CBSE Test Paper-04

Chapter 02 Money and Banking

1. Barter system is **(1)**
    a. Exchange of foreign exchange
    b. Exchange of trade
    c. Exchange of goods
    d. Exchange of money
2. One of the secondary functions of money is **(1)**
    a. Medium of exchange
    b. Measure of value
    c. Store of wealth
    d. Standard of deferred payments
3. Calculate the money multiplier if LRR is 10%. **(1)**
    a. 20.0
    b. 30.0
    c. 40.0
    d. 10.0
4. One of the functions of Central Bank among the following is **(1)**
    a. Bank of securities
    b. Bank of banks
    c. Bank of foreign exchange
    d. Bank of delivery
5. State the primary functions of banks. **(1)**
6. What is reverse repo rate? **(1)**
7. What is banking? **(1)**

8. what is bank money? **(1)**
9. Banks accept deposits in several forms according to requirement of different sections of the society. Which kind of deposit the following consumers should prefer. Give reason for your answer. (i) A businessman (ii) A student (iii) An old man who seeks high interest (iv) Suggest any two ways to increase the banking habit of the people. **(3)**
10. Explain the bankers' bank function of the Central Bank. **(3)**
11. What is Barter system? What are its drawbacks? **(4)**
12. Explain the 'Unit of account' function of money. **(4)**
13. Explain the banker to the Government9 function of the Central bank. **(4)**
14. What are the alternative definitions of money supply in India? **(6)**
15. What is Legal Reserve Ratio? Explain its components? **(6)**

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Answers

1. c. Exchange of goods
   Explanation: A barter system is an old method of exchange. This system has been used for centuries and long before money was invented. People exchanged services and goods for other services and goods in return.
2. d. Standard of deferred payments
   Explanation: It's by definition.
3. d. 10.0
   Explanation: Here,LRR =0.1 , so money multipliar =1/0.1=10
4. b. Bank of banks
   Explanation: It's an apex bank and is only source of base money.
5. (i) Acceptance of deposits and (ii) Advancing of loans.
6. Reverse repo rate is the rate at which the Central Bank of a country accepts deposits of commercial banks.
7. Banking implies accepting deposits of money from the public for the purpose of lending or investment which is repayable on demand and can be withdrawn by means of cheques, drafts order etc.
8. Bank money is the money created by the commercial banks in the form of demand deposits over and above cash deposits of the people with the banks.
9. i. Current Account : The account allows infinite number of transactions and also provide cheque facility.
   ii. Saving Account: Provide cheque facility and carry a rate of interest.
   iii. Fixed Deposit : These deposits carry a high rate of interest.
   iv. a. By opening more banks.
       b. By widening the scope of banking system.

10. Broadly speaking, the Central bank acts as a bankers' bank in three capacities:

    i. As the custodian of the cash reserves of the commercial banks.
    ii. As the lender of the last resort.
    iii. As the bank of central clearance, settlement and transfers. A Central Bank has almost the same relationship with the other Commercial Banks of the country that the Commercial Banks have with the common public. That is why the Central Bank is also called banker's bank.

11. Barter system of exchange is a system in which goods are exchanged for goods. The drawbacks of barter system are as follows:

    i. Lack of double coincidence of wants.
    ii. Lack of divisibility
    iii. Difficulty in storing wealth.
    iv. Absence of common measure of value.
    v. Lack of standard of deferred payment.

12. i. Another important function of money is that it serves as a common measure of value or a unit of account.
    ii. Under barter economy there was no common measure of value in which the values of different goods could be measured and compared with each other. Money has also solved this difficulty. 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.
    iii. Money works as a common denominator into which the values of all goods and services are expressed.
    iv. When we express the values of a commodity as a price, it is easy to calculate exchange ratios between them by knowing the price of various commodities..

13. The Central bank acts as a banker to the central and state government. Central bank is a banker, agent and financial adviser to the government.

    i. As a banker : Central bank performs the same function for the government as commercial banks perform for their customers. It maintains the accounts of the central as well as the state governments. It receives deposits from the government and makes short term advances to the government. It collects cheques and drafts deposited in the government accounts.

ii. As a Fiscal agent: The central bank collects taxes and other payments on behalf of the government. It raises loans from the public and thus manage public debt.
iii. As a Financial adviser: The central bank gives advice to the government on economic, monetary, financial and fiscal matters such as deficit financing, devaluation, trade policy and foreign exchange etc. According to De Kock, “The central bank operates as govt’s banker because of the intimate connection between public finance and monetary affairs”.

14. The alternative definitions of money supply in India can be the four measures of money supply. They are explained as under:
Measure of M_1 Include:

    i. Currency notes and coins with the public (excluding cash in hand of all commercial banks [C]
    ii. Demand deposits of all commercial and co-operative banks excluding inter-bank deposits. (DD),
    Where demand deposits are those deposits which can be withdrawn by the depositor at any time by paid on such deposits.
    iii. Other deposits with RBI [O.D]

    $M_1 = C + DD + OD$

    Where, Other deposits are the deposits held by the RBI of all economic units except the government and banks. OD includes demand deposits of semi-government public financial institutions (like IDBI, IFCI, etc.), foreign central banks and governments, the international Monetary Fund, the World Bank, etc.
    Measures of M_2

    i. $M_1[C + DD + OD]$
    ii. Post office saving deposits

    Measures of M_3

    i. M_1
    ii. Time deposits of all commercial and co-operative banks.

    Where, Time deposits are the deposits that cannot be withdrawn before the expiry of the stipulated time for which deposits are made. Fixed deposits are made. Fixed deposit is an example of time deposit.

Measures of M_4

i. M_3

ii. Total deposits with the post office saving organization (excluding national saving certificates).

15.
- Legal Reserve Ratio (LRR) refers to that legal minimum fraction of deposits which the banks are mandate to keep as cash with themselves.
- The LRR is fixed in India by the Reserve Bank of India. The LRR may either refer to the CRR or SLR in the context of the Indian Banking syste.
- LRR can be of two types: Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

i. Cash Reserve Ratio (CRR) : It refers to the minimum amount of funds that a commercial bank has to maintain with the Reserve Bank of India in the form of deposits. For example, suppose the total assets of a bank are worth Rs. 200 crores and the minimum cash reserve ratio is 10%. Then the amount that the Commercial Bank has to maintain with RBI is ₹ 20 crores. An increase in CRR reduces the lending ability of the Commercial Banks. If this ratio rises to 20%, then the reserve with RBI increases to ₹ 40 crores. Thus, less money will be left with the commercial bank for lending. This will eventually lead to considerable decrease in the money supply. On the contrary, a fall in CRR will lead to an increase in the money supply.

ii. Statutory Liquidity Ratio (SLR) : SLR is concerned with maintaining the minimum reserve of assets with RBI, whereas the cash reserve ratio is concerned with maintaining cash balance (reserve) with RBI. So, SLR is defined as the minimum percentage of assets to be maintained in the form of either fixed or liquid assets with RBI. The flow of credit is reduced by increasing this liquidity ratio and vice-versa. A rise in SLR will restrict the banks to pump money in the economy, thereby contributing towards decrease in money supply. The reverse case happens if there is a fall in SLR, as it increases the money supply in the economy.