

Ch-8 Central Bank

Good Morning Students,

This lesson is of class 10th for the subject of Economics. The topic for today is 'Central Bank and its functions' which is covered in chapter 8 titled 'Central Bank' of your book Economics.

This lesson is being submitted to you on 21.10.2024 and the voice is of Mr. Lokesh Arora.

Students, now please open page number 174 of your book and listen attentively.

Central Bank:-

Central bank is the supreme market monetary institution at the apex (top) of the monetary and banking structure of a country. It is the leader of money market and as such controls, regulates and supervises the activities of commercial banks. It is the central monetary authority which manages the currency and credit policy of the country and functions as a banker to the government as well as to the commercial banks.

Each country has one central bank. 'Reserve Bank of India' is the

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central bank of our country. It was set up in 1935 under the Reserve Bank of India Act, 1934. The Reserve Bank of India plays very important role in stabilising the country's economy.

Now we will discuss the difference between A Central Bank and A Commercial Bank.

Refer to page number 148 for the difference

Now we will discuss need for a central Bank.

Every country has a central bank. The need for establishing central bank arises from the following :-

- (i) Monetary system requires management. Paper currency which is widely adopted everywhere in the world has to be directed by some central authority. This job can best be done by the central bank.
- (ii) There has been vast expansion in the monetary, fiscal and trade activities of the government. Some bank, therefore, is required to act as banker to the government. This task again can be performed in a better way by central bank.
- (iii) There has been vast expansion of

Commerce and Industry. Some body must be there to exercise its control on the credit expansion or contraction activities of the commercial banks. And this function can be performed efficiently by the central bank of the country.

- (iv) Every modern economy wants to achieve the twin objectives of full employment and price stability. Therefore, a sound monetary policy directed by a central bank is highly needed.

Functions of Central Bank:-

The functions of central banks vary from country to country. But there are certain basic functions which are commonly performed by every central bank in the world. These include the following:-

- (1) Bank of Note-Issue:-

The central bank of the country has the monopoly to issue currency notes. Government grants the exclusive right to the central bank to issue notes on its behalf. However, the monopoly of central bank to issue the currency notes may be partial in certain countries. For example in India, one rupee notes are issued by the Ministry of Finance.

and all other currency notes are issued by Reserve Bank of India. In order to inspire public confidence in paper currency, the central bank keeps reserve of gold and silver against issue of notes.

Following are the main reasons for giving monopoly right of note-issue to the central bank:-

- (i) It brings uniformity in notes circulation.
- (ii) It gives distinctive prestige to the note-issue. As a result, people develop faith in the currency.
- (iii) It enables the government to have supervision and control over the supply of money in the country.
- (iv) It enables the central bank to exercise the control over the creation of credit by the commercial banks.

(2) Banker, Agent and Adviser to the Government:-

(a) As Banker:-

The banking transactions of the government run into crores of rupees. If the business is entrusted to any single bank, it would give that Bank a certain status and would add substantially to its resources and this

would be unfair to other banks. Therefore, the government gives its banking business to the central bank. It offers all these services to the government which a commercial bank offers to the general public. As banker to the government it performs the following functions:-

- (i) It receives deposits from the government and collects cheques and drafts deposited in the government accounts.
- (ii) It makes purchases and sales of government securities.
- (iii) It provides cash to the government as required for various payments.
- (iv) It makes payments on behalf of the government.
- (v) It supplies foreign exchange to the government for repaying external debts.

Students before going further in this topic, I will ask you some questions. You can pause the audio for few minutes and write the answers in your note-book.

Qn 1. Give two differences between a Central Bank and a Commercial Bank.

Qn 2. What is the need of a Central Bank?

Qn 3. Give the reasons behind giving the monopoly right of note-issue to the central bank.

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(b) Functions of Central Bank as a fiscal Agent to the Government:-

- (i) It manages the public borrowings
- (ii) It collects taxes and other payments on behalf of the government.
- (iii) It represents the government in the international financial institutions (such as World Bank, International Monetary fund etc) and conferences.

(c) As Adviser to the Government:-

The central bank also acts as the financial adviser to the government. It gives advice to the government on all financial and economic matters such as deficit financing, devaluation of currency, trade policy, foreign exchange policy etc.

3. Banker to the Banks:-

Central bank acts as banker to the banks in the four ways

(a) As a custodian of cash reserves of the commercial banks:-

Central bank maintains the cash reserves of the commercial banks. Each commercial bank is required to keep a certain percentage of their deposits with the central bank. These reserves enables the central bank to exercise control over credit by commercial banks.

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(b) As a lender of the last resort:-

As bankers to the banks, the central bank acts as the lender of last resort. Whenever a commercial bank needs financial assistance, it may borrow from other commercial banks. But other commercial banks may not be in position to provide funds to bank in need. In such a case the central bank provides funds to commercial banks either by granting loans or by purchasing its securities. In this way central bank acts as the lender of last resort.

(c) As a Clearing Agent:-

As the custodian of cash reserves of the commercial banks, the central bank acts as the clearing house for these banks. Since all banks have their accounts with the central bank, the central bank can easily settle the claims of various banks against each other simply by book entries of transfers from and to their accounts. This method of settling accounts, is called 'Clearing House Function' of the central bank.

(d) As Supervisor:-

The central supervises, regulates and controls the commercial banks. This function is done by using its vested

powers relating to licensing, branch expansion, liquidity of assets, merger of banks and winding up of banks.

(4) Custodian of Foreign Exchange:-

The central bank is the sole custodian of gold and foreign currency reserves such as US dollars, British pound etc. This right of central bank helps it to overcome the balance of payments difficulties and to maintain stability in exchange rate. Whenever there are wide fluctuations in the exchange rate, the central bank buys and sells foreign currency to stabilise exchange rate.

(5) Controller of Credit:-

Commercial banks create credit by lending money. They may create too much or too little credit. The level of credit in the country causes fluctuations in the price level. It becomes necessary to exercise control over credit so as to ensure stability in the economy. The central bank exercises strict control on the credit granting capacity of commercial banks.

(6) Promoter of Economic Development:-

The central bank also performs developmental and promotional functions

- (i) It helps in the development of money and capital markets in the country.
- (ii) It undertakes measures to maintain price stability necessary for the growth of an economy.
- (iii) It adopts suitable measures to maintain exchange rate stability which again is required for growth of international trade and foreign investment.
- (iv) It also creates special financial institutions for promoting economic development in different sectors of economy.

(7) Other Functions:-

Besides performing the above mentioned functions, the central bank also performs some other functions as follows:-

- (i) It maintains relations with the international organisations such as International Monetary Fund, World Bank, etc.
- (ii) It collects and publishes various types of statistics providing useful information about the economy.
- (iii) It conducts research studies, surveys

- seminars, etc. and publishes reports
- (iv) It provides training facilities to the staff working in various banking institutions in the country.

With this, I am ending my topic here. I will give you few questions. You are required to write the answers in your note-books.

1. Explain the functions of Central Bank as a fiscal agent to the government.
2. Explain the clearing house function of Central bank.
3. Explain various promotional functions of Central Bank.

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