CHAPTER

5

Monetary Economics

Inflation is taxation without legislation.

-Milton Friedman

Learning Objectives

1. To understand the evolution of money, types, functions, meaning of inflation, types, causes, effects of inflation and measures to control.
2. To know the various phases of trade cycle.

5.1 Introduction

Monetary Economics is a branch of economics that provides a framework for analyzing money and its functions as a medium of exchange, store of value and unit of account. It examines the effects of monetary systems including regulation of money and associated financial institutions.

5.2 Money

5.2.1 Meaning

Money is anything that is generally accepted as payment for goods and services and repayment of debts and that serves as a medium of exchange. A medium of exchange is anything that is widely accepted as a means of payments. In recent years, the importance of credit has increased in all the countries of the world. Credit instruments are used on an extensive scale. The use of cheques, bills of exchange, etc. has gone up. It should however, be remembered that money is the basis of credit.

5.2.2 Definitions

Many economists developed definition for money. Among these, definitions of Walker and Crowther are given below:

" Money is, what money does"

- Walker.

"Money can be anything that is generally acceptable as a means of exchange and at the same time acts as a measure and a store of value".

–Crowther

5.2.3 Evolution of Money

Barter System

The introduction of money as a medium of exchange was one of the greatest inventions of mankind. Before money was invented, exchange took place by Barter, that is, commodities and services were directly exchanged for other commodities and services. Under the barter system, buyers and sellers of commodities had to face a number of difficulties. Surplus goods were exchanged for money which in turn was exchanged for other needed goods. Goods like furs, skins, salt, rice, wheat, utensils, weapons, etc. were commonly used as money. Such exchange of goods for goods was known as "Barter Exchange" or "Barter System".

The history of Barter system starts way back in 6000 BC

- Barter system was introduced by Mesopotamia tribes.
- Phoenicians adopted bartering of goods with various other cities across oceans.
- Babyloninan's also developed an improved barter system, where goods were exchanged for goods.

Metallic Standard

After the barter system and commodity money system, modern money systems evolved. Among these, metallic standard is the premier one. Under metallic standard, some kind of metal either gold or silver is used to determine the standard value of the money and currency. Standard coins made out of the metal are the principal coins used under the metallic standard. These standard coins are full bodied or full weighted legal tender. Their face value is equal to their intrinsic metal value.

Gold Standard

Gold Standard is a system in which the value of the monetary unit or the standard currency is directly linked with gold. The monetary unit is defined in terms of a certain weight of gold. The purchasing power of a unit of money is maintained equal to the value of a fixed weight of gold.

Silver Standard

The silver standard is a monetary system in which the standard economic unit of account is a fixed weight of silver. The silver standard is a monetary arrangement in which a country's Government allows conversion of its currency into fixed amount of silver.

Paper Currency Standard

The paper currency standard refers to the monetary system in which the paper currency notes issued by the Treasury or the Central Bank or both circulate as unlimited legal tender. Paper currency is not convertible into any metal. Its value is determined independent of the value of gold or any other commodity. The paper standard is also known as managed currency standard. The quantity of money in circulation is controlled by the monetary authority to maintain price stability.

Plastic Money

The latest type of money is plastic money. Plastic money is one of the most evolved forms of financial products. Plastic money is an alternative to the cash or the standard "money". Plastic money is a term that is used predominantly in reference to the hard plastic cards used every day in place of actual bank notes. Plastic money can come in many different forms such as Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards. They aim at removing the need for carrying cash to make transactions.

Crypto Currency

A digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a Central Bank.

Decentralised crypto currencies such as Bitcoin now provide an outlet for Personal Wealth that is beyond restriction and confiscation.

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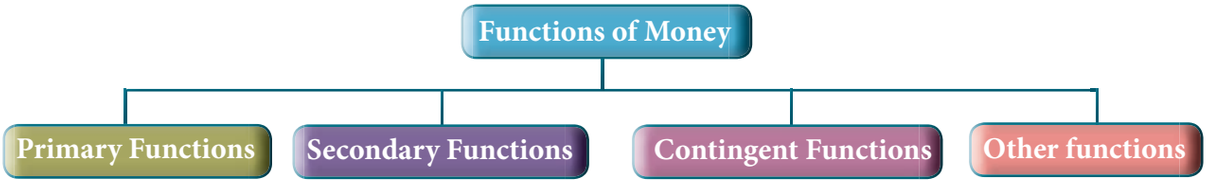
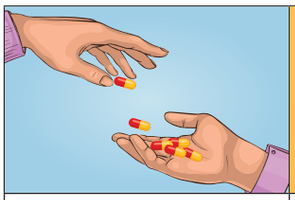
5.2.4 Functions of Money

The main functions of money can be classified into four categories:



1.Primary Functions:



Medium of exchange

Store of Value

Measure of value

Standard of deferred payments

i) **Money as a medium of exchange:** This is considered as the basic function of money. Money has the quality of general acceptability, and all exchanges take place in terms of money. On account of the use of money, the transaction has now come to be divided into two parts. First, money is obtained through sale of goods or services. This is known as sale. Later, money is obtained to buy goods and services. This is known as purchase. Thus, in the modern exchange system money acts as the intermediary in sales and purchases.

ii) **Money as a measure of value:** The second important function of money is that it measures the value of goods and services. In other words, the prices of all goods and services are expressed in terms of money. Money is thus looked upon as a collective measure of value. Since all the values are expressed in terms of money, it is easier to determine the rate of exchange between various types of goods in the community.

2.Secondary Functions

i) **Money as a Store of value:** Savings done in terms of commodities were not permanent. But, with the invention of money, this difficulty has now disappeared and savings are now done in terms of money. Money also serves as an excellent store of wealth, as it can be easily converted into other marketable assets, such as, land, machinery, plant etc.

ii) **Money as a Standard of Deferred Payments:** Borrowing and lending were difficult problems under the barter system. In the absence of money, the

borrowed amount could be returned only in terms of goods and services. But the modern money-economy has greatly facilitated the borrowing and lending processes. In other words, money now acts as the standard of deferred payments.

iii) **Money as a Means of Transferring Purchasing Power:** The field of exchange also went on extending with growing economic development. The exchange of goods is now extended to distant lands. It is therefore, felt necessary to transfer purchasing power from one place to another.

3.Contingent Functions

i) **Basis of the Credit System:** Money is the basis of the Credit System. Business transactions are either in cash or on credit. For example, a depositor can make use of cheques only when there are sufficient funds in his account. The commercial bankscreate credit on the basis of adequate cash reserves. But, money is at the back of all credit.

ii) **Money facilitates distribution of National Income:** The task of distribution of national income was exceedingly complex under the barter system. But the invention of money has now facilitated the distribution of income as rent, wage, interest and profit.

iii) **Money helps to Equalize Marginal Utilities and Marginal Productivities:** Consumer can obtain maximum utility only if he incurs expenditure on various commodities in such a manner as to equalize marginal utilities accruing from them. Now in equalizing these marginal utilities, money plays an important role, because the prices of all commodities are expressed in money. Money also helps to equalize marginal productivities of various factors of production.

iv) **Money Increases Productivity of Capital:** Money is the most liquid form of capital. In other words, capital in the form of money can be put to any use. It is on account of this liquidity of money that capital can be transferred from the less productive to the more productive uses.

4.Other Functions

i) **Money helps to maintain Repayment Capacity:** Money possesses the quality of general acceptability. To maintain its repayment capacity, every firm has to keep assets in the form of liquid cash. The firm ensures its repayment capacity with money. Likewise, banks, insurance companies and even governments have to keep some liquid money (i.e., cash)to maintain their repayment capacity.

ii) **Money represents Generalized Purchasing Power:** Purchasing power kept in terms of money can be put to any use. It is not necessary that money should be used only for the purpose for which it has been served.

iii) **Money gives liquidity to Capital:** Money is the most liquid form of capital. It can be put to any use.

5.3 Supply of Money

Money supply means the total amount of money in an economy. It refers to the amount of money which is in circulation in an economy at any given time. Money supply plays a crucial role in the determination of price level and interest rates. Money supply viewed at a given point of time is a stock and over a period of time it is a flow.

Meaning of Money Supply

In India, currency notes are issued by the Reserve Bank of India (RBI) and coins are issued by the Ministry of Finance, Government of India (GOI). Besides these, the balance is savings, or current account deposits, held by the public in commercial banks is also considered money. The currency notes are also called fiat money and legal tenders.

Money supply is a stock variable. RBI publishes information for four alternative measures of Money supply, namely M_1,M_2,M_3 and M_4.

M_1 = Currency, coins and demand deposits

M_2 = M_1 + Savings deposits with post office savings banks

M_3 = M_2 + Time deposits of all commercial and cooperative banks

M_4 = M_3 + Total deposits with Post offices.

M_1 and M_2 are known as narrow money

M_3 and M_4 are known as broad money

The gradations are in decreasing order of liquidity.

Currency Symbol ₹

The new symbol designed by D.Udaya Kumar, a post graduate of IIT Bombay was finally selected by the Union cabinet on 15th July, 2010. The new symbol, is an amalgamation of Devanagri 'Ra' and the Roman 'R' without the stem. The symbol of India rupee came into use on 15thJuly,2010. After America, Britain, Japan, Europe Union. India is the 5th country to accept a unique currency symbol.

Determinants of Money Supply

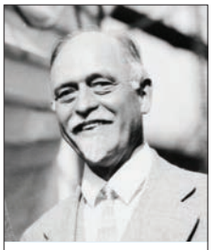
1. Currency Deposit Ratio (CDR); It is the ratio of money held by the public in currency to that they hold in bank deposits.

2. Reserve deposit Ratio (RDR); Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.

3. Cash Reserve Ratio (CRR); It is the fraction of the deposits the banks must keep with RBI.

4. Statutory Liquidity Ratio (SLR); It is the fraction of the total demand and time deposits of the commercial banks in the form of specified liquid assests.

5.4 Quantity Theories of Money



Irving Fisher

Quantity theories of money explain the relationship between quantity of money and value of money. Here, we are given two approaches of Quantity Theory of Money, viz. Fisher's Transaction Approach and Cambridge Cash Balance Approach.

(a) Fisher's Quantity Theory of Money: The quantity theory of money is a very old theory. It was first propounded in 1588 by an Italian economist, Davanzatti. But, the credit for popularizing this theory in recent years rightly belongs to the well-known American economist, Irving Fisher who published his book, 'The Purchasing Power of Money" in 1911.He gave it a quantitative form in terms of his famous "Equation of Exchange".

The general form of equation given by Fisher is

$$MV = PT$$

Where M = Money Supply/quantity of Money

V = Velocity of Money

P = Price level

T = Volume of Transaction.

Fisher points out that in a country during any given period of time, the total quantity of money (MV) will be equal to the total value of all goods and services bought and sold (PT).

MV = PT

Supply of Money = Demand for Money

This equation is referred to as "Cash Transaction Equation".

It is expressed as P = MV / T which implies that the quantity of money determines the price level and the price level in its turn varies directly with the quantity of money, provided 'V' and 'T' remain constant.

The above equation considers only currency money. But, in a modern economy, bank's demand deposits or credit money and its velocity play a vital part in business. Therefore, Fisher extended his original equation of exchange to include bank deposits M1 and its velocity V1. The revised equation was:

$$PT = MV + M^1V^1$$

$$P = \frac{MV + M^1V^1}{T}$$

From the revised equation, it is evident, that the price level is determined by (a) the quantity of money in circulation 'M' (b) the velocity of circulation of money 'V' (c) the volume of bank credit money M_1 (d) the velocity of circulation of credit money V_1 and the volume of trade (T)

Diagrammatic Illustration

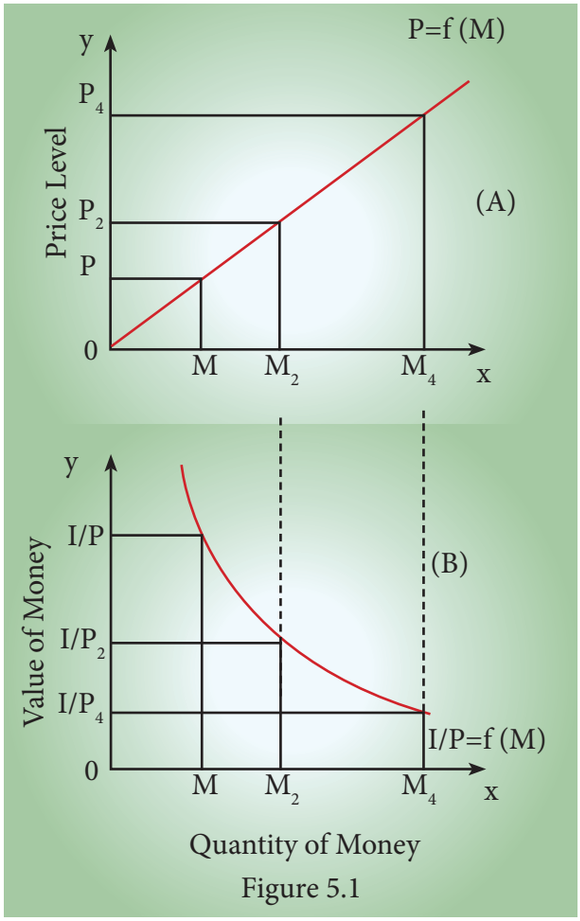


Figure 5.1

Figure (A) shows the effect of changes in the quantity of money on the price level. When the quantity of money is OM, the price level is OP. When the quantity of money is doubled to OM_2, the price level is also doubled to OP_2. Further, when the quantity of money is increased four-fold to OM_4, the price level also increases by four times to OP_4. This relationship is expressed by the curve OP = f (M) from the origin at 45^0.

Figure (B), shows the inverse relation between the quantity of money and the value of money, where the value of money is taken on the vertical axis. When the quantity of money is OM, the value of money is OI / P. But with the doubling of the quantity of money to OM_2, the value of money becomes one-half of what it was before, (OI / P_2). But, with the quantity of money increasing by four-fold to OM_4, the value of money is reduced by OI / P_4. This inverse relationship between the quantity of money and the value of money is shown by downward sloping curve IO / P = f(M).

b) Cambridge Approach (Cash Balances Approach)

i) Marshall's Equation

The Marshall equation is expressed as:

M = KPY

Where

M is the quantity of money

Y is the aggregate real income of the community

P is Purchasing Power of money

K represents the fraction of the real income which the public desires to hold in the form of money.

Thus, the price level P = M/KY or the value of money (The reciprocal of price level) is 1/P = KY/M

The value of money in terms of this equation can be found out by dividing the total quantity of goods which the public desires to holdout of the total income by the total supply of money.

According to Marshall's equation, the value of money is influenced not only by changes in M, but also by changes in K.

ii) Keynes' Equation

Keynes equation is expressed as:

n = pk (or) p = n / k

Where

n is the total supply of money

p is the general price level of consumption goods

k is the total quantity of consumption units the people decide to keep in the form of cash,

Keynes indicates that **K** is a real balance, because it is measured in terms of consumer goods.

According to Keynes, peoples' desire to hold money is unaltered by monetary authority. So, price level and value of money can be stabilized through regulating quantity of money (n) by the monetary authority.

Later, Keynes extended his equation in the following form:

n = p (k + rk') or p = n/(k + rk')

Where,

n = total money supply

p = price level of consumer goods

k = peoples' desire to hold money in hand (in terms of consumer goods) in the total income of them

r = cash reserve ratio

k' = community's total money deposit in banks, in terms of consumers goods.

In this extended equation also, Keynes assumes that, **k**, **k'** and **r** are constant. In this situation, price level (P) is changed directly and proportionately changing in money volume (n).

5.5 Inflation

Both inflation and deflations are evils of economy. So, understanding of these is essential.

5.5.1 Meaning of Inflation

Inflation is a consistent and appreciable rise in the general price level. In other words, inflation is the rate at which the general level of prices for goods and services is rising and consequently the purchasing power of currency is falling.

Definitions

" Too much of Money chasing too few goods"

- Coulbourn

"A state of abnormal decrease in the quantity of purchasing power"

- Gregorye

5.5.2 Types of Inflation

On the basis of speed

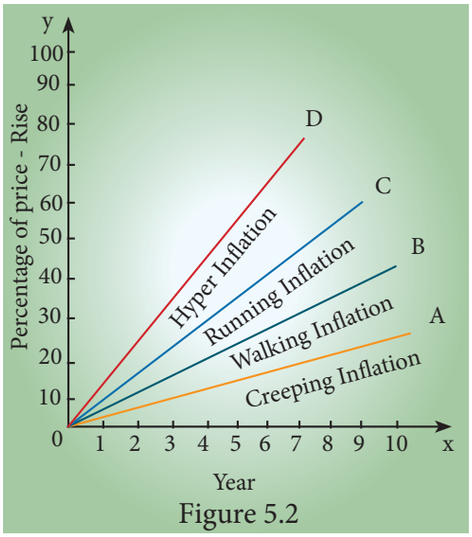


Figure 5.2

(i) Creeping inflation (ii) Walking inflation (iii) Running inflation and (iv) Galloping inflation or Hyper inflation.

The four types of inflation are indicated in Figure-5.2.

i) Creeping Inflation: Creeping inflation is slow-moving and very mild. The rise in prices will not be perceptible but spread over a long period. This type of inflation is in no way dangerous to the economy. This is also known as mild inflation or moderate inflation.

ii) Walking Inflation: When prices rise moderately and the annual inflation rate is a single digit (3% - 9%), it is called walking or trolling inflation.

iii) Running Inflation: When prices rise rapidly like the running of a horse at a rate of speed of 10% - 20% per annum, it is called running inflation.

iv) Galloping inflation: Galloping inflation or hyper inflation points out to unmanageably high inflation rates that run into two or three digits. By high inflation the percentage of the same is almost 20% to 100% from an overall perspective.

The first hyper inflation of the 21st century Zimbabwe's annual inflation rate surged to an unprecendented 3714 percent at the end of April 2007.

Demand-Pull Vs Cost-Push inflation

i) Demand-Pull Inflation: Demand and supply play a crucial role in deciding the inflation levels in the society at all points of time. For instance, if the demand is high for a product and supply is low, the price of the products increases.

Demand Pull Inflation

Too much of money chasing too few goods

ii) Cost-Push Inflation: When the cost of raw materials and other inputs rises inflation results. Increase in wages paid to labour also leads to inflation.

Wage-Price Spiral

Wage-price spiral is used to explain the cause and effect relationship between rising wages and rising prices or inflation.

Other types of inflation (on the basis of inducement)

i) Currency inflation: The excess supply of money in circulation causes rise in price level.

ii) Credit inflation: When banks are liberal in lending credit, the money supply increases and thereby rising prices.

iii) Deficit induced inflation: The deficit budget is generally financed through printing of currency by the Central Bank. As a result, prices rise.

iv) Profit induced inflation: When the firms aim at higher profit, they fix the price with higher margin. So prices go up.

v) Scarcity induced inflation: Scarcity of goods happens either due to fall in production (eg. farm goods) or due to hoarding and black marketing. This also pushes up the price. (This has happened is Venezula in the year 2018)

vi) Tax induced inflation: Increase in indirect taxes like excise duty, custom duty and sales tax may lead to rise in price (eg. petrol and diesel). This is also called taxflation.

5.5.3 Causes of Inflation

The main causes of inflation in India are as follows:

i) Increase in Money Supply: Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand. The higher the growth rate of the nominal money supply, the higher is the rate of inflation.

ii) Increase in Disposable Income: When the disposable income of the people increases, it raises their demand for goods and services. Disposable income may increase with the rise in national income or reduction in taxes or reduction in the saving of the people.

iii) Increase in Public Expenditure: Government activities have been expanding due to developmental activities and social welfare programmes. This is also a cause for price rise.

iv) Increase in Consumer Spending: The demand for goods and services increases when they are given credit to buy goods on hire-purchase and installment basis.

v) Cheap Money Policy: Cheap money policy or the policy of credit expansion also leads to increase in the money supply which raises the demand for goods and services in the economy.

vi) Deficit Financing: In order to meet its mounting expenses, the government resorts to deficit financing by borrowing from the public and even by printing more notes. This raises aggregate demand in relation to aggregate supply, thereby leading to inflationary rise in prices.

vii) Black Assests, Activities and Money: The existence of black money and black assests due to corruption, tax evasion etc., increase the aggregate

demand. People spend such money, lavishly. Black marketing and hoarding reduces the supply of goods. These trends tend to raise the price level further.

viii) **Repayment of Public Debt:** Whenever the government repays its past internal debt tothe public, it leads to increase in the money supply with the public. This tends to raise the aggregate demand for goods and services.

ix) **Increase in Exports:** When exports are encouraged, domestic supply of goods decline. So prices rise.

5.5.4 Effects of Inflation

The effects of inflation can be classified into two heads:

(1) Effects on Production and

(2) Effects on Distribution.

1. Effects on Production:

When the inflation is very moderate, it acts as an incentive to traders and producers. This is particularly prior to full employment when resources are not fully utilized. The profit due to rising prices encourages and induces business class to increase their investments in production, leading to generation of employment and income.

i) However, hyper-inflation results in a serious depreciation of the value of money and it discourages savings on the part of the public.

ii) When the value of money undergoes considerable depreciation, this may even drain out the foreign capital already invested in the country.

iii) With reduced capital accumulation, the investment will suffer a serious set-back which may have an adverse effect on the volume of production in the country. This may discourage entrepreneurs and business men from taking business risk.

iv) Inflation also leads to hoarding of essential goods both by the traders as well as the consumers and thus leading to still higher inflation rate.

v) Inflation encourages investment in speculative activities rather than productive purposes.

2. Effects on Distribution

i) **Debtors and Creditors:** During inflation, debtors are the gainers while the creditors are losers. The reason is that the debtors had borrowed when the purchasing power of money was high and now repay the loans when the purchasing power of money is low due to rising prices.

ii) **Fixed-income Groups:** The fixed income groups are the worst hit during inflation because their incomes being fixed do not bear any relationship with the rising cost of living. Examples are wage, salary, pension, interest, rent etc.

iii) **Entrepreneurs:** Inflation is the boon to the entrepreneurs whether they are manufacturers, traders, merchants

or businessmen, because it serves as a tonic for business enterprise. They experience windfall gains as the prices of their inventories (stocks) suddenly go up.

iv. Investors: The investors, who generally invest in fixed interest yielding bonds and securities have much to lose during inflation. On the contrary those who invest in shares stand to gain by rich dividends and appreciation in value of shares.

5.5.5 Measures to Control Inflation

Keynes and Milton Friedman together suggested three measures to prevent and control of inflation.

(1) Monetary measures,
(2) Fiscal measures (J.M. Keynes) and
(3) Other measures.

1. Monetary Measures: These measures are adopted by the Central Bank of the country. They are (i) Increase in Bankrate (ii) Sale of Government Securities in the Open Market (iii) Higher Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) (iv) Consumer Credit Control and (v) Higher margin requirements (vi) Higher Repo Rate and Reverse Repo Rate.

2. Fiscal Measures: Fiscal policy is now recognized as an important instrument to tackle an inflationary situation. The major anti-inflationary fiscal measures are the following: Reduction of Government Expenditure, Public Borrowing and Enhancing taxation.

3. Other Measures: These measures can be divided broadly into short-term and long-term measures.

i) Short-term measures can be in regard to public distribution of scarce essential commodities through fair price shops (Rationing). In India whenever shortage of basic goods has been felt, the government has resorted to import so that inflation may not get triggered.

ii) Long-term measures will require accelerating economic growth especially of the wage goods which have a direct bearing on the general price and the cost of living. Some restrictions on present consumption may help in improving saving and investment which may be necessary for accelerating the rate of economic growth in the long run.

5.6 Meaning of Deflation, Disinflation and Stagflation

Deflation: The essential feature of deflation is falling prices, reduced money supply and unemployment. Though falling prices are desirable at the time of inflation, such a fall should not lead to the fall in the level of production and employment. But if prices fall from the level of full employment both income and employment will be adversely affected.

Disinflation: Disinflation is the slowing down the rate of inflation by controlling the amount of credit (bank loan, hire purchase) available to consumers without causing more unemployment. Disinflation may be defined as the process of reversing

inflation without creating unemployment or reducing output in the economy.

Stagflation: Stagflation is a combination of stagnant economic growth, high unemployment and high inflation.

5.7 Trade Cycle

The economic activity in a capitalist economy will have its periodic ups and downs. The study of these ups and downs is called the study of Business cycle or Trade cycle or Industrial Fluctuation.

5.7.1 Meaning of Trade Cycle

A Trade cycle refers to oscillations in aggregate economic activity particularly in employment, output, income, etc. It is due to the inherent contraction and expansion of the elements which energize the economic activities of the nation. The fluctuations are periodical, differing in intensity and changing in its coverage.

Definition

"A trade cycle is composed of periods of good trade characterised by rising prices and low unemployment percentages altering with periods of bad trade characterised by falling prices and high unemployment percentages".

- J.M. Keynes

5.7.2 Phases of Trade Cycle

The four different phases of trade cycle is referred to as (i) Boom (ii) Recession (iii) Depression and (iv) Recovery. These are illustrated in the Figure 5.3.

Phases of Trade Cycle

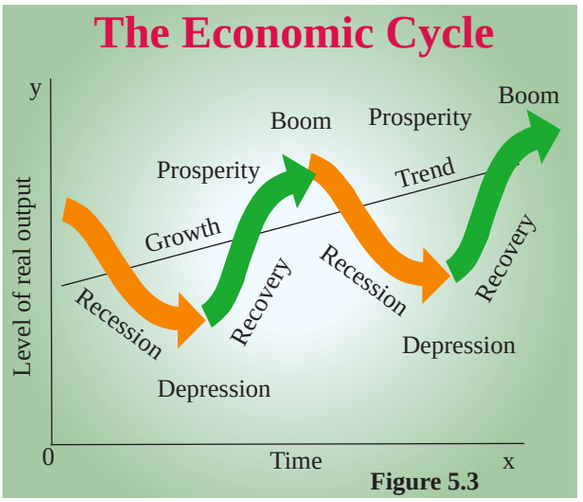


Figure 5.3

i) **Boom or Prosperity Phase:** The full employment and the movement of the economy beyond full employment is characterized as boom period. During this period, there is hectic activity in economy. Money wages rise, profits increase and interest rates go up. The demand for bank credit increases and there is all-round optimism.

ii) **Recession:** The turning point from boom condition is called recession. This happens at higher rate, than what was earlier. Generally, the failure of a company or bank bursts the boom and brings a phase of recession. Investments are drastically reduced, production comes down and income and profits decline. There is panic in the stock market and business activities show signs of dullness. Liquidity preference of the people rises and money market becomes tight.

iii) **Depression:** During depression the level of economic activity becomes extremely low. Firms incur losses and closure of business becomes a common

feature and the ultimate result is unemployment. Interest prices, profits and wages are low. The agricultural class and wage earners would be worst hit. Banking institutions will be reluctant to advance loans to businessmen. Depression is the worst phase of the business cycle. Extreme point of depression is called as "trough", because it is a deep point in business cycle. Any person fell down in deeps could not come out from that without other's help. Similarly, an economy fell down in trough could not come out from this without external help. Keynes advocated that autonomous investment of the government alone can help the economy to come out from the depression.

iv. **Recovery:** After a period of depression, recovery sets in. This is the turning point from depression to revival towards upswing. It begins with the revival of demand for capital goods. Autonomous investments boost the activity. The demand slowly picks up and in due course the activity is directed towards the upswing with more production, profit, income, wages and employment. Recovery may be initiated by innovation or investment or by government expenditure (autonomous investment).

Summary

Currency is created by the RBI and Union Government. Bank deposits are created by Commercial Banks and Co-operative Banks. The demand for money is determined by a number of factors such as income, price level, interest rate etc.

Glossary

- **Barter :** The exchange of one good for another without the use of money.
- **Money :** An asset that is generally acceptable as a medium of exchange
- **Supply of Money :** It refers to the amount of money which is in circulation in an economy at any given time
- **Inflation :** An increase in average level of prices
- **Deflation :** A fall in average level of prices, the opposite of inflation
- **Disinflation :** Process of reversing inflation without generating adverse effects.
- **Stagflation :** The co-existence of a high rate of unemployment and inflation. (derived from stag(nation) and (in) flation).
- **Trade Cycle :** The more or less regular upward and downward movement of economic activity over a period of years.
- **Recovery :** An increase in business activities after the lowest point, (i.e. depression.)
- **Narrow money :** M_1 and M_2 are is narrow money as they includes currency plus demand deposits in banks and other deposits.

MODEL QUESTIONS

H7YLDS

Part-A

Multiple Choice Questions

1. The RBI Headquarters is located at

(a) Delhi
(b) Chennai
(c) Mumbai
(d) Bengaluru

2. Money is

(a) acceptable only when it has intrinsic value
(b) constant in purchasing power
(c) the most liquid of all assets
(d) needed for allocation of resources

3. Paper currency system is managed by the

(a) Central Monetary authority
(b) State Government
(c) Central Government
(d) Banks

4. The basic distinction between M_1 and M_2 is with regard to .

(a) post office total deposits
(b) saving deposits with post office savings bank
(c) Terms deposits of banks
(d) currency

5. Irving Fisher's Quantity Theory of Money was popularized in

(a) 1908
(b) 1910
(c) 1911
(d) 1914.

6. MV stands for

(a) demand for money
(b) supply of legal tender money
(c) Supply of bank money
(d) Total supply of money

7. Inflation means

(a) Prices are rising
(b) Prices are falling
(c) Value of money is increasing
(d) Prices are remaining the same

8. _____ inflation results in a serious depreciation of the value of money.

(a) Creeping
(b) Walking
(c) running
(d) Hyper

9. _____ inflation occurs when general prices of commodities increases due to increase in production costs such as wages and raw materials.

(a) Cost-push
(b) demand pull
(c) running
(d) galloping

10. During inflation, who are the gainers?

(a) Debtors
(b) Creditors
(c) Wage and salary earners
(d) Government

11. _____ is a decrease in the rate of inflation.

(a) Disinflation
(b) Deflation
(c) Stagflation
(d) Depression

12. Stagflation combines the rate of inflation with

(a) Stagnation
(b) employment
(c) output
(d) price

13. The study of alternating fluctuations in business activity is referred to in Economics as

(a) Boom
(b) Recession
(c) Recovery
(d) Trade cycle

14. During depression the level of economic activity becomes extremely

(a) high
(b) bad
(c) low
(d) good

15. "Money can be anything that is generally acceptable as a means of exchange and that thesame time acts as a measure and a store of value", This definition was given by

(a) Crowther
(b) A.C.Pigou
(c) F.A.Walker
(d) Francis Bacon

16. Debit card is an example of

(a) currency
(b) paper currency
(c) plastic money
(d) money

17. Fisher's Quantity Theory of money is based on the essential function of money as

(a) measure of value
(b5) store of value
(c) medium of exchange
(d) standard of deferred payment

18. V in MV = PT equation stands for

(a) Volume of trade
(b) Velocity of circulation of money
(c) Volume of transaction
(d) Volume of bank and credit money

19. When prices rise slowly, we call it

(a) galloping inflation
(b) mild inflation
(c) hyper inflation
(d) deflation

20. _____ inflation is in no way dangerous to the economy.

(a) walking
(b) running
(c) creeping
(d) galloping

Answers

1	2	3	4	5	6	7	8	9	10
c	c	a	b	c	b	a	d	a	a
11	12	13	14	15	16	17	18	19	20
a	a	d	c	a	c	c	b	b	c

Part – B

Answer the following questions in one or two sentences.

21. Define Money.
22. What is barter?
23. What is commodity money?
24. What is gold standard?
25. What is plastic money? Give example.
26. Define inflation.
27. What is Stagflation?

Part – C

Answer the following questions in one paragraph.

28. Write a note on metallic money.
29. What is money supply?
30. What are the determinants of money supply?
31. Write the types of inflation.
32. Explain Demand-pull and Cost push inflation.
33. State Cambridge equations of value of money.
34. Explain disinflation.

Part – D

Answer the following questions in about a page

35. Illustrate Fisher's Quantity theory of money.
36. Explain the functions of money.
37. What are the causes and effects of inflation on the economy?
38. Describe the phases of Trade cycle.

ACTIVITY

1. Ask the students to visit anyone of the public sector or private sector nationalized banks to know the types of savings such as current account deposits, savings deposits, fixed deposits, interest rate and facilities.
2. Make the students to collect ancient period coins, currency notes and also Indian and foreign countries coins and currency notes.

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