

Macroeconomics , Class-12th,Ch-4,Money , Notes

1. What is Barter system? What are its drawbacks? [3 Marks]

Ans : Barter system of exchange is a system in which goods are exchanged for goods. It's Drawbacks are:

1. Lack of double coincidence of wants.
2. Lack of divisibility.
3. Difficulty in storing wealth.
4. Absence of common measure of value.
5. Lack of standard of deferred payment.

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

[6 Marks] Or

Explain the problem of double coincidence of wants faced under barter system. How has money solved it? [CBSE 2013]

Ans:

1. "Money is a matter of the following four functions: A medium, a measure, a standard, a store".
2. Money has overcome the short-coming of a barter system in the following manner:

(a) Medium of exchange

- Under barter system, there is lack of double coincidence of wants.
- With money as a medium exchange individuals can exchange their goods and services for money and then use this money to buy other goods and services according to their needs and conveniences.
- A buyer can buy goods through money and a seller can sell goods for money.

(b) Measure of value

- Under barter system, there was no common measure of value. 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.

- Money works as a common denominator into which the values of all goods and services are expressed.
- When we express the values of a commodity in terms of money, it is called price and by knowing prices of the various commodities, it is easy to calculate exchange ratios between them.

(c) Store of value

- Under barter system it is very difficult to store wealth for future use.
- Most of the goods are perishable and their storage requires huge space and transportation cost.
- Wealth can be conveniently stored in the form of money.
- Money can be stored without loss in value.
- Money can easily be stored for future use.

(d) Standard of deferred payments

- Under barter system, transactions on deferred payments are not possible.
- With money, the debtors make a promise that they will make payments on some future dates. In those situations money acts as a standard of deferred payments.
- It has become possible because money has general acceptability, its value is stable, it is durable and homogeneous.

3. What is transaction demand for money? How is it related to the value of transactions over specified period of time?

Ans: Deleted from syllabus.

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

Ans: Deleted from syllabus

5. What are the alternative definitions of money supply in India?[3-4 Marks]

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

Measures of M_1 include:

1. Currency notes and coins with the public (excluding cash in hand of all commercial banks) [C]
2. 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 means of cheque. No interest is paid on such deposits.

3. 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

1. $M_1[C + DD + OD]$
2. Post office saving deposits

Measures of M_3

1. M_1
2. 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 deposit is an example of time deposit.

Measures of M_4

1. M_3
2. Total deposits with the post office saving organization (excluding national savings certificates).

6. What is a 'legal tender'? What is 'fiat money'?

Ans:

1. **Legal tender:**
 - (a) Legally, money is anything proclaimed by law as a medium of exchange.
 - (b) Paper notes and coins (together called currency) is money as a matter of law.
 - (c) Nobody can refuse its acceptance as medium of exchange.

2. **FIAT Money:** It is defined as a money which is under the 'FIAT' (order/authority) of the government to act as a money.

7. What is High powered money?

Ans: It is money produced by the RBI and the government. It consists of two things:

1. currency held by the public and
2. Cash reserves with the banks.

MORE QUESTIONS SOLVED

I.VERY SHORT ANSWER TYPE QUESTIONS (1 Mark)

1. Define Barter system.

Ans: Barter system of exchange is a system in which goods are exchanged for goods.

2. What is meant by double coincidence of wants?

Ans: Double coincidence of wants means that goods in possession of two different persons must be useful and needed by each other.

3. Define Money.

Ans: Money is something which is generally acceptable as a medium of exchange and can be converted into other assets without losing its time and value.

4. What is the basic characteristic of money?

Ans: Durability and weight.

5. What is the legal definition of money?

Ans: Legally, money is anything proclaimed by law as a medium of exchange. Paper notes and coins (together called currency) is money as a matter of law.

6. Define money supply.[CBSE Foreign 2004, 2031]

Ans: The stock of money held by the public at a point of time, in an economy, is referred to as the money supply. Money supply is a stock concept.

7. What items are included in the M_3 measure of money supply?

Ans:

1. M_3 (currency notes and coins with public + demand deposits of commercial and co-operative banks + other deposits with RBI),
2. Time deposits of all commercial and co-operative banks.

8. State two components of money supply. [CBSE Sample Paper 2010] Or State the components of money supply. Or [CBSE 2010] What is included in money supply?[CBSE 2010C, 2011]

Ans: Currency notes and coins with public + demand deposits with the banks.

9. Define demand deposits.[CBSE 2013, Set I, HOTS]

Ans: Demand deposits are those deposit which can be withdrawn by the depositor at any time by means of cheque. No interest is paid on such deposits.

10. What are time deposits in banks?[AI 2013, C Set I]

Ans: Time deposits are the deposits which can not be withdrawn before the expiry of the stipulated time for which deposits are made. Fixed deposit is an example of time deposit.

11. State the components of supply of money. [AT 2013 Set I]

Ans:

1. Coins and currency notes with public.
2. Demand deposits with banks.

II.MULTIPLE CHOICE QUESTIONS(1 Mark)

1. M1 in the money stock in India refers to:

- (a) Post office savings deposits.
- (b) Total post office deposits.
- (c) Currency plus demand deposits plus other deposits with the RBI.
- (d) Time deposits with banks.

Ans:(c)

2. Narrow money refers to:

- (a) M_1 (b) M_2
- (c) M_3 (d) M_4

Ans: (a)

3. Broad money refers to:

- (a) M_1 (b) M_2
- (c) M_3 (d) M_4

Ans: (c)

4. The basic distinction between narrow and broad money is the

- (a) treatment of post office deposits
- (b) treatment of time deposits of banks
- (c) treatment of savings deposits of banks
- (d) treatment of currency

Ans:(b)

5. Read the following dialogue between two people:

Sita : I want 1 kg of potatoes

Rani : What will you give in exchange?

Sita : I can give you 2 litres of milk in return for the potatoes.

Rani: I don't need milk. I want a pair of shoe

Which of the following problems is being faced by Sita and Rani in their exchange process?

- (a) Lack of double coincidence of wants
- (b) Absence of common units of value
- (c) Lack of store of value
- (d) Lack of standard of deferred payment.

Ans: (a)

6. Which of the following agency is responsible for issuing ? 1 currency note in India?[CBSE Sample Paper 2016]

- (a) Reserve Bank of India
- (b) Ministry of Commerce
- (c) Ministry of finance
- (d) Niti Aayog

Ans:(c)

III. SHORT ANSWER TYPE QUESTIONS [3-4 Marks]

1. Explain the 'medium of exchange' function of money.[CBSE Delhi 2014, AI 2013]

Ans:

1. Money when used as a medium of exchange helps to eliminate the basic limitation of barter trade, that is, the lack of double coincidence of wants.
2. Individuals can exchange their goods and services for money and then can use this money to buy other goods and services according to their needs and convenience.
3. Thus, the process of exchange shall have two parts: a sale and a purchase.
4. The ease at which money is converted into other goods and services is called "liquidity of money".

2. Explain the ' Unit of account' function of money. [CBSE 2004C; AI 2007]

Ans:

1. Another important function of money is that it serves as a common measure of value or a unit of account.

2. 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.
3. 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.
4. Money works as a common denominator into which the values of all goods and services are expressed.
5. When we express the values of a commodity in terms of money, it is called price and by knowing prices of the various commodities, it is easy to calculate exchange ratios between them.

3. Explain Standard of deferred payments function of money.[CBSE Delhi 2004 C, 2007, 2012, Sample Paper 2013]

Ans:

1. Credit has become the life and blood of a modern capitalist economy.
2. In millions of transactions, instant payments are not made.
3. The debtors make a promise that they will make payments on some future date. In those situations money acts as a standard of deferred payments.
4. It has become possible because money has general acceptability, its value is stable, it is durable and homogeneous.

4. Explain Store of value function of money.[CBSE 2006, 2006C, 2007; AI 2007, 2013 C, Sample Paper 2013]

Ans:

1. Wealth can be conveniently stored in the form of money. Money can be stored without loss in value.
2. Savings are secured and can be used whenever there is a need.
3. In this way, money acts as a bridge between the present and the future.
4. Money means goods and services. Thus, money serves as a store of value.
5. It is also known as asset function of money.

5. Explain the problem of double coincidence of wants faced under barter system. How has money solved it? [CBSE 2013 (Set-I)]

Ans:

1. Under barter system, there is lack of double coincidence of wants.
2. With money as a medium exchange individuals can exchange their goods and services for money and then use this money to buy other goods and services according to their needs and conveniences.
3. A buyer can buy goods through money and a seller can sell goods for money.

IV.TRUE OR FALSE

Giving reasons, state whether the following statements are true or false.

1. Standard of deferred payments led to capital formation and economic development of the economy.

Ans: True. It is so because credit has become the life and blood of a modern capitalist economy that leads to economic development of the country.

2. Measure of value function has removed the difficulty of lack of double coincidence of wants.

Ans: False. Medium of exchange function has removed the difficulty of lack of double coincidence of wants.

3. Store of value function of money facilitates transfer of purchasing power from present to future.

Ans: True. It facilitates transfer of purchasing power from present to future.

4. Money supply is a stock concept.

Ans: True. Money supply is a 'stock concept' as it is measured at a particular point of time.

5. M_1 includes time deposits of commercial banks.

Ans: False. M_1 includes currency notes and coins, demand deposits of commercial and cooperative banks and other deposits. Time deposit is a component of M_3 .

6. Money supply does not include money held by government and banking system.

Ans: True. As money held by them do not come into actual circulation in the country.

7. Lack of double coincidence of wants exists in barter exchange difficulty in simultaneous fulfilment of mutual wants of buyers and sellers.

Ans: True. It exists under barter exchange because of difficulty in simultaneous fulfilment of mutual wants of buyers and sellers.

Note: As per CBSE guidelines, no marks will be given if reason to the answer is not explained.

V. HIGHER ORDER THINKING SKILLS

1. Define high-powered money. [1 Mark]

Ans: High-powered money is money produced by the RBI and the government. It consists of two things:

1. Currency held by the public and
2. Cash reserves with the banks.

2. What are other deposit measures of M_1 ? [1 Mark]

Ans: 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.

3. Why post office saving are less liquid than demand deposits? [1 Mark]

Ans: Post office saving banks are not as liquid as demand deposits with the banks (commercial or cooperative) as they are not chequeable account. However, saving deposits with post offices are more liquid than time deposits with the banks.

4. Explain why time deposits measures of M_3 is less liquid than the demand deposits measure of M_1 [3 Marks]

Ans:

1. It is generally thought that time deposits with the banks are not as liquid as demand deposits, because the time deposits are not chequeable (i.e., these cannot be withdrawn through cheques drawn on them).
2. However, loans against these time deposits can be easily taken. Hence, they can be used in times of need.
3. Moreover, they can also be withdrawn at any time by forgoing some interest earned on them.

5. What are the characteristics or features of money? [3 Marks]

Ans:

1. **Durability:** Money must be durable and not likely to deteriorate rapidly with frequent handling. Currency notes and coins are being used repeatedly and shall continue to do so for many years.
2. **Medium of exchange:** Money is the thing that acts as a medium of exchange for the sale and purchase of goods and services.
3. **Weight:** Money must be light in weight. Paper money is better than metal coins because it is light in weight.
4. **Measure of value:** It not only serves as medium of exchange but also acts as a measure of value. The value of all the goods and services is expressed in terms of money. [1 Mark]

1. Why is the use of money more convenient for exchange than barter system? Explain. [3 Marks]

Ans:

1. Medium of Exchange
2. Store of Value
3. Standard of deferred payment Value: Empathy

2. Why do all the compensations in form of money than toys more convenient to an employee working in a toy manufacturing factory? [1 Mark]

Ans: There is lack of general acceptability in case of toys, while in the case of money there is general acceptability; so, he can purchase any goods and services with the help of money at any point of time and he does not have to face any problem of lack of double coincidence of wants.