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Name:

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ALLAMA IQBAL OPEN UNIVERSITY, ISLAMABAD

Course: Fundamentals of Money and Banking (1414) • Level: BS/AD

Semester: Autumn 2026

Assignment No. 1 (Units 1–4)

Total Marks: 100 • Pass Marks: 50

SOLVED ASSIGNMENT GUIDE

(For Study & Reference)

Note: This guide is prepared for study and reference purposes. Students are advised to read the relevant units of the course book, understand the concepts, and then write the assignment in their own words.

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Question 1: What is Money? Forms and Functions of Money (20 Marks)

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

Introduction

Money is the most familiar yet the most important invention of economic life. Almost every economic activity of a modern society — earning, spending, saving, borrowing, lending, investing and paying taxes — is carried out through money. It is difficult to imagine a modern economy without money, because production today is specialised, exchange is impersonal, and millions of transactions take place every day between people who do not know one another. In the earliest stages of human civilisation, goods were exchanged directly for goods under the barter system, but barter suffered from serious defects which made the invention of money necessary. Money removed those defects and became the lubricant of the entire economic machine.

In simple words, money is anything which is generally acceptable as a medium of exchange and which also acts as a measure and store of value. Different economists have defined money from

different angles. Walker defined money as "what money does", meaning that whatever performs the functions of money is money, whatever its form may be. Crowther defined money as "anything that is generally acceptable as a means of exchange and that at the same time acts as a measure and store of value". Robertson described money as "anything which is widely accepted in payment for goods or in discharge of other kinds of business obligations". Combining these views, we may say that general acceptability is the essential quality of money: a thing becomes money not because the government declares it so, but because people accept it confidently in exchange, knowing that others will accept it from them in turn.

The Barter System and the Need for Money

The barter system, under which goods were exchanged directly for goods, suffered from five well-known difficulties. First, it required a double coincidence of wants: a person having wheat and wanting cloth had to find another person who had cloth and wanted wheat, which wasted much time and effort. Second, there was no common measure of value, so it was impossible to say exactly how much wheat was equal to one goat or one piece of cloth. Third, many goods were indivisible — a cow could not be divided to buy small items without destroying its value. Fourth, barter provided no satisfactory store of value, because most goods are perishable and lose value with time. Fifth, it offered no standard for deferred payments, so borrowing and lending over time were risky and rare. Money solved all these problems at once, which is why its invention is counted among the greatest steps in human progress.

Forms of Money

Money has taken many forms in history, and its forms continue to evolve with technology. The main forms found in a modern economy are described below.

- Commodity money: In early times, goods such as cattle, grain, shells, salt, tobacco and beads were used as money. Such money had intrinsic value, but it was bulky, perishable and not uniform in quality.
- Metallic money: Coins made of gold, silver, copper and other metals replaced commodity money. Full-bodied coins had face value equal to their metal value, while modern token coins have a face value higher than the value of the metal they contain.
- Paper money: Currency notes issued by the central bank (in Pakistan, the State Bank of Pakistan) are the most visible form of money today. Paper money is light, portable and easy to count, and it is legal tender, meaning it cannot legally be refused in settlement of a debt.
- Credit or bank money: Deposits held in banks, transferable by cheque, debit card or online transfer, form the largest part of money supply in modern economies. Bank money is created when banks lend, and it circulates without any physical movement of cash.
- Near money: Assets such as treasury bills, savings certificates, prize bonds and money-market instruments are not money itself because they cannot be spent directly, but they can be converted into money quickly and without loss, so they are called near money or quasi-money.
- Electronic and digital money: Mobile wallets, internet banking balances, debit and credit cards, and central bank digital currency experiments represent the newest form. In Pakistan, systems such as Raast, Easypaisa and JazzCash have brought digital money to millions of users, including people in remote areas.

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- Legal tender and optional money: Legal tender money must be accepted by law in payment of debts, whereas optional money — such as cheques and drafts — is accepted only because of the trust and credit of the payer.

Table 1: Main forms of money in a modern economy

Form of Money	Examples	Main Feature
Commodity money	Cattle, grain, shells, salt	Has intrinsic value; earliest form
Metallic money	Gold, silver and token coins	Durable and divisible; coins still used for small payments
Paper money	Currency notes issued by the central bank	Legal tender; light and portable
Bank (credit) money	Current and savings deposits, cheques	Largest share of money supply; created by bank lending
Near money	Treasury bills, prize bonds, certificates	Highly liquid but not directly spendable
Digital money	Mobile wallets, cards, Raast transfers	Instant, low-cost and increasingly popular

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Functions of Money

Economists usually divide the functions of money into primary, secondary and contingent functions. The primary functions are those which money performs in every economy, at all times.

Primary Functions

First, money is a medium of exchange. It removes the need for a double coincidence of wants because every sale and purchase is split into two independent acts: goods are sold for money, and money is then used to buy what is needed. This single function has made large-scale trade, specialisation and the division of labour possible. Second, money is a measure of value or unit of account. The value of every good and service is expressed in money prices, which makes

comparison, accounting, costing and national income measurement possible. Just as a yard measures length, money measures value, and without such a common denominator the price system could not work.

Secondary Functions

The secondary functions grow out of the primary ones. Money is a store of value: wealth can be held in money form safely for future use, because money is durable, generally acceptable and more liquid than any other asset — although inflation reduces this quality. Money is a standard of deferred payments: loans, instalments, salaries, rent and interest are contracted and repaid in money, which makes credit, banking and long-term business planning possible, provided the value of money remains reasonably stable. Money also transfers value from one person and place to another: a person can sell property in one city and buy in another, or send remittances abroad, simply by transferring money.

Contingent and Other Functions

Among the contingent functions, money is the basis of the credit system, since bank credit is built upon cash reserves. Money helps in the distribution of national income, because rent, wages, interest and profit are all paid in money. It helps consumers maximise satisfaction by equalising the marginal utility of money spent on different goods, and it helps producers decide what and how much to produce by studying prices. Money also guarantees solvency — a firm holding money can meet its obligations and avoid bankruptcy — and it gives its holder general purchasing power and freedom of choice, which no other asset provides to the same degree.

Qualities of Good Money

For money to perform these functions well, the material or system behind it must possess certain qualities: general acceptability, durability, portability, divisibility, uniformity, cognizability (easy recognition) and stability of value. Gold and silver remained money for centuries because they possessed most of these qualities. Modern paper and digital money possess all of them except that their stability depends on disciplined monetary management by the central bank. When a central bank issues money excessively, its value falls, prices rise, and people lose confidence — which shows that trust, ultimately, is the real foundation of modern money.

Conclusion

To conclude, money is anything generally acceptable as a medium of exchange, a measure of value, a store of value and a standard of deferred payments. Its forms have evolved from commodities and metal coins to paper currency, bank deposits and digital balances, but its functions have remained the same and have grown in importance. In a modern economy money is not a veil over real activity; it actively influences production, employment, saving, investment and the distribution of income. A stable, trusted and efficiently managed money is therefore one of the strongest foundations of economic progress.

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Question 2: Value of Money and the Factors Determining It (20 Marks)

What is the value of money? Discuss the factors determining the value of money in an economy.

Introduction

The value of money is a phrase we use every day without thinking: we say that money "has lost its value" when prices rise, and that money "is strong" when it buys more than before. Unlike ordinary goods, money is not valued for its own sake. Nobody eats currency notes or wears them; money is wanted only because of the goods and services it can command. The value of money, therefore, means its purchasing power — the quantity of goods and services that one unit of money, for example one rupee, can buy in exchange. Understanding what determines this purchasing power is one of the oldest and most important questions in monetary economics, because changes in the value of money affect every debtor, creditor, saver, worker and businessman in the country.

Meaning of the Value of Money

The value of money is the reciprocal of the general price level. If P stands for the general level of prices, then the value of money is 1/P. When prices double, the value of money is halved; when prices fall by half, the value of money doubles. This inverse relationship is absolute: a rise in the general price level is, by definition, a fall in the value of money, and inflation is simply the name given to a continuing fall in money's value. Economists measure changes in the value of money through index numbers of prices, such as the Consumer Price Index (CPI) compiled in Pakistan by the Pakistan Bureau of Statistics, which tracks the prices of a representative basket of goods and services consumed by households.

It is also important to distinguish the internal value of money from its external value. The internal value is its purchasing power over goods and services inside the country, discussed above. The external value is its exchange value in terms of foreign currencies — the exchange rate. When the rupee depreciates in the foreign exchange market, imports become costlier, which raises domestic prices and thus reduces the internal value as well; the two values are therefore connected. A third sense in which the term is sometimes used is the rate of interest — the price paid for the use of money over time — but in monetary theory the standard meaning is purchasing power.

The Quantity Theory Background

The classical explanation of the value of money is the quantity theory of money, expressed by Irving Fisher in the equation MV = PT, where M is the quantity of money, V its velocity of circulation, P the price level and T the volume of transactions. If V and T remain constant, any increase in M raises P in the same proportion and reduces the value of money accordingly. The Cambridge cash-balance approach expressed the same idea through the demand for money: people hold a fraction (k) of their money income as cash balances, so P = M / (kY). Although modern economists do not accept the theory mechanically, its central lesson remains valid: in the long run, the value of money depends mainly on how much money exists in relation to the goods and services it has to buy.

Factors Determining the Value of Money

The value of money is determined by the demand for and supply of money, and a large number of factors work through these two sides.

1. Quantity of Money in Circulation

The most important factor is the total supply of money — currency with the public plus bank deposits — relative to the output of goods and services. If the money supply grows faster than real production, more money chases the same quantity of goods, prices rise and the value of money falls. This is why excessive deficit financing and money creation by the central bank are the classic causes of inflation and of a falling value of money in developing countries, including Pakistan in several periods of its history.

2. Velocity of Circulation

Money changes hands many times in a year, and the speed at which it circulates — its velocity — affects its effective supply. Even with an unchanged quantity of money, if people spend faster (velocity rises), the total flow of spending increases, prices tend to rise and value falls. Velocity rises when people expect prices to rise further and hurry to spend, and it falls in depressions when people and banks hold money idle out of fear and uncertainty.

3. Volume of Production and Trade

On the other side stands the quantity of goods and services to be exchanged. If production of food, manufactures and services increases while money supply remains steady, prices fall and the value of money rises. Agricultural harvests, industrial output, imports and the overall growth of real GDP all strengthen the value of money by increasing the supply of purchasable goods. Conversely, supply shocks — crop failure, energy shortages or disrupted imports — reduce goods available and push prices up.

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4. Demand for Money and Liquidity Preference

People demand money for transactions, precautionary and speculative motives, as Keynes explained. If the desire to hold money balances increases — for example in uncertain times — money becomes scarcer relative to goods and its value tends to rise. If people prefer to hold goods, property or foreign currency instead (as happens in high inflation, called flight from money), the value of money falls further and faster.

5. Credit Creation by Banks

Modern money supply is not created by the central bank alone; commercial banks multiply money through lending. Rapid expansion of bank credit raises deposit money, increases spending power and tends to raise prices; tight credit control by the central bank through the policy rate and reserve requirements works in the opposite direction and protects the value of money.

6. Fiscal Policy of the Government

Government budgets influence money value directly. Persistent budget deficits financed by borrowing from the central bank inject new money into the economy and erode its value. Responsible fiscal policy — expenditure matched by genuine revenue — supports price stability, while heavy indirect taxation and administered price increases for fuel and utilities can themselves push the price level up.

7. External Factors: Exchange Rate, Imports and Foreign Prices

In an open economy, the value of money also depends on the balance of payments, export earnings, workers' remittances, foreign debt and the prices of essential imports such as oil and

edible oil. A depreciation of the rupee raises import prices (imported inflation), while strong export and remittance inflows support both the external and internal value of the currency.

8. Expectations and Confidence

Finally, psychology matters. If traders, businesses and the public expect prices to rise, they raise prices, demand higher wages and spend quickly, making the expectation self-fulfilling. Confidence in the government, the central bank and political stability therefore anchors the value of money, while uncertainty and rumours destroy it even without any immediate change in money supply.

Effects of Changes in the Value of Money

Changes in the value of money redistribute income and wealth unfairly. When money loses value, creditors, fixed-salary earners, pensioners and small savers lose, while debtors and owners of real property gain. When money gains value sharply (deflation), borrowers suffer, business profits shrink and unemployment rises. Because both directions are harmful, modern central banks — including the State Bank of Pakistan, which has an explicit price-stability mandate — aim at keeping the value of money broadly stable, tolerating only a low, predictable rate of inflation.

Conclusion

In conclusion, the value of money is its purchasing power, the reciprocal of the general price level, measured through price index numbers. It is determined by the interaction of the quantity and velocity of money, bank credit, fiscal policy and public confidence on one side, and the volume of production, trade and imports on the other. No single factor acts alone; stable money value requires a balanced combination of disciplined money creation, growing real

production and public trust. Where that balance is maintained, money performs all its functions smoothly; where it is lost, the whole economy pays the price through inflation.

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Question 3: Inflation — Concept, Types and Control in Pakistan (20 Marks)

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

Introduction

Inflation is the most widely discussed economic problem in Pakistan today, because it touches every household's daily life — the price of flour, milk, petrol, electricity and bus fare. Whenever people complain that "everything has become expensive", they are describing inflation. Pakistan has experienced repeated episodes of high inflation, most severely in 2022–24, when the Consumer Price Index rose by more than 29 percent in fiscal year 2023 and monthly inflation touched a record of about 38 percent in May 2023, before easing gradually under tight monetary and fiscal policies. A clear understanding of what inflation is, what its types are, and how it can be controlled is therefore essential for every student of money and banking.

Concept and Definition of Inflation

Inflation is defined as a continuous and significant rise in the general level of prices, resulting in a fall in the purchasing power (value) of money. Three points in this definition deserve emphasis. First, inflation refers to the general price level, not the price of one or two commodities; a rise in the price of onions alone is not inflation. Second, the rise must be continuous and sustained over time, not a temporary or seasonal jump. Third, the rise must be significant — a very small increase, say one percent a year, is usually not described as a problem. Crowther defined inflation as "a state in which the value of money is falling, i.e., prices are rising", while Pigou described it as a condition where "money income is expanding

faster than the income in real terms". Inflation is measured in Pakistan through the CPI, the Sensitive Price Indicator (SPI) for weekly essentials, and the Wholesale Price Index (WPI).

Inflation must also be distinguished from its opposite, deflation (a continuous fall in prices), and from related terms: disinflation means a falling rate of inflation (prices still rising, but more slowly), stagflation means inflation combined with stagnant growth and unemployment, and reflation means a deliberate mild expansion to lift an economy out of deflation.

Types of Inflation

Inflation is classified in several ways — by rate or speed, by cause, and by coverage.

Types by Rate or Speed

- Creeping or mild inflation: prices rise slowly, up to about 2–3 percent a year. It is generally considered harmless, even helpful, because it encourages production and investment.
- Walking or trotting inflation: prices rise at about 3–10 percent a year. It is a warning stage; if not checked, it can accelerate.
- Running inflation: prices rise at 10–20 percent a year, seriously eroding savings and fixed incomes.
- Galloping or hyperinflation: prices rise at very high, uncontrolled rates — twenty percent and above, in extreme historical cases doubling within months, as in Germany in 1923 and Zimbabwe in 2008. Money loses its functions, people resort to barter or foreign currency, and the economy breaks down.

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Types by Cause

- Demand-pull inflation: “too much money chasing too few goods”. When aggregate demand — consumer spending, investment, government expenditure or exports — exceeds the economy's productive capacity, buyers bid prices up.
- Cost-push inflation: rising costs of production — higher wages, dearer raw materials, fuel and electricity, higher taxes or costly imports after devaluation — are passed on by producers into higher prices, even when demand is not excessive.
- Monetary inflation: caused by excessive expansion of money supply and bank credit, usually to finance government deficits.
- Imported inflation: transmitted through rising prices of imports (oil, machinery, edible oil) or depreciation of the domestic currency.
- Structural inflation: found in developing economies where bottlenecks — food shortages, weak transport, energy deficits, monopolistic middlemen — keep particular prices rising persistently.
- Mark-up or administered inflation: prices raised by firms with market power, or by government decision on utilities and fuel, rather than by market forces.

Table 1: Major types of inflation and their main cause

Type	Main Cause	Typical Remedy
Demand-pull	Excess aggregate demand over supply	Tight monetary and fiscal policy
Cost-push	Rising wages and input costs	Productivity growth, supply measures, incomes policy
Monetary	Excess money and credit creation	Control money supply and deficit financing
Imported	Costly imports, currency depreciation	Export growth, reserves, energy efficiency

Structural	Supply bottlenecks and shortages	Investment in agriculture, energy, transport

How Can Inflation Be Controlled in Pakistan?

No single measure can control inflation in Pakistan, because its causes are mixed — monetary, fiscal, structural and imported. A coordinated package is required.

Monetary Measures

The State Bank of Pakistan must follow a firm anti-inflationary monetary policy: raising the policy (interest) rate to make credit expensive and saving attractive, selling government securities through open market operations to absorb liquidity, raising the cash reserve requirement of banks, and strictly limiting government borrowing from the central bank. The State Bank (Amendment) Act 2022 strengthened the Bank's autonomy and made price stability its primary objective, which supports such measures. Pakistan's experience of 2023–24, when the policy rate was raised to 22 percent and inflation subsequently fell, shows that firm monetary policy works, though with a time lag and at the cost of slower growth.

Fiscal Measures

The government must reduce its budget deficit by broadening the tax base — especially by taxing under-taxed sectors such as retail, agriculture income and real estate — curbing non-development expenditure, reducing subsidies that benefit the well-off, and avoiding the printing of money to finance deficits. On the other hand, targeted subsidies and cash support for the poorest (for example through the Benazir Income Support Programme) should be protected, because the poor suffer most from inflation. Public debt management that

lengthens maturities and relies on genuine savings rather than bank borrowing also reduces inflationary pressure.

Supply-Side and Structural Measures

In the long run, inflation in Pakistan is controlled mainly by producing more. Raising agricultural productivity — better seed, water management, mechanisation and support prices announced on time — stabilises food prices, which carry the largest weight in the CPI. Solving the energy crisis and reducing circular debt lowers production costs across the economy. Expanding exports and remittances strengthens the rupee and reduces imported inflation. Investment in storage, transport and competitive markets breaks the grip of hoarders and middlemen, while effective price-control administration and action against hoarding and smuggling (especially of wheat, sugar and fuel across borders) protect consumers in the short run.

Incomes, Wage and Exchange-Rate Measures

Wage increases should be linked to productivity so that a wage-price spiral does not start. A stable, market-based exchange rate supported by adequate foreign exchange reserves prevents sudden imported inflation. Coordination between the Ministry of Finance and the State Bank — fiscal policy supporting, not fighting, monetary policy — is essential, because monetary tightening alone is defeated if the government continues to borrow heavily.

Conclusion

To conclude, inflation is a sustained rise in the general price level and a fall in the value of money, classified by speed into creeping, walking, running and galloping, and by cause into demand-pull, cost-push, monetary, imported and structural types. In Pakistan its roots lie in deficit financing, energy and food supply problems, currency depreciation and administered

price adjustments. It can therefore be controlled only by a combined strategy: a firm and autonomous central bank, a disciplined budget, and above all long-run investment in agriculture, energy and exports that increases the supply of goods. Short-term pain from tight policies is unavoidable, but the alternative — uncontrolled inflation — is a cruel tax that falls heaviest on the poor and destroys saving, investment and trust in money itself.

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Question 4: Financial Assets — Types and Structure (20 Marks)

What are the financial assets? Discuss the types and structure of the financial assets.

Introduction

Every economy has two kinds of wealth: real assets and financial assets. Real assets — land, buildings, machinery, inventories — produce goods and services directly. Financial assets, by contrast, produce nothing by themselves; they are claims on income, on real assets, or on other persons and institutions. A bank deposit, a share certificate, a government bond and an insurance policy are all financial assets. Yet modern economic life would be impossible without them, because they are the instruments through which the savings of millions of households reach the businesses and governments that need funds for investment. The financial system of Pakistan — its banks, stock exchange, mutual funds, insurance companies and government securities markets — is essentially a machinery for creating, pricing and exchanging financial assets.

Meaning and Definition of Financial Assets

A financial asset is an intangible asset whose value arises from a contractual claim: the holder has a right to receive cash or another financial instrument from another party in the future. Every financial asset is simultaneously somebody else's financial liability — a bank deposit is an asset of the depositor and a liability of the bank; a company's share is an asset of the shareholder and part of the company's equity. Financial assets share certain common properties: they are divisible into small units, they carry a degree of risk, they offer an expected return, they have a maturity (or none, in the case of shares), and most of them are liquid, meaning they can be sold and converted into money quickly. Unlike physical assets, they do not

depreciate through use and are cheap to store and transfer, especially in today's electronic, dematerialised form maintained in Pakistan by the Central Depository Company (CDC).

Types of Financial Assets

Financial assets are classified in several ways, and the classification most used is by the nature of the claim and the market in which they are traded.

1. Money Market Instruments (Short-Term Debt)

These are debt instruments with maturity up to one year, traded in the money market. They include treasury bills (T-bills) issued by the Government of Pakistan through the State Bank, commercial paper issued by large companies, certificates of deposit issued by banks, bankers' acceptances, and repurchase agreements (repos). They are highly liquid, low-risk and low-return, and are used by banks and companies to manage short-term cash.

2. Capital Market Instruments — Shares and Bonds

Shares (equity securities) represent ownership in a company. Ordinary shareholders are the owners of the company: they receive dividends when profits allow, enjoy voting rights, and bear the risk of loss, but they have no maturity and no guaranteed return. Preference shares carry a fixed dividend and priority in payment but usually limited voting rights. Bonds and debentures are long-term debt: the holder is a creditor entitled to fixed interest and repayment of principal at maturity. In Pakistan, long-term government instruments include Pakistan Investment Bonds (PIBs) and Ijara Sukuk, while companies raise funds through Term Finance Certificates (TFCs) and corporate Sukuk.

3. Bank Deposits and Certificates

Current, savings and term deposits, and instruments such as Defence Saving Certificates, Special Saving Certificates and Regular Income Certificates issued through National Savings, are financial assets of households. They offer safety and a known profit, which makes them the most popular financial asset of small savers in Pakistan.

4. Derivatives

Derivatives — futures, options, forwards and swaps — derive their value from an underlying asset such as a share, a commodity or a currency. They are used for hedging risk and for speculation. Futures contracts trade on the Pakistan Mercantile Exchange (PMEX) and the derivatives segment of the Pakistan Stock Exchange (PSX).

5. Collective Investment and Retirement Assets

Units of mutual funds and pension funds pool the savings of many small investors and invest them in diversified portfolios of shares, bonds and money-market instruments. Insurance policies and provident/pension fund balances are long-term contractual financial assets that provide protection and retirement income.

6. Islamic Financial Assets

Consistent with Shariah principles, Islamic financial assets are based on trade, leasing or partnership rather than interest: Sukuk (asset-backed certificates), Murabaha and Ijara financing certificates, and Mudaraba certificates. Their market share in Pakistan is growing steadily under the State Bank's Islamic banking framework.

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- Classification by claim: debt assets (fixed claim — deposits, bonds, T-bills) versus equity assets (residual ownership claim — ordinary shares) versus hybrid assets (preference shares, convertible instruments).
- Classification by maturity: short-term (money market), medium-term and long-term (capital market) assets.
- Classification by issuer: government securities, corporate securities, bank instruments and household-sector claims.

Structure of Financial Assets

The "structure" of financial assets refers to the way the whole stock of financial claims in an economy is arranged — which instruments exist, who issues them, who holds them, and how they are layered upon real assets and upon each other. Several features describe this structure.

First, there is a structure by instrument: at the base lies money itself — currency and bank deposits — which is the most liquid financial asset; above it stand money-market instruments, then bonds and Sukuk, and at the top shares and derivatives, which carry the highest risk and expected return. Generally, as we move up this ladder, maturity lengthens, risk rises, return rises and liquidity falls — a trade-off every investor must judge.

Second, there is an institutional or layered structure: households hold deposits in banks; banks hold treasury bills and government bonds; the government spends the funds on development; companies issue shares held by mutual funds, which are themselves held by households. Financial assets are thus stacked in layers of intermediation, with each layer transforming small, short-term, safe savings into large, long-term, risky investments. In Pakistan, bank deposits

form the overwhelming bulk of financial assets, government securities dominate banks' portfolios, and the share of the stock market and corporate bonds remains comparatively small — a structure typical of a bank-dominated developing financial system.

Third, the structure can be viewed by risk and return characteristics: risk-free assets (government securities in domestic currency) form the benchmark; investment-grade corporate debt stands next; equities follow; derivatives and speculative instruments sit at the extreme. Interest rates throughout the system are built as additions to the risk-free rate according to maturity, credit risk and liquidity, which is why the structure of financial assets and the structure of interest rates are studied together.

Table 2: Structure of financial assets — risk, return and liquidity

Category	Examples	Risk / Return	Liquidity
Money and deposits	Currency, bank deposits	Lowest / Lowest	Highest
Money market instruments	T-bills, commercial paper	Low / Low	High
Government long-term securities	PIBs, Ijara Sukuk	Low / Moderate	Moderate–High
Corporate debt	TFCs, corporate Sukuk	Moderate / Higher	Moderate
Equity shares	PSX-listed ordinary shares	High / Potentially highest	Moderate
Derivatives	Futures, options	Highest / Variable	Varies by contract

In Pakistan, the total structure is supervised by two regulators: the State Bank of Pakistan regulates banks, money markets and government securities, while the Securities and Exchange Commission of Pakistan (SECP) regulates the stock exchange, mutual funds, insurance and the corporate sector. Together they aim to widen and deepen the structure — more instruments,

more issuers, more holders — because a richer structure of financial assets mobilises more saving and channels it to more productive investment.

Functions and Importance of Financial Assets

Financial assets perform vital economic functions. They channel funds from surplus units (savers) to deficit units (investors and government); they allow risk to be shared, transferred and diversified, since a saver can hold a portfolio instead of a single risky project; they provide liquidity, allowing wealth to be converted into cash without disturbing the underlying real investment; they generate price signals — share prices and interest rates — that guide the allocation of capital; and they give monetary authorities the instruments (especially government securities) through which monetary policy is implemented by open market operations.

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Conclusion

To conclude, financial assets are contractual claims representing value without physical form — deposits, bills, bonds, Sukuk, shares, fund units and derivatives. Their types are classified by claim, maturity and issuer, and their structure is a layered pyramid running from safe, liquid money at the base to risky, high-return equities and derivatives at the top, issued and held through a chain of financial intermediaries. A sound, diversified and well-regulated structure of financial assets is a hallmark of a developed financial system; Pakistan's continuing task is to deepen that structure beyond bank deposits and government paper so that private industry can raise more long-term finance from the capital market.

Question 5: Notes on the World Bank and the Asian Development Bank (20 Marks)

Write a note on the following: (i) World Bank (ii) Asian Development Bank

Introduction

The Second World War left the economies of Europe shattered and the developing countries of Asia and Africa poor and short of capital. No single country could finance reconstruction and development alone, so the international community created multilateral financial institutions — banks owned jointly by many governments — to pool resources and lend them for development. Two such institutions matter most for Pakistan: the World Bank at the global level and the Asian Development Bank at the regional level. Almost every major development effort in Pakistan — dams, highways, power projects, education and health programmes, flood reconstruction — has received financing, technical advice or both from one or both of these banks. This note describes their origin, structure, objectives and functions, and their role in Pakistan.

Part (i): The World Bank

Origin and Membership

The World Bank was established at the Bretton Woods Conference of 1944, along with the International Monetary Fund, and began operations in 1946 with its headquarters in Washington D.C., USA. Its formal name at birth was the International Bank for Reconstruction and Development (IBRD), reflecting its first task: the reconstruction of war-torn Europe. When Europe recovered, largely through the Marshall Plan, the Bank turned its attention to the development of poor countries. Today it has 189 member countries, and membership of the

IMF is a precondition for membership of the Bank. Pakistan is a founding-era member, having joined in 1950.

The World Bank Group

Over time the institution grew into the World Bank Group of five organisations. (1) The IBRD lends to middle-income and creditworthy low-income governments at near-market terms. (2) The International Development Association (IDA), created in 1960, gives very soft loans (credits) and grants to the poorest countries, with long maturities and little or no interest. (3) The International Finance Corporation (IFC), 1956, invests in and lends to private companies in developing countries without government guarantee. (4) The Multilateral Investment Guarantee Agency (MIGA), 1988, insures foreign investors against political risks such as expropriation and war. (5) The International Centre for Settlement of Investment Disputes (ICSID), 1966, provides facilities for settling investment disputes between governments and foreign investors. Strictly, "the World Bank" usually means IBRD plus IDA.

Objectives and Functions

The Bank's stated purpose is to reduce poverty and promote shared prosperity by financing development. Its functions include: making long-term loans to member governments for productive projects — power, irrigation, transport, agriculture, industry, education and health; providing technical assistance, research and policy advice so that projects are well designed and institutions strengthened; encouraging foreign private investment by co-financing and guarantees; promoting long-term balanced growth of international trade in cooperation with the IMF; and helping countries during emergencies and natural disasters. Loans are normally given for specific, appraised projects, are repayable over 15–25 years, and carry lower interest

than commercial sources available to poor borrowers. The Board of Governors (usually finance ministers) is the supreme body, while resident Executive Directors conduct daily business; voting power depends largely on capital share, so the largest economies — the United States being the biggest shareholder — have the strongest voice, a point often criticised by developing countries.

The World Bank and Pakistan

Pakistan has been one of the Bank's major clients. The Bank helped finance the Indus Basin Development Programme (the Mangla and Tarbela dams) after the Indus Waters Treaty of 1960, which it also helped to broker. It has supported agriculture, power sector reform, education, health and nutrition, social protection including the Benazir Income Support Programme, tax and economic reforms, and massive reconstruction after the 2010 and 2022 floods — committing about two billion dollars after the 2022 floods alone. Its country partnership framework guides lending priorities, and its reports and data are widely used by Pakistani policymakers and researchers.

Part (ii): The Asian Development Bank

Origin, Membership and Headquarters

The Asian Development Bank (ADB) is the regional counterpart of the World Bank for Asia and the Pacific. Established under an agreement adopted in 1965, it began operations in December 1966 with its headquarters in Manila, Philippines. It has 68 members (as of recent years), of which 49 are from within the Asia-Pacific region and 19 from outside, including the United States and European countries; Japan and the United States are the largest shareholders, and

the Bank's president has traditionally been Japanese. Pakistan is a founding member of the ADB.

Objectives and Functions

The ADB's mission is to foster economic growth, reduce poverty and promote regional cooperation and integration in Asia and the Pacific — a region that historically contained the majority of the world's poor. Its functions are making loans and equity investments for economic and social development projects of member countries; providing technical assistance grants for project preparation and institutional development; promoting public and private investment in the region and co-financing with other sources; helping members coordinate development policies and plans; and responding to members' requests for assistance in accordance with its charter. The Bank raises most of its resources by borrowing cheaply on world capital markets, thanks to its AAA credit rating, and on-lends them on favourable terms. For its poorest members it maintains the Asian Development Fund (ADF), which gives concessional loans and grants similar to IDA credits. Ordinary capital resources loans go to middle-income members such as Pakistan on near-market but still advantageous terms.

Areas of Operation

The ADB concentrates on infrastructure — energy, transport (highways, motorways, railways, ports), water supply and sanitation — because infrastructure shortages are Asia's biggest development bottleneck. It also works in agriculture and rural development, education, health, finance sector development, climate change and disaster risk management, gender equality and regional connectivity projects such as the Central Asia Regional Economic Cooperation

(CAREC) corridors, in which Pakistan participates. Its long-term corporate strategy, Strategy 2030, aligns its work with poverty reduction, climate action and inclusive growth.

The ADB and Pakistan

The ADB is among Pakistan's largest development partners, with cumulative lending and assistance running into tens of billions of dollars. It has financed national highways and motorways, power transmission and distribution, irrigation and flood protection, urban services in Punjab and Sindh cities, education reforms, and budget-support programmes linked to economic reform. After the 2022 floods, the ADB approved significant emergency and reconstruction assistance, and it continues to support energy sector reform, climate resilience and private sector development. Its country office in Islamabad coordinates a country partnership strategy agreed with the government.

Similarities and Differences

Both institutions are multilateral, government-owned development banks that lend for projects and programmes, attach policy conditions, and provide technical assistance; both have a concessional window (IDA and ADF) for the poorest borrowers. They differ in scope: the World Bank is global and larger, covering every continent, while the ADB is regional and focused on Asia-Pacific; the World Bank Group uniquely includes private-sector and guarantee arms of worldwide scope (IFC, MIGA), whereas the ADB, though it has private-sector operations, remains predominantly a public-sector lender in its region. For a country like Pakistan, the two are complementary rather than competing: both are used together, often co-financing the same sectors.

Conclusion

To conclude, the World Bank and the Asian Development Bank are the two most important multilateral development banks serving Pakistan. The World Bank, born at Bretton Woods in 1944, works globally through IBRD and IDA, with IFC, MIGA and ICSID completing its group; the Asian Development Bank, founded in 1966 and headquartered in Manila, performs the same developmental role regionally for Asia and the Pacific. Both mobilise capital from world markets and rich member countries and channel it, with expertise and policy advice, into the power plants, roads, schools, farms and reform programmes that poor and middle-income countries cannot finance alone — a partnership from which Pakistan has benefited continuously for over seven decades.

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