

Al-Saudia Virtual Academy

Pakistan Online Tuition – Online Tutor Pakistan

Functions:

Following are the functions of Central Bank

- Issue of Currency:

According to Prof. Decock:

“The privilege of note issue was almost everywhere associated with the origin and development of central banks. In fact until the beginning of the twentieth century, they were generally known as the bank of issue”.

Issuance of currency was the first factor that formed the basis of central banking. Now in almost all countries of the world, central bank enjoys complete monopoly over note issue and this is by far the most important function and feature of the central bank.

This function of central bank is also the source of different advantages for the economy which are as under.

ADVANTAGES:

- Uniformity:

This ensures control and uniformity over the process of note issue. Also it brings harmony and ensures safe and sound functioning of the whole banking structure.

- Control:

This function gives central bank an opportunity to unlimited powers in respect of supply of currency. Central bank controls the supply of currency in the best interest of the economy. The supply of currency is increased when central bank plans to act on an expansionary monetary policy. On the other hand in case of contractionary monetary policy the supply of currency is decreased by central bank.

- Bank's Leading:

This function also helps central bank to exercise effective control over lending power of commercial banks. By this central bank ensures that credit is advanced in the best interest of the economy and not for the sake of private profits only.

Soundness of Monetary system:

This function is the source of soundness of monetary system. If this note issuance right is delegated to commercial banks then they will issue notes to make personalized profits. This can cause risk to financial and monetary system. Thus the monopoly of not issue of central bank ensures.....and sound running of monetary system.

- Public Confidence:

Lastly, such monopoly increases public confidence over the local currency. In Pakistan, the central bank i.e. SBP enjoys complete monopoly over the note issue however one rupee note and coins are issued directly by the government. In some other countries, central banks have residuary monopolies. This means that they act on the advice of government in the process of note issue. The Federal Reserve's Bank of United State is an example of a central bank that has residuary of Note Issue.

- Banker to the Government:
- As already mentioned central bank is a special bank

Government. Central bank relation with the government is similar to that of commercial banks with its clients. It gives all those services to the government which the commercial banks give to his clients. It receives payments on the behalf of government and holds all cash balances of the government. It holds all tax revenues and receipts. Furthermore it is also involved in the collection of cheques, drafts on the behalf of government. It in time of need, may grant short and medium term loans to the government. Such loans are usually granted against government securities. It also pays pensions and other transfer payments on the behalf of government. As it is a nonprofit organization so it does not charge any fee for its services and it also does not give any interest on deposits.

- Agent to the Government:

Central bank also functions as the agent of the government. It represents government on various economic issues and monetary matters. In times of need or emergency, it advance short term and medium term loans to the government. It also enjoys the responsibility of making all sorts of adjustments regarding conversion or redemption of government loans. The underwriting of the securities of government is also one of the essential responsibilities of Central bank. As an

agent it can issue new treasury bills on behalf of government. In matters of foreign exchange business and exchange control, central bank acts as financial agent of government.

- Advisor to the Government:

Central bank enjoys extraordinary powers, rights and authorities. It also enjoys special expertise in monetary and fiscal matters. From time to time, it advises government on different financial and economic matters such as devaluation deficit financing, economic planning and development, fiscal and monetary policies and events. Besides this a central bank is the most well informed body about economic indicators so it can best help the government in devising any new economic policies for development.

- Banker to Commercial Banks:

We now that all commercial banks holds some reserves with the central bank and further the central bank provide commercial banks very nearly the same services as those provided by commercial banks for their clients. Thus central bank can very rightly be called Bank of commercial banks. It advances loan to commercial banks and rediscounts their bills of exchange. It guides commercial banks and other elements of banking world in the best interest of the nation and economy. It helps commercial banks in times of economic difficulty and ensures their free and smooth functioning during monetary fluctuations and crises.

- Clearing House:

Meanings:

Clearing house refers to the function whereby commercial banks settle claims which they have against each other.

“ A process by which bankers exchange and settle for cheques, bill of exchange, drafts and other banking instruments drawn against each other received by them for collection and clearance from their customers”.

In simple words clearing house is a place where both the debtors and creditors are different commercial banks and they settle their claims. In practice where central bank branches not present any representative bank of central bank performs the clearing house function.

Process:

Suppose a person receive a cheques of bank X and deposits in the bank named Bank Y. Now Bank X is a debtor of bank Y. In everyday life there is large

number of cheques drawn and received. So banks became debtors and creditors to each other. The easiest way to set off these claims is to receive or pay the net amount. This process is called clearing and the function is performed by central bank.

MERITS:

Safety:

As in this method there is less involvement of cash, so this method is safe.

Flexibility:

It brings flexibility in banking transactions. Banks are not needed to hold excessive cash reserves with the central bank. Also there is no need to move bulk of cash from one bank to another.

Credit Facility:

As due to this function, banks are not compelled to hold excessive cash reserves so they can lend money to investors.

Co-operation:

In case of financial difficulties and recession, banks can co-operate with each other such as payments can be delayed to overcome timely difficulties.

Quick Payments:

This function brings quickness in the process of receiving and making payment.

Checking Competition:

The clearing house function also helps to prevent undesirable competition among commercial banks.

Controller of Credit:

The most important function of the central bank is to control credit in the economy. Excessive and too low supply of credit can cause many economic difficulties to the country. So central bank keeps on visualizing the credit situation of the country and credit creating potential of commercial banks. If commercial banks are not timely checked then, they may produce extraordinarily high credit supply for the sake of private profit. But this can cause serious inflationary trends in the economy. On the other hand, excessive credit contraction can cause deflationary trends. So central bank ensures the proper and appropriate supply of

credit by controlling the credit creating potential of commercial banks. This is done through the tools of monetary policy which will be discussed later.

7. Lender of the last Resort:

Central bank job is to examine and guide the banking system in best national interest. In case commercial banks face any panic and suspect any bank run, then central bank immediately comes to their help. In case, when commercial banks face any shortage of reserves and feel difficulty in fulfilling financial obligations, they can receive help from central bank. The central bank increases the liquidity of commercial banks by rediscounting their bills of exchange and thus it plays an important role in the free and smooth flow of economy.

8. Custodian of Foreign Exchange Reserves:

Central bank also keeps close eye on capital movements in and out of the country and on foreign exchange matters. It is entrusted with the responsibility of safeguarding country's foreign exchange reserves. It regularly checks the capital flights across borders and takes important decisions to stabilize foreign exchange rates.

9. Development Role:

Central bank is the most important monetary authority of the country. Thus it plays a very significant role in the overall economic development and planning of the country. It ensures smooth running of the economy by providing and directing finances towards various needy sectors of the economy. It takes care of the country in widespread depression and recessions and helps the economy in avoiding cyclical monetary fluctuations.

10. Other Functions:

Besides these functions, there are some other duties which are performed by central banks. These are as follows.

- Central bank provides training facilities for less experienced staff working in different banking organizations.
- It holds relation with different international agencies e.g. WB, IMF, IDB etc.
- It issues reports about various economic and fiscal indicators.
- It conducts different surveys, programmers meetings for creating economic awareness.

- It publishes annual report containing all details of economic operations of the whole year.

Conclusion:

Central bank performs variety of important functions. All these functions in turn play & role in economic development of the country. Central bank can be deemed of as a castle that takes care of the whole banking system of the economy.