JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

Government of Rajasthan established

Through ACT No. 17 of 2008 as per UGC ACT 1956

NAAC Accredited University

Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA B.Ed 4th Semester

Course – Money Banking and Public Finance

Digital session name – Paper Standard

Introduction

Paper standard refers to a monetary standard in which inconvertible paper money circulates as unlimited legal tender. Under paper money standard, although the standard money is made of paper, both currency and coins serve as standard money for purpose of payment. No gold reserves are required either to back domestic paper currency or to facilitate foreign payments.

The paper standard is known as managed standard because the quantity of money in circulation is controlled and managed by the monetary authority with a view to maintain stability in prices and incomes within the country. It is also called fiat standard because paper money is inconvertible in gold and still regarded as full legal tender. After the general breakdown of gold standard in 1931, almost all the countries of the world shifted to the paper standard.

Features of Paper Standard:

The paper standard has the following features:

(i) Paper money (paper notes and token coins) circulates as standard money and accepted as unlimited legal tender in the discharge of obligations.

(ii) The unit of money is not defined in terms of commodity.

(iii) The commodity value (or intrinsic value) of the circulating money is particularly nil.

(iv) Paper money is not convertible in any commodity or gold.

(v) The purchasing power of the monetary unit is not kept at par with any commodity (say gold).

(vi) Paper standard is national in character. There is no link between the different paper currency systems.

(vii) The foreign rate of exchange is determined on the basis of the parity of purchasing powers of the currencies of different countries.

Merits of Paper Standard:

Various merits of paper standard are described below:

1. Economical:

Since under paper standard no gold coins are in circulation and no gold reserves are required to back paper notes, it is the most economical form of monetary standard. Even the poor countries can adopt it without any difficulty.

2. Proper Use of Gold:

Wastage of gold is avoided and this precious metal becomes available for industrial, art and ornamental purpose.

3. Elastic Money Supply:

Since paper money is not linked with any metal, the government or the monetary authority can easily change the money supply to meet the industrial and trade requirements of the economy.

4. Ensures Full Employment and Economic Growth:

Under paper standard, the government of a country is free to determine its monetary policy. It regulates its money in such a way that ensures fall employment of the productive resources and promotes economic growth.

5. Avoids Deflation:

Under paper standard, a country avoids deflationary fall in prices and incomes which is the direct consequence of gold export. Such type of situation arises under gold standard when a participating country experiences adverse balance of payments. This results in the outflow of gold and contraction of money supply.

6. Useful during Emergency:

Paper currency is very useful in times of war when large funds are needed to finance war. It is also best suited to the less developed countries like India. To these economies, it makes available large amounts of financial resources through deficit financing for carrying out developmental schemes.

7. Internal Price Stability:

Under this system, the monetary authority of a country can establish stability in the domestic price level by regulating money supply in accordance with the changing requirements of the economy.

8. Regulation of Exchange Rate:

Paper standard provides more effective and automatic regulation of exchange rate, whereas, under gold standard, the exchange rate is absolutely fixed. Whenever, exchange rate fluctuates as a result of disequilibrium between demand and supply forces, the paper standard works on imports and exports and restores equilibrium. It allows the forces of demand and supply to operate freely to establish equilibrium.

Demerits of Paper Standard:

The paper standard suffers from the following defects:

1. Exchange Instability:

Since the currency has no link with any metal under paper currency, there are wide fluctuations in the foreign exchange rates. This adversely affects the country's international trade. Exchanging instability arises whenever external prices move more than domestic prices.

2. Internal Price Instability:

Even the commonly claimed advantage of paper standard, i.e., domestic price stability, may not be achieved in reality. In fact, the countries now on paper standard experience such violent fluctuations in internal prices as they experienced under gold standard before.

3. Dangers of Inflation:

Paper standard has a definite bias towards inflation because there is always a possibility of over- issue of currency. The government under paper standard generally has a tendency to use managed currency to cover up its budget deficit. This results in inflationary rise in prices with all its evil effects.

4. Dangers of Mismanagement:

Paper currency system can serve the country only if it is properly and efficiently managed. Even the minor mistake in the management of paper currency can bring such disastrous result that cannot be conceived of in any other form of monetary standard. If the government issues little more or little less currency than what is required for maintaining price stability, it may lead to cumulative inflation or cumulative deflation.

5. Limited Freedom:

In the present world of economic dependence, it is almost impossible for a particular country to isolate itself and remain unaffected from the international economic fluctuations simply by adopting paper standard.

6. Absence of Automatic Working:

The paper standard does not function automatically. To make it work properly, the government has to interfere from time to time.