

Chapter 3 MONEY AND CREDIT

1. What is double coincidence of wants? How does money solve double coincidence of wants?

i. It was a situation that existed in the barter system of exchange, before the introduction of money. What a person desires to sell and buy is exactly what the other wishes to buy and sell. That is, both parties have to agree to sell and buy each other's commodities. In this situation, it is difficult to find a person who is willing to exchange two commodities each other.

ii. Where money is in use goods can be bought and sold to different people. Whatever one person wants to sell, he can sell it to any one who wants it and get money. He can use the money to buy some thing from a different person. Here money acts as a medium of exchange and double coincidence of wants is eliminated.[Mention the example from Text Book]

2. Why is money accepted as a medium of exchange?

i. Money is portable and easy to carry. It solves the problems of double coincidence of wants.

ii. It is accepted as a medium of exchange because the currency is authorized by the government of any country. Moreover, the law legalizes the use of money as a medium of payment. No individual in India can legally refuse a payment made in currency. Hence, it is widely accepted as a medium of exchange.

3. Trace the stages in the growth and use of money.

i. Before the introduction of coins, a variety of objects was used as money. For example, since the very early ages, Indians used grains and cattle as money in the barter system.

ii. Thereafter came the use of metallic coins — gold, silver, copper coins — a phase which continued well into the last century.

iii. Modern forms of money include currency — paper notes and coins. Unlike the things that were used as money earlier, modern currency is not made of precious metal such as gold, silver and copper. Unlike grain and cattle, they are neither of everyday use. The modern currency is without any use of its own.

4. How is modern currency different from early objects of transactions?

i. Modern currency is not made of precious metals such as gold, silver and copper.

ii. Unlike the objects used like grain or cattle, money does not have a use of its own.

5. What are demand deposits? What are its features.

i. The money deposited in the bank accounts which can be withdrawn on demand is known as demand deposits. It is eligible to get a small rate of interest. The time of withdrawal is not specified in this account.

ii. It shares the essential feature of money. Payments can be done by cheques instead of cash.

iii. The facility of cheques against demand deposits makes it possible to directly settle payment without the use of cash. Since demand deposits are accepted widely as a means of payment along with currency, they constitute money in the modern economy.

How do demand deposits possess the essential features of money? (Same above)

6. What is a bank cheque?

i. A cheque is a paper instructing the bank to pay a specific amount from the person's account to the person in whose name the cheque has been made.

7. How do banks mediate between the depositors and borrowers? Or Describe the mechanism at work in the banks. Or What do banks do with the public deposits?

A. Banks accept deposit from depositors, by offering interest.

B. A small percentage of all the deposits will be kept as reserves in the banks to pay when depositors demand it, hoping all depositors will not withdraw money at a time.

C. Banks use the major portion of the deposits to extend loans. People take loan from banks for various purposes. Banks charge a higher interest rate on loans than what they offer on deposits. The difference between what is charged from borrowers and what is paid to depositors is their main source of income for the banks.

8. How is credit a boon and a curse to the borrower? Or What are the two different situations of credit?

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

B. Credit will be a boon to a borrower if the interest rate is very low and if he is able to pay back in time. In this situation credit helps to increase earnings and therefore the person is better off than before.

C. In different situation, if a borrower is not able to pay back the loan because of high rate of interests or and an unexpected situation like a crop failure, credit pushes the person into a debt trap and recovery from this situation is difficult. To repay the loan he has to sell a portion of the land or other property. In this situation, the person is clearly much worse off than before.

What is meant by debt trap? (Write Point C above)

9. What is collateral? Why do lenders ask collateral while lending?

i. Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid.

ii. If the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to obtain payment. Property such as land titles, deposits with banks, livestock are some common examples of collateral used for borrowing.

10. What is credit? Explain the various terms of credit with examples.

Credit (loan) refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment. The terms of credit are the following:

i. Interest rate: Formal sector demands less rate of interest compared to informal sector.

ii. Collateral and documentation requirement: It refers to the security against the loan demanded and kept by the lender until the loan is paid back. It can be gold or documents of properties or other certificates attached with the application.

iii. The mode of repayment: The borrower should pay back the interest and the principal amount weekly or monthly by cash or cheques as decided at the time of making agreements.

11. Differentiate between formal and informal sectors of credit in India.

i. Formal Sector of credit includes Commercial banks, Grammeen Banks, Cooperative societies etc. who provide loan to farmers. Informal sector includes moneylenders , traders, employers, relatives and friends who provide loans.

ii. There is no organization, which supervises the credit activities of lenders in the informal sector. However, Reserve Bank of India supervises the formal sector and issue guidelines.

iii. Compared to the formal lenders, most of the informal lenders charge a much

higher interest and put other terms on loans. Thus, the cost to the borrower of informal loans is much higher. This may push them in to debt trap.

iv. Informal lenders adopt unfair means to get their money back. On the other hand, Banks follow only legal measures to recover loans. In many cases, they may even 'write off' agricultural loans.

v. Cheap and affordable credit is crucial for the country's development. It is available in banks and cooperatives. It reduces the dependence of rural households in the informal sector.

12. Why should banks and cooperatives need to lend more?

(Write points ii to v above)

This would lead to higher incomes and many people could then borrow cheaply for a variety of needs.

13. Why should credit at reasonable rate be available for all? (Why do we need to expand formal sources of credit in India?)

i. To start and continue an economic activity: Activities like crop production requires considerable cost on seeds, fertilizers, pesticides, water , electricity, repair of equipment, transportation etc. Since most of the farmers are poor, they require credit facilities. People also could set up business, industries and trade in goods.

ii. To save from the debt trap: Most of the informal lenders charge a much higher interest and put other terms on loans. Thus, the cost to the borrower of informal loans is much higher. This may push them in to debt trap. Reasonable rate of interests in the formal sector may save them.

iii. Cheap and affordable credit is crucial for the country's development. It is available in Banks and cooperatives. It reduces the dependence of rural households in the informal sector. Hence, we should expand formal sources of credit in India. This lead to the establishment of various economic activities.

14. What is the general pattern of credit taken by the rural and urban households?

i. Majority of the rich urban and rural households depends on formal sector such as banks for their credit facilities.

ii. Majority of the poor urban and rural households depends on informal sources of credit like the moneylenders.

iii. Formal sector meets only about half of the credit requirements of the rural people. The remaining credit needs are met from informal sources.

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15. Describe the functioning of Self Help Group. (SHG)

i. A typical SHG has 15-20 members, usually belonging to one neighbourhood, who meet and save regularly. Saving per member varies from Rs 25 to Rs 100 or more, depending on the ability of the people to save.

ii. Members can take small loans from the group itself to meet their needs. The group charges interest on these loans but this is still less than what moneylenders charge. After a year or two, if the group is regular in savings, it becomes eligible for availing loan from the bank. Loan is sanctioned in the name of the group and is meant to create self-employment opportunities for the members.

iii. Most of the important decisions regarding the savings and loan activities are taken by the group members. The group decides as regards the loans to be granted — the purpose, amount, interest to be charged, repayment schedule etc.

iv. Also, it is the group which is responsible for the repayment of the loan. Any case of non-repayment of loan by any one member is followed up seriously by other

members in the group. Because of this feature, banks are willing to lend to the poor women when organized in SHGs, even though they have no collateral as such.

v. Thus, the SHGs help borrowers overcome the problem of lack of collateral. They can get timely loans for a variety of purposes and at a reasonable interest rate.

Moreover, SHGs are the building blocks of organization of the rural poor.

vi. Not only does it help women to become financially self-reliant, the regular meetings of the group provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.

16. In situation with high risks, credit might create further problem to the borrower. Explain.

i. High rate of interests and undue conditions may find borrowers difficult to repay the loan taken and it push them to debt trap.

ii. In an unexpected situation like a natural calamity and a crop failure, a borrower may find it difficult to repay the loan taken and some times, he will be forced to sell off a portion of the land or other property to re pay the loan.

17. What is the basic idea behind the SHGs for the poor?

i. To develop saving habit among its members.

ii. To help each other at times of need for credit.

iii. To save them from the money lenders and the debt trap.

iv. To overcome the problem of collateral for loans and to become financially self-reliant.

18. What are the reasons why the banks might not be willing to lend to certain borrowers?

i. The risk involved in their activities like a crop failure, which may lead to no repayment of loans.

ii. Banks might not be willing to lend to certain borrowers who fails to provide collateral as a security to the loan.

19. In what ways does the Reserve Bank of India supervise the functioning of banks? Why is it necessary? (Explain any 4 main functions of the RBI)

i. The RBI monitors that all banks actually maintain the minimum cash balance.

No bank is allowed to lend from the cash reserves.

ii. Similarly, the RBI sees that banks give loans not just to profit-making businesses and traders but also to small cultivators, small scale industries, to small borrowers etc.

iii. Periodically, banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.

iv. It is necessary to make the activities of all banks uniform in the country. It also helps to prevent unfair practices in banking.

20. What is the role of credit in development?

i. It converts idle money into capital. Normally people take loan to engage in economic activities to earn a living. In this process, excess money that some people have is used for productive purposes. Credit provides both fixed and working capital in the processes of production. It helps the land less poor and unemployed youths to start enterprises.

ii. It promotes thrift and savings, which is essential for development. The money that is saved can be used as credit; like wise, the borrower also has to save to repay the loan taken.

iii. It helps businessmen or employers and employees, at times of financial crisis to come out of the situation and to sustain the economic activities.

iv. The development plans of the country and a number of schemes to reduce unemployment and poverty are implemented through banks and thus through credit.

21. What are the advantages of formal source of credit?

- i. Most of the formal lenders charge a much lower interest and do not put other terms on loans. Thus, the cost to the borrower of formal loans is much lower.
- ii. Banks follow only legal measures to recover loans. In many cases, they may even 'write off' agricultural loans.
- iii. Cheap and affordable credit is crucial for the country's development. It is available in banks and cooperatives. It reduces the dependence of rural households in the informal sector.
- iv. Reserve Bank of India supervises the formal sector and issue guidelines. (any two)

22. Suggest two measures for improving the share of formal sector in total credit.

- i. Reduce the interest rate.
- ii. Make the terms and conditions and procedures easy
- iii. Do not demand collateral. (Explain any two)

23. Why is moneylender still the largest single source of credit? (or Why are the poor households still depending on informal sources of credit in India?)

- i. Banks are not present everywhere in rural India. Even if it is present, it is not easy to get loans from a bank since many procedures are required.
- ii. Absence of collateral and documentation required in formal sector, forces poor households to depend on informal sectors like moneylenders where such collateral and documentations are not required.
- iii. Borrowers can approach the money lenders even without repaying their earlier loans.
- iv. Since the lender and the borrower in informal sector are personally known to each other availability of loan is easy at any time required.

24. What are the importance of SHG?

SHG help borrowers to overcome the problem of lack of collateral.

SHGs are the building blocks of organization of the rural poor.

It help women to become financially self reliant.

The regular meetings of the group provide a platform to discuss and act on a variety of social issues such as health ,nutrition, domestic violence etc.