

Ch: 14 Banking

Good Morning students,

This lesson is of class X for the subject of Commercial studies. The topic of today is Functions of Central Bank which is covered in Chapter 14 'Banking' of your book titled 'Commercial Studies'. This lesson is being submitted to you on 18.11.2024.

All the students please open page no. 241 of your book and pay attention.

Central Bank:-

Central bank means the bank which regulates the entire banking system in the country and carries out its monetary policy. Central bank is the apex bank and every country has a central bank. 'Reserve Bank of India' is the 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. It tackles the balance of payments and foreign exchange problems of India.

As the central bank, Reserve Bank of India performs the following functions.

- (1) Monopoly of Note Issue:- The central bank ①

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of a country has the monopoly to issue currency notes. Government grants the exclusive right to the central 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~~ rupee notes are issued by the Ministry of finance. 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.

2. Government's Bank:-

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 there would be unfair to other banks. Therefore, the government gives its banking business to the central bank. The central bank acts as a banker, fiscal agent and advisor to the Government.

Functions as a Banker:-

(i) It makes and receives payments on behalf of the Government.

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(ii) It advances short term loans to the government to meet the deficit in its budget.

As a Fiscal Agent:-

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

As an Adviser:-

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, ~~for~~ trade policy, foreign exchange policy etc.

(3) 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 exercise strict control on the credit granting capacity of commercial 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 the exchange rate.

Whenever there are wide fluctuations in the exchange rate, the central bank buys and sells foreign currency to stabilise the exchange rate.

[5] Banker's Bank:-

Central bank acts as the banker to the banks in the following ways:-

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

Commercial banks are required to keep a certain percentage of their deposits in the form of cash reserves with the central bank. These reserves enable the central bank to exercise control over credit by commercial banks. A central bank maintains the cash reserves of the commercial banks.

(b) As a 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 Supervisor:- The central bank supervises, regulates and controls the commercial banks. This function is done by using its vested powers relating to licensing, branch expansion, merger of banks and winding up of banks.

(d) Clearing House Function:-

The central bank provides clearing house facility to commercial banks. Each commercial bank has an account with central bank. Central bank settles the claims of commercial bank through a process of book entries.

Let us explain the process with an example. (Punjab National Bank)

~~Each~~ Suppose PNB has to give 20 Crore to SBI (State Bank of India). To settle this PNB will issue a cheque to SBI. The Reserve Bank of India will reduce the balance of PNB account and increase the balance of SBI (As I had mentioned each bank has an account with central bank)

(7) Development Function:-

The Central Bank also performs certain promotional and development functions. It tries to provide adequate funds for development of agriculture, trade, transport and industry.

The Reserve Bank of India creates special financial institutions for promoting economic development in different sectors of economy. Agriculture Finance Corporation, Industrial Finance Corporation of India are examples of these institutions.

Students, before going further in the chapter, I will ask you some questions. You may pause the audio for few minutes to write down the answers in your note books.

- Q. 1. Explain the function of central bank as a lender of last resort.
- Q. 2. Explain clearing house function of central bank.

Students now we will discuss the role of banks in economic development of an economy.

Banking is the lifeline of an economy and business activities cannot operate smoothly without banking services.

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The efficient administration of banking system can provide a healthy and prosperous life to the nation. Banking is useful to trade and commerce in the following ways:-

1. Safety of Money.
2. Increase in Credit
3. Savings.
4. Transfer of Money.
5. Collection of Money.
6. Facilitate Foreign Trade
7. Mobilisation of Savings!
8. Capital Formation.

Refer to page no. 244 for explanation

Now I am ending my topic here. I will give you some questions, all the students are required to write the answers in their note-books

1. Who has the monopoly of note-issue?
2. Explain the function of central bank as a banker to the Government.
3. Explain the role of banks in economic development of a nation.

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