest rises with the time of deposit

D] Recurring deposit accounts it is also a form of time deposit. In these accounts, a depositor makes a regular deposits every month of a sum over an agreed period of time. Interest is paid on this deposits. Interest rate increases with the increase in term of deposit.

2.GIVING LOANS Bank keeps a certain portion of the deposit as reserves and give the rest of the borrowers in the form of loans and advanced on approved securities. Loan and advances are given to all types of person such as Businessman, farmers, consumers and employers etc. In this way Banks act as a mediator between who save the money but does not use the money and those who requires money for consumption or investment purposes. The different types of loans given by banks are as follows:-

A] cash credit in this type of loans, the borrower is allowed to withdraw up to a certain limit of the given security. the security mainly includes stock of goods, bill receivable from others, etc. the borrower has to pay the interest only on that amount which is actually withdrawn (not on the total amount of loan sanctioned).

B] term loans banks have also started advancing medium term and long term loans along with short term loans. The term loans includes personal loans, loans for working capital or loans for priority sector. These loans are given against some security.

C] demand loans those loans which can be relised on demand. They had no maturity date.

3. Overdrafting :- it is form of advance in which current account holder overdraw his current account upto certain limit.

4. Discounting bills of exchange :- itb is a method of advances by banks. A bill of exchange is a written promise by a debtor to a creditor to pay a certain sum of money after a certain period of time.

5. Investment of funds :- banks invest their surplus funds in three types of securities

A] government – treasury bills of state or central government, NSC, etc.

B] other approved securities – securities approved under banking regulation act,1949,etc.

C] other securities – securities of ‘A’ CLASS

OR

ANS 23.1] currency authority the central bank is the sole authority for the issue of currency in the country. due to this function is known as Bank of issue. It has it issue department which issue notes and coins. Coins are manufactured in the government mint but they are put into circulation through the central bank. While issuing currency notes RBI follows minimum reserve system

2] Banker to the government the central bank act as a Banker to the central and state government in various respects. Such as

a) government keeps its cash balance on current account with the central bank

b) the central bank accept receipt and make payment for the Government and carries out exchange, remittance and other banking operation

c) Central Bank also provide term loans to the government

d) it provides foreign exchange reserve to the government to repay external debt

e) it manage public

3] banker`s bank and the supervisors the central bank act as a banker and supervisor to commercial banks in various respect

a) it provides financial assistant to banks by discounting their bills and through loans and advances against approve securities

b) it holds a part of cash reserves of commercial banks in two ways ; part of cash balance with themselves SLR and another part with the central bank as deposit CRR

c) the central bank regulates commercial bank by giving them licence, branch expansion, liquidity of assets, management and winding up of bank

d) the central bank exercise the periodic inspection of commercial banks.

4] controller of money supply and credit the central bank controls the money supply and credit in the best interest of the economy. By this Central Bank can control inflation and deflationary situation in the economy. Central Bank issues various instruments to perform this function which can be categorised in qualitative instruments such as Margin requirement, moral suasion, consumer credit, rationing of credit, differentiated rate of interest and direct action (Aims to influence the use of credit and direction of credit). quantitative instruments such as bank rate, open market operations CRR and SLR (AIMS at controlling cost of credit and availability of credit).

5] Lander of last resort the central bank act as a lender of Last Resort for commercial banks when commercial banks fails to meet obligation of their depositors or they are in some financial crisis, the central bank comes to their rescue. The central bank advances necessary credit against eligible security subject to certain terms and conditions.

6] clearing house function thousands of interbank transactions occur daily in a small city in the form of check, strap, pay order etc. every commercial bank has to pay a certain sum daily to other banks in cash which will be very cumbersome to the bank. but this function is easily performed by Central Bank.

7]custodian of the Nations reserves of foreign exchange all receipts and payment in foreign exchange are made by the central bank Central Bank maintenance Foreign Exchange Reserves in order to promote international trade to maintain the rate of exchange.

ANS 24 Qualitative measure includes those measures of Central Bank which control the direction of credit creation in economy. They are also term the selective measures. It includes –

i] margin requirement the difference between the value of security and amount of loan section is known as margin requirements by changing the marching requirement Central Bank can increase or decrease the credit creation in desired direction is central bank wants to increase the credit in a particular used that it will decrease the margin requirement for that use

ii] consumer credit loan given by commercial bank to the consumers to purchase the durable consumer goods are known as consumer credit Central Bank can make the loans attractive or unattractive by following way; a) by charging the minimum down payment b) by changing the maximum period of repayment instalment

iii] differentiated rate of interest Central Bank and decide different interest rate for different uses to affect the direction of credit Central Bank will increase the rate of interest for those uses where it wants to discourage the credit and will decrease the rate of interest for those uses where it want to increase the credit

iv] rationing of credit by rationing of credit Central Bank can affect the direction of credit by following way; a) deciding an aggregate portfolio of commercial banks b) deciding the limits of maximum loan to a particular use

v] moral appeal by this method Central Bank make moral or advise or request suggestion to commercial banks to co-operate with the monetary policy of the central bank so that more credit will flow in the desired direction

vi] direct action if commercial banks does not create the credit in decide direction as Central Bank likes to then Central Bank can take direct action against such commercial bank such as Central Bank and Nationalised the commercial banks or refused to finance the commercial bank at the time of financial crisis or may charge penalized interest rates from such commercial banks or main reviews to give exchange credit

ANS 25. QUANTITATIVE INSTRUMENT

1. These are influence the total credit Without distinguish between essential and non-essential uses of credit.
2. . These are indirect and impersonal
3. They affect lenders
4. Ex. (i) Bank Rate (ii) Cash Reserve Ratio

QUALITATIVE INTRUMENT

1. These are discriminatory in nature in the sense that it distinguish between essential and non-essential uses of credit.
2. These are direct.
3. They affect both lenders and borrowers
4. Ex. (i) Margin Requirement (ii) Rationing of Credit.

ANS 26 . Credit creation means multiple expansion of deposits of banks. By this process banks can give loans many times more than their cash reserves. In this way commercial banks increases the total money supply of the economy.

Credit creation by the commercial banks depends on :-

i] Cash deposit or primary deposits or initial deposits : Deposits by customers of banks in their accounts. It is positively related with the credit creation.

Ii] Derivative deposits or credit deposits or secondary deposits : Loan amount deposited by banks in customers loan account. It is positively related with credit creation.

Iii] Legal reserve ratio : It includes cash reserve ratio and statutory liquidity ratio. It is negatively related with credit creation.

When a bank takes deposits from a customer then it is termed as primary deposits. The depositor however does not immediately withdraw the money from the bank , a part of these deposits is given out to somebody as loan and another part is kept as reserve ratio. A minimum legal reserve ratio has to be maintained by the commercial banks which is determined by the central bank. When a bank gives loan to somebody, it simply creates a bank deposits equal to the loan amount in the name of borrower. Bank again kept a part of these derivative deposits as reserve and lend rest of it to any other person, which will again creates the new deposits. In this way bank go on creating money as long as they go on getting new deposits. Total money creation by the commercial banks can be calculated by the given formula :-

TOTAL MONEY CREATION = INITIAL DEPOSITS x 1/LRR

Initial deposits = Rs.10,000 LRR = 20%

ROUND	DEOSITS	RESERVE	LOANS
1	10,000	2,000	8,000
2	8,000	1,600	6,400
3	6,400	1,280	5,120
4	•	•	•
	•	•	•
	•	•	•
TOTAL	50,000	10,000	40,000

Process of money creation :- suppose LR is 20% initially of opposite is rupees 10000 to bank will keep rupees 2000 as reserve and line the remaining amount rupees 8000 to the bore our Bank deposit is amount in the account of forever which will create new deposit with bank 20% of these deposit that is rupees 1600 and land the rest amount rupees 6402 another 4 over this will again create the new deposit in the bank the money goes on increasing this way until the money created in extra round become zero the total money creation in this case will be rupees 50000 which is 5 times of initial deposits.

OR

(A)if an institution does not receive deposits but only lands money it will be a money lending Institution and not a bank LIC UTI in IDBI give loans and make investments but even they are not considered as banks because they do not expect check cable deposits

(B) the facility given by the banks to the current account holder to Overdrive from his account up to a certain limit is known as over drafting the amount which exceed the deposit is given as an advanced to the depositor and the bank charges interest for that.

(C) in case of cash credit the interest rate charged only on the amount actually withdrawn from the sanction loan where is in case of term loan the interest is charged on the total amount sanction for loan.