

Question 1. What is a barter system? What are its drawbacks?

Answer : Barter System Barter system refers to the exchange of goods for goods.

e.g., If a person exchange wheat with rice. It is a barter system.

Drawbacks of Barter system are as follows

1. Difficulty of Double Coincidence of Wants It is not necessary that goods in possession of two different individuals are needed by each other.
2. Lack of a Common Unit of Value It implies that the goods which are exchanged not measured in a common unit.
3. Lack of a System for Future Payments Evolution is difficult thus future payments would not be possible.

Question 2. What are the main functions of money? How does money overcome the shortcomings of a barter system?

Answer The functions of money can be divided in two categories-

1. Primary or (Main functions)
2. Secondary functions

I. The primary functions are of two types

1. Medium of Exchange It can be used to make payment for all transactions of goods and services.
2. Measure of Value It means that the value of each goods and services are measured in the monetary unit.

II. Secondary functions are of three types

1. Deferred Payments Money is used to make the future payments.
2. Store of Value It implies store of wealth.
3. Transfer of Value Money is used as a convenient mode of transfer of value.

The money over comes from the short comings of the barter system in a following manner

- (a) Use of money removed the difficulty of double coincidence of wants in the barter system.
- (b) Money facilitates storage of value.
- (c) Use of money removed the difficulty of division of commodity.
- (d) It removed the difficulty of medium of exchange.
- (e) Use of money removed the difficulty of deferred payments.

Question 3. What is transaction demand for money? How is it related to the value of transactions over a specified period of time? Answer The transaction motive relates to the demand for money to meet day-to-day transactions.

According to Keynes, "Transaction demand for money is positively associated with the level of income, as higher the level of Income, larger would be the size of money holdings for transactions. The relationship between the value of transactions and transaction demand is

$$M_T^d = KT$$

or $\frac{1}{K} M_T^d = T$

or $VM_T^d = T$

$$V = \frac{1}{K}, \text{ represents velocity of circulation of money.}$$

Here, T = Total value of transactions of money.
 K = Positive fractions
 M_T^d = Stock of money hold by people

Question 4. Suppose a bond promises ~ 500 at the end of two years with no intermediate return. If the rate of interest is 5% per annum what is the price of the bond?

Answer $A = P \left(1 + \frac{r}{100}\right)^n$

Given, $A = ₹ 500$, $r = 5\%$, $n = 2$ yrs

$$500 = P \left(1 + \frac{5}{100}\right)^2$$

$$500 = \left(\frac{105}{100} \times \frac{105}{100}\right)$$

$$500 = P \left(\frac{441}{400}\right)$$

$$P = \frac{500 \times 400}{441}$$

$$P = 453.51$$

∴ Price of the bond = ₹ 453.51

Question 5. Why is speculative demand for money inversely related to the rate of interest?

Answer The interest rate varies inversely with the market value of bonds because when interest rate rises, market value of bonds falls. Hence, demand for money for speculative motive becomes less at high rate of interest and becomes large at low rate of interest.

Question 6. What is 'liquidity trap'?

Answer Liquidity Trap It is a situation of very low rate of interest in the economy where every economic agent expects the interest rate to rise in future and consequently bond price falls, causing capital loss. Everyone holds her/his wealth in money and speculative demand for money is infinite.

Question 7. What are the alternative definitions of money supply in India?

Answer There are four alternative measures of money supply in India.

These are known as

M_1 , M_2 , M_3 and M_4 define as

$M_1 \Rightarrow$ Currency with public + Demand deposits + Other deposits with RBI

$M_2 \Rightarrow M_1 +$ Saving with post office saving account

$M_3 \Rightarrow M_1 +$ Net time deposits with banks

$M_4 \Rightarrow M_3 +$ Total deposits with post office (except NSC)

Question 8. What is a 'legal tender'? What is 'fiat money'?

Answer Legal Tender Legal tender refers to the money which can be legally used to make payment of debts or other obligations. Fiat Money Fiat money refers to the money which is backed with order of the government under law. It must be accepted for all debts.

Question 9. What is high powered money?

Answer High Power Money It means currency (coins and notes) held by the public and cash reserves with the commercial banks.

Question 10. Explain the functions of a commercial bank.

Answer Function of Commercial Bank

The function of commercial bank divided into three categories

(i) Primary Functions A commercial bank performs two primary functions

(a) Accepting Deposits Commercial bank accepts deposits from public by several kinds of account like

- (a) Current account
- (b) Fixed deposit account
- (c) Saving account
- (d) Recurring deposit account

(b) Providing Loans and Advances A commercial bank provides loans and advances both for productive purpose as well as consumption (household) purpose. The commercial bank provides-cash credit, demand loans and short term loans.

(ii) Secondary Functions In addition to the primary functions, banks also perform the following secondary functions

(a) Overdraft Facility It refers to a facility in which an account holder is allowed to overdraw amount up to limit from his current account.

(b) Discounting Bills of Exchange The commercial bank provides the facility of discounting bill before the date of maturity.

(iii) Agency Functions A commercial bank acts as an agent of his customer. Some of the agency functions are

- (a) Transfer of funds.
- (b) Collection and payment of various items.
- (c) Purchase and sale of foreign exchange.
- (d) Purchase and sale of securities
- (e) Act as consultant.
- (f) Provide locker facility
- (g) Provide information and statistics data to the customers.