Q # 1 **discuss various kinds of bank**
OR

What is bank? Explain different kinds of banks.

OUTLINE
Introduction & history of Bank
Definition
Simple definition
Expert Views
Comprehensive Definition
Types of banks
On the basis of Function
On the basis of Ownership
On the basis of Registration

History of bank

Money is very important and necessary to satisfy human wants. Man has been needy in every era due to which the collection and supply (receipts and payments) of money has been an essential part of human life. Different commodities have been used as money in different ages, like, stones, metals, animals, different eatables and minerals. The concept of money, its sources and uses have been passing through from the revolutionary stages along with the evolution of human culture. Even a good number of people directly started dealing in money e.g. merchants, gold smiths, and money lenders etc. the concept of loan, interest, written documents i.e. cheque a bill of exchange came into time light only because of them

Origin of the word **"BANK"**

Opinion differs regarding the origin of the word "BANK". According to some authorities, the word "**BANK**' is derived from the Italian word "**BANCO", "BANCUS**". Which mean that "a bench upon which Italian money changers used to sit with their cons to transact business".
The German experts says about the word "BANK" is originally derived form the word "**BACK**" which means a join stock firm or

fund. This word was Italianized into "Banco" when Germans were masters of great part of Italy.
Generally it is said that "A financial institution which deals in money and credit. It borrows and lends money and credit. It borrows money and lends money and in this way acts as financial intermediary between the lender and borrower"
We can simply say that

"The banker is a man who lends you an umbrella when it rains, and takes it away when the weather is fair".

Definitions:

Simple definition:

- "Banks are Financial Departmental stores"

Experts Views:

Prof Kinley views:

"A bank is an institution which receives deposits and advances loans"

According to H.L.Hart

"A banker is one who, in, the ordinary course of his business, honours cheques drawn upon him by persons from or for whom he receives money or current account".

According to Prof. Crowther

"A bank collects money form those who have it spare or who are saving it out of their incomes. It lends money to those who require it."

Comprehensive Definition

According to Banking companies' ordinance 19

"Banker means a person transacting the business of accepting for purpose of lending or investing of money from the public, repayable on demand or otherwise with draw able by cheque, draft, and order or otherwise.

Kinds of Banks:-

(a) On the basis of Functions

(b) On the basis of Ownership

(c) On the basis of Registration

(d) On the basis of Domicile

Functional Classification:-

(i) Commercial Banks:-

The most popular kind of banks is the commercial bank receives surplus money from the public and lends to others who needs funds. The bank collects cheques, Bill of exchange etc for customers .Its transfers money from one place to another. The purpose of a commercial bank is to earn profit. The main commercial banks of Pakistan are National Bank, Habib Bank, Allied Bank, United Bank, MCB etc. These banks play a vital role in economic development.

Central Bank:-

Central bank is the most important bank of any country. Almost all countries of the world now have central bank. The central bank is the leader of all other banks. It does not compete for profit. It has a right to note issue. It controls the operations of other banks for monetary and economic stability in country. The central bank represents the Govt in International conferences.

Industrial Banks:-

The industrial bank is very important for the development of any country. To provide medium and long-term finance to industry is the distinguishing Features of these banks. Industrial banks generally provide finance for fixed capital requirement. They provide finance for expansion, modernization and establishment Bank (IDBP) was set up in 1961. The other institution engaged in providing financial assistance to industries are PICIC, NDFC, SME, etc.

Agricultural Banks:-

Pakistan is an agricultural country and most of our exports consist of Agro-based products. So well organized agriculture sector is necessary for the development of a country. Agricultural banks provide loan for this purpose. ADBP, Agriculture credit advisory committee and rural credit banks are the few examples of "Agriculture Banks in Pakistan"**.**

Saving Bank:-

The banks are established for encouraging and collecting savings of people. Saving banks are not banks in the real sense of term. They only provide saving facility. These banks usually invest their funds in Govt securities. The well-Known Post Office savings Banks is an institution of this type. Commercial banks are also providing the service of saving banks in Pakistan**.**

Investment Banks:-

The bank is opened to buy and sell shares and other securities. It also provides loans for purchase of shares and debenture etc. It keeps new companies by under writing the share, bonds & other securities.

At the end of June, 1992 Seventeen investment Banks, both Pakistani and foreign were functioning in Pakistan.

Merchant Bank:-

The bank provides services like acceptance of bills of exchange, corporate finance, Leasing, hire-purchase and insurance broking. It is a whole sale bank and accepts large sums for fixed term from individual, companies and financial institutions.

Baring, lazards are examples of Merchant Bank.

Consortium Banks:-

A Consortium bank is owned by other banks. The bank is formed to meet the financial requirements of large companies for long period of time. The bank receives the funds from the parent Bank. It can also arrange syndicate loans.

International energy Bank, British Middle East Bank, Orion Bank are the examples of consortium Banks.

Labour Bank:-

The Bank is opened by trade union of labourers. The purpose of this bank is to manage worker funds like pension funds, Provident fund etc in a better way. The Labourers also keep their saving in it. The bank provides loans to the concerns which are under the control of trade union. E.g. Union Bank, Saving Bank of Chicago, State Bank of Kansas city.

School Bank:-

The banks provide banking facilities to the students in schools. The boxes or bags are supplied to the students who keep their saving in boxes. Accounts are opened in the name of students. The bank officers go to the school after regular interval and collect the amount of their saving. In U.S.A Beloit saving Bank started working school bank in 1882.

Mortage Bank :-

These banks provide loans to people against moveable and immovable property. HBFC is doing the working of Mortage Bank.

Cooperative Bank:-

These banks are set up to provide credit facilities to farmers and small producers. The bank is opened by persons of similar occupations living in same areas for providing banking facilities. In Pakistan the Co-Operative bank registered under the Co-Operative societies Act 1925 and can be registered with registrar of Co-Operative societies at provincial headquarters.

On the Basis Of Ownership:-

Public sector Bank:-

Such banks are owned by government and works under the direct control of the government. The chief executive of such banks is appointed by federal government. NBP are examples of public sector banks, First woman Bank.

Private Sector Bank:-

These banks are under the direct ownership of the private organization of Co-Operative Societies. The banks are controlled by the individuals or Pvt Organization, MCB, ABL and KASB Bank is the examples.

On The Basis Of Registration:-

Scheduled Bank:-

These are the banks which are registered in the list of central bank. They are bound to follow the instruction and policies of central bank.

Non Scheduled Banks:-

These are the banks which are not registered in list and policies, Instruction of central Bank.

On The Basis Of Domicile:-

Domestic Bank:-

The banks which are registered and incorporated with in the country are called domestic bank. These banks provide financial assistance domestically. In Pakistan the banks regulated under Pakistan Banking companies' ordinance 1962 are domestic banks. E.g. N.B, H.B.L, Askari Bank are examples of Domestic banks.

Foreign Bank:-

The bank which have their origin and head offices in foreign country are called foreign bank. Foreign banks are the branches of the banks incorporated abroad. The standard chartered Bank Ltd, National and Grind lays Bank Ltd, Al-Falah Bank Ltd are examples of foreign banks.

Q # 2 Define Commercial bank. Discuss the functions of commercial bank

Outline

Introduction & history of Bank

Definition

Simple definition

Expert Views

Comprehensive Definition

Functions of commercial bank

Primary functions

Secondary functions

Agency functions

Utility functions

Conclusion

A commercial bank is public limited company it is set up under companies' ordinance 1984. The operations of commercial banks are controlled under banking companies' ordinance 1962. Foreign exchange ACT 1947 and state bank of Pakistan ACT 1956. The bank receives deposits from general public. Different accounts are opened to collect money. The bank keeps some money to honour cheques of customers. A large part of such money is provided to people as loans. The bank is important for government, businessman and general public.
Commercial bank plays very important role in economic development of the country it is often called the HEART of financial system of an economy.

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Functions of commercial banks

Primary Functions

1. Accepting deposits

Bank accept deposits form those who have extra money out of their income in their hands, but they can't use it in a profitable way so banks give them opportunity to deposit their money and enjoy profit.

a. Current Account

In this account the depositor can deposit and withdraw money at any time. Normally traders, businessmen, are interested to open this account bank pays no interest on this accounts. A cheque book is given to the account holder to with draw his money.

b. Profit & Loss sharing OR saving account

This account is suitable for those people who have small level of savings. In this account a nominal interest is paid to customer cheque book is given to account holder.

c. Fixed OR term deposits account

In this account a specified amount is deposited in the bank for particular period of time. The longer the duration the higher would be the interest. In this account, a receipt is given to customer, called fixed deposit receipt (FDR).

2. Advance loans

The bank gives loans in order to earn profit. In this way it accepts deposits at low rate of interest and advances loan at high rate of interest. The difference becomes profits of the bank. Advances are given in the following types.

a. Over Draft

This is a shot period financing facility. In this facility the bank sanctions that the customer can withdraw his money over and above the balance lying in the bank. This facility is provided to current account holders.

b. Discounting Bills of Exchange

Its mean, making payment before the maturity of the bill the payment made the bank before the date of maturity is the loan to the bill holder.

c. Cash credit

In this loan facility the bank sanctions a particular amount. The facility is provided against security.

d. Time loans

- **Short term loan** in which the time period is less than one year.
- **Medium term loan** for period of 1 to 3 or 5 years
- **Long term loan for** period of more than 5 years and the entire loan are given against proper security.

Secondary functions

1. Transfer of money

The banks transfer money form place to place by means of draft collection of cheques telephonic transfer and direct debt. The banks purchase bills of exchange to help their customer for collection of money.

2. Issue of credit money

 The banks issue various types of near money the cheques bank draft credit car, are main instrument which is valid as medium of exchange to settle their obligations.

3. Investment of funds

 The banks can invest funds in stocks shares and bounds. As per law commercial banks at least 25% of their deposits in securities.

4. Financing foreign trade

 The bank performs duty of financing foreign trade. The respites and payment on accounts of exports and imports is possible through bank.

5. Foreign exchange dealing

 The bank deal in foreign exchange they buy and sell currencies of other countries. The commercial banks are dealer of foreign exchange market.

6. Status report

 The commercial bank act as referee for supply of information about its customer, relating to financial position of party concerned.

Agency Functions

1. Collection of cheque

 A commercial bank acts as agent to the customer to collect and make payment on the cheques. The cheques may be local or out station.

2. Collection of income

 Banks collect pension, dividend, rent and interest of their customers. A credit voucher is sent to customer for information.

3. Payment of expenses

 The bank makes payment of insurance premium trade subscription, school fee and similar other expenses.

4. Act as trustee

 The bank can act as trust to mange trust property as per will of property owner. The order of court is obtained to act as trustee. (Takes care affairs of its client)

5. Tax return

The bank act as agents of customers, those are bound to pay tax to government.

6. Hajj application
   The bank collects Hajj application from general public on behalf of government.
7. Safe custody
   The bank accepts valuables and other papers for safe keeping. A nominal fee is charged from customer.
8. Zakat deduction
   The bank automatically deduct Zakat on first Ramzan every year from his customer accounts

Utility functions

1. Letter of credit
   Commercial banks issue letter of credit in order to provide financial assistance to the customers dealing in foreign trade.
2. Information
   The banks collect and supply trade information to businessman the issue bulletins that provide update information abut companies working abroad.
3. Govt loans
   The banks participate in debt management for government. The bank can buy bonds, and others securities offered by central bank
4. Lockers facility
   Banks provide lockers facility to general public gold ornaments, documents and their valuables can be placed in lockers.
5. Share application
   Bank accepts applications for subscription of shares on Behalf Company the price of shares is collected with application money.
6. Accepting bills of exchange
   Banks accept bills of exchange on behalf of customers to meet their financial needs.

Conclusion

"Commercial banks play a vital role in promotion economic development by mobilizing the financial resources of the country. As well as through commercial banks provided multiple services to their customers for the purpose of increasing their business and becoming reliable entity for their customers"

Q# 3what is central Bank? Explain its function in detail? Or discuss in detail the function of state Bank of Pakistan

Outline

Introduction & history of Bank

Definition

Simple definition

Expert Views

Comprehensive Definition

Objectives of central bank

Functions of central bank

Conclusion

Introduction & history of central bank

Money and credit play a very important role in modern society. We can derive maximum benefit from money and credit if their supply can be kept with in reasonable limits. Otherwise they will give rise to many social evils. Money supply takes place through commercial banks and other financial institutions .They primarily to serve their own interest.

The central banking system was originated in different countries during the last century. But it was in a very crude form during that time. The modern system of central banking particularly developed in the 1st half of the present century (i.e. the 20th century). The need f the present century banking system was strongly felt during the financial crisis caused by First World War (1914_1918).

After the war there was complete confusion in currency and exchange markets. There were large with drawls of money from banks. The bank reserves fell below the needed level. There was no institution which could supervise the working of banks and also serve as a fiscal agent. In order to solve the monetary problems of the countries and set them on healthy footing, a conference was held at Brussels in 1920. It was decided in that conference that to control the supply of money and credit in the economy and maintain stable business conditions, each country must establish its own central bank.

Central bank is the most important bank of a country. Its important has increased manifold during past 50 years. It is the symbol of financial sovereignty and stability of the country. It is head of banking and monetary system. The principles on which a central bank operates are different from those of commercial bank. It does not work for profit. It acts in the public interest and earning profit is only a secondary consideration.

Evolution & Growth

The Riksbank of Sweden was set up in 1656 and declared as central bank in 1668 and is considered to be the old of the central banks. The Bank of England was established in 1694. The Bank of France was set up in 1800. The national bank of Denmark was opened in 1818 and National bank of Belgium in 1850. The Reich's Bank of Germany was made in 1875. In U.S.A Federal Reserve System was set up in 1914. The Reserve Bank of India was formal in 1935 and the State Bank of Pakistan was established on July 1, 1948.

Organization of Central Bank

The organization of central bank differs from country to country. So it is difficult to speak of single types as a standard. There are central banks which are owned and managed by the private shareholders, such as the federal reserve system of the U.S.A. There are other central banks, The Bank of England, The Bank of France which are fully owned and managed by the government. Again there may be central banks which are jointly owned and managed by the government and Pvt Shareholders. UP to Dec 1973, the State bank of Pakistan was a government and private shareholders bank. Under The Bank Nationalization Ordinance 1974, The State Bank of Pakistan has become purely government owned institution. Today no central Bank is completely free the government influence.

Definition of central bank

Simple defection

"A Central bank is a bank, which controls credit

Expert views

According to Dr De. Kock:-

"The guiding principle of a central bank is that it should act only in the public interest for the welfare of the country as a whole and without regard to profits as a primary consideration"

In words of Prof. Hawtry,s:-

"A central bank is that which is lender of last resort"

Comprehensive definition

According to R.P.Kent:-

"An institution which is charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of general public welfare"

Objective of Central Bank

Following are the principles/objectives of central bank:-

1-Safeguarding Financial Stability:-

The main objective of the central bank is to protect and safeguard economical and financial stability. It is established in order to design and implement policies to avoid depression and unwanted fluctuations in economy.

2-**<u>Working In Public Interest</u>:-**

Central bank works in the best interest of the economy and public. It does not give advances, not it allows any interest on deposits. It performs its function without any consideration of profit.

3-**<u>Supervision Of Banking System</u>:-**

Central bank object is to have supervision and effective control over commercial banks structure, central bank set guidelines for commercial bank, and parameters in which commercial banks are allowed to perform their operation.

4-**<u>Control Of Credit & Money Supply</u>:-**

Central bank object is to exercise effective control over credit and currency supply in the economy. It has a sole monopoly over note issue and it constantly keeps an eye on the supply of currency in the economy. It also watches the credit creation of commercial bank.

5-<u>Accommodation Commercial Banks</u>:-

It saves commercial banks from bank runs and panics. It case commercial banks find any difficulty in meeting their liabilities; the central bank comes to their help.

6-**<u>Ensuring Economic Development</u>:-**

The objects of central bank are by direct finances towards important sectors of the economy and ensure that credit requirements of such sectors are full filed.

Function of central bank

A central bank usually performs the following function:-

Monopoly of Note Issue

In early periods of banking development, all banks used to issue their own notes. This caused confusion, frequent trouble, over issued, causing high inflation and economic crisis. At present through out the world, central banks have the sole right of issuing currency notes. In Pakistan "State Bank of Pakistan" issues the currency notes of worth five to Rs 5000, (5, 10, 20, 50, 100, 500, and 1000). The main propose of giving the monopoly right of note issue area as under:-

- Uniformity in the system of note issue.
- The central bank can exercise better control over money supply.
- It increases public confidence.

There are two principles of note issue:

- Banking principles
- Currency principles

Banker to the Government

Central bank is the banker to the Government. It means that central bank provides some important services for Government as:

- Control of gold and other reserves of Government.
- Keeps the Government account.
- Principle advisor of Govt (Regarding annual budget, taxation system, international trade and foreign exchange reserves etc).
- To formulate of lending facility (For various projects).
- Agent to Govt (Attending national and international conference on behalf of Govt).

Banker's Banks

The control bank acts as banker to commercial bank as:

- It holds cash reserves and deposits of commercial banks.
- Discounting of bill of exchange of commercial banks.
- Enabling the commercial banks to create credit.
- Clearing house facility (i.e. the settlements of mutual claims of commercial banks).
- Lender of last resort (Granting of loans to commercial banks in the days of financial crises).
- Establishment of new banks (Prior permission necessary).
- The advance policy (Keeping in mind the influence of rate of interest).
- Every commercial bank sends a monthly statement of its assets and liabilities to central bank.

Lender of last Resort

Central bank is the lender of last resort to the commercial banks. It means that whenever the scheduled commercial banks are short of funds and are unable to get help from anywhere, it is the central bank which provides them loans and brings them out of trouble. A commercial bank gets loans from other banks in normal routine. But when they do not get such help, they approach the central bank.

Clearing House

Central bank also performs the functions of a clearing house. Since central bank holds the cash reserves of other bank, it easily helps to settle their mutual obligation. Payments by one bank to another are settled through central bank. Daily, in every bank, people deposit cheques which are to be drawn from other banks. In this way every bank has to receive amounts on behalf of its customers and has to make payments on behalf of them. But the banks do not get cash from each other. They settle their accounts with the help of central bank. Every bank has account at central bank, so funds can be transferred from the account of one bank to other bank.

Controller of credit

The central bank also regulates and controls the supply of money in the country. In order to manage the supply of money it implements monetary policy. The important tools of monetary policy are bank rate open market operation and varying reserve requirement.

Maintenance of exchange rate & foreign exchanges

The whole business of foreign exchange control and financing of international trade is done be the central bank. And give the suggestion to the govt. in case of balance of payment. As well as it control the forging exchange rate because a stable rate is promote the forging trade

Role in economic development

Through polices of central bank of any country is directly influence the rate of economic development. It establishes financial institutions with the help of it countries takes suitable measure to promote economic development.

Supervision

The central bank can supervise activities of bank management. The bank has powers to look after working of commercial banks. If commercial banks are not follows the policy of central bank then the central bank imposed fine on banks.

Other functions

- Representation in international financial institution (World Bank, IMF)

- Industrial and agricultural bank
- Publication of annual report
- Establishment of training institutes

Conclusion

Central bank play very important role in the economy, the policies of the central bank beneficial for the country as well as commercial banks, with the help of it rate of inflation becoming increase after it economic development started.

CENTRAL BANK	**COMMERCIAL BANK**
1. FROMMATION The central bank is formed under an act of parliament or ordinance	The commercial bank is formed under the companies law
2. Ownership The share capital of the central bank is owned by the government or people	the share capital of the commercial bank is owned by the public
3. Management The management and employees are appointed by the government	The management and employees are appointed by the board of directors.
4. Number of bank There is only one central bank for every country.	There are many commercial banks in every country.
5. Branches The central bank has only inside branches. It has no foreign branches	The commercial banks have inside and as well as outside branches.
6. Aim The aim of central bank is to maintain monetary and economic stability therefore profit is not the aim of the central bank	The basic aim of commercial bank is to earn profit.
7. Issue of money The central bank can issue currency money	The commercial bank can issue cheque, credit card and visa card. The individual, partnership, limited companies are the

like Rs. 5, 10,50,100, 500, 1000, 5000 8. **Account holder** The government and commercial banks is the accounts holder of the central bank. 9. **Adviser** The central bank advises the government on financial matters.	accounts holder of commercial bank The commercial banks advise their customers for investment of business consultancy

CENTRAL BANK	COMMERCIAL BANK
10. Nature of accounts The central bank opens the government accounts under various head of accounts	The commercial banks open current, saving, PLS, fixed deposit accounts.
11. Money market Central bank is leader of money market	The commercial bank is the member of money market
12. Credit controller The bank controls the volume of credit through various methods.	The commercial bank creates credit according to money available.
13. Exchange control It is the controller of foreign exchange.	It is the authorized dealer in foreign exchange under the supervision of central bank.
14. Wind up The central bank can not be closed up even if working at loss.	The commercial bank can be closed up if the management decides due to loss.
15. Foreign payment It makes the foreign payment on behalf of the government.	It makes the foreign payment for customers due to import of goods and services.
16. **Transfe**r It transfer money from one place to	It transfers the money from place to place for the people.
	It provides loans, cash credit and overdraft to the customers.

another for the government and banks	
17. Loans If arranges loans for the government and provides loans to commercial banks as lender of last resort.	It discount the bills of the customers They assist the central bank for achieving monetary stability.
18. Discounting bills It discount the bills of the commercial banks	The commercial bank can not issue currency notes
19. Monetary stability It is responsible for the money tray stability of a country.	The commercial bank does not have direct relation with international financial institutions
20. Right to issue notes The central bank has the sole right to issue currency notes	
21. Relations with international financial institutions It holds relations with international financial intuitions such as IMF, World	

Q #5 defines the term banker and customer. What is the relationship between them? And

discuss the reason for termination of relationship.

Outline

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Definition

Banker
Customer

Relationship

General relationship
Special relationship

Termination of relationship

Banker
Definition
G. crowther

"A banker is a dealer in debt of his own and other peoples"

J.W.Gilbert

"A banker is a dealer in capital or more properly a dealer in money. He is an intermediate party between the borrower and the lender. He borrows from one party and lends to another"

Customer
Definition
By dr. hart

"A customer is one who has an account with the banker or for whom a banker habitually underrates to act as such"

By Justice Lindley

"Customer is a person who has some sort of account either deposit or current account or some similar relation with a banker"

The customer must be.....

- He should not be a minor
- He should be person of sound mind
- He should not have been debarred from entering into any contract under the law

Relationship

General Relationship

Debtor and creditor

"The basic relationship is that of debtor and creditor. If a customer deposits money in the bank he is the creditor and the bank is debtor. If the customer has an overdraft balance then he is the debtor and bank is the creditor"

Special Relationship

Principal and agent

The customer is the principal when deposits cheque, drafts, dividends for collection with bank. The bank is an agent when he sells or purchases securities and installment of loans etc.

Bailer and Bailee

When a customer hands over his valuable to the bank for safe custody then the customer becomes the bailer and the bank is the bailee. And charges small amount for services rendered

Pledger and Pledgee

When the customer pledges moveable properly with the banker as security for loans, he becomes pledger and banker as pledge. This relationship also knows as pawner and Pawnee. The pledged good should be returned after the debt is repaid by customer.

Mortgagor and mortgagee

When the loan is taken against immovable property the customer is called mortgager and the banker is mortgagee.

Banker is a trustee and Executor

The banker receives valuable and documents of he customer and keeps them in safe custody. The banker also executes the standing instructions of its customers so banker becomes as trustee and executor.

Consultant

Bank usually undertakes financial consultancy for their client. In such a situation the bank becomes a consultant. When a bank advises his client on any important financial matter, bank becomes advisor and client becomes advisee.

Guarantor and principal debtor

Guarantor is the person who gives the guarantee. Principal debtor is the person for whom the guarantee is given. Today's banking business giving of guarantee is an ordinary job of a bank when a bank gives guarantee, it becomes guarantor and client becomes principal debtors.

Financer and Financee

When the banker provide loan to his customer he become financer and customer becomes financee.

Indemnifier and indemnity holder

Indemnity is a contract when one party promises to save the other party form the loss caused to him by the conduct of the promisor himself or by the conduct of any other person the person who promises to make good the loss is called indemnifier and promise is called indemnity holder. So the bank makes a contract of indemnity with the client, bank becomes indemnifier and client becomes indemnity holder.

Reference and referee

When a bank informs the state bank or any other authority about the financial status of a client, bank is called referee and client becomes reference

Termination of the relationship

The relationship between customer and bank is terminated in following conditions

- Termination by customer
- The rate of interest is not acceptable to him
- Bank does not give him facility as offered by other
- Not satisfied with the services
- His confidence in the bank is shakened
- Due to change of customer death
- He change his place of residence

Termination by banker

- If the customer does not obey the banking hours.
- Intimation of death of customer
- Due to insanity of customer
- Due to insolvency of the customer
- Due to court order
- Character is not satisfactory

Q # 6 defines banker and customer. Discuss the Right and Duties of Banker and Customer in detail.

Outline

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Banker
Customer

Right and duties of customers

Right and duties of banker

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- He should be person of sound mind
- He should not have been debarred from entering into any contract under the law

Right and duties of customers

Rights of customers

1. **Right to encash a cheque**

It is the right of the customer that his cheque is to be encashed. He should be given the amount as per the balance.

2. **Right to receive documents**
   It is the right of the customer to receive the pass book, cheque book, and statement of account from the bank.
3. **Right to sue against wrongful dishonor**
   A customer has the right to sue a bank if the bank dishonors the cheque with out and positive reason.
4. **Secrecy**
   It is the right of customer that bank can be kept his account secret and not disclosed to any one.
5. **Right to interest**
   It is the right of customer to receive the interest and bank, is bound to pay, and depends upon the nature of account.

Duties of customer

1. **Obey banking hours**
   A customer must present his cheque for encashment (payment) and collection with in banking hours and days.
2. **Safe custody of cheque book**
   It is the duty of the customer to keep his cheque book safe. So that it may not be go into the hands of unauthorized person.
3. **Presentation of cheque before expiry**
   It is the duty of the customer that he should present the cheque with in six month of its issue date. Otherwise no claim would be for payment.
4. **Case of forged cheque**
   It is the duty of the customer that he must inform the bank believing that his signature is being forged on a cheque so that no payment should be made.

Right and duties of banker

Right of banker

1. **Right of interest and charges**
   The banker has the right to charge interest on loans. It also charges commission as for services provided. The services include collection of cheque, bills of exchange and dividends etc.
2. **Right of lien**
   The bank has a lien on the goods and securities of the customer until he repays his dues. The bank can sell such items after giving proper notice.

3. **Charge compound interest**
   The banker has right to charge compound interest on over drafts calculated o daily balance. There is agreement between banker and customer about rate and time period.
4. **Adjustment of balances**
   The banker has right to adjust debit balance against credit balance.

Duties of banker

1. **The honour the customer's cheque**
   It is the duty of the banker to honour cheque issued by the customers. The cheque must be drawn properly and presented **during working hours.**
2. **Secrecy of customers account**
   The bank should maintain the secrecy of the customer account if it is disclosed the customer may suffer loss.
3. **Purchase and sale of securities**
   It is the duty of the bank to obey the instructions regarding the purchasing and selling of securities

4. **Opening of letter of credit (L/C)**
It is one the duties of the bank to issue letter of credit for its customers in the international trade.

Q.7 Discuss role of central bank as controller of credit

OR

What do you mean by monetary policy discuss its objectives and methods of monetary policy explain the limitations of monetary policy

OR

Explain the different methods of credit control.

OUTLINE

Definition
Simple definition
Expert views
Objectives of monetary policy
Methods of monetary policy
Qualitative methods
Quantitative methods
Limitations of monetary policy
Conclusion

The central bank is responsible for regulation and control of monetary system. Because its first priority to increasing in public interest, for this central bank developed policies for control the supply and credit money in the market, such policy called **Monetary policy.**

Definition

Simple definition

Monetary policy refers to the measures which the central bank of a country takes in controlling the money and credit supply in a country, with a view to achieving certain specific economic objectives

Expert views

According to S.A. Meenai

Monetary policy is the regulation of the cost and availability of money and credit in the economy

According to H.W.Arudt

Monetary policy is that branch of economic policy, which is concerned, with regulation of the supply, the cost and the direction of credit

According to H.G. Jhonson

It is a policy of central bank in control the supply of money with the aim of achieving macro economic stability

Objective of monetary policy

Control on inflation and deflation

Central bank generates economic stability by controlling inflation and deflation in a country, through monetary policy

Economic growth

A good policy of credit control ensures economic growth. The decisions regarding sanction of credit to deferent sectors of the economy greatly affect the rate of economic growth.

Increase in investment

State bank give the instructions to commercial banks provides loan to productive sectors, with the help of it industry promote and as well as employment also increased

Increase in exports

With the help of monetary policy the commercial bank issued loan to exporters of the countries. And due to this facility country get foreign currency, and economic growth automatically enhanced

Price stability

The economic growth depends on stable price level. For this central bank fixing the credit limit for the commercial bank, then supply of money is controlled. Due to this effect industries control the price level till it become stable

Stable in money market

The central bank must keep stable money market. The demand and supply of credit must be adjusted in the best of interest of the country.

Method of monetary policy

- **Quantitative control**
- **Qualitative control**

- **Quantitative control**

1. Bank reserve rate policy

Bank reserve rate means the rate that is deposited by commercial bank to central bank

a. In case of inflation

When there is inflation on the country, then central bank for the purpose of control over the inflation increase the Reserve rate of commercial bank, then supply of money control automatically as well as inflation becoming control.

Symbolically

BRR ↑ ⟷ ↓ SM ↑ ⟷ ↓ i ⟷ ↓ I ⟷ **p**
inflation decrease

b. In case of deflation

In case of deflation central bank decreased the reserve rate due to this supply of money increased and price is also increased and at the end deflation decreased

Symbolically

BRR$\downarrow \longleftrightarrow \uparrow$ SM $\downarrow \longleftrightarrow$ i$\uparrow \longleftrightarrow$ I$\uparrow \longleftrightarrow$ **Pro.$\uparrow$ Eco. Growth**

2. **Open market operation**
   Its mean sale and purchase of Govt. securities in the open market by the state bank of Pakistan. If the inflation condition exit then central bank sells the govt securities to general public and in case of deflation central bank purchase the govt securities from open market.
3. **Credit limits**
   The central bank controls the credit supply with the help of fixing the credit. After it supplies of money control as well as inflation also controlled.
4. **Discount rate policy**
   Discount means when the central bank discounting the bills of exchange of banks. In case of inflation central bank increase the discount rate and vice versa

2. Qualitative control

1. Consumer credit control

The central bank can increase or decrease number of installments payable under installment sale agreement. Sometimes the grant o credit for consumer goods on installment basis is completely banned by central bank.

2 marginal requirements

Margin means the difference between the amount of loans and value of security. The minimum margin requirement on securities may be relaxed o encourage the borrowing and can be imposed to discourage the borrowing.

3. Direct action

When commercial bank fails to follow credit policy of central bank, direct action may be taken against defaulter bank. By following action

- ❖ Doest not provide the facility of clearing house
- ❖ Increase the reserve ratio of case
- ❖ Reuse to discount the bills of exchange
- ❖ Declares the scheduled banks as non-schedule bank and takes the facility back.

4 Moral persuasions

The central bank can use this method of moral persuasion as leader of commercial bank. It regularly advises and guides commercial banks to follows a particular policy for loans.

Limitations of monetary policy

1. **Co-operation of banks**
   It is very difficult for central bank to control to credit, if commercial banks do not extend their full co-operation
2. **Conflicting objectives**
   The greatest difficulty in controlling credit is the simultaneous, achievement of conflicting objectives of price stability, economic stability etc.
3. **Conventional techniques**
   In under developed countries like Pakistan the conventional techniques of credit control namely bank rate policy open market and reserve ratio are not all powerful.
4. **Existence of non-monetized sector**
   In underdeveloped counties there exists a large non-monetized and rural subsistence sector. Thus a bi sector of community is quiet unaffected by the monetary policy
5. **Deficit financing**
   A large scale of deficit financing by govt may make the central bank powerless in controlling the credit which cause inflationary pressure in he country.

Conclusion

As we study in above question about policies. But all these policies are affective when these are implemented by the Govt. of Pakistan. Inflation stage required 5 to 10 years to convert in equilibrium position. That is not possible during the daily changing in presented and other member of Govt. so these policies only for the reading not for implementing.

==

Q9: How do the commercial banks create credit? Indicate the limitations on the power of a bank to create credit?

OR

"Loans are children to deposit and deposits are children of loans" Explain.

Outline

Introduction

Definition

Simple definition

Expert views

Assumptions

Process of credit creation

Limitations of credit creation

Conclusion

Introduction:-

Credit: -

The term credit is an evolution of a Latin word "credo" which means "I entrust and i put my faith in. The word credit has been described by GIDE in the following ways.

"An exchange which is complete after the expiry of certain period of time after payment".

In simple words credit means a Loan.

Credit Creation: -

The creation of credit or deposit is one of the most important functions of commercial banks. Like other corporations banks aim at earning profits. Credit creation is the multiple expansions of banks demand deposits. When a bank advances a loan, it does not pay the amount in cash, but it opens a current account in his name and allows him to withdraw the sum by cheque. In this way the banks create deposit or credit. It is an open secret that banks advance a major portion of their deposits to the borrowers and keep smaller part of them for payment to the customers on demand.

Definition

Simple definition

"The tendency on the part of commercial banks to expend their demand deposits as a multiple of their excess cash reserves is known as creation of credit"

Expert views

According to Prof Crowther:-

"The important work of bank is to provide easy people. Banks are considered as manufacturer of credit. It means they are not only the dealer of money but in actual meaning they are creator of credit."

A single bank can not create credit. It is the banking system as a whole which can make loans more then their excess cash reserves.

Assumption of credit creation process:-

The process of credit creation is based on certain assumptions which are as under:-

- There are many banks say A, B and C etc in the banking system.
- Each bank has to keep 20% of its deposits as required reserves. In other words 20% is the reserve rate fixed by law.
- Business conditions remain normal in the country.
- Central bank does not adopt any credit policy.
- The loan amount drawn by the customer of one bank is deposited in full in the second bank and that of the second bank into the third bank and so on.

Process of credit creation

The bank creates credit in four ways-

- Loans.
- Overdraft.
- Discount Bills of Exchange.
- Purchase of Assets.

By over drafting bank creates credit. Secondly, bank purchase the securities and paid them with its own cheque. The holder of these cheques deposits them in the bank. They create deposits which is nothing other than creation of credit.

It is recognized that the process of credit creation can't proceed with out involvement of the whole banking system.

According to Samvelson,

"The banking system as whole can do what each small bank can not do. It can extend its loans and investment many times. The new reserves of cash created for it's even though small bank is lending out only a fraction of its deposits

Explanation:-

The credit creation process can be explained as follow:-

The bank receives RS 5000 as fresh deposits from a customer. The bank keeps some cash to honors cheques of customers. The amount so kept is known as cash receives. Suppose cash receives ratio is 20% the bank can be lend 80% of deposit to the needy people. The position of first category bank after credit creation is as follow:-

Balance sheet of 1st bank

Liabilities	Rs	Assets	Rs
Deposits	5000	Cash 20 %	1000
		Loan 80%	4000
	5000		5000

The loan of RS 4000 may be deposited by the customer with this or other bank. The receiving bank can lend 80% of it by keeping 20% as cash reserve. It can be stated in the balance sheet of second bank.

Balance sheet of 2nd bank

Liabilities	Rs	Assets	Rs
Deposits	4000	Cash 20 %	800
		Loan 80%	3200
	4000		4000

The deposits creation position of the third bank is stated below.
Balance sheet of 3rd bank

Liabilities	Rs	Assets	Rs

Deposits	3200	Cash 20 % Loan 80%	640 2560
	3200		3200

The process is not yet complete. It will continue further. The whole process can be settled in a summary form as follow.
Expansion of bank deposits

Bank	**Deposits**	**Cash reserve**	**Loans**
A	5000	1000	4000
B	4000	800	3200
C	3200	640	2560
D	2560	512	2048
E	2048	410	1638
F	1638	328	1310
G	-	-	-
H	-	-	-
	-	-	-
	25000	5000	20000

The fresh deposit of RS 5000 is used to create credit of RS 25000; if the reserve ratio is 10% then created credit will be RS 50000. The amount can be calculated by following formula.

$$\frac{\text{Deposits} * 100}{\text{Cash reserve } \%}$$

We have discussed the credit creation process through loans. Deposits can also be created by overdraft, discounting of bills and purchase of assets.

Limitation on the power of Bank to create credit:-

Following are the limitation of credit creation:-

Amount of Cash:-

The credit creation power of bank depends upon the primary deposits with the bank. The larger cash, the larger amount of credit that can be created by bank.

Proper Security:-

An Important factor that limits the power of bank to create credit is the availability of securities because the bank advance loans to its customers on the basis of securities or a share, or a bank, or a building or some other types of a

Banking Habits of the People:-

If people have more banking habits banks will create more credit and vice versa.

Legal Reserve Ratio:-

The ability to create credit also depends upon the cash reserves ratio imposed my central bank. The higher this ratio the lower is the power to create credit.

Shortage of Borrowers:-

If there is shortage of borrowers due to business. Slump or due to any reason, the ability of banks to create credit will also be decreased.

Clearance Facility:-

If banks enjoy clearing house facility by the central bank then they can create more credit and vice versa.

Behaviour Of Other Banks:-

The power of credit creation is further limited by the behaviour of other banks. If some of the bank do not advance loans to the extent required of the banking system, the chain of credit expansion will be broken.

Policy Of The Central Bank:-

The central banks policy regarding the expansion and contraction of credit also restricts the credit creation by the commercial banks.

Cash In Circulation:-

If the loan issued by the bank may not be deposited in the bank. The cash may remain in circulation can not be used by banks for credit creation.

Economic Climate:-

Bank can not continue to create credit limitlessly. Their power to create credit depends upon the economic climate in the country.

Summing Up:-

We can say that creation of credit is an important function of commercial banks. However the power of credit creation by the bank is not unlimited.

Q.9 Define letter of credit? What are various parties involved in letter of credit? What is procedure to open a letter of credit?

Out Line

Introduction
Definitions
Parties involved in letter of credit
Procedure of letter of credit
Conclusion

Introduction

In different countries goods are import and exports by their businessman, for import and export the reliable source for payment for importer is Letter of Credit. L.C is issued by the buyer bank in the favor of seller bank,

Definitions

by frank Henious

"A letter of credit is a written instrument, issued by the buyer's bank, authorizing the seller to draw in accordance with certain terms and conditions"

By Pritchard

A letter of credit is a commitment on the part of the buyer's to pay or accept draft, drawn upon it, provided such drafts, do not exceed specified amount.

Parties in letter of credit

Buyer/ Importer/opener

The person who wants to purchase goods and commodities from foreign as well as at whose request letter of credit is opened is called importer.

Importer bank/ Buyer bank

The bank, which opens the letter of credit at the buyer request is called buyer bank

Exporter/seller

The person who wants to sell the goods to foreign country as well as to whose favor letter of credit is open

Exporter bank/ seller bank

The bank which makes the payment to the exporter after receiving the letter of credit is called seller bank.

Requirements of opening letter of credit

Sales contract

First of all there must be a contract between buyer/importer and seller/exporter of sales and purchase, and they agreed all term and conditions as well as mode of payment

Import License

The banker demands the applicant about import License, and indent of goods to be imported. After checking such document allow importer to file on application on printed form.

Application form

Its means the agreement for irrevocable letter of credit, i.e. filled up by the banker and signed by the Importer. As well as it contain all term and conditions of the sale agreement.

Completion and scrutiny of the form

Letter of credit is filled by the banker as per information provided by the applicant (buyer) the banker complete and scrutinizes the documents.

Opening letter of credit

When all the information is completed then banker opened letter of credit on the behalf of importer.

Information to exporter bank

The issuing bank informs the seller bank about the issuance the letter of credit. And after it 3 copies are made by the issuer bank. One copy retain by the buyer bank, other 2 send to seller bank, out of which one copy send to seller by the seller bank.

Information to the seller

The seller bank inform to seller about receiving letter of credit form buyer bank, then seller send the good to buyer according to term and condition and shipping documents to seller bank. After checking documents the seller bank sends it to buyer bank.

Margin on letter of credit

Central bank of Pakistan decides the percentage of amount to be paid to the issuing bank, by the importer. Such chargeable amount is called margin.

Payment to the Exporter

The buyer bank, on receipt of shipping documents, make payment to seller bank, and seller bank make payment to seller.

Types of letter of credit

Irrevocable letter of credit

A letter of credit which cannot be cancelled is called irrevocable L.C. such type of L.C provided fully protection to exporter.

Revocable letter of credit

A letter of credit which can be cancelled by the importer bank at any time without any obligations. After this such L.C is not acceptable by the exporter.

Confirmed letter of credit

In which the exporter bank gives guarantee to make payment to the exporter even if the importers bank fails to make the payment. And on the other hand importer bank also give the guarantee to importer. So the seller gets double protection of payment.

Unconfirmed letter of credit

A letter of credit in which the exporter bank does not gives and guarantee to exporter about payment. The bank give payment if the importer the provided the payment to exporter bank.

Documentary letter of credit

In which the payment is made after receiving following documents

- ❖ Invoice
- ❖ Packing list
- ❖ Insurance policy
- ❖ Bill of lading

Clean letter of credit

A letter of credit in which there is no condition of document attached for the payment.

Fixed letter of credit

It is a letter of credit in which the credit is available for a fixed total amount payable in one or more than one draft.

Revolving letter of credit

In which the amount of credit can be revolved or renewed on the fulfillment of credit conditions.

And all the term and conditions can be renewed by the commitment of both parties.

Q.No.10 what is barter system? Discuss the problems of barter economy. Explain the evaluation of money, and how money removes the problems of barter system.

Out Line

Introduction

Definition

Inconveniences/problems of barter system

How money remove the problems of barter system

Conclusion

Introduction

A system of direct exchange of one commodity or service for another without the use of money is called barter. One has to exchange the product which one has in excess with those who have other surplus product with themselves.

Definitions

By R.H.Parker

Barter is the direct exchange of goods and services with out the use of money as either a means of payment or a unit of account.

By Sloan

Direct exchange of commodity or services for another without use of money

By G.Thomas

Barter is a form of trading in which goods are exchanges directly for other goods without the use of money as an intermediary.

Inconveniences of Barter system

1. **Lack of double coincidence of wants**
   The basic problem in barter system is double coincidence of wants. It means that there must be double satisfaction of wants. Both parties in barter. For instance, goods can be exchange effectively if a person is able to spare what the other person wants and at the same time needs what the other can spare.
2. **Lack of common measure**
   In barter system, there is no common measurement for exchangeable goods. For instance, if a person have cow and other have goat, and 1st want to exchange cow after receiving

two goats, and other is not agree from 1st because there is no common measurement of goods.

3. **Lack of sub-division**
   As there are some commodities which cannot be sub divided. Like a person have a horse and other want to 20 Kg Rice. So in this situation which part of horse should be given in exchange for 20 Kg. of Rice?
4. **Lack of store value**
   In barter system there is no facility of store value. Because there were some goods that have no storage facility. Like vegetables, fruits, etc
5. **Lack of capital formation**
   The formation of capital goods is necessary for further production of goods and services. Barter is the enemy of capital formation. The basis of capital formation is saving. In the absence of capital formation the economic progress become zero.
6. **Difficulties in tax collection**
   In barter tax collected by revenue department in the form commodities. The goods collected form tax payer will not be stored for a longer period. They will lose their value with the passage of time.
7. **Difficulties in transfer of wealth**
   There is great difficulty in transferring wealth from one place to another under barter. More ever immovable property can not be transferred.
8. **No budgeting**
   Under barter it was not possible to budget expense and incomes. People were unable to forecasting the worth of their mechanism and merchandise. They therefore can not make any estimate of their future incomes and revenues.
9. **No investment no saving**
   Under barter there is no concept of investment and saving. Because we can not express our income in any monetary unit.
10. Difficulty in future payment
   In barter there is no concept of credit. And have no facility of future payment, because lack of monetary unit.

Removal of inconvenient of barter

1. **Money as a medium of exchange**
   The goods and services are now purchased and sold with the help of money. The difficulty of double coincidence of want has been removed.
2. **Money as a common measure of value**
   Money is used as a common measure of value, by which we can measure and compare the values of different goods and services.
3. **Money as a standard of future payment**
   A modern economy, goods and services are sold and bought on the promise to pay in future. So it acts as the standard of future payment.
4. **Money as store value**
   Under barter system goods animals and commodities cannot be stored for a longer period. Now a day's wealth is stored in the form of money.
5. **Money is an instrument of making loans**.
   People save money and deposit to businessmen and industrialists so savings are transferred to investment.
6. **Liquidity to wealth**
   Money imports liquidity to various forms of wealth such as land, machinery, stocks, and stores etc, these forms of wealth can easily be converted into money.
7. **Establishment of financial institutions**
   The introduction of money has made it possible to establish financial institutions like the central bank, commercial bank etc which deal in currency and near money assets such as bills of exchange, bonds, shares, etc
8. **Tax collection**
   The collection of tax was practically impossible in barter economy money solved this problem. Due to the introduction of money, the tax system is working quite successfully.
9. **Development of banking system**
   Money is an integral part of baking system. Without money the concept of banking system seems t be meaningless. The barter system gives no idea of banking.

10. Money and problem of sub-division

The problem of sub-division was also solved by the use of money. Now with the help of money we can purchase each and every kind of goods.

Conclusion

No doubt money have remove the all the problem of barter system but still in developing countries like Pakistan, china use the barter system.

Q No. 11. What is paper money? Describe its different forms? Also discuss the advantage and disadvantage of paper money?

OUT LINE

Introduction of paper money

Definitions

Forms of paper money

Advantages and disadvantages of paper money

Conclusion

Introduction:

Paper money means the currency notes issued by central bank of country. In the present age paper money has got a significant place in place of metallic money. Paper money is convenient to carry and easy to handle and store. It is the most advance form of money. It fulfils nearly all the characteristics of ideal money. It is believed that different attempts are make or introduce paper money i.e. In China during 9^{th} century, Iran 13^{th} century and finally paper money was originated by gold smith of England in early 17^{th} century. Now in all developed and underdeveloped countries of world, Inconvertible paper money is used as medium of exchange and standard of value.

Definitions

Prof. Hanson

"Paper money means the paper instruments such as bank notes, cheque, bills and other forms which act as a currency".

ACCORDING TO F. PERRY

"Paper money is document representing money such as bank notes, promissory notes, bills of exchange etc".

ACCORDING TO PROF. GREENER

"Paper money means documents with a value started on them but having no value in them".

KINDS OF PAPER MONEY:

Paper money is classified into following kinds:-

- Representative paper money.
- Convertible paper money.
- Inconvertible paper money.
- Fiat paper money

REPRESENTATIVE PAPER MONEY

Representative paper money is one which is fully state is in a position to convert all the notes into gold, If they are presented for conversion at the same time. The govt keeps reserves for the confidence of people. In USA before 1934 the notes were issued on this principle. The example of this is American gold and silver certificates.

- **CONVERTIBEL PAPER MONEY**

  It is such a form of money which can be converted into gold and metallic reserves, but not all the notes issued by the state are fully backed by Govt. No need to keep 100% gold reserves as compare to representative paper money.

- **INCONVERTIBLE PAPER MONEY**

  Inconvertible paper money cannot be exchange or converted into gold. The gold or silver reserves are not kept by the monitory authority. The money is issued on the written promise of the government. This paper money can cause over issue of notes.

- **FAIT PAPER MONEY**

Fait money is the form of inconvertible money having little or no value in it. Fait means the order of government. Fait money is accepted by the people for purchase or exchange of goods, due to government order. Paper money is fait money. Whenever government cancels any notes, the holder will lose the whole value.

ADVANTAGES OF PAPER MONEY

ECONOMICAL

Paper money is normally much easy to issue. The cost of currency as compared to its face value is very low. The central bank has not to keep gold or silver for issuing of the paper notes.

UNLIMITED LEGAL TENDER

Paper currency is unlimited legal tender money. I.e. any amount of debt can be paid in it. It can be used to discharge all kinds of business obligations and liabilities. No one refuse to accept in settlement of any debt.

LIGHT WIEGHT

The paper money has less weight then metallic money. It is easy to handle then metallic money.

ELASTICITY

Paper money due to its elasticity is very useful for the government. It can be increased or decreased according to business requirement.

EASY COUNTING

The paper money is convenient to carry and transfer. It can be easily kept in pocket or wallet.

DIFFICULT TO COPY

The design of paper currency is very intricate and special type of ink and paper is used hence it is difficult to copy it.

RECORD

Paper currency is always numbered. Each one has a distinct number. So in case of robbery, bank fraud, the involved person can be traced out when. They use the embezzled money.

EASILY RECOGNIZABLE

The paper money is easily recognizable. There is no botheration of testing the genuineness of the money material.

CONVERTIBILITY

Paper currency is easily convertible into other. Credit instruments such as draft, promissory note and bills etc.

USEFUL IN EMERGENCY

The paper money can be used in emergency like war and floods. The government can meet the expenses by printing notes in short period.

SAVING IN USE OF METAL

Paper currency indirectly leads to the saving in the metallic reserves of the country. Due to the issuance of paper currency there is no need to issue coins in greater value.

HIGH VALUE IN SMALL BULK

Paper money has the quality that it has value in small quantity or bulk.

UNIFORMITY

The paper money stays uniform. The apparent loss of colour or tearing of paper does not affect the value. It is uniform in colour, size, design, weight etc.

EASY PAYMENTS

It is easier and less expensive to make payment in thousand of rupees through paper money.

ADVANTAGES TO BANK

Paper money is of great advantage to banks. They can keep cash reserves in this form.

INTERATIONAL TRADE

The present state of international trade also owes great to paper currency. Different type of paper money can be conveniently interred changed and used in different parts of world. This has increased the liquidity of world's economy.

PRINCE MECHANISM

Our market forces of demand and supply works because of price mechanism. Paper money has greatly help in making price mechanism workable and effective.

MONETARY MANAGEMENT

As the supply of paper money can be regulated by central bank so, monetary management becomes easy. The volume of circulation of money central bank.

Disadvantages of paper money

Limited acceptance

Demerit of paper money is that it has a limited acceptance. Its acceptance is limited with in the boundaries of home cont ray. It is not legal tender money in other countries.

Danger of inflation

The biggest demerit is that paper money is over issued then it brings inflation in the country which is harmful for purchasing power.

Lack of durability

Normally paper money has a short life than metallic money. There are chances of damages to paper. Fire may burn it. Paper money loses its good appearance and shape.

Small denominations

Paper money is not suitable for small monetary denominations such as 1, 2, 5, 10, 25, and 50 paisa. In this case metallic money gets preference over paper money.

Balance of payment

When paper money over issued in the market then it cause the inflation, and in which prices will be higher on the other hand value of money decrease and balance of payment becoming unfavorable day to day with the affect of inflation.

Less stability

There is less stability in the value of the paper money as compared to metallic money. Some time it is over issued and people lose confidence in the value of money and they prefer to keep their savings in terms of gold and silver.

Loss due to fire and water

Although the paper money is not affected by and apparent wear and tear or loss of colour yet it can be damaged due to fire or water.

DANGER OF MISMANAGEMENT

Paper money is useful only when it is efficiently managed. If the monetary authority is not vigilant and does not issue the paper currency as required, it often leads to inflation deflation.

PRICE INSTABILITY

Paper money has given rise to wide scale price fluctuation in different countries of world. The fluctuations in exchange rate market also produce serious effects on the general price level in the economy. Weak paper money fails to enjoy. The confidence of the people and cause price instability.

CONCLUSION

From above discussion we concluded that paper money has also some defects. It is better than metals and it is also helpful for removing the economic problems. It is a source of blessing for mankind. However when it is not properly managed it becomes source of perils & confidence.

Q No.12 Define money and explain the different function of money?

OUT LINE

Definitions

Functions

Primary functions

Secondary functions

Contingent functions

Conclusion

Definitions

By R.P Kent

"Money is anything which is commonly used and generally accepted as a medium of exchange or as a standard of value"

By Marshall

"All those things which are, at any time and place, generally current without doubt or special enquiry as a means of purchasing commodities and services and of defraying of expenses"

By Geoffrey Crowhter

"Anything that is generally acceptable as a means of exchange (i.e. as means of settling debts) and at the same time acts as a measure and as a store of value"

Functions of money

Primary functions

Medium of exchange

Now a day's money is used as a medium of exchange. With the help of money we purchase goods and commodities according to our demand at any time. And money also used for the payment of goods and services. We can simply say money act as medium of exchange between purchaser and seller.

A standard of value

Money used as standard value; we can measure the units in terms of money. Only specific goods can not measured like love, care, and respect etc, other wise every thing is measured in term of money. Price can be settled of good and services with the help of money

A store of value

To store the perishable commodities for a long period of time is very difficult. Now a day's money has removed this problem. We can easily store for a long period of time.

A standard of deferred payment

Money provides the facility of future payment, but in barter there is no facility of credit. Because there is no standard value for payment of credit. But money has removed this problem and we can pay future payments. As well as credit transactions also possible with money.

Secondary functions

Facilities productions

With the help of Money we can ensure the availability of factor of productions. If a person wants to start a business then with through money all factor of productions (land, labor, and organizations etc) available easily.

Easy consumptions

In barter system the main problem of consumption goods according to demand of peoples, because it require double coincidence of wants. Money removed this problem, and every can easily purchase commodities according to his demand,

Promotes savings and investment

It is easy to save and invest in terms of money. The establishment of big projects absorbing huge investment can be possible only due to the dynamic role of money.

Enhance trade activates

Money promote trade activates by serving as a medium of exchanging making exchange of goods easy.

Facilitates distributions of rewards

With the help of money we easily distribute the rewards. Its helps us in finding the correct value of goods produced and the contribution of each factor of production to the production process. It thus becomes a base for the disturbing for rewards among the contributing factors.

Enhance capital function

Injecting more and more funds in the form of money can increase capital formation required for the development of an economy.

Ensure fair distribution of income

Money ensures fair distribution of income through progressive taxation system, which can only be implemented in money economy.

Easy borrowing and lending

Borrowing and lending activities have become easy which easy which otherwise were difficult in barter economy. Banks create credit on the basis of money deposits they receive

Contingent functions

Distribution of national income

Money helps us in the fair distribution of national income among factors of production.

Credit creation & contraction

The process of credit creation and contraction by commercial banks depends upon cash reserve, which they maintain from money deposits of the accounts holders.

Equalizer of marginal utilities and productivities

Money enables consumers to get maximum satisfaction through the law of equi-marginal utilities. Similarly the producer can get maximum profit by equalizing the marginal productivities of different factors of productions.

A liquid asset

Because of having the quality of general acceptability, the households and businessmen keep it with themselves to meet the current domestic and business requirements. Further, it is easy to hold it and the holder faces no problem of its depreciation as in case of goods. So it serves as a liquid asset.

A Guarantor of solvency

A trader always keeps sufficient ready cash to meet the obligations. If a trader or a company fails to meet the obligation, when fall due, it is said to be insolvent irrespective of its asset and liabilities statement. Similarly, banks keep cash reserves to pay their depositors usually at a moment notice. Therefore, we can say that it serves as a guarantor of solvency.

Conclusion

In barter economy there were so many problems of exchange and transaction according to consumer wants, because their was no any standard value of measurement. But money has removed all the problems and as well as facilities the consumers. Businessmen can exchange goods and services according to their customers demand. After this when consumer is satisfied on the behalf of supplier then economic growth is starting day to days.

Q.No.13 How the value of money is determined?

OR

Critically explain Quantity Theory of money?

OUTLINE

Introduction

Definitions

Assumption of Quantity Theory of money

Equation of Exchange

Numerical Presentation

Graphical Presentation

Criticism of Theory

Conclusion

Introduction

The quantity theory of money was first introduced by Davan Zat in the 16th century. After it David Hume and J.S Mill had worked on this Theory in 17th and 18th centuries. But the Theory is most famous in 19th centuries by Irving Fisher, American economist in his book "The Purchasing Power of Money" in 1911 with the help of Equation.

In his book he presented the money as value of money that means The Purchasing power of money. And it shows the inverse relationship between value of money and price level. Now we discuss in detail about the Quantity Theory of Money.

Definitions

By Irving Fisher

"Other things remaining unchanged as the quantity of money in circulation increases, the price level also increases in direct proportion and the value of money decreases and vice versa."

By Prof. Taussing

"Other things remaining the same, double the quantity of money, price level will be twice high as before; and the value of money on half. Half the quantity of money, prices will be one half of what they were before; and the value of money doubles."

Assumptions of Theory

Full Employment

The theory is based on the assumption of full employment in the country.

Price as a passive factor

It assumes that price is a passive factor. It means that if means that it is affected by other factors in the equation but does not affect others.

Constant velocity of money

According to fisher equation the velocity of circulation of money and bank money is constant.

No change in volume of trade

The total volumes of transaction (goods and services produced) remain same and are not affected by change in money supply.

Barter Transactions

Quantity theory of money is applicable on the money economy. It is not applicable on barter system.

Proportional relation between M&M1

There is proportional relation between currency money (M) and bank money (M1).

No change in hoarded money

There should be no change in hoarded money. Suppose it increases, the money in circulation will decrease, prices will fall and the value of money will rise.

Equation of Fisher

Professor Fisher expressed the following equation.

$$\mathbf{PT = MV + M1V1}$$

OR

$$\mathbf{P = \frac{MV + M1V1}{T}}$$

Where:

PT = total demand for money.

P = General Price level

M =quantity of legal tender money.

M1 =quantity of bank/credit money.

V = velocity of circulation of legal tender money

V1 = velocity of circulation of bank money.

T = total Transactions

Numerical presentation (example)

Suppose:

M = 100, M1= 100, V = 3, V1 = 2, T = 100

Now putting the values in formula

$$P = \frac{MV+M1V1}{T}$$

$$= \frac{100*3+100*2}{100}$$

$$= \underline{300+200}$$

100

$$= \frac{500}{100}$$

$$= \text{Rs.}5$$

In order to prove that variation in money supply produces proportional change in price, now we double the supply of money by keeping other variable constant.

$$P = \frac{200*3+200*2}{100}$$

$$= \frac{600+400}{100}$$

$$= \frac{1000}{100}$$

$$= \text{Rs } 10$$

The general price level has doubled by doubling supply of money. Now we half the supply of money and keeping other variables constant.

$$P = \frac{50*3+50*2}{100}$$

$$= \frac{150+100}{100}$$

$$= \frac{250}{100}$$

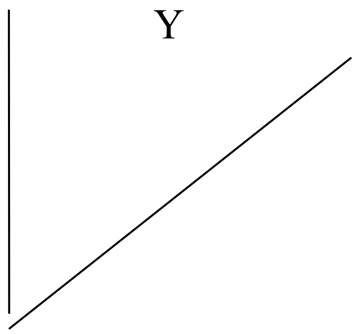
$$= \text{Rs.}2.50$$

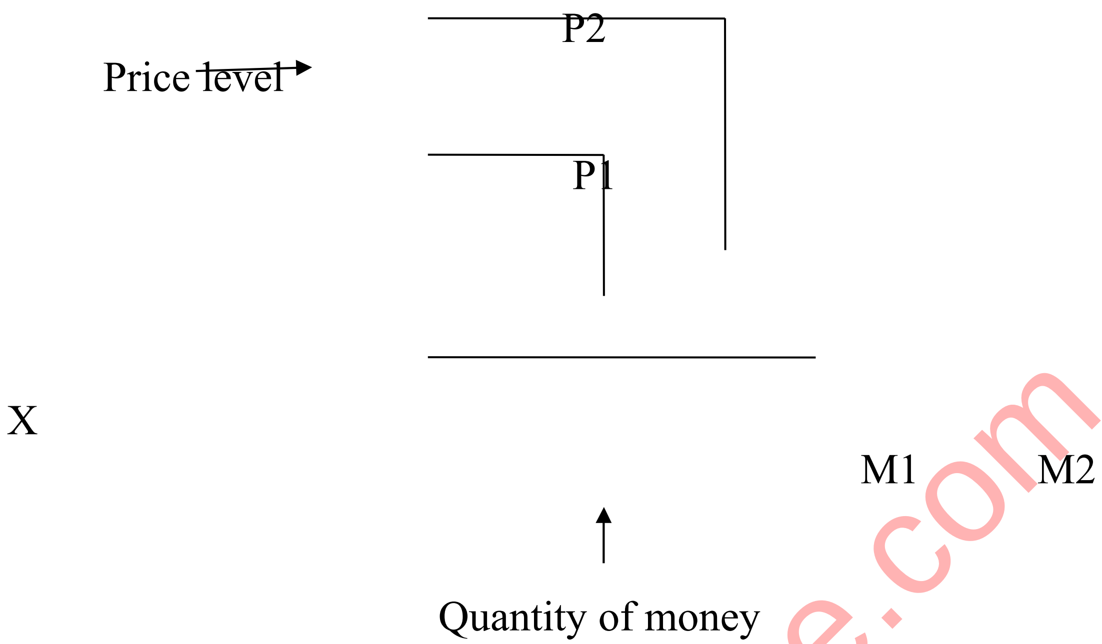
Now we can see general price level is half when we half the supply of money.

Graphical presentation

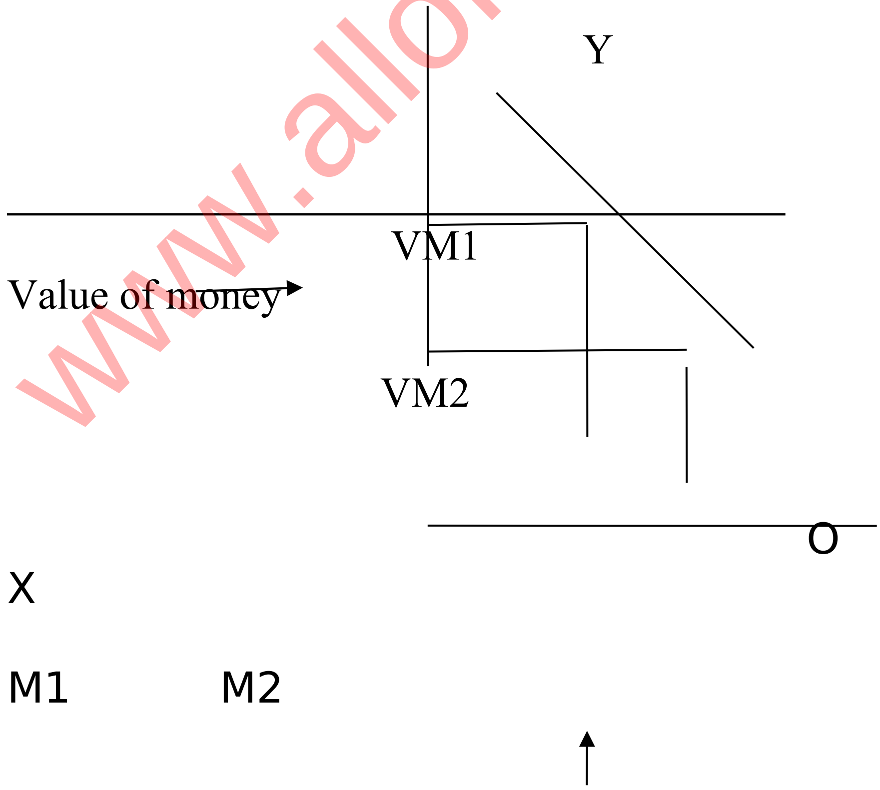
The quantity theory of money can be explained with the help of following diagrams

Quantity theory of money (Diagram 1)





The above diagram shows the direct and proportionate relationship between the supply of money and the general price level. When the supply of money is increased from M1 to M2 then it shows the doubled price level also increased proportionately.



Quantity of money

The diagram shows the inverse relationship between the quantity on money and the value of money. When the quantity of money is OM1 the value of money is OVM1, when the quantity of money is increased to OM2 (doubled) the value of money reduces to OVM2 (one half).

Criticism

Circulation of money

It is very difficult to measure the circulation of the legal money and credit money, therefore velocity of money can not be measured in a country.

Ignore demand for money

The theory discusses only of money as the main determinant of price level and the value of money. It ignores the role of demand for money in determining price level. Therefore it may be called one sided theory.

Assumption of fully employment

In this theory assumed about the full employment in the country, it is not possible for any country to provided full employment.

Proportional change

When the price level of goods is changed then on the other hand the quantity of money not changed at the same proportion. Like if quantity of money increase by 10% meanwhile it is not compulsory the price level is also increased by 10%, may be it can decreased.

Static theory

The economist says that it is static theory because in every economy up and downs and changed must occurred. But in this theory does not mention about the changing.

Useless assumptions

All the equation and diagram are made on the base of some assumptions without them theory is useless, as well as such assumption also useless

Ignores short Run

Lord Keynes says that it ignores the changes in prices in short run period and it considered only long run period.

Trade cycle

As in early ages business faced the situation of depression, like in 1930. Then that time many countries tired to raise general price level by increasing the supply of money. But it was not successes able in that time. So it proved that this theory does not take into account the phases of trade cycle.

Conclusion

The quantity theory of money is not entirely useless. The supply of money does affect the price level. Acknowledging the importance of this theory, miltion Friedman presented wealth theory of demand for money on its basis.

Q. No.14. What are the Principal and Methods of notes issues? Which Methods adopts in Pakistan?

OUT LINE

Principal of Notes issues
Advantages and disadvantages of the principal
Methods of Notes issues
Advantages and Disadvantages of the Methods
The System used in Pakistan
Conclusion

Principal of Notes issues

Basically there are two principal of notes issues that are adopt in different countries.

1. **Currency Principal**

   In currency Principal central bank of the country issued notes after taking 100% Reserve of gold. Central bank cannot print notes without the100% Gold Reserve of gold. Because of this system have some Advantages:

   Advantages of currency Principal

   1. **Full safety**

      Due to reserve of gold this system provide the fully safety to paper money
   2. **More confidence of people**

      According to this principal paper money got the more confidence of peoples because central banks can convert the money into gold.
   3. **Stability**

      Paper money has the stable value in currency principal due to 100% backing reserve of gold.
   4. **No danger of inflation**

      Under this principal gold must required for the purpose of the printing notes. Because of this notes are issued according to the demand of peoples, so there is no chance of over issue, and as well as control on inflation.

   Disadvantages of currency principal

   1. **Inelastic**

      This principal make the supply of money inelastic, we cannot increase the quantity of money else we have 100% gold for reserve.
   2. **Locking up gold**

Under this system gold become fully lock up and can not use for other purpose.

3. **Not Development Oriented**

   For the development of new industries and business paper money is required, but under this principal for printing of new notes for industry etc gold must be required, if govt has no gold then banks cannot print notes for development purpose

2. **Banking Principal**

   In banking principal for issuing paper money the central bank of the country not legally bound to take the gold as reserve. Notes are issued according to the requirement of the businessman and peoples. However the central bank maintain an adequate reserve of gold bullion.

Advantages of banking Principal

1. **Elasticity**

   Under this principal the central bank can increase or decrease the quantity of money as per need of peoples of the country. Because gold is not necessary as reserve. So the bank enjoys the facility of elasticity.

2. **Economical**

   As above mentioned 100% backing gold is not required, because of this banking principal economical for the central bank of the country

3. **Development oriented**

   Banking principal of notes issue is development oriented, because the central bank increases the quantity of money according to the requirement of industries and other development sectors.

4. **Most suitable in emergency**

   This principal of note issue helps a country to meet the emergencies, which may arise during war or any natural disaster like flood, earthquake etc.

Disadvantages of banking principal

1. **Chances of inflation**

Due to normal reserve of gold the central bank issue the notes over demanded of the peoples of country, after it when the quantity of money rise then value of money fall meanwhile inflation will be occur in the economy.

2. **Less confidence of people**

   Banking principal not able to got the full confidence of the people after issuing the notes, because there is not 100% backing of gold reserve.

3. **Monetary mismanagement**

   There are more chances of monetary mismanagement in banking principal as compared to the currency principal. The negative role of money may appear on the scene.

Methods of notes issues

There are three methods of notes issues as following.

1. **Fixed fiduciary issue**

   This method allows the central bank of country for issuing the fixed limit of notes without taking any metallic reserve. The government securities used as backed reserve in this system. If the issued notes excess the limit of fixed fiduciary then over limit notes will be fully backing the reserve of gold.

   This system is more famous, first time UK adopts in 1844 and still in UK as well as in Norway and Japan.

   Advantages of fixed fiduciary issues.

   1. **Elastic**

      The beauty in this system is this elasticity. The supply of money can be changed by changing the fiduciary limit without disturbing the metallic reserve provision.

   2. **More safe**

      In this system all the issued notes are fully safe, because notes are issued according to the limit. If the over limit notes are issued in the market, then before issuing the notes gold backed as reserve.

   3. **Control over the inflation**

      Under this system a fixed limit is issued by the central bank of the country, so there is less chances of over issue. And also control on the inflation.

   Disadvantages of fixed fiduciary issue

1. **Less confidence in currency**
   When currency is over issued people lose confidence I currency due to its devaluation
2. **Danger of over issue**
   In this system danger of over issue remain occur. Because the central bank can change the fixed fiduciary limit, because of this notes are over issued in the market. On the other hand if quantity of notes rises then chances of inflation also occur in the market.

Proportional Reserve System

In this method of notes issue the central bank of the country keep a certain percentage of gold reserve for issuing the paper money. Generally these percentages vary from 25% to 40%. And the remaining portion of percentage that is cover with gold, should reserve backed with Trade bill and Govt. securities. This method was first introduced in Germany in 1875, in USA 1914, as well as Pakistan adopt this in 1965.

Advantages of Proportional reserve system

1. **Widely adopted system**
   This system is widely adopted in different courtiers all over the world, due to its less quantity of gold as well as elasticity.
2. **Elasticity**
   The chief merit of this system is its elasticity. The money supply can be increased or decreased by changing the reserve requirement.
3. **Safe**
   The notes are issued under this method are safe, because notes cannot be issued without meeting the gold reserve requirement.

Disadvantages of Proportional Reserve system

1. **Unable to control price**
   This system does not help in controlling sharp fluctuations in prices which brings inflation in the economy.
2. **Uneconomic use of gold**
   In this system gold is locked up in the bank, and we can not use the gold for other productive purposes for the economy.

Exchange Management OR Modified Proportional Reserve System

As its name shows, it is the modified form of proportional reserve system. In which bank is required by law to keep the percentage required against the notes issued in the form of gold, foreign bills or cash at some foreign banks where gold standard prevails.

Advantages

1. **Elastic**

   This system also has the beauty of elasticity. Central bank can increase and decrease the quantity of notes according to requirement of industries and consumers.etc.

2. **Gold not compulsory**

   In this system Gold is not necessary for the issuing of notes in the market. Only foreign bills and cash are enough for printing the notes.

Disadvantages

1. **Danger of inflation**

   There is more danger of inflation as there are more chances of over issues.

2. **Monetary mismanagement**

   There are more chances of monetary mismanagement. If the government is less responsible.

   Method being followed in Pakistan

   Till the 1965 the note issue in Pakistan under Proportional Reserve system. Meanwhile currently adopt the exchange management system. Under this system the central bank of Pakistan keep reserve only 30% of gold, silver, or approved foreign exchange against the notes issue.

Q No. 15 defines money? What are the significance and importance of money?

OUT LINE

Definition of money

Significance & importance of money
Conclusion

Definition of money

According to R.P Kent

"Money is anything which is commonly used and generally accepted as a medium of exchange or as a standard of value"

According to D.C Colander

"Money is a fanatical asset that makes the real economy function smoothly by serving as a medium of exchange, a unit of account and a store of wealth"

According to coulborn

"Money is a means of valuation and of payment"

As we read in definitions money used as medium of exchange and standard for measuring value for the economy. The economic development, which we see in different sectors like trade, commerce, industry, is possible only due to the presence of money.
The modern economists fully recognize the significant economic role of money in the capitalistic and centrally controlled economy.

Role of money in Capitalistic economy

1. **Increase consumption**
   With the help of money the consumption process famous in the market, because with money human being are able to buy and sell goods according to their needs and wants, after the utilization process human want become satisfied. On the other hand there is facility of consumption according to human wants in barter system.

2. **Easy Production**
   In barter economy the production of goods so much difficult, because problem of raw material, hiring labour, and after it selling output of the goods. But now with the evolution of the money production process is easy, with money availability of factor of production (land, labour, capita, and organization) is possible.

And finding out the cost of goods in term of money no more problems.

3. **Facilitates exchange Transaction**

In barter system exchange of goods according to demand of different people so much difficult, due to lack of common measurement. But now with the help of money these problems removed. Now goods are exchanged according to demand of the user with the process of sale and purchase.

4. **Equal distribution of national income**.

In barter economy there is no concept of distribution of national income because people are produced good as per their need and no concept of saving and income etc. now currently we can check equally share of four factor of production i.e. rent of land, wages for labour, interest on capital, and profit on entrepreneur is paid in term of money.

5. **Public finance**

Money is an important tool in the field of public finance; with the help of it people can invest their finance in different sectors, after it human activities increase due to this financer got the benefit in the shape of profit after increasing the level of production according to consumer needs.

6. **Developed Banking system**

With the help of money, economy is able to develop the banking sectors. Due to this peoples enhance their saving and got the interest on their saving from the banks. On the other hand in barter economy there is no concept of saving and investing.

7. **Determination of prices**.

The capitalistic economic system, which is followed by a large number of countries, is based on price mechanism and price mechanism depends on the existence of money. The prices of any commodity easily calculate with the help of money.

8. **Enhance saving and investment**

When different person receive their income from different sectors in the form of money. After spending the money on their basic needs some person save there income for future condition, as well as some of them invest it to their business. After it they got the benefits in shape of profits. On the other hand in barter economy there is no concept of saving and investment.

9. **Capital formation**

   It is a process of increasing physical and human capital of a country through best utilization of resources. With the help of money we can increase the quantity of capital, as per industry needs.

10. **Monetary policy**

    The monetary policy gives momentum to the economic activities. It can only be formulated and implemented in money economy.

Q. 16 what do you mean by Inflation? Explain the different kinds of inflation.

OUT LINE
Introduction
Definition
Kinds of inflation
Conclusion

Introduction

It represents the rise in general price level. Basically when the state bank of the country issue the over demanded notes then it decrease the value of money. Meanwhile raises the general price level in the market.

Some authors define the inflation as follows

By J.M.Keynes

"Inflation is a rise in price level after the full employment has been achieved"

By R.P Kent

"Inflation is nothing more than a sharp upward movement in the price level"

By Crowther

"In the state of Inflation the prices are raising, i.e. the value of money is falling"

On the basis of causes

1. **Demand pull Inflation**
   In which inflation arises due to increase in demand of goods. On the other hand supply of the goods not according to demand of consumers at the result price level increase of existing goods, this situation creates the inflation in the market.
2. **Cost push Inflation**
   When the cost of production increase and producer raise the price level in the market, it's called cost push inflation. During the manufacturing process, increase the cost of Factor of Production show the high cost of production, at the result producer reduce the supply of goods due to lesser profit ratio, the general price level increased.
3. **Budgetary Inflation**
   When the Govt. of the country borrows from banks or prints new currency notes cover the budget deficit. After it quantity of money increase in the market, which tends the falling the value of money as well as increase the price level in the market. These situations create the inflation.
4. **Profit induced inflation**
   When the monopolist earns the more profits on goods produced. It creates the profit induced inflation. In which basically producer raise the price level as per its wants, at the result price level increase, also becoming inflation.
5. **Food inflation**
   When the prices of foods items increase sharply, it is as food inflation. Just like during the days of Eid, Ramzan etc
6. **Income inflation**
   The inflation that occurs from high income level. Income may increase due to change in salary or foreign remittance.
7. **Monetary inflation**
   This inflation arises due the increase in supply of money with no increase in production is called monetary inflation.

On the basis of rate of inflation

1. **Creeping inflation**
   In which when the price level of goods raises at slow rate over a period of time. It also called mild inflation. The rate of inflation may be upto 2% P.A. this types of inflation faced by Japan, USA, and Singapore.
2. **Walking inflation**
   In walking as the word represent, price level increase in continuous form with fast speed as compare to creeping inflation. The rate of inflation around 5% annually.
3. **Running inflation**
   In which general price level near about 8% to 10% annually is called running inflation.
4. Trotting inflation
   In trotting inflation price level rise with double digit i.e. 20% annually. Some authors say about percentage 5% to 20% annually. Pakistan faced the trotting inflation during 1970-80 and 1990-2000.
5. **Galloping inflation**
   When the rate of inflation across the limit of 20% per annum. Then galloping inflation arrived. Maximum limit of galloping inflation is 1000% P.A. during 1980-93 Argentina faced such inflation with the rate of 423.4% p.a.
6. **Hyper inflation**
   When the rate of inflation is more than 1000% p.a. we can say it's a final stage of inflation. In Poland the rate of inflation was more than 1000% in 1898. Germany also experienced with hyper inflation during 1922-24.

On the basis of degree of control

1. **Open inflation**
   When inflation get out of control of the Govt. in which all measurement and polices are failed to control the price level as well as inflation in the market,
2. **Suppressed inflation**
   If the Government can control over the inflation is called suppress inflation. But on the other hand some other problems are created like hoarding, corruption, and black money.

Other types

1. **Partial inflation**
   According to J.M, Keynes, partial inflation occurs when the price level rises partly due to an increase in the cost of production on goods and partly due to rise in supply of money provided the economy is operating below the level of full employment.
2. **Full inflation**
   When in economy General Price level rise due to full employment in the market, because when consumer got the jobs, then they demand more for the purpose of satisfaction, but due to lesser supply of goods price of goods rise and inflation occurs.

Conclusion

As we know inflation very harmful condition for consumers of the economy. Especially for the poor's, Govt should develop the polices for controlling over inflation with implementation. Because it required 5 to 10 years to removing the inflation from the economy,

Q 17. Define inflation, what are the causes of inflation? How we can remove the inflation?

Out line
Introduction
Definition
Causes of inflation
Measurement to control the inflation
Conclusion

Introduction

It represents the rise in general price level. Basically when the state bank of the country issue the over demanded notes then it decrease

the value of money. Meanwhile raises the general price level in the market.
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Causes of Inflation

Demand pull Inflation

In which inflation arises due to increase in demand of goods. On the other hand supply of the goods not according to demand of consumers at the result price level increase of existing goods, this situation creates the inflation in the market.

Causes of Demand pull inflation

1. **Increase in supply of money**

   Rapid increase in supply of money creates the demand pull inflation. Due to it income of people rises, and they demanded more goods but on the other hand supply not according to demand of goods, at the result price level of existing goods will rise, after it inflation occur.

2. **Deficit financing**

   When government of the country borrows money from banks or prints more notes to finance the projects. These projects become productive after sometimes but the income of the factors engaged with these projects increase suddenly. This increase in income causes increase in aggregate demand for goods. At the result price level of existing goods will rising up.

3. **Foreign Remittance**

   When foreign income of the people increase, due to this purchasing power of the peoples also rising up. But supply of goods not according to requirement of consumers, after it price level of exiting goods will increase due to increase in demand of goods.

4. **Rapid increases in population**
When the rate of population rises very sharply, then goods are more demanded in the market. But supply of goods and services not is according to demand at the result price level of goods rising up as well as inflation occurs.

5. **Increase in wages**
When the wages of the employees increased then the income level of peoples will rise as before they earned. Then purchasing power of the consumer increased but on supply side, it's not according to demand and after it prices are shooting up.

6. **Hoarding and smuggling**
The artificial shortage called hoarding may result in rising prices. Similarly, when the output of our country is smuggled abroad, the prices increase due to domestic shortage of goods.

7. **High consumption**
High level of consumption, just like, adds fuel to the fire of inflation. When people increase their consumption then producer increase the prices of goods, and inflation occurs

8. **Black money**
It may earn through smuggling tax evasion etc. increase the demand for luxurious goods. After it prices of these goods rise, and inflation occurs

9. **Non-development expenditure**
The larger non-development expenditures of a country increase the money supply that creates more demand for goods and services. It thus becomes an active factor to inflationary pressure in a country.

Cost push Inflation

When the cost of production increase and producer raise the price level in the market, it's called cost push inflation. During the manufacturing process, increase the cost of Factor of Production show the high cost of production, at the result producer reduce the supply of goods due to lesser profit ratio, the general price level increased

Causes of cost push inflation

1. **Rising prices of imported goods**
   When the prices of imported goods increases then cost of producers goods also rises, and for the purpose earning more profit producer rise the price level and meanwhile inflation occurs.
2. **Rise in oil and Gas prices**
   When the government of the country increases the prices of oil and gas for industries etc. then cost of production will rise and after it price also rise and inflation occurs in the market
3. **Increase in wages**
   Due to shortage of skilled and efficient labour in the market, the remaining part raises their wages level. Due to this rise producers will pay more as before. After it cost of the producer will rise and inflation occurs.
4. **Increase in indirect Taxes**
   When increase in indirect taxes (sales tax, excise, duties etc) result in increasing the cost of production of goods after it the manufacturer increased in general price level of the goods.
5. **Rise in support prices of agriculture corps**
   In order to protect the interests of the farmers, the agriculture countries provide support to agricultural products. It has cost push inflationary effect on the economy.
6. **Sick industrial units**
   There are a lot of industrial units which are closed due to shortage of fund. For this reason the output of industry is decreasing and price level rising.

Measurement to control the inflation

Basically inflation is very danger factor for the economy. And for its controlling not only one

Measurement is required, so under following some sort of measurement to control the

Inflation from the market.

1. **Proper check on monetary expansion**

Currency notes should issued by central bank of the country according to the requirement of the peoples and industries. If over demanded notes are controlled then day to day inflation also controlled from the market.

2. **Deficit financing**
The government of the country should control the deficit financing in the form of bank borrowing and printing notes of new currency.

3. **Reduction in Tax rates**
Government should reform the whole structure of Tax for the purpose of to attracting the new investors and businessmen etc. after it production level increase, as well as price falling.

4. **Revival of sick industries**
The revivals of sick industries units, would increase production and reduce inflation

5. **Compulsory saving**
The government of the country may start schemes of compulsory savings to take from each person some portion of his income. For the purpose of decreasing saving power of consumers,

6. **Reduction in import duties**
The reduction in import duties on industrial raw material, machinery and selected consumer item would greatly help in checking smuggling and controlling inflation in the country.

7. **Price control committee**.
Price committees must be formulated to control the price level. The weekend markets must be introduced in order to stabilize the price level.

8. **Consumer courts**
The consumer courts can contribute a lot to control inflation in the country.

9. **Increase in production**
The increase in production of goods is helpful to increase the supply in the market. The increased production can regulate the price level.

10. **Control of investment**

The govt. should control the investment for those areas where the output equal to zero. And motivate the level of investment where the productivity level rises.

11. <u>Control on marriage expenditure</u>

The govt. control on excessive spending on marriage ceremonies can greatly help in controlling inflation.

12. <u>Special bazaars</u>

The govt. should arrangement for holding Friday, Tuesday, and Sunday bazaars in big cities to ensure the availability of fruits, vegetable and kitchen items at fair prices, will helpful to control the inflation.

<u>Conclusion</u>

As above discussed inflation is very difficult to control. But being a Muslims we have a strong Believe on Allah, because Allah can do every thing. If we spend our life according to Islam then all the problems are easily remove from the economy. Richer give the Zakat to poorer, then they can buy basic necessities of life. And all above measurement are interlink each other if these are implemented by the govt. then we can say 5 to 10 year required to remove the inflation from the market.

Q.18 Defines the Term Trade cycle. Explain its characteristics of Trade cycle, explain the different Phases of the Trade cycle.

<u>OUT LINE</u>

Introduction

Definition

Features of Trade Cycle

Phases of Trade cycle

Conclusion

Introduction:

History tells us about the ups and down in Business cycle. In which some time good trade of the business that shows the Profit period of it, and some time bad trade of the business that shows the loss period of it. Such good or bad Trade is called the business Cycle or Trade cycle. We can say it the Periodic fluctuations in economic activities of a country are called business cycle.

Definitions

By Prof. Haberler:

"Business cycle in the general sense may be defined as an alternation of period of prosperity and depression of good and bad Trade."

By Hansen:

"Business cycle is the fluctuation in the employment: output and prices."

By M.Keynes:

"A trade cycle is composed of period of good trade characterized by rising prices and low unemployment percentage alternating with period of bad trade characterized by falling prices and high unemployment percentage."

Features of Trade Cycle

1. **Regular Intervals**
   The main features of Trade cycle is regular intervals of its different phases. Every Boom is followed by depression and in turn depression s followed by boom. Every phase takes two to three years to complete. The total time period of a business cycle is usually 8 to 12 years.
2. **Slow Recovery**
   The movement of business activity is slow from depression to Boom.
3. **Rapid down falling**
   There is rapid down falling of the business activity form boom to depression
4. **World wide**
   A trade cycle is not the problem of one country. It is world wide in nature.

5. **Similar application**
   When each of one phase is starts then it effect all the industries, like if there is Boom then all industries will reflect the same. On the other hand if their is depression phase, the same characteristics can be seen in all sectors of the economy.
6. **Employment level**
   The employment level falls with the contraction of business activity and rises with the expansion of business activities.
7. **Capita goods**
   The capital goods industries are the first to be depressed and first to be recovered.

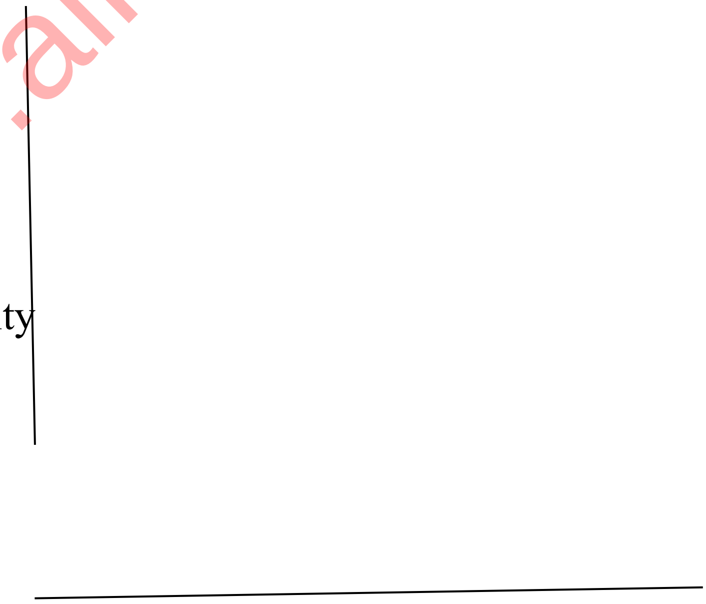
8. **Rise and fall in economic variables**
   The economic variables i.e. income, output, profit, wages and prices rise in boom and fall in depression.

Phases of Trade Cycle

There are four phases of Trade Cycle as under

1. Depression
2. Recovery
3. Boom
4. Recession

Economic activity



Time

Depression/ Contraction

A period of trade in which business experienced with low profit ratio, as well as suffering loss, with low productivity and sales. In simple words we can say it's a period of Bad trade. It's characterized as under:

1. Low productivity
2. Low national income
3. Low per capita income
4. Low purchasing power of people.
5. Decrease in average demand
6. Fall in price
7. Low profit margin
8. Insufficient rate of investment
9. Fall in bank credit
10. High rate of interest
11. High unemployment

Recovery or Revival

After the depression has lasted for sometime, a ray of hope appears on the business horizon. Businessmen start thinking about their businesses. They decide to repair their industrial units and alert the factors of production. Thus is characterized by:

1. Optimistic approach of businessmen
2. Initiative of investment in consumer and producer goods industries
3. Profit margin re-appears
4. Per capital income is increasing
5. Purchasing power of people is improving
6. Prices show upward trend
7. Ranks started advancing loans by lowering the rate of interest
8. Employment rate is increasing

Boom, Peak

A period of good trade is called boom. We can say it is the end of recovery period.

It's characterized as under:

1. New investment in all sectors of the economy.
2. Revival in all industries
3. High level of national income.
4. High per capita income.
5. High propensity to consume.
6. High prices
7. Low purchasing power of money
8. High purchasing power of people
9. Credit expansion by the banks
10. High profit margin
11. High employment rate

Recession

In this period economy moves from boom to depression. The period of boom does not last forever. In order to increase production in boom, less efficient factors of production are employed at high cost. Due to increased demand, the production falls short which results in increase in prices.

It's characterized as follow

1. Pessimistic demand starts decreasing
2. Aggregate demand starts decreasing
3. National income also starts falling
4. Per capita income is falling
5. Over production takes place
6. Investment starts decreasing
7. Prices also come down
8. The profit margin decreases
9. Unemployment creates in the economy
10. Banks feels hesitation in advancing loans

Conclusion:

No doubt Trade cycle create more fluctuation for the economy. But it's compulsorily for business. And during its different phases some time business enjoying the period of profit, and some time suffering period of loss.

Q. 19 Define Negotiable Instrument, explain the difference between the Bills of Exchange, Cheque, Promissory note.

Definition

"According to Negotiable instrument Act, a negotiable instrument means a promissory note, bill of exchange or cheque payable either to order or to bearer. "

Bills of Exchange	**Cheque**	**Promissory note**

1. Definitions It is a written instrument containing an unconditional order, signed by the maker, directing certain person to pay a specified sum of money on demand or at a fixed or the determinable future time, only to or to the bearer of the instrument.	It is an written instrument containing an unconditional order, signed by the maker directing to certain bank to pay, on demand a certain sum of money only to or to the order of a person or to the bearer of the instrument.	It is an written instrument containing unconditional undertaking, signed by the maker to pay a certain sum of money on demand or at a fixed or determinable future time only to or to the order of a certain person or to the bearer of instrument.
2. Drawee It is drawn upon a specified person including a bank.	It is drawn only upon a bank	It is draw upon a specified person
3. Acceptance It is always accepted by the Drawee	It does not require any acceptance.	It does not require any acceptance.
4. When payable It is payable either on demand or on the expiry of a fixed period or determinable future time.	A cheque is always payable on demand.	It is payable either on demand or on the expiry of a fixed period or determinable future time.
5. Grace period Three days of grace are given after maturity date.	No grace period is given. It is immediately payable on demand.	No grace period given. It is immediately payable on demand.
6. Stamp It must be properly stamped.	It does not require any stamp. It can be crossed.	It does not require any stamp.

7. Crossing It cannot be crossed. **8. Stop payment** The payment of Bills of exchange cannot be stopped **9. Notice of Dishonor** It bill of exchange is dishonoured , a notice of dishonour must be given	The payment of a cheque can be stopped When a cheque is dishonoured, a notice of dishonour is not required to be given	It cannot be crossed. The payment of a cheque can be stopped In case payment of P/N is not made, a notice of dishonour is not necessary.

10. **Protection to Drawee** The Drawee is not protected if he makes payment under forged endorsement.	The banker is protected if he pays a cheque under forged endorsement.	The Drawee is protected.
11. **Noting and Protesting** Noting and sometimes protesting is required	Noting and protesting are not required.	Noting and protesting are not required.
12. **Payable to** It can be made payable to the drawer	It can be made payable to the maker or Drawer	It cannot be made payable to the maker but to payee or endorsee.
13. **Liability of Drawer** In case of B/E, the liability of the drawer is secondary; he is liable only when the acceptor refuses to pay.	In case of cheque the liability of the drawer is secondary; he is liable only when the acceptor refuses to pay.	In case of promissory note, the liability of the maker is primary and absolute.
14. **Responsibility** The acceptors of B/E are jointly responsible only.	The maker may jointly as well as severally responsible	The maker may jointly as well as severally responsible
15. **Who Draws** It is drawn by the creditor	It is written by the debtor	It is written by the debtor
16. **Order Or Promise** Bills of exchange is order to pay	Cheque is order to pay	Promissory note is promise to pay
17. **Parties**	There are usually three parties involved in Cheque a) Drawer b) Drawee c) payee	There are usually two parties involved in P/N, a) Maker, b) payee

involved There are usually three parties involved in B/E i.e. a) Drawer b) Drawee c) payee		

Q. 20 Define Deflation? What are its causes and Remedies of Deflation?

OUT LINE
Introduction
Definitions
Causes of Deflation
Remedies of Deflation

Introduction:

It refers a situation in which quantity of money becoming fall as per demand, and value of money rises due to shortage of money, also fall in price of goods. When deflation occurs then people don't have money to buy goods and services. There is over production in the economy. New investments are not made.

Definition:

By Prof. Crowther

"Deflation is that state of the economy where the value of money is rising or prices are falling."

By James Phillips:

"Deflation is a period during which level of prices declines and the value of money rises."

By William J. Baumol:

"Deflation refers to a sustained decrease in the general price level.

Causes of Deflation

1. **Fall in Quantity of money**
   The main cause of deflation is shortage in QM in market. Banks are not able to a position to fulfilling the demand of money for the economy. Due to it value of money increase.
2. **Over Production**
   When production of goods and service becoming over rise as per demand of the economy, then it create the low price

level of the goods and services, and meanwhile deflation occurred.

3. **High Taxes**
   A high rate of income taxes means the low purchasing power of general public. The decrease in income due to taxes forces the people to buy than before high force the people to lower their demand rate.
4. **Fall in investment**
   During deflation banks charges high interest due to lesser quantity of money. Then people hesitate to getting loan from the bank, as well as hesitate to investing the money on business due to low profit ratio of earning.
5. **Less Demand of goods & services**
   The decrease in demand is cause of deflation. On the other hand demand decrease in income, wages. The excess supply and lesser demand bring the fall in price level and after it deflation will be occurred.
6. **Poor storage facility**
   The businessmen may have poor storage faculties. The perishable goods can not be kept for long period of time. The sellers have no choice but to sells goods at any rate. The result is that the price level comes down.
7. **Lower profit**
   Due to decrease price level of goods the businessmen cut down their profit to retain in the market. After it deflation occurred due to over production of goods in the market.
8. **High reserve ratio**
   The central bank has power to regulate the resave ratio when riser ratio raised
   The banks are bound to keep cash with them. The lending capacity is lowered in order to lower the money supply in the market.
9. **High cost of goods**

Cost of production increased due to increased the cost of factors of production. At the result producer raised the price level of goods and consumer fails to buy the costly goods

10. **Decrease in population**
The decrease in population can lower the demand for goods and services. All marketing activates are useless when there is no demand. The population is a source of demand for purchase of goods.

11. **Heavy imports**
Imports in large quantity increase supply of goods in country. The excess supply puts the pressure on businessmen the rate of profit comes down. Thus excess imports are the reason for lowering the business work.

Remedies of Deflation

1. **Rise in supply of money**
To control the deflation their must be rise in quantity of money with the help of central bank. And central bank increases the currency notes for the development of the country.
2. **Increase in credit**
With the policies of Central bank, commercial bank raised the limit of credit for businessmen and industrialist, after it business activates increased and production supplied according to demand of peoples.
3. **Low rate of bank**
Deflation may be controlled by lowering the bank rate. The central bank lowers the bank rate to provide more funds to commercial banks. The lower bank rate means that there is less money supply in the economy.
4. **Fall in tax rates**
Deflation can be controlled with the low rate of Tax, because it will bring the lesser cost of goods, as well as lesser price of goods, then after it deflation will be automatically controlled.

5. **Public works**
   The Govt. can start public works programmed to climate deflation. The amount is transferred from govt. to general public. The demand for goods increases and there is increase in production.
6. **New investment**
   The investment can be made to set up new factories and mills. The production and employment increases due to new investment.
7. **Production control**
   The control over production can help to control deflation. The producers can fix production quota for each producer. The control over supply is necessary to maintain price level.
8. **Increase in exports**
   The exporters can play their part for selling extra out put in the overseas market. The businessmen can reduce the worries of deflation.
9. **Increase in wages**
   The wages of workers can be increased to control the deflation. The govt fixes the minimum wage rate the increased wages raise the income level of worker they go to market for purchase of goods and services.

Q. No. 21 Define Nationalization, explain the advantages and disadvantages of Nationalization.

OUT LINE

Introduction

Definition

Advantages

Disadvantages

Introduction

The government headed by Z.A. Bhutto privatized all industrial units and banks. The consumer goods industries, steel industries, cement industries automobile industries and all banks ere taken over by the government. Banks are also nationalized with the effect form July 1, 1974 under Nationalization of bank act 1974.

Definition

Its means taking over the management and control of organization owned by private individuals, called nationalization.

Advantages of Nationalization

1. **Fair distribution of credit**
   Before nationalization the directors of banks were used to avail big loans for the promotion of their business and industries.

The nationalization of banks remove that wrong practice and made the distributed of credit fair among all indiscriminately. The small businessmen, small industrialist and small farmer could avail for their respective concern.

2. **Price stability**
   Another advantage of nationalization was that the central bank with the help of nationalized bans could minimize the fluctuations in economies activities. It would discourage the speculation, hoarding and other anti-social activities. That would stabilize the prices.
3. **Financing of agriculture**
   Agricultural sector totally ignored before nationalization of banks, due to uncertainty of production and income which may lead to default. After it govt. provided liberal loans to farmers. That caused increase in production and agriculture income to the farmer.
4. **Service motive**
   Nationalization was advocated on another ground that nationalized institutions would provide better services to the customers. The commercial approach was replaced by the spirit of service to people.
5. **No concentration of bank credit**
   Before nationalization there was concentration of bank credit in few hands. Business and industrial monopolies were formed. Nationalization helped in fair distribution of credit and thus eliminated the chances of monopoly formation.
6. **Removing of wasteful competition**
   The burden of huge publicity expenses was shifted to consumers in the form of raising prices of the products. Nationalization was supposed to eliminate such competition thus providing ultimate relief to the customers.

7. **Abolition of Malpractices**
   The banks and other private sector enterprises were nationalized to stop the malpractices like that of unlawful

transactions, evasion of foreign exchange, evasion of taxes, heavy advances to directors etc.

8. **Improvement in efficiency**
   The efficiency of nationalized institutions would improve when they would be operated in the interest on nation. Before nationalization, the making of more profit was the only criterion of efficiency.
9. **Security in depositors**
   People showed more confidence in a state owned organization. Their deposits were safe in nationalized banks.
10. **Economic growth**
    The rate of economic growth would increase because the nationalized bank would formulate the credit policy in accordance with the growing needs of different sectors.

Disadvantages of Nationalization

1. **Malpractices**
   The malpractices in nationalized banks were going on. The favoritism still exit in banks in different forms.
2. **Fall in service standard**
   The service standard had not improved. It had rather deteriorated.
3. **No stability in price**
   Nationalization of banks had done nothing in the stabilization of prices because all the requisites of price stability could not be achieved with nationalization.
4. **Low efficiency**
   The workers are appointed on the basis of their political affiliation rather than their standard of education, capabilities and efficiency. The result was inefficient management and low efficiency was the job security in government service.
5. **Immigration of skilled persons**
   The able bankers preferred foreign job where they given due regard in the form of high remunerating and other benefits.
6. **Less chances of promotion**
   The chances of promotion in nationalized banks were less. Their promotion depended on the length of service, whereas private banks consider efficiency for promotion.

Q. No.22 Define privatization; explain the advantages and disadvantages of privatization.

<u>OUT LINE</u>

Introduction

Definition

Advantages of Privatization

Disadvantages of privatization

Introduction

In Pakistan the term privatization became popular in1977 when the government headed by Gen. Zia-ul-Haq decided to hand over the nationalized industrial units to private sector in order to encourage private sector. The private investors were not interest in making investment in Pakistan due to fear of nationalization.

Benazir Bhutto came in to power in 1988. She continued the privatization policy of the previous government and gave confidence to private sector by giving them some incentives. Nawaz sharif came into power in 1990. He is an industrialist and therefore the accelerated the privatization process. It is said that the pace of privatization of Nawaz government was even faster then the privatization of U.K

Pervez Musharraf and Shaukat Aziz also privatized some public sector like Pak Arab Fertilizer and PTCL was also privatized. The privatization of Pak steel mill was challenged in Supreme Court. As a result, court stopped privatizing Steel Mill. That is why Chief Justice Iftikhar Ahmed Ch. was punished by then President Pervaiz Musharraf for his intervention in their black act.

Privatization of banks

1. MCB and ABL were handed over to private sector through privatization commission to Mansha Group and allied Management Group respectively.
2. HBL was privatized in 2004
3. UBL shares were offered to private sector in 2005
4. Some percentage of shares of National bank of Pakistan is also sold to private person.
5. IDBP, ZTBL, SME bank are also planned to be privatized.

Advantages of Privatization

1. Increase in productivity
2. Increase in efficiency
3. Improvement in quality
4. Healthy competition
5. Increase in exports
6. Extension of market
7. Increase in employment
8. Adoption of modern technology
9. Mobilization of resources.
10. Encouragement to private sector
11. Increase in output
12. Price stability
13. Increase in taxes
14. Acceleration of economic growth

Disadvantages of privatization

1. Increase in inflation
2. Artificial shortage
3. Increase in smuggling of food items
4. Commercial approach
5. Focus on advertisement
6. Exploitation of consumers
7. Increase in poverty
8. Class conflict
9. Increase in crime values

Q. No 23 Define Trade cycle, what are causes of Trade cycle? How we can control the Trade cycle?

OUT LINE

Definition

Causes of Trade cycle

1. **Internal causes**
2. **External causes**

Remedies to control the T.C

Definitions

By Prof. Haberler:

"Business cycle in the general sense may be defined as an alternation of period of prosperity and depression of good and bad Trade."

By Hansen:

"Business cycle is the fluctuation in the employment: output and prices."

By M.Keynes:

"A trade cycle is composed of period of good trade characterized by rising prices and low unemployment percentage alternating with period of bad trade characterized by falling prices and high unemployment percentage

Causes of Trade cycle

Internal causes

1. **Under consumption**
   There is too much saving during boom which reduces the level of consumption. The price goes on increasing but wages lag behind. The profit of rich increase at higher rates but income of the poor does not increase as compared to price level. The result is that demand for consumption gods decrease.
2. **Unsold stock**
   Trade cycle occurs due to unsold stock. There is excess supply of goods and services but people are unable to buy goods of their own choice. The unsold to buy in depression.
3. **Imports**

The imports increase the supply of goods in the economy. If the total stock of goods is more than its demand there is depression.

4. **Money supply**
The change is money and credit supply has a major effect upon the level of economic activity. An expansion money and credit supply. Stimulates economic activity and its contraction brings down economic variables over period of time.
5. **Over investment**
Excessive investment in capital goods industries brings upswing and a fall in investment brings downswing in economic activity.
6. **Marginal efficiency of capital**
Keynes claims that fluctuations in marginal efficiency of capital are the main cause of trade cycles. The expansionary phase of the trade cycle commence when the marginal efficiency of capital is higher than the rate of interest an vice versa brings the contraction phase.
7. **Aggregate market**
The business cycle can also be caused by changes in aggregate demand and change in aggregate supply. The contraction phase of the business cycle is caused by decline in aggregate demand and expansion phase by increase in aggregate demand.

External causes

1. **Wars**
During war the resources are used for the production of armaments. As such the output of capital and consumer goods greatly falls. The fall in output, income, profit etc, causes contraction in economic activity.
2. **Population**
The population increases aggregate demand. The investment, employment and income go up. There is tendency towards boom. High rate of inflation will make the bankers nerves.

They will take back loan due to which investment level will shrink.

3. **Science and technology**
The discovery of new material, machines, and methods helps to produce more at low cost. The invention leads to high level of competition in the economy. There is big investment in the economy. There is tendency towards boom.
4. **Government polices**
Govt. polices at home an abroad bring changes in total spending and hence in the level of economic activity.
5. **Surplus exports and forging Ai**d
Surplus exports and foreign aid raise the level of consumption and investment spending. The output income and employment are boosted.
6. **Weather**
The good and bad weather affect the production in agriculture sector. When weather conditions are bad threes low production in agriculture, as well as low production in industrial sector. The demand is the same but output is low so price level goes up.

Remedies to control the Trade cycle

Monetary policy

1. **Bank rate**
The central bank can increase bank rate when there is prosperity. The bank rate can be reduced in case of depression the borrowing and lending is make according depression the borrowing and lending is made according to bank rate. The commercial banks help the central bank to control trade cycle.
2. **Market operation**
The central bank can buy and sell bills and government securities. When money supply is less as compared to its demand the central bank buy the securities and vice versa. For the purpose of regulate supply.

3. **Reserve ratio**
   The central bank can increase or decrease the reserve ratio. The ratio of reserve is decreased during depression and increase in expansion.
4. **Selective control**
   The central bank can provide credit to one sector at low rates and at high rate for another sector. The central bank can check the loans granted by commercial banks, to control trade cycle.

Fiscal policy

1. **Public work**
   The government can start public words program during depression and stop construction of various projects during good trade period. Public works program help to control trade cycle.
2. **Taxes**
   The state can increase or decrease rates of taxes. The government can raise more taxes for
   Contraction of money supply. The tax rates may be lowered to provide excess money supply.
3. **Budget**
   The government can prepare surplus budget during boom period. There is need of deficit budget during deflation. The government can use budgetary measure along with other methods to control trade cycle.
4. **Public debt**
   The government must take loans during depression to meet various needs. In case of boom the debt should be repaid. The government can overcome the difficulties of low business activity through public debt.
5. **Imports**
   The government can allow import of goods, which are needed by public. During depression there is no need to import the items, but when there is boom period the supply of goods can be maintained through imports.

International measures

1. **Production**

The production control measure can be made at international level. The goods produced in excess of demand create from such stock. In case of excess production they hold sups stock. Control over supply means control over trade cycle.

2. **Buffer stock**
   Buffer stock can be kept in warehouses. When production is low the suppliers can meet the demand from such stock. Encase of excess demand production they hold surplus stock. Control over supply means control over trade cycle.

3. **Investment control**
   The government may allow investment in an area where there is low investment. Excess investment in any sector may lead towards depression. There is need for balanced investment in all economic sectors.

Q. No. 24 what is an index number? Discuss its constriction, its uses, also discuss its limitation, and explain and construct the simple index number and weighted index number.

OUT LINE

Definition

Construction of index number

Construction of simple & weighted index number

Uses of index number

Limitation of index number

Definition

By D.Greenwald

"Index numbers a measure of relative changes auguring in a series of values compared with base year"

By A. Haber

"An index number is a ratio usually expressed as a percentage of prices, quantities or values that relates a given period with a comparison period"

Steps for construction of Index Number

1. **Selection of base year**

One year is selected in the past as base. The index number for the base in 100 changes in prices is expressed in percentage from the base year.

2. **Selection of commodes**
   A number of commodities are selected. The class of consumers must be decided to select the goods. The selection depends on the purpose for which the index number is prepared.
3. **Market price quotations**
   The price quotations are obtained from selected market only, the price of each commodity is noted.
4. **Weighting**
   Each commodity is a weight. The weight shows the importance people give to different commodities
5. **Percentages changes**
   The percentage change in prices is calculated.
6. **Calculation of average**
   The average of individual index is calculated. The individual indices are added up and divided by no of weights. This average figure is called index number.

Construction of simple & weighted index number

Simple interest:

According simple index number all items are equally important for the people. But in practical life it is not so. The commodities should be given due importance according to their consumption

Formula R $\frac{\text{price in current year}}{\text{Price in base period}} * 100$

OR

$\frac{P1}{P0} * 100$

Commodity	Price in 1990 (p0)	Base 1990=100	Price in 2000 (p1)	Relative price (R)
A	20 kg	100	25	125
B	5kg	100	10	200
C	15 m	100	30	200
D	40 kg	100	50	125

E	200 quintal	100	450	225
N = 5				∑R = 875

1. 25/20*100 =125
2. 10/5*100 = 200
3. 30/15*100 = 200
4. 50/40*100 = 125
5. 450/200*100 =225

Price in 2000 = ∑R/n = 875/5 = 175
As the index is 175 which means that the price level raise 75% in 2000 over 1990.

Weighted index number

Now are assign high weight to commodities of greater importance to consumers and lesser weights to commodities of lesser importance.

Commodity	Weight (W)	Prices in 1990 (p0)	Base year 1990=100	Prices in 2000 (p1)	Price relative (R)	W*R
A	5	20	100	25	125	625
B	4	5	100	10	200	800
C	2	15	100	30	200	400
D	3	40	100	50	125	375
E	10	200	100	450	225	2250
	∑W=24					∑WR=4450

The weighted index in 2000= ∑WR/ ∑W =4450/24 = 181.2
The weighted price index number is more accurate than the simple index number. The index 181.2 shows that there is 81.2% rise prices in 2000 as compared to 1990.

Uses of index number

1. **Comparison**
   Index numbers are very useful for comparing the values of things over two periods.
2. **Forecasting**
   Index number is very helpful for forecasting economic and business conditions.
3. **Policy making**
   Many economic polices are formulated with the help of index number.
4. **Price index number**
   Index number is used to compare the prices of two periods it serve as a guide for framing monetary and fiscal policy and other policies.

5. **Cost of living index number**
   It is very important in order to know the economic welfare of the people. Cost of living index numbers are very helpful in adjusting wages and in the settlement of wages dispute.
6. **Production**
   Index number are useful for measuring the change in production level the goods and services on e year are compared with the goods and services out put level. The government can decide to import or export goods for welfare of people.

Limitation of index numbers

1. **Selection of base year**
   The base year must be accurate otherwise the results achieved will be misleading
2. **Selection of commodity**
   The pattern of consumption of all categories of people is not the same. Selection of commodities is a difficult job.
3. **Price quotation**
   An index number may be for whole sale or retail prices. Whole sale prices are easy to obtain, but they do not show the real cost of living.

4. **Weighting**
   The weight of goods i.e. people give to different commodities in base year may be changed, in current period due to change in taste and income etc.
5. **Average**
   An index number is an average. An average can not give a complete picture of the situation.

Q. No. 25 Define finance, discuss the various source of business

OUT LINE

Definition

Source of Equity finance

Source Debt finance

1. **Short term finance**
2. **Medium term finance**
3. **Long term finance**

Definition

That business activity which is concerned with the acquisition and conservation of capital funds in meeting the financial needs and overall objectives of the business.

By kriz and duggen

Business finance concerns a firm's acquisition of funds and the management of these funds for various operations.

Source of business finance

1. **Equity finance**

   The financing made by the person who plans the business and makes permanent investment in the form of land, building, machinery etc. is called equity finance

   Source of equity finance

   1. **Sole proprietorship**

      The only source of equity financing in sole proprietorship is the amount, which an entrepreneur invest in the business in money terms or otherwise i.e. land, building, machinery, etc,

   2. **Partnership**

      Partner's contribution to capital fund is the source of equity financing in partnership. They may contribute money or money's worth to business.

   3. **Joint stock company**

      The shareholders are the source of equity financing for a company. They contribute to the capital fund of the company by purchasing shares. It is a permanent source of capital fund and can be increased by further issue of shares.

2. **Debt financing**

   The financing made in a business by the person other than the owner is called debt finance.

We discuss the source of debt financing with reference to the financial needs of a business,

Which may be **short term, intermediate or long term?**

1. **Short term financing**

The financing made by the creditors or periods of one year or less is called short-term financing.

Sources of short term financing

1. **Trade creditors**
   The manufactures, wholesalers and other suppliers of goods who give the facility of credit purchase to their customers are called trade creditors. This is not a cash loan but it is a loan in the form of goods and an important source of short term financing
2. **Commercial bank**
   Commercial bank provide short term finance to a business enterprise in the form of **over draft, discounting bills of exchange, loans against security**
3. **Finance companies**
   The finance companies are providing the service of short term financing. These institutions are not common and know to people but have contribution in promoting small business. For example small business finance corporation SME bank, Khshhali bank etc.
4. **Customers**
   Sometimes a company receives a part of total payment from the customers by way of advance. It is also a sort of short term finance
5. **Pledging the accounts Receivable**
   Some business enterprises obtain loan by pledging their accounts receivable with bank. This is the least used method in Pakistan.

Intermediate financing

To finance a business for a period of more than a year but less than 5 years is called intermediate financing

Sources of intermediate financing

1. **Commercial banks**
   Commercial banks provide intermediate term finance to traders and manufactures against security.
2. **Insurance companies**
   Insurance companies provide finance to manufactures against the security of assets.

3. **Industrial development bank**
   Industrial development bank of Pakistan was particularly established in 1961 to provide intermediate and long term financing to establish and expand industries
4. **Small business finance corporation**
   The corporation is playing a significant role in providing loans to establish small and medium size businesses and industrial units. Youth investment promotion society is also working under this corporation to provide loans to the unemployed educated youth.
5. **Pakistan industrial credit and investment corporation**
   This corporation was set up in 1957 and is major source of debt financing for medium and long term projects. It also provides loans for working capital
6. **Hire purchase**
   The manufactures can avail the facility of hire purchase where they scheme generally charges more price for the goods supplies by him and transfer the right of ownership after receiving the final installment.

Long term financing

In order to have a good capital structure and al well planned business long term financing is required. The period is generally more than 5 years.

Sources of long term financing

1. **For non company business**
   1. Owner's capital and the profit retained in the business
   2. Loan from friends, relatives employees at fixed rate of interest. When one has to purchase his competitor's business or to set up new branches of office or to sign a favorable contract.
   3. Admission of a new partner in partnership business
   4. Commercial banks and other financial institutions like IDBP, PICIC, etc
2. **For company business**
   1. Sale of shares
   2. Issue of debenture certificates
   3. Commercial banks

4. IDBP-industrial development bank of Pakistan
5. PICIC- Pakistan industrial credit and investment corporation
6. ICP- investment corporation of Pakistan
7. NIT – national investment trust
8. EPE- equity participation fund

Q. 26. Explain non-interest banking/ Islamic banking; discuss the source of non-interest banking/ Islamic modes of financing

Out line

Introduction

Islamic modes of financing

Loan financing by lending

Trade related modes of financing

Investment related modes of financing

Introduction

Council of Islamic banking

In October 1977 the council of Islamic ideology was charges with responsibility of bringing about Islamic economic system to be enforced in the country according to teaching o f Holy Quran and Sunnah. The council constituted a panel of economists and bankers which was assigned to prepare a blueprint for non interest banking system.

Islamic modes of financing

There are 12 Islamic modes of financing. These have been approved by State Bank of Pakistan from July 1985. A brief description of Islamic instrument of financing as under

1. **Loans financing by lending**
    1. Interest free loans
    2. Qard-e-Hasana

1. **Interest free loans**

    It is a new concept of lending based IJTIHAD the banks are permitted to lend funds free of interest. They are to cover only the service charges. This modes is beings used to finance exports agriculture inputs and provision of funds to salaried persons.

2. **Qard-e-Hasana**

    Under this scheme, interest free loans are granted to students who do not sufficient funds to continue their education. Qard-e-Hasana is given to the students who are less than 35 years of age and available for post intermediate students in engineering, medical, agriculture, economic commerce etc. loans given will be in the name of student and secured by guarantee of parents guardians for repayment of loans a grace period of 2 year granted after completion of studies.

Trade related modes of financing

1. **Mark up**

   The mark up or BAI MUAJJAL is a purchase of goods by banks and their sale to clients at inappropriate mark up in price on deferred payment basis. The mechanism is as follow.

   1. The customer contacts the bank for financing the purchase of goods.
   2. The bank purchases the required goods and sells these to him on a price mutually agreed between the bank and customer. The price is based on the banks cost plus profit margin of the bank
   3. Payment can be made in installments or lump sum over a specified period of time

2. **Mark down**

   It is a purchase of moveable or immoveable property by the bank with buy back agreement according to this mode, the customer sells the moveable or immoveable property to the bank with a promise to buy back the same from the bank on future date. The payment can be made in installment or lump sum. The difference between the customer price and purchase price is the profit of the bank,

3. **Leasing**

   Leasing also called IJARA is a medium and long term financing mode. In the mode the lessee acquired the use of an asset form the lessor. For fixed period of time. On payment of specified refund as over a period. The title of property remains with the lessor and asset is given back to the lessor after specified period of time.

4. **Hire purchase**

   The state bank of Pakistan has allowed the commercial banks to provide finance for the purchase of machinery to their clients in trade and industry on the basis of hire purchase. In this deal the bank purchases the specified goods at the request of customers and hires them to the client on the payment in periodical installment. The bank charges a fair return form the goods.

5. **Development charges.**

   It is a very useful mode of trade financing. The bank makes advances to customers for the development of land or property. It then shares in value addition of property. This share is known as development charges.

Investment mode financing

1. **MUSHARKIA**

   IT IS an agreement between the bank and the client to participate in a business as temporary partner by providing agreed amount of funds for sharing profit and losses during a specified period of time.

   1. Business is run by the client but the bank will examine the feasibility and profit projection so as to monitor and supervise the business transactions.
   2. Profits are to be shared as agreed.
   3. Losses will be shared strictly in the ratio of their respective investment
   4. This mode is applicable to finance working capital needs of a business.

2. **MODARABA**

   MODARABA means the business in which the subscriber participates with money and manager with knowledge and skill.

   1. It is an agreement in which one party invest funds and other party with managerial efforts.
   2. Modaraba must be registered under the Modaraba ordinance 1980
   3. As per rule the partner who puts in managerial skills must have at least 10% share Modaraba
   4. Profit is shared in agreed ratio.
   5. Modaraba certificates are transferable.
   6. It may be perpetual or for a specified time.

3. **Participation term certificates**

PTC is an instrument of finance issued by company for meeting medium and long term capital needs. A company is authorized to issue the ptc's to schedule banks and financial institutions.

1. Ptc's is an investment of medium and long term financing
2. It is transferable
3. Profit is shard in agreed ratio
4. Losses are shared in the ratio of banks and companies investment
5. Only joint stock company can issue ptc's
6. Short term ptc's are issued to meet working capital needs of a business
7. Long term PTC's are issued in order to meet the fixed capital needs.

4. **Investment on the basis of equity participation**

Equity participation means sharing of risks and rewards of ownership

1. Under this scheme the financer (bank) purchases the shares of the company at market price or at an agreed price.
2. Profit will be shared in the form of interim or annual dividend
3. Loss will be borne in the form for reduction in the market price of shares purchased.

5. Investment on the basis of rent sharing

Rent sharing is applicable to finance the constriction of houses.

1. The bank and the client will contribute funds as agreed.
2. Rent of building will be calculated area wise
3. Rent may able revises after three years.