

## Ch 3 - Money and Credit

1. The currency notes on behalf of the Central Government are issued by whom?

A Reserve Bank of India.

2. What do banks do with the deposits they accept from customers?

A Banks use a major portion of deposits to extend loans to people.

3. What comprises 'terms of credit'?

A Interest rate, collateral and documentation requirements and mode of repayment together comprise terms of credit.

4. What is the main informal source of credit for rural households in India?

A Money lenders are the main source of informal credit for rural households.

5. Which body supervises the functioning of formal sources of loans?

A Reserve Bank of India

6. 'Modern currency is without any use of its own'; then why is it accepted as a medium of exchange?

A • Modern currency is accepted as a medium of exchange because it is certified for a particular denomination (£10, £100, etc.) of the country by authorities set up by the Central Government.

• It is issued by the Reserve Bank of India and it can be used for buying any commodity which is on sale. It

is authorized by the government of the country.

7. What is the meaning of 'barter system'?

- A • Barter system refers to the system of exchange of goods and services. It is the system by which one commodity is exchanged for another without the use of money. Before money was introduced, people practised the barter system.  
• Example : A farmer could buy a dhoti from a weaver or a pair of shoes from a cobbler in exchange of grains he produced.

8. What is meant by the double coincidence of wants?

- A Double coincidence of wants means when both parties have agreed to sell and buy each other's commodities.

9. How does money act as a medium of exchange?

- A Money acts as a medium of exchange as it acts as an intermediate in the exchange process and transactions. A person holding money can easily exchange it for any commodity or service that he or she might want.

10. How do the deposits with banks become their source of income?

- A Banks charge a higher interest rate on loans they extend than what they offer on deposits. The difference of interest is the main source of income of banks.

11. Why one cannot refuse a payment made in rupees in India?

A One cannot refuse a payment made in rupees in India because it is accepted as a medium of exchange. The currency is authorised by the government of the country.

Q12 Compare formal sector loans with informal sector loans regarding interest only.

A Most of the informal ~~sector~~ lenders charge a much higher interest on loans than the formal sector.

Q13 Why is the supervision of the functioning of formal sources of loans necessary?

A Supervision of the functioning of formal sources of loans is necessary because banks have to submit information to the RBI on how much they are lending, to whom they are lending and at what interest rate etc.

Q14 Prove with an argument that there is a great need to expand formal sources of credit in rural India.

A There is great need to expand formal sources of credit in rural India because:

- There is no organisation that supervises the credit activities of lenders in the informal sector. They lend at whatever interest rate they choose.
- No one can stop rural-money lenders from using unfair means to get their money back.

Q15 Why are most of the poor households deprived from the formal sector of loans?

A Most of the poor households are deprived from the formal

sector loans because of lack of proper documents and absence of collateral.

16. What do you understand by demand deposits?

A To ensure safety of their money, people deposit their money with banks. Banks accept deposits and pay interest on deposits. People have the provision to withdraw their money as and when they require. Since money can be withdrawn on demand deposits.

#### Features:

- A demand deposit has the essential characteristic of money.
- The facility of cheques against demand deposits makes it possible to make payments without cash.
- Since Demand Deposits are accepted widely as a means of payment along with currency, they constitute money in the modern economy.

17. Which country has successfully organized SHGs? Who had initiated the programme?

- A. Bangladesh has successfully organized SHGs. Grameen Bank of Bangladesh is the biggest success story in reaching the poor to meet their credit needs at reasonable rates.
- Grameen Bank has over 6 million borrowers in 40000 villages across Bangladesh. Most of the borrowers are women and belong to the poorest section of the society.

This idea is the brain child of Prof. Mohammad Yunus, recipient of the 2006 Nobel Prize for Peace.

18. Highlight the inherent problem in double coincidence of wants.

A Double Coincidence of wants means that when someone wants to exchange his goods with another person, the latter must also be willing to exchange his goods with the first person. It can only work when both people are ready to exchange each other's goods.

19. How does the use of money make it easier to exchange things? Give an example

A The use of money solves the problem of double coincidence of wants. Money acts as a medium of exchange and serves as a unit of value.

### Short Answer Questions

1 What is money? Why is modern money currency accepted as a medium of exchange?

A Money is a medium of exchange in transactions. A person holding money can easily exchange it for any commodity or service that he or she might want.

• Modern money currency is accepted as a medium of exchange because it is certified for a particular denomination (for example, ₹ 10, ₹ 20, ₹ 100, ₹ 500, ₹ 2000)

- It is issued by the Central Bank of the Country.
  - It is abolished authorized by the government of the country.
2. What are the modern forms of money? Why is the 'rupee' widely accepted as a medium of exchange? Explain two reasons.

or

Why is modern currency adopted accepted as a medium of exchange without any use of its own? Give Reasons?

- A (a) Modern Forms of money currency in India include paper notes and coins which are known as Rupees and Paise
- (b) It is accepted as a medium of exchange because the currency is authorized by the Government of India.
  - (c) In India, the Reserve Bank of India issues currency notes on behalf of the Central Government of India.
  - (d) The law legalizes the use of rupee as a medium of payment that cannot be refused in settling transactions in India.
  - (e) No individual in India can legally refuse a payment made in rupee therefore, the rupee is widely accepted as a medium of exchange.

3. What is collateral? Why do lenders ask for collateral while lending? Explain.

A (a) Collateral is an asset that the borrower owns (land, buildings, vehicle, livestock, land documents, deposits with banks, etc.) which stands as a security against the money borrowed.

- (b) In case the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to recover the loan money.
- (c) Most lenders ask for collateral while lending as a security against their own funds.

4. "Cheap and affordable credit is essential for poor households both in rural and urban areas." In light of the above statement explain the social and economic values attached to it.

or

"Cheap and affordable credit is crucial for the country's development." Assess the statement.

or

"Credit has its own unique role for development". Justify the statement with arguments.

A (a) Credit means it refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future repayment.

(b) Cheap and affordable credit is crucial for the country's growth and economic development. Credit is ~~in great~~ demand for various kinds of economic activities - big or small investments, to set up business, buying cars, houses, etc.

- (c) In rural areas credit helps in development of agriculture by providing funds to farmers to buy seeds, fertilizers, and expensive pesticides.
- (d) Manufacturers need credit for buying raw materials or to meet ongoing expenditure of production.
- (e) Credit helps in the purchase of plants, machinery, equipment, etc.

Some people may need to borrow for illness, marriages, etc.

Thus, cheap and affordable credit is crucial for the country's growth and economic development.

5. How does money solve the problem of double coincidence of wants?

Explain with an example.

- A
- (a) Money acts as a medium of exchange. Money can be exchanged for any kind of commodity or service of one's choice or need.
  - (b) Before money was introduced, people practiced the barter system. They exchanged goods with each other.
  - (c) Example, a farmer could buy a dhoti from a weaver or a pair of shoes from a cobbler in exchange for the grains he produced.
  - (d) The problem with the barter system was that both parties had to agree to sell and buy each other's product. This is known as double coincidence of wants.
  - (e) In the barter system, where goods are directly exchanged without the use of money, it is essential that there is a double coincidence.

(b) Double coincidence is a situation where two persons ~~not~~ needs or desire to have each other's product.

Money solves this problem as with money we can buy whatever we want and whenever we want, without having to exchange something in return.

6. How is money used in every day life? Explain with examples.

A (a) Money plays a central role in our daily life. It is used as a medium of exchange to carry out transactions. Money buys us food, clothing, shelter and other necessities of life.

(b) Money provides us social security.

(c) It is needed to procure services like transport, education, health care, entertainment, recreation and so on.

(d) Money facilitates businesses and trade and is basis of the working of an economy.

7. Explain with examples how people are involved with the banks.

A a) Banks help people to save their money and keep their money safe custody of the bank.

b) Banks accept deposits from the public and also help people to earn interest on their deposits.

c) People can withdraw the money deposited with the bank at the time of their need.

d) As the money can be withdrawn on demand, these are called demand deposits.

e) Banks also grant loans to people for a variety of purposes. In times of need individuals, businesses, houses and

industries can borrow money from the banks.

8. Why is it necessary for the banks and cooperative societies to increase their lending facilities in rural areas? Explain.

- A a) Banks and Cooperatives can help people in obtaining cheap and affordable loans.  
 b) This will help people to grow crops, do business, set-up small scale industries or trade in goods and help indirectly in the country's development.  
 c) They should do so that relatively poor people do not have to depend on informal sources of credit (money-lenders).

9. How can money be easily be exchanged for goods or services? Give an example to explain.

A Money as a medium of exchange for goods and services:

- a) A person holding money can easily exchange it for any commodity or service that he or she might want. Everyone prefers to receive payments in money and exchange the money for things they want.  
 b) For example: A shoemaker wants to sell shoes in the market and buy wheat. The shoemaker will first exchange shoes for money and then exchange the money for wheat. If the shoemaker had to directly exchange shoes for wheat without the use of money, he would have to look for a wheat growing farmer who not only wants to sell wheat but also wants to buy the shoes in

exchange. Both the parties have to agree to sell and buy each other's commodities. This process is very difficult, time consuming and unhealthy.

10. "The credit activities of the informal sector should be discouraged." Support the statement with arguments.

A The credit activities of the informal sector should be discouraged because:

- 85% of loans taken by by the poor households in the urban areas are from informal sources. There is no organisation that supervises the credit activities of lenders in the informal sector.
- Informal lenders charge very high interest on their loan. They try to charge more and more interest on their loans as there are no boundaries and restrictions.
- Higher cost of borrowing means a larger part of the earnings of the borrowers is used to repay the loan.
- In certain cases, the high interest rate for borrowing can mean that the amount to be repaid is greater than the income of the borrower. This could lead to increasing debt and debt trap, therefore the credit activities of the informal sector should be discouraged.

11. Why do we need to expand formal sources of credit in India?

A (a) There is no organisation that supervises the credit activities of lenders in the informal sector. They lend at whatever interest rate they choose.

- b) No one can stop rural money-lenders from using unfair means to get their money back.
- c) Informal lenders charge a very high interest rate on loans and as a result a larger part of the earnings of the borrowers and farmers are used to pay the loans.
- d) The amount to be repaid is often greater than income, and farmers, and other borrowers in villages fall in debt trap.

Thus, it is necessary that banks and co-operatives increase their lending, particularly in rural areas, so that dependence on informal sources of credit ends.

### Long Answer Questions

1 What is the basic objective of 'Self Help Groups'? How do they work? Describe any four advantages of 'Self Help Groups' for poor people.

- A a) The basic objective of 'Self Help Groups' is to organize rural poor, particularly women belonging to <sup>one</sup> neighbourhood into small Self Help Groups - (15 - 20 members).
- b) These members save regularly and the amount varies from ₹25 - ₹100 or more depending upon their ability to save.

The four advantages of Self Help Groups are as follows:

- a) The members can take small loans from the group itself to

meet their needs. The group charges interest on these loans which is still less than what moneylenders charge.

- b) After a year or two, if the group is regular in savings, it becomes eligible for availing loan from the bank which is sanctioned in the name of the group to create self employment opportunities.
- c) All important decisions regarding loans, purpose, amount of interest, non-payment of loan are taken by the group members.
- d) For instance, small loans are provided to the members for releasing mortgaged land, meeting working capital needs, for acquiring assets like sewing machines, handlooms, cattle, etc.
- e) Since non-repayment of loans is dealt seriously by group members, therefore banks are willing to lend to the poor women when organized in SHGs, even though they have no collateral as such. Thus, the SHGs help women to become financially self reliant.
- f) The regular meetings of the groups provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.

2. 'Banks and cooperatives help people in obtaining cheap and affordable loans.' Which values according to you does this support?

A ~~at~~ Cheap and affordable loans help people to grow, do business, set up small scale industries or trade in goods.

This Promotes :

- a) Self reliance and financial security and independence of people.
- b) Protection of the relatively poor against corrupt moneylenders.
- c) Eradication of Poverty in General.

All this indirectly helps in the country's development.

3. What is Credit? Why is cheap credit important for the country's development? Give four reasons.

or

What is credit? Why is cheap and affordable credit important for country's development?

- A
- Credit means loans. It refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future repayment.
  - Cheap and affordable credit is crucial for the country's growth and economic development. Credit is in great demand for various kinds of economic activities - big or small investments, to set up business, buying cars, houses, etc.
  - In rural areas credit helps in the development of agriculture by providing funds to farmers to buy seeds, fertilizers, expensive pesticides.
  - Manufacturers need credit for buying raw materials or to meet ongoing expenditure of production. Credit helps in the purchase of plant, machinery, equipment, etc.
  - Some people may need to borrow for illness, marriages, etc.

Thus, cheap and affordable credit is crucial for the country's growth and economic development.