NON COLLEGIATE WOMEN'S EDUCATION BOARD

Hansraj College Centre, University of Delhi, For 14/03/2020

B.A. (Prog) IInd Year, Section - A, Room No.- A206 (08:40-09:40)

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PAPER – ECONOMICS

UNIT – 6 MONEY IN A MODERN ECONOMY

FUNCTIONS OF MONEY –

Secondary Functions –

1) Standard of Deferred Payments –

Deferred payments are those payments which will be paid in future like repayment of loans. Under the barter system it was difficult to assess that how much units of a commodity will be returned to settle a loan, money simplifies credit transactions. The buying and selling of shares and debentures is made possible by money.

2) Store of Value -

Money is something which can be kept for longer periods without deterioration. It is a form in which wealth can be kept intact from one year to the next i.e. storing purchasing power to be used sometimes in the future. This function of money facilitates to discharge unforeseen contingencies and debts in future. But the store of value function of money also suffers from changes in the value of money with time.

3) Transfer of Value -

Unlike any immovable property money can easily be transferred from one place to another. If a person owns a house in Delhi but needs money in Jaipur then he obviously can't move his house to Jaipur. But he can simply sell out his house and carry the money received to Jaipur. Thus money facilitates transfer of value between person and places.

Contingent Functions -

1) Calculation of National Income –

It was very difficult to measure national income of the economy under barter system but money made it simple to measure national income. This measurement has become possible since various goods and services produced in the country began to be assessed in terms of money. Once we know income we may calculate per capita income to find the extent of income inequalities.

2) Basis of the Credit System –

A commercial bank cannot crate credit without having sufficient money in reserve. People save a part of their income and deposit it with the banks and banks on the basis of these money reserves make loans and advances to the public. Thus money serves as the basis of all these credit creation.

3) Equalisation of Marginal Utilities –

The main aim of a consumer is to maximise his satisfaction by spending a given sum of money on various goods. He/she may do so by equalising marginal utilities obtained by consuming given units to their prices. Thus money facilitates the concept of consumer's equilibrium.

4) Distribution of National Income –

Money also helps in the distribution of national income. Rewards of factors of production in the form of wages, rent, interest and profit are determined and paid in terms of money. For the growth and development of any nation, income must be equitably distributed.

MONEY SUPPLY –

Money supply refers to the quantity of money available in the economy. It is considered as the sum of total currency in circulation and demand deposits at a point of time. Currency is the sum of coins and paper notes circulating in the economy. Demand deposits are deposits with the banks which holder can withdraw on demand or can be transferred by issuing cheques.

Various Measures of Money Supply –

Earlier there was only one measure 'M' based on Keynes narrow measure of money supply. But Reserve Bank of India introduced four measure of money supply in 1977.

M_1 = Currency with the public + Demand Deposits with banks + Other Deposits with RBI.

M_2 = Currency with the public + Demand Deposits with banks + Other Deposits with RBI + Deposits with the post office saving banks.

M_3 = Currency with the public + Demand Deposits with banks + Other Deposits with RBI + Time deposits with banks.

M_4 = Currency with the public + Demand Deposits with banks + Other Deposits with RBI + Deposits with the post office saving banks + Time deposits with banks.

Here it is worth to mention that M_1 is called **'Narrow Money'** and M_3 is also known as **'Broad Money'**.

DETERMINANTS OF MONEY SUPPLY -

The determinants of money supply are both exogenous and endogenous which can be described broadly as -

1) High Powered Money -

This is the sum of commercial bank reserves and currency held by the public which is issued by the central bank and the government. High powered money is the monetary base for the expansion of bank deposits and creation of the money supply. The supply of money varies positively with changes in the monetary base.

2) CRR & SLR –

The Cash reserve ratio and Statutory liquidity ratio are important determinants of the money supply in India. The rising of these ratios have the effect of reducing the money supply with commercial banks for lending purposes and lowering of them tend to increase the money supply with the banks for loans and advances.

3) Velocity of Circulation of Money –

A unit of money can be used many times during a period thus velocity of money is the number of times a unit of money changes hands during a specified period of time. Supply of money during a period of time is estimated by multiplying the quantity of money by its velocity.

4) Desire to Hold Cash –

If people are in the habit of keeping less cash and more deposits with commercial banks, the money supply will be large. This will happen because banks can create more credit with larger deposits. On the contrary if people do not have banking habits and prefer to hold their cash with them, credit creation by banks and supply of money in the economy will be less.