QB365 Question Bank Software Study Materials

Monetary Economics Important 2,3 & 5 Marks Questions With Answers (Book Back and Creative)

12th Standard

Economics

Total Marks : 75

2 Marks

10 x 2 = 20

1) Define Money.

Answer : (i) Money is, what money does - Walker:

(ii) 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.

2) What is barter?

Answer : (i) Exchange of goods for goods.

(ii) Commodities and services were directly exchanged for other commodities and services.

3) What is commodity money?

Answer : (i) Surplus goods were exchanged for money which in turn was exchanged for other needed goods.

(ii) Goods like furs, skins, salt, rice, wheat, utensils, weapons were used as money

4) What is gold standard?

Answer : (i) The value of the monetary unit is directly linked with a certain weight of gold.

(ii) The purchasing power of a unit of money is maintained equal to the value of a fixed weight of gold.

5) What is plastic money? Give example.

Answer : (i) Plastic money refers to the hard plastic cards used everyday in place of actual bank notes.

(ii) They aim at removing the need for carrying cash to make transactions.

(iii) (E.g.) Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards.

6) Define inflation.

Answer : (i) "Too much of Money chasing too few goods" - Coulbourn

(ii) "A state of abnormal increase in the quantity of purchasing power" - Gregorye

7) What is Stagflation?

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

8) Write about “Money as a Standard of Deferred Payments” in short.

Answer : (i) Borrowing and lending were difficult problems under the barter system.

(ii) In the absence of money, the borrowed amount could be returned only in terms of goods and services.

(iii) But the modern money-economy has greatly facilitated the borrowing and lending processes.

9) What are the other names for M1, M2, M3 nd M4 Money?

Answer : (i) M1 and M2 are known as narrow money

(ii) M3 and M4 are known as broad money

10) What is Reserve deposit Ratio (RDR)?

Answer : Reserve Money consists of two things (a) vault cash in banks and (b) deposits of commercial banks with RBI.

3 Marks

10 x 3 = 30

11) Write a note on metallic money.

Answer : (i) After the barter system and commodity money system, modern money systems evolved.
(ii) Metallic standard is the premier one.
(iii) Some kind of metal, gold or silver is used to determine the standard value of the money and currency.
(iv) Standard coins made out of the metal are the principal coins used under the metallic standard.
(v) These Standard coins are full bodied or full weighted legal tender.
(vi) Their face value is equal to their intrinsic metal value.

12) What is money supply?

Answer : (i) Money supply means the total amount of money in an economy.
(ii) It refers to the amount of money which is in circulation in an economy at any given time.
(iii) Money supply determines the price level and interest rates.
(iv) Money supply viewed at a given point of time is a stock and over a period of time it is a flow.

13) What are the determinants of money supply?

Answer : **Currency Deposit Ratio (CDR):**
It is the ratio of money held by the public in currency to that they hold in bank deposits.
Reserve deposit Ratio (RDR):
Reserve Money consists of vault cash in banks and deposits of commercial banks with RBI.
Cash Reserve Ratio (CRR):
It is the fraction of deposits the banks must keep with RBI.
Statutory Liquidity Ratio (SLR):
It is the fraction of the total demand and time deposits the commercial bank must keep with itself.

14) Write the types of inflation

Answer : (i) On the basis of speed there are four types of inflation - Creeping inflation, Walking Inflation, Running inflation, Galloping inflation.
(ii) Demand-Pull inflation, Cost-Push inflation.
(iii) On the basis of inducement - currency inflation, credit inflation, deficit induced inflation, profit induced inflation, scarcity induced inflation, tax induced inflation.

15) Explain Demand-pull and Cost push inflation.

Answer : **Demand-Pull Inflation:**
(i) Demand and supply decide the inflation level.
(ii) If the demand is high for a product and supply is low, the price of the products increase.
Cost-Push Inflation:
(i) When the cost of raw materials and other inputs rises inflation results.
(ii) Increase in wages paid to labour also leads to inflation.

16) State Cambridge equations of value of money.

Answer : (i) The Marshall equation is
M = KPY where
(ii) M is the quantity of money
(iii) Y is the aggregate real income of the community
(iv) P is purchasing power of money
(v) K is the fraction of the real income which the public desires to hold in the form of money.
P= M / KY
(vi) The value of money is 1 / P = KY / M.

17) Explain disinflation.

Answer : (i) It 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.
(ii) It is defined as the process of reversing inflation without creating unemployment or reducing output in the company.

18) Explain the concept of Plastic Money.

Answer : (i) The latest type of money is plastic money.
(ii) Plastic money is one of the most evolved forms of financial products. Plastic money is an alternative to the cash or the standard "money".
(iii) 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.
(iv) 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.

19) What are the Contingent Functions?

Answer : **(i) Basis of the Credit System:** Money is the basis of the Credit System. Business transactions are either in cash or on credit.
(ii) Money facilitates distribution of National Income: The task of distribution of national income was exceedingly complex under the barter system.
(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.
(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.

20) Explain Effects on Production of Inflation.

Answer : When the inflation is very moderate, it acts as an incentive to traders and producers. 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.
(ii) When the value of money undergoes considerable depreciation, this may even drain out the foreign capital.
(iii) With reduced capital accumulation, the investment will suffer a serious set-back which may have an adverse effect on the volume of production.

5 Marks 5 x 5 = 25

21) Illustrate Fisher's Quantity theory of money.

Answer : **Introduction:**

(i) It was first propounded in 1588 by an Italian economist Davanzatti. It was popularised by an Americill economist, Irving Fisher is his book, "The Purchasing Power of Money" in 1911. He gave it a quantitative form in terms of "Equation of Exchange".

Equations:

MV = PT

(i) The Supply of Money = Demand for Money

M = Money Supply

V = Velocity of Money

P = Price level

T = Volume of Transaction.

(ii) The total quantity of money will be equal to the total value of all goods and services bought and sold.

$P=\frac{MV}{T}$

(iii) The quantity of money determines the price level and the price level varies directly with the quantity of money provided 'V' and 'T' remain constant.

(iv) Later Fisher extended his exchange to include bank deposits M_1 and its velocity V_1.

$PT=MV+M'V'$

$P=\frac{MV+M'V'}{T}$

- The price level is determined by

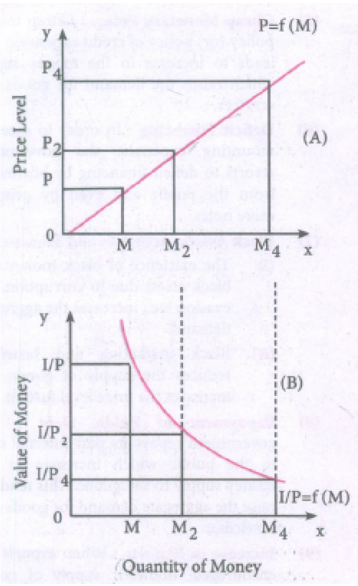
(a) quantity of money in circulation M

(b) velocity of circulation of money V

(c) volume of bank credit money M_1

(d) velocity of circulation of credit money V_1

(c) Volume of trade ('T')



(i) It show's the effect of changes in the quantity of money on the price level.

(ii) When quantity of money is OM_1, the price level is OP_1.

(iii) When the quantity of money is doubled to OM_2, the price level is also doubled to OP_2.

(iv) When quantity of money is increased four-fold to OM_4, the price level also increases by 4 times to OP_4 his relationship is shown by the curve OP = f(M) from the origin at 45°.

Quantity of money

(i) Fig B shows the inverse relation between the quantity of money and the value of money.

(ii) Value of money is taken on the vertical axis.

(iii) When the quantity of money is OM_1, the value of money is OI / P_1.

(iv) When quantity of money is doubled to OM_2, the value of money becomes one half of what it was before (OI / P_2)

(v) When quantity of money increases by the four fold to OM_4, the value of among is reduced by OI / P_4

(vi) This inverse relationship between the quantity of money and the value of money is shown by downward sloping curve 1 / OP= f(M).

22) Explain the functions of money

Answer : **(i) Primary Functions:**

Medium of exchange:

(i) Money has general acceptability and all exchanges take place in terms of money.

(ii) First, money is got through sale of goods or services.

(iii) Later, money is used to buy goods and services.

(iv) Thus, in the modern exchange system money acts as the intermediary in sales and purchases.

Measure of value

(i) Money measures the value of goods and services.

(ii) Prices of all goods and services are expressed in terms of money.

(iii) 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.

(ii) Secondary Functions:

Store of value:

(i) Savings is done in terms of money.

(ii) Money is a store of wealth, as it can be easily converted into other marketable assets such as land, machinery, plant.

Standard of Deferred Payments:

(i) Borrowing and lending is done in money.

Means of Transferring Purchasing Power:

(i) The field of exchange went on extending with growing economic development.

(ii) The exchange of goods is now. extended to distant lands.

(iii) So it is necessary to transfer purchasing power from one place to another.

(iii) Contingent Functions:

Basis of the Credit System:

(i) Business transactions are either in cash or on credit.

(ii) A depositor uses cheques only when there are sufficient funds in his account.

(iii) The commercial banks create credit on the basis of adequate cash reserves.

(iv) Money is at the back of all credit.

Money facilitates distribution of National Income:

(i) Money is used in the distribution of income as rent, wage, interest and profit.

Equalize Marginal Utilities and Marginal Productivities:

(i) Consumer gets maximum utility only if he incurs expenditure on various commodities in such a manner as to equalize marginal utilities accruing from them.

(ii) Here, money plays an important role, because the prices of all commodities are expressed in money.

(iii) Money helps to equalize marginal productivities of various factors of production.

Increases Productivity of Capital:

(i) Money is the most liquid form of capital.

(ii) It can be put to any use.

(iii) So it can be transferred from the less productive to the more productive uses.

(iv) Other Functions:

Maintains Repayment Capacity:

(i) Money has general acceptability.

(ii) To maintain its repayment capacity, every firm has to keep assets in the form of money.

(iii) Firms, banks, insurance companies and governments have to keep some liquid money (i.e., cash) to maintain their repayment capacity.

Represents Generalized

Purchasing Power:

(i) Purchasing power kept in terms of money can be put to any use.

Gives liquidity to Capital:

(i) Money is the most liquid form of capital & so can be put to any use.

23) What are the causes and effects of inflation on the economy?

Answer : **Causes:**

Increase in Money Supply:

1. Increase in money supply leads to increase in aggregate demand.

2. The higher the growth rate of nominal money supply, the higher is the rate of inflation.

Increase in Disposable Income:

1. When disposable income increases, it raises their demand for goods and services.

2. Disposable income may increase with the rise in national income or reduction in taxes or saving of the people.

Increase in Public Expenditure:

1. Government activities have been expanding due to developmental activities and social welfare programmes.

2. This is also a cause for price rise.

Increase in Consumer Spending:

1. The demand for goods and services increases when they are given credit to buy goods on hire-purchase and instalment basis.

Cheap Monetary Policy:

1. Cheap monetary policy leads to increase in the money supply which raises demand for goods and services.

Deficit Financing:

1. To meet the expenses, government resorts to deficit financing by borrowing from the public and even by printing more notes.

2. This raises aggregate demand leading to inflation.

Black Assets, Activities and Money:

1. It leads to corruption, tax evasion.

2. People spend black money lavishly.

3. Black marketing and hoarding reduces the supply of goods and increases.

Repayment of Public Debt:

1. Whenever government repays its past internal debt to the public, money supply increases.

Increase in Exports:

1. When exports are encouraged, domestic supply of goods decline, prices rise.

Effects:

On Production:

1. When inflation is very moderate it is an incentive to traders and producers.

2. When profit increases the business men increase their investments in production leading to more employment and income.

3. Hyper inflation leads to depreciation of the value of money and discourages savings.

4. It may even drain out the foreign capital already invested in the country.

5. The reduced capital accumulation, discourage entrepreneurs and business men from taking business risk.

6. Inflation also leads to hoarding of essential goods by traders and consumers leading to still higher inflation rate.

7. Encourages investment in speculative activities rather than productive purposes.

On Distribution:

Debtors and Creditors:

1. During inflation debtors are the gainers.

2. 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.

Fixed-income Groups:

1. They are worst hit because their incomes being fixed has no relationship with the rising cost of living.

Entrepreneurs:

1. Inflation is a boon to manufacturers, traders, merchants, businessmen, because it serves as a tonic for business enterprise.

2. They get windfall gains as the prices of their stocks suddenly go up.

Investors:

1. Those who invest in fixed interest yielding bonds and securities lose during inflation.

2. Those who invest in shares stand to gain by rich dividends and appreciation in value of shares.

24) Describe the phases of Trade cycle.

Answer : **Boom or Prosperity:**

1. The employment and the movement of the economy beyond full employment is the characterized features of boom.
2. There is hectic activity, money wages rise, profits increase, interest rates go up, demand for bank credit increases.
3. There is all round optimism.

Recession:

1. The turning point from boom condition is recession.
2. Failure of a company or bank brings a phase of recession.
3. Investments are drastically reduced, production falls, income and profits decline.
4. There is panic in the stock market and business is dull.
5. Liquidity preference of the people rises and money market becomes tight.

Depression:

1. The level of economic activity becomes extremely low.
2. Firms incur loss and close down resulting in unemployment.
3. Interest rate, profits, wages are low.
4. Agricultural class and wage carners are badly affected.
5. Banks do not lend to businessmen.
6. The extreme point of depression is called as "trough".
7. Keynes said that autonomous investment of the government can help the economy to come out of depression.

Recovery:

1. After depression, recovery sets in the upswing.
2. It begins with the revival of demand for capital goods.
3. The demand slowly picks up and in due course there is more production, profit, income, wages and employment.
4. Recovery may be initiated by innovation or investment or by government.

25) Distinguish between Fisher's and Cambridge Equation.

Answer :

Base of difference	Fisher's Equation	Cambridge's Equation
1. Flow and stock of Money	Fishers's equation gives importance to flow of money	Cambridge's equation stress on stock of money.
2. Natural of Price Level	P represents the average price level of all goods and services.	P represents the price of consumer goods.
3. Stress on Demand Supply	Fisher's viewpoint stress on supply of money	Cambridge's viewpoint stresses on demand of money
4. Time	It is associated with a period of time	It is associated with the point of time
5. Demand of Money	According to Fisher, the Demand of money is for actual transactions	According to Cambridge ideology, the demand of money is for the storage of money.