

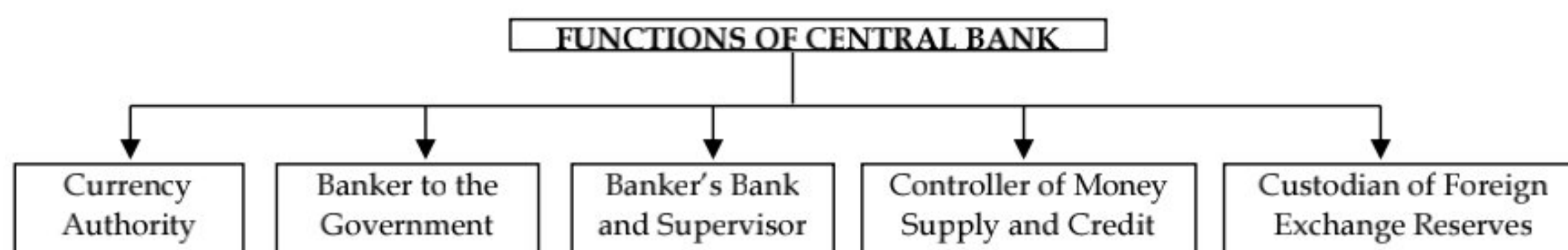
## CLASS-12 CENTRAL BANK

**Central Bank is an 'Apex' body that controls, operates, regulates and directs the entire banking and monetary structure of the country.**

It is known as the apex (supreme) body as it occupies the top most position in the monetary and banking system of the country. All the financially developed countries have their own central bank. India's Central Bank is the Reserve Bank of India (RBI). RBI was established in April 1, 1935 under Reserve Bank of India Act passed in 1934.

Central bank is known by different names in different countries. In India, it is Reserve Bank of India (RBI), in UK as Bank of England and in USA, it is known as Federal Reserve System.

**FUNCTIONS OF CENTRAL BANK:** As the Central Bank of the country, The Reserve Bank of India performs the following functions:



### **Currency Authority (Bank of Issue)**

Central Bank has the sole authority for issue of currency in the country. In India, Reserve Bank of India (RBI) has the sole right of issuing paper currency notes (except one-rupee notes and coins, which are issued by Ministry of Finance). It works with the system of unlimited legal tender.

All the currency issued by the Central Bank is its monetary liability, i.e. Central Bank is obliged to back the currency with assets\*\* of equal value, to enhance the public confidence in paper currency.

### **Advantages of Sole Authority of Note issue with RBI**

- (i) It leads to uniformity in note circulation.
- (ii) It gives the central bank power to influence money supply because currency with public is a part of money supply.
- (iii) It enables the government to have supervision and control over the central bank with respect to issue of notes.

### **Banker to the Government**

The Reserve Bank of India acts as a banker, agent and a financial advisor to the Central Government and all the State Governments (except that of Jammu and Kashmir).

As a *banker*, it carries out all banking business of the government.

- Provide banking services.
- Act as an agent and underwriter.
- Act as advisor.

As an *agent*, the central bank also has the responsibility of managing the public debt. As a financial advisor, the central bank advises the government from time to time on economic, financial and monetary matters.

### **Banker's Bank and Supervisor**



There are a number of commercial banks in a country. There should be some agency to regulate and supervise their proper functioning. Being the apex bank, the central bank (RBI) acts as the banker to other banks. In this sense, it bears the same relationship with commercial banks as the latter maintains with the general public.

As the banker to banks, the central bank functions in three capacities:

**(i) Custodian of Cash Reserves:** Commercial banks are required to keep a certain proportion of their deposits (known as Cash Reserve Ratio or CRR) with the central bank. In this way, central bank acts as a custodian of cash reserves of commercial banks.

*For 'Advantages of Centralised Cash Reserves with Central Bank refer Power Booster.*

**(ii) Lender of the Last Resort:** When commercial banks fail to meet their financial requirements from other sources, they approach the central bank to give loans and advances as lender of the last resort. Central bank assists these banks through discounting of approved securities and bills of exchange.

**(iii) Clearing House:** As central bank holds the cash reserves of all the commercial banks, it becomes easier and more convenient for it to act as their clearing house. All commercial banks have their accounts with the central bank. Therefore, the central bank can easily settle claims of various commercial banks against each other, by making debit and credit entries in their accounts.

**As a supervisor,** central bank regulates and controls the commercial banks. The regulation of banks may be related to their licensing, branch expansion, liquidity of assets, management, merging, winding up, etc. The control is exercised by periodic inspection of banks and the returns filled by them.

#### FAQ'S

1. Explain the function of a Central Bank as a banker to the government.

OR

Explain 'banker to the government' function of Central Bank.

2. Explain Central Bank's function as currency authority.

OR

Explain 'bank of issue' function of central bank.

3. Explain the 'banker's banks' and 'supervisor' function of the central bank.

OR

Explain 'banker's bank' function of Central bank,