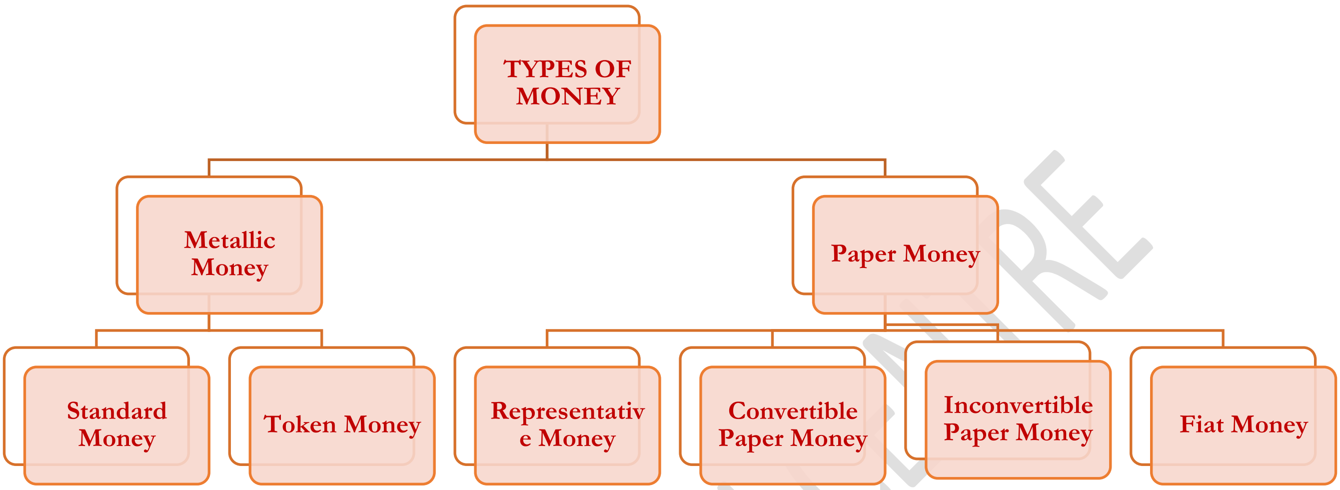
MONEY AND BANKING

BHU B.COM ENTRANCE – IMPORTANT TOPICS



Metallic Money:

If money is made up of any special metal like gold, silver, copper or nickel it is called as Metallic Money. It can be classified into:

a. **Standard Money:**
   a. This is also referred to as the principal money or full bodied money.
   b. Standard coins are made of pure and superior metals like gold or silver.
   c. Coins are made of a well-defined weight and fineness.
   d. There is free coinage
   e. It is an unlimited legal tender
   f. They have Face Value = Intrinsic Value
   g. The value of metal used to make the coin is Intrinsic Value

b. **Token Money:**
   a. It is metallic money made up of impure and inferior metals.
   b. This type of metallic money has the face value greater than the intrinsic value.
   c. Since, the prices of metals change with the time; the standard metallic money is not proper type of money. Moreover, there is need of large quantity of superior and pure metals to mint the large amount of coins.
   d. Indian Rupee Coins are usually an example of Token Money and Limited Legal Tender

Some additional terms:

1. Subsidiary Money: the money of smaller denomination used to pay smaller amounts.
2. Limited Legal Tender: The money which can be used to pay in transactions only upto a limited amount. Like Indian Rupee can be used to pay an amount only upto Rs. 1000 as per Indian Coinage Act, 2011.

3. Unlimited Legal Tender: The money which can be used to pay upto any amount in a transaction. Like Currency Notes in India are an unlimited legal tender.

Paper Money:

China was the first country in the world to make use of paper currency in the 9th century. The use of paper money began in India in the 19th century.

Paper Money can be classified under four heads.

Representative Paper Money: This type of paper is fully backed up by gold and silver reserves. In the beginning, the main objective of issuing paper currency was to avoid wastage of metals consequent upon wear and tear (depreciation) of metallic coins. The Hilton Young Commission recommended in 1925 the introduction of representative paper money in India, but this recommendation could not be implemented due to certain reasons.

Convertible paper Money: It refers to that type paper money which is convertible into standard coins at the option of the holder.

Inconvertible Paper Money: The system of inconvertible paper money prevails in a country when the monetary authority gives no guarantee to convert the paper notes into coins or other valuable metals. Such a type of paper currency circulates on account of the high credit enjoyed by the monetary authority.

Fiat Money: This is only a variety of inconvertible paper money. Fiat money is issued generally at a time of crisis. That is why it is sometimes referred to as emergency currency. It was resorted to in 1914 as a temporary measure but has come to stay since then as a permanent variety of money. It is simply an inconvertible paper money made a legal decree.

Digital Currency In India: A currency which is not exists in physical form but exist in digital form. It is a part of cashless currency. In world, digital currency consist 'Bitcoin'.

Cheap Money- It refers to that money which is made available to the borrowers at a low rate of interest. It accelerates the process of credit expansion by the banks. It is used as a measure to combat depression and revive the economy

Plastic Money: It is a term given to credit cards/debit cards issued by central bank or any banks and "financial institutions.

Actual Money and Money of Account

J.M. Keynes in his Treatise on Money has distinguished between actual money and money of account.
Actual money (also called Unit of Currency) is that money which actually circulates and is current in practice in a country. Actual money is the medium of exchange of goods and services in country. It is in the shape of actual money that all payments are made and a store of general purchasing power is held. For example, in India, the coins and paper notes of various denominations are actual money.

Money of account (also called Unit of Account) is "that in which debts and prices and general purchasing power are expressed. It is that form of money in terms of which the accounts of a country are kept and transactions made." The monetary unit in which the money of account is expressed may not exactly be a circulating medium (Usually it is same as in India it is Rupee in both cases)

Credit Money

Credit money. also known as bank money, refers to bank deposits kept by people with banks which are payable on demand and can transferred from one party to another via the use of cheque . The cheque is an in instrument used to transfer bank deposits and it offers the some conveniences as money.

GRESHAM'S LAW

Sir Thomas Gresham who was the master of the mint under Queen Elizabeth. Gresham enquired about the phenomenon in 1558. And came to the conclusion that "bad money drives out good money". This has came to be known as Gresham's law.

Under bimetallism, coins of over – valued metal are called 'bad money' and coins of under-valued metal as 'good money' .

Under the paper standard, if both standard coins of superior metal and inconvertible paper notes are circulating together, metallic coins are regarded as 'good money' and paper notes as 'bad money'.

METALLIC STANDARD

The monetary units under metallic standard comprise metallic coins referred to as standard coins. Metallic Standard can be classified under two heads :(i) Monometallism, and (ii) Bimetallism

MONOMETALLISM

When the standard coins in a monetary system are made of one mental only, the monetary standard is knows as monometallism. Monometallism can be of two types: (i) Silver Standard (ii) Gold Standard. Till 1893, India was on the Silver Standard. Great Britain, on the contrary, was on the Gold Standard till 1931.

1. The Gold Currency Standard: This is the oldest form of gold standard. In this form actual gold coins are in circulation. This type of gold standard is sometimes referred to as Orthodox Gold Standard, Traditional Gold Standard, or Full Gold Standard.

2. **The Gold Bullion Standard:** This standard is only a revised version of the gold currency standard. It was evolved and adopted by some countries of Europe after the First World War. The Currency Notes which were issued were fully backed by Gold Reserves and was also convertible into Gold.
3. **The Gold Exchange Standard:** This system was found suitable for underdeveloped countries which could not afford the luxury of a full gold standard. Under this system, the government takes no responsibility of converting internal currency into gold for meeting domestic requirements.

4. **Gold Reserve Standard:** This standard was developed in 1936.it worked well in Western Europe from 1936 to 1939. The objective of this standard was to ensure stability in exchange rates. To ensure stability of exchanger rates, greats, Great Britain, the U.S.A and France entered into a Tripartite Monetary Agreement in 1936. For this purpose, Exchange Equalization Funds were created. The gold reserve standard functioned successfully for three years and came to an end with the outbreak of World War II.
5. **Gold Parity Standard:** In essence, gold parity standard is the modern version of the gold standard. It came into force with the establishment of the International Monetary Fund (IMF) in 1946. Under this standard, every member country has to define the par value of its currency in terms of gold in order to determine the exchange rate. The gold parity standard aims at maintaining stable exchange rates without interfering into the domestic monetary system of the member countries.

Important MCQ questions

1. Which of the following is known as 'Actual Money'?
   a. Unit of currency
   b. Unit of account
   c. Commodity money
   d. Representative money.
2. J. M. Keynes has classified money as :
   a. Actual Money and Money of Account
   b. Unit of Currency and Unit of Account
   c. Legal Tender Money and Optional Money
   d. Metallic Money and Paper Money.
3. Which of the following is not a characteristic of Standard Coin ?
   a. Principal coin of the country
   b. Face value is equal to intrinsic value
   c. Free coinage
   d. Limited legal tender
4. Which of the following types of Paper Money is presently in circulation ?
   a. Representative
   b. Convertible
   c. Inconvertible
   d. Fiat.
5. Which is a part of liquid money ?
   a. Cash
   b. Building
   c. Goods
   d. None of these.
6. Which is a digital currency ?
   a. Debit Card

b. Dollar

c. Pound

d. Bitcoin.

[Ans. 1. (a), 2. (a), 3. (d), 4. (c), 5. (a), 6(d).]

1. An essential characteristic of Gold Standard is :

   a. Circulation of full-bodied gold coins

   b. Convertibility of currency into gold

   c. 100% gold reserves for money into circulation

   d. The value of principal currency defined in terms of gold.

2. When the money in circulation is defined in terms of a foreign, currency which is based on gold standard, it is a case of :

   a. Gold Bullion Standard

   b. Gold Exchange Standard

   c. Gold Reserve Standard

   d. Gold Parity Standard.

3. Exchange equalisation funds were established under which form Gold Standard?

   a. Gold Exchange Standard

   b. Gold Billion Standard

   c. Gold Reserve Standard

   d. Gold Parity Standard.

4. Working of Gold Standard does not essentially require :

   a. Stability of exchange rates

   b. Stability of internal prices

   c. Free trade

   d. Elastic demand.

5. Bimetallism existed upto :

a. 1873

b. 1803

c. 1900

d. 1930.

6. Which of the following is not a characteristic of Bimetallism ?

a. Circulation of gold and silver coins together

b. Coins are unlimited legal tender

c. The ratio between the gold and silver coins is fixed by market rate

d. Both coins have equality intrinsic value between face value and intrinsic value

Ans. 1. (d), 2. (b), 3. (c), 4. (b), 5. (c), 6. (c)