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Department of Commerce / Business Administration

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IMPORTANT NOTICE

Assignments Last Date: 20-02-2027

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Question No. 1

What is money? Discuss the various forms and functions of money in a modern economy. (20 Marks)

Answer

1. Introduction and Definition of Money

In economic literature, **money** is defined as any asset or verifiable record that is universally accepted as a medium of exchange for goods, services, and the repayment of debts within a specific socio-economic context or country. According to Professor Walker, "*Money is what money does.*" Economically, money eliminates the friction of trade and serves as the lifeblood of modern financial infrastructure.

Money possesses three fundamental defining characteristics:

1. **General Acceptability:** It must be trusted and acknowledged by all market participants without dispute.
2. **Legal Tender Status:** It is backed by state decree (*fiat*), requiring creditors by law to accept it for debt discharge.
3. **Liquidity:** It represents absolute liquidity (L_1), meaning it can be instantly converted into any real asset or service with zero transaction cost and zero price loss.

2. Functions of Money in a Modern Economy

Economists traditionally categorize the functions of money into Primary, Secondary, and Contingent functions.

A. Primary Functions

- **Medium of Exchange:** Money acts as an intermediary instrument in commercial transactions. Prior to money, the barter system suffered from the "*Double Coincidence of Wants*"—the requirement that two parties each possess the exact commodity the other desires. Money decouples buying from selling, allowing specialized production and market efficiency.
- **Unit of Account (Measure of Value):** Money provides a common denominator or pricing benchmark through which the economic value of diverse goods and services can be measured and compared. Instead of quoting wheat in terms of shoes, cloth, or cattle, all prices are denominated in standard monetary units (e.g., PKR, USD).

B. Secondary Functions

- **Store of Value:** Money allows economic agents to defer consumption from the present to the future. It holds purchasing power over time, provided price levels remain relatively stable.
- **Standard of Deferred Payment:** Modern economies rely heavily on credit. Money provides a stable unit for specifying future financial obligations, enabling long-term contracts, mortgages, bonds, and business loans.
- **Transfer of Value:** Money facilitates the seamless movement of purchasing power across geographic locations and asset classes.

C. Contingent and Dynamic Functions

- **Distribution of National Income:** Total national output ($Y = C + I + G + X_n$) is distributed among factors of production (Land, Labor, Capital, Entrepreneurship) in the form of monetary rent, wages, interest, and profits.
- **Equalization of Marginal Utility:** Consumers allocate monetary expenditure across goods to equate marginal utility per rupee spent ($\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$).
- **Basis of Credit System:** Commercial banks utilize primary monetary deposits to create credit expansion (M_2, M_3) via the money multiplier.

3. Various Forms of Money

Over monetary history, money has evolved through several distinct phases:

Table 1: Comparative Structure of Forms of Money

Form of Money	Key Characteristics	Liquidity Level	Examples
Commodity Money	Has intrinsic value as a usable good.	Low to Moderate	Gold, Silver, Salt, Cattle
Metallic Money	Standardized minted coins with fixed weight and purity.	High	Gold Sovereigns, Silver Coins
Paper / Fiat Money	Issued by central bank decree; zero intrinsic value.	Absolute (100%)	PKR Currency Notes, USD Bills
Bank / Credit Money	Deposits created by commercial banks transferred via instruments.	High	Cheques, Pay Orders, Demand Drafts
Electronic / Digital	Computerized ledger balances and cryptographic tokens.	Absolute Instantaneous	Debit Cards, Raast, CBDCs, E-wallets

1. **Commodity Money:** Early currency where the medium itself held intrinsic utility (e.g., precious metals).
2. **Fiat Money:** Currency established as money by government regulation or law. It has no intrinsic value but derives value from public trust and legal backing.
3. **Fiduciary Money:** Money accepted based on trust between payer and payee (e.g., cheques, drafts).
4. **Digital and Near-Money:** Financial assets easily convertible to liquid cash, such as savings deposits, Treasury bills, and electronic wallet funds.

Question No. 2

What is the value of money? Discuss the factors determining the value of money in an economy. (20 Marks)

Answer**1. Concept of the Value of Money**

The **value of money** refers to its purchasing power—the quantity of real goods and services that a single unit of currency can command in exchange. Unlike physical commodities whose value is judged by utility, the value of money is purely functional and inversely related to the general price level (P).

Mathematically, the internal value or purchasing power of money (V_m) is expressed as:

$$V_m = \frac{1}{P} \quad (1)$$

where P is the general price index (such as the Consumer Price Index, CPI).

- When price level P increases ($\uparrow$), the value of money V_m decreases ($\downarrow$) $\rightarrow$ **Inflation**.
- When price level P decreases ($\downarrow$), the value of money V_m increases ($\uparrow$) $\rightarrow$ **Deflation**.

Economists distinguish between two dimensions of the value of money:

1. **Internal Value:** Domestic purchasing power of currency over local goods and services.
2. **External Value:** Foreign purchasing power, measured by the nominal and real effective exchange rates (NEER/REER) relative to foreign currencies.

2. Theoretical Frameworks

The determination of money's value is explained by classical and modern monetary theories:

A. Irving Fisher's Quantity Theory of Money (Equation of Exchange)

Irving Fisher posited that the quantity of money determines the price level directly:

$$M \cdot V = P \cdot T \quad \implies \quad P = \frac{M \cdot V}{T} \quad (2)$$

where M = Money Supply, V = Velocity of Circulation, P = Price Level, and T = Transaction Volume. Assuming V and T remain constant in the short run, doubling the money supply (M) doubles the price level (P) and halves the value of money ($\frac{1}{P}$).

B. Cambridge Cash Balance Approach

Developed by Marshall and Pigou, this focuses on demand for money balances (k):

$$M = k \cdot P \cdot Y \quad \implies \quad P = \frac{M}{k \cdot Y} \quad (3)$$

where k is the proportion of annual real income (Y) people desire to hold in liquid monetary form.

3. Factors Determining the Value of Money in an Economy

Key Determinants of the Value of Money

- **Total Quantity of Money Supply (M_2, M_3):** Excessive currency issuance by the central bank dilutes purchasing power.
- **Velocity of Money (V):** Higher transaction speed increases effective aggregate demand, driving up prices.
- **Aggregate Supply of Goods and Services (Q):** Industrial and agricultural output growth absorbs money supply and stabilizes V_m .
- **Fiscal Deficits and Monetization:** Printing money to finance budget shortfalls (*seigniorage*) creates inflationary pressure.
- **Exchange Rate Volatility:** Currency depreciation increases imported raw material costs, lowering domestic purchasing power.
- **Interest Rates and Credit Policy:** Low policy rates accelerate commercial bank credit creation, expanding money supply.
- **Public Trust and Inflation Expectations:** Anticipation of future price rises reduces cash holding (k), accelerating price increases.

Question No. 3

Describe in detail the concept and types of inflation. How can inflation be controlled in Pakistan? (20 Marks)

Answer

1. Concept of Inflation

Inflation is defined as a persistent, sustained, and general increase in the overall price level of goods and services in an economy over a given period. It does not refer to a one-time price spike in a single commodity, but rather a macroeconomic condition where the purchasing power of the national currency declines systematically.

Inflation is measured using price indices such as the Consumer Price Index (CPI), Wholesale Price Index (WPI), and GDP Deflator:

$$\text{Inflation Rate (\%)} = \frac{\text{CPI}_t - \text{CPI}_{t-1}}{\text{CPI}_{t-1}} \times 100 \quad (4)$$

2. Taxonomy and Types of Inflation

A. Classification by Speed / Intensity

- **Creeping Inflation (1% – 3% per annum):** Mild and manageable; beneficial for economic expansion as it encourages investment.
- **Walking Inflation (3% – 10% per annum):** Warning stage where consumers purchase goods in advance to avoid higher future prices.
- **Galloping Inflation (10% – 50% per annum):** Severe disruption; economic contracts become index-linked, and national currency loses trust.

- **Hyperinflation** (> 50% per month): Total collapse of monetary system (e.g., Germany 1923, Zimbabwe 2008).

B. Classification by Fundamental Cause

1. **Demand-Pull Inflation:** Occurs when Aggregate Demand (AD) expands faster than Aggregate Supply (AS) at full employment ($AD > AS$).
2. **Cost-Push Inflation:** Driven by rising production costs (e.g., energy tariffs, raw material prices, wages) shifting the supply curve leftward.
3. **Imported Inflation:** Caused by currency devaluation raising the cost of imported essential commodities (crude oil, palm oil, pulses).
4. **Structural Inflation:** Caused by institutional bottlenecks, supply chain inefficiencies, and hoarding in developing agrarian economies.

3. Comprehensive Strategy to Control Inflation in Pakistan

Pakistan has historically experienced double-digit inflation driven by fiscal deficits, currency devaluation, and supply chain disruptions. Controlling inflation requires a synchronized multi-pronged strategy:

Table 2: Policy Matrix for Inflation Control in Pakistan

Policy Realm	Specific Action Plan	Expected Economic Impact
Monetary Policy	• Maintain positive real interest rates. • Increase Cash Reserve Ratio (CRR). • Restrict SBP direct government borrowing.	Cools aggregate demand and curtails private credit expansion.
Fiscal Policy	• Broaden tax base via FBR digitisation. • Eliminate non-targeted subsidies. • Enforce strict fiscal discipline.	Reduces budget deficit and limits government borrowing needs.
Exchange Rate & External Sector	• Accumulate foreign exchange reserves. • Curb smuggling of USD and commodities. • Encourage remittances via formal channels.	Stabilizes PKR exchange rate and mitigates imported inflation.
Supply-Side Reforms	• Support agricultural sector inputs. • Eliminate market cartels and hoarding. • Expand Utility Stores subsidy network.	Enhances food availability and stabilizes basic commodity prices.

Question No. 4

What are the financial assets? Discuss the types and structure of the financial assets. (20 Marks)

Answer

1. Definition and Concept of Financial Assets

A **financial asset** is a non-physical asset whose value is derived from a contractual claim on an underlying entity, cash flow, or physical asset. Unlike real assets (such as real estate, gold, or machinery) which possess direct physical utility, financial assets represent intangible claims to future monetary returns.

Key economic characteristics of financial assets include:

- **Liquidity:** Ease of converting the asset into standard currency without significant value discount.
- **Return/Yield:** Compensation received by the holder for deferring consumption and bearing risk (interest, dividends, capital gains).
- **Risk Profile:** Vulnerability to default, market volatility, inflation, and liquidity shifts.
- **Maturity Period:** Time duration before the issuer must redeem the principal obligation.

2. Types of Financial Assets

A. Cash and Cash Equivalents

Includes currency notes, demand deposit balances, and highly liquid short-term instruments (e.g., Treasury Bills) with maturities under 90 days.

B. Debt Securities (Fixed Income Instruments)

Contractual obligations where the borrower agrees to pay fixed interest payments (coupons) and return principal at maturity.

- **Government Bonds (Treasury Bonds / PIBs):** Low-risk instruments issued by sovereign governments.
- **Corporate Bonds & Debentures:** Debt issued by private corporations to fund capital expansion.
- **Islamic Sukuk:** Shariah-compliant asset-backed certificates representing undivided ownership in tangible assets.

C. Equity Securities (Shares)

Instruments representing fractional ownership in a corporation's net assets and earnings.

- **Common Stock:** Voting rights and variable dividend entitlement based on profitability.
- **Preferred Stock:** Fixed dividend preference over common equity, usually non-voting.

D. Derivative Instruments

Contracts whose values are derived from underlying assets (commodities, currencies, interest rates, equities). Includes Futures, Options, Forwards, and Swaps.

3. Structure of Financial Assets in the Financial System

Structural Classification of Financial Assets

1. Money Market vs. Capital Market Assets:

- *Money Market Assets (< 1 Year)*: Commercial Paper, Certificates of Deposit (CDs), Treasury Bills. Focus on liquidity management.
- *Capital Market Assets (> 1 Year)*: Pakistan Investment Bonds (PIBs), Equities, Long-term Corporate Sukuk. Focus on capital formation.

2. Primary Market vs. Secondary Market Assets:

- *Primary Assets*: Newly issued instruments (e.g., Initial Public Offerings - IPOs).
- *Secondary Assets*: Existing instruments traded among investors on stock exchanges (e.g., PSX).

3. Direct vs. Indirect Financial Assets: Direct claims issued by final borrowers versus indirect claims created by financial intermediaries (e.g., bank deposits, mutual fund units).

Question No. 5

Write a note on the following:

(20 Marks)

i. World Bank

ii. Asian Development Bank

Answer

i. World Bank

1. Background and Organizational Structure

The **World Bank** was established alongside the International Monetary Fund (IMF) at the Bretton Woods Conference in July 1944. Originally created to rebuild war-torn Europe post-WWII, its mission evolved into global poverty reduction and economic development.

The World Bank Group consists of five closely associated international institutions:

1. **IBRD (International Bank for Reconstruction and Development)**: Grants loans to middle-income and creditworthy developing governments.
2. **IDA (International Development Association)**: Provides interest-free loans (*credits*) and grants to the poorest developing countries.
3. **IFC (International Finance Corporation)**: Promotes private sector investment in developing countries.
4. **MIGA (Multilateral Investment Guarantee Agency)**: Offers political risk insurance and credit enhancement to investors.
5. **ICSID (International Centre for Settlement of Investment Disputes)**: Conciliates and arbitrates international investment disputes.

2. Core Objectives and Functions

- Financing large-scale infrastructure projects (energy, dams, highways, water supply).

- Supporting human capital development through education, health, and social safety nets.
- Providing structural adjustment loans tied to policy and institutional reforms.
- Offering technical assistance, economic research, and policy advisory services.

3. Role in Pakistan's Economy

The World Bank has been a partner in Pakistan's development since 1950. Major landmark interventions include funding the **Indus Basin Project** (Tarbela and Mangla Dams), the **Benazir Income Support Programme (BISP)**, energy sector reforms, and climate resilience reconstruction projects following the 2022 floods.

ii. Asian Development Bank (ADB)

1. Background and Mandate

The **Asian Development Bank (ADB)** is a regional development bank established on December 19, 1966, headquartered in Manila, Philippines. It envisions a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty in the region.

ADB comprises 68 member nations, of which 49 are from within the Asia-Pacific region.

2. Key Functions and Operations

- **Sovereign Lending:** Providing concessionary loans, grants, and technical assistance to member governments.
- **Non-Sovereign Operations:** Direct equity investments and loans to private enterprises driving regional development.
- **Policy Dialogue and Knowledge Sharing:** Assisting governments in drafting sector strategies and economic reforms.
- **Regional Integration:** Funding cross-border transport and energy corridors (e.g., CPEC, CAREC corridors).

3. Portfolio and Impact in Pakistan

Pakistan is a founding member of the ADB. ADB's total cumulative assistance to Pakistan exceeds \$35 billion. Key focus areas in Pakistan include:

- Power sector reforms, transmission network expansion, and renewable energy transitions.
- Urban infrastructure development, such as the Peshawar Bus Rapid Transit (BRT) project.
- Emergency budgetary support and disaster risk financing following natural calamities.