BANKING AND MONETARY ECONOMICS

3rd YEAR BME

Economic Department

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Banking

What is banking?

Basic Definition: A system of trading money which: provides a safe place to save excess cash, known as deposits. supplies liquidity to the economy by loaning this money out to help businesses grow and to allow consumers to purchase consumer products, homes, cars etc.

Section 5 (b) of the Banking Regulation Act 1949 defines "Banking" as "Accepting for the purpose of lending and investment, deposits of money from the public repayable on demand or otherwise and withdraw able by cheque, draft, order or otherwise" No definition of banking can be comprehensive enough in the present context

MONEY

Money is anything that is generally accepted as a medium of payment.

Money is not income, and money is not wealth. Income and wealth are measured in **money.**

Money has the following functions:

- Medium of payment
- Store of value
- Unit of account

An Overview of Banks and Their Services

Banks are among the most important financial institutions in the economy. They are the principal source of credit (loanable funds) for millions of individuals, families, businesses and many units of governments.

What is Bank: A financial intermediary accepting deposits and granting loans; offers the widest menu of services of any financial institution. Banks are those financial institutions that offer the widest range of financial services- especially credit, savings, and payment services-and perform the widest range of financial functions of any business firm in the economy. This multiplicity of bank services and functions has led to banks being lebeled "financial department stores"

Nonbank Banks: Depository institutions offering checking accounts or commercial loans but not both.

Central Bank

- **Central Bank may be defined as an institution charged with the responsibility of managing the expansion and contraction of the volume of money** supply for general **Economic Welfare.**
- **The Central Bank is the Apex institution in the banking and financial structure** of the country.

Distinction between the Central Bank and the Commercial Bank

Basis	Central Bank	Commercial Banks
1. Number	There is only one Central Bank in a country.	The number of Commercial Banks in a country
2. Status	Central Bank is an apex institution of the money market.	Commercial Banks are units in the banking system which work under the control of Central Bank.
3. Aim	The aim of Central Bank is to control and supervise monetary and banking systems.	The primary objective of commercial banks is to earn profit.
4. Ownership	Central Bank is owned by the government.	Commercial Banks may be owned by government or by private parties.
5. Dealing	Central Bank does not deal directly with the public.	Commercial Banks deal with the public.
6. Issuing of Currency	Central Bank has the monopoly to issue currency.	Commercial Banks are not authorised to issue currency.
7. Credit	Central Bank controls availability of credit in the economy.	Commercial Banks create credit in the economy.

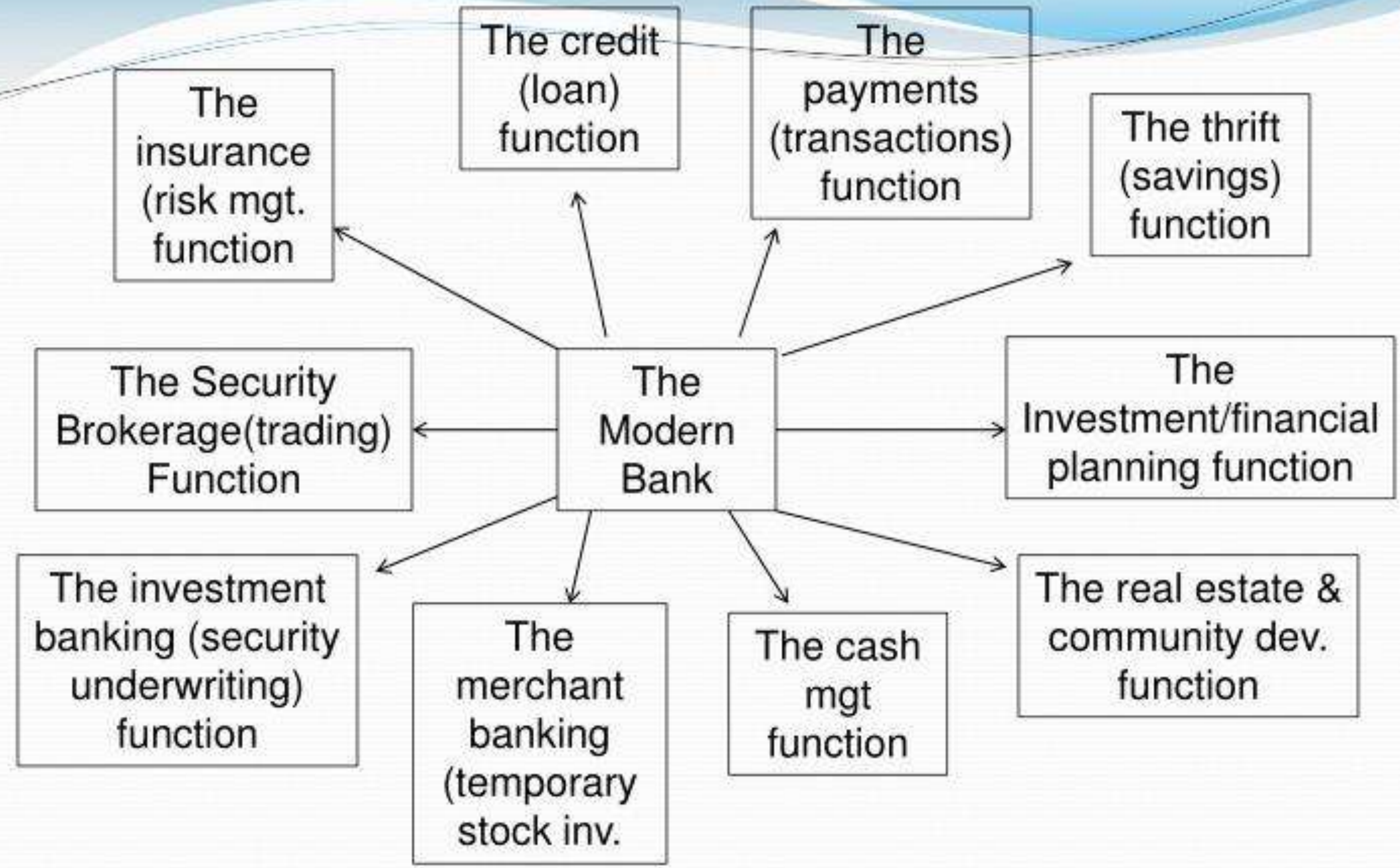


Figure: Service Areas in the Modern Bank

Four Types of Economic Systems:

- These questions are answered by the type of economic system a nation has. There are four types of economies:

1. Pure Market Economy
2. Pure Command Economy
3. Traditional Economy
4. Mixed Economy

Let's review each of these types of economies.

Pure Market Economy

- NO government involvement in economic decisions. Private firms account for all production.
- Consumers decide WHAT should be produced. They do this through the purchases they make.
- Businesses determine HOW the products will be produced. They must be competitive.
- WHO buys the products? The people with the most money are able to buy more goods and services.

Problems

- Difficulty enforcing property rights - no laws.
- Some people have few resources to sell - no minimum income.
- Some firms try to monopolize markets - conspiring and price fixing.
- No public goods. - national defense?

Pure Command Economy

- All resources are government-owned.
- One person (dictator) or a group of officials decide WHAT products are needed.
- The government runs all businesses, controls all employment, and decides HOW goods and services will be produced.
- The government decides WHO receives the products that are produced.

Problems

- Consumers get low priority.
- Little freedom of choice – few products.
- Resources owned by the state are often wasted – individuals don't care if they don't own it.

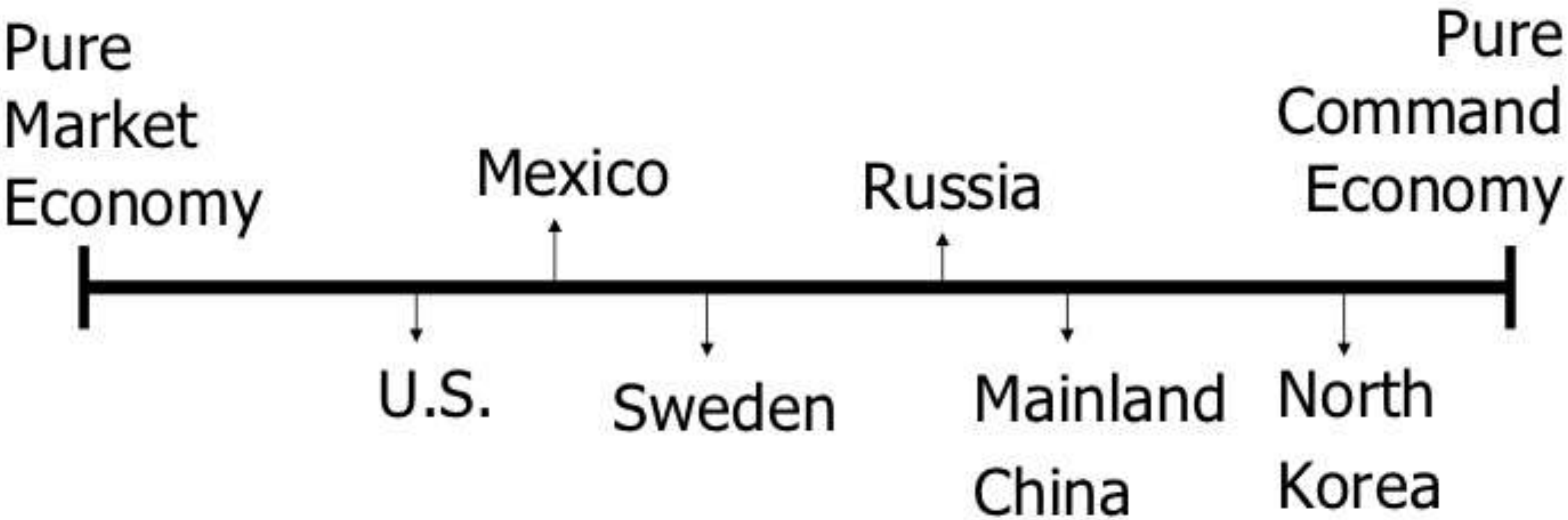
Traditional Economy

- Economy is shaped largely by custom or religion.
- Customs and religion determine the WHO, WHAT, and HOW.
- Example: India has a caste system which restricts occupational choice. (A social class separated from others by distinctions of hereditary rank, profession, or wealth.)

Mixed Economy

- Most economies in the world today are mixed.
- Classification is based on how much government intervention there is.
- In the U.S. the government accounts for about 1/3 of all U.S. economic activity.

Example of Economies…



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