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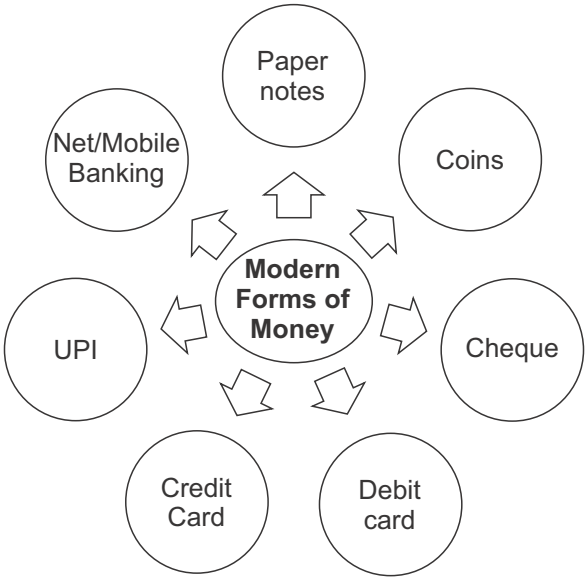
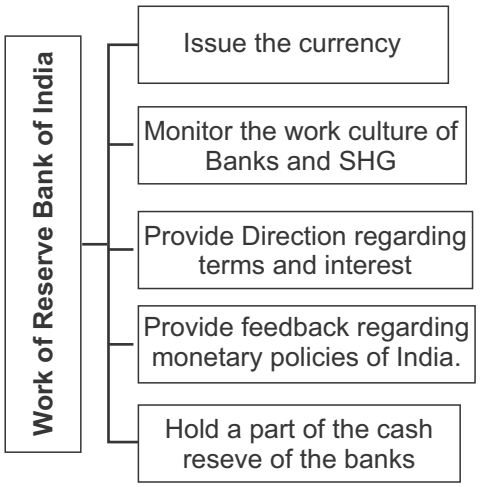
Chapter-3

Money and Credit

Points to Remember:

- When goods are directly exchanged for goods and there is no use of money, it is called Barter System.
- Money is something that can act as a medium of exchange in transaction. It eliminates the need for double coincidence of wants.
- When both parties have to agree to sell and buy each other's commodities. This is known as the double coincidence of wants.





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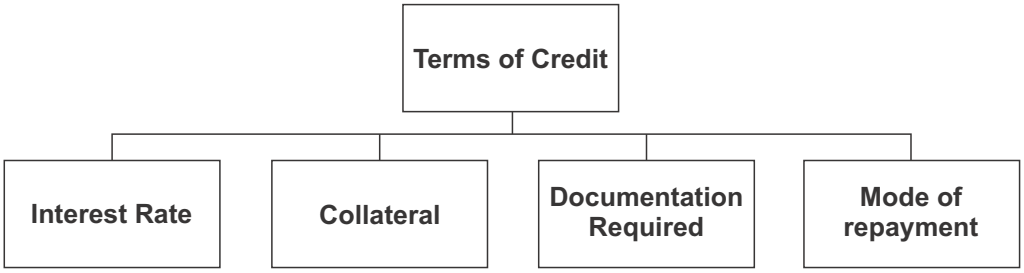
- Credits refers to an agreement in which the lender supplies the borrower money, goods and services in return for the promise of future repayment.

Credit as an asset:

- During the festival season, a shoe manufacturer Salim has received an order of making shoes in bulk, within one month's time. To complete this production, he hires extra workers and has to purchase the raw materials. He asks the supplier to supply leather now and, promise to pay him later. Then he takes some advance payment from trader. By the end, of the month, he is able to deliver the order, make a good profit and repay the money he had borrowed.

Credit as a debt trap:

- A farmer swapna picks up loan from a money lender to meet the expenses of cultivation. But unfortunately the crop was hit by the pests and there was crop failure. So, she is unable to repay the loan and debt grows larger with Interest.
- Collateral is asset that the borrower owns (Such as land, building vehicle, livestock) and uses this as a guarantee to a lender until the loan is repaid.



- Self Help Groups: It's basic idea is to provide financial resources for the poor through organizing the rural poor especially women into Small Help Groups.

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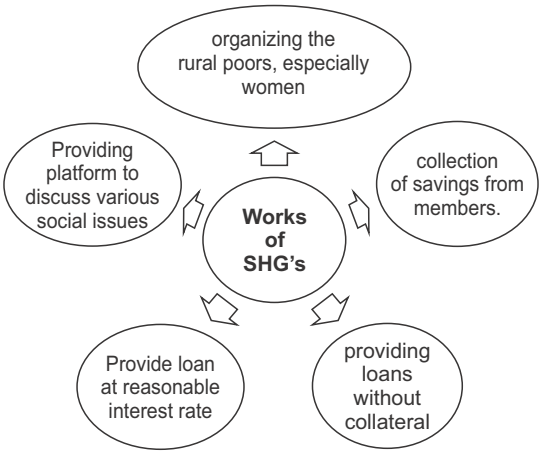

1 Marks Questions

Q.1 Which of the following can be considered as modern form of Money?

1. Paper note 2. Gold Coins 3. Silver Coins 4. Copper coins

Q.2 In India, Which agency is authorize to issue the notes and currency?

1. NABARD 2. Reserve Bank of India 3 . World Bank 4. State Bank of India

Q.3 Where does the large part of deposits spend by the bank?

1. For opening new Branches
2. To pay taxes
3. To pay interest on loan
4. To provide loan

Q.4 Which of the following is not included in the formal source of loan?

1. Bank 2. Co-operative Banks 3. Employer 4. None of the above

Q.5 Which of the following is a symptom of debt Trap?

1. Unable to repay the loan 2. Able to repay the loan
3. Both are correct 4. Both are wrong

Q.6 Which of the following is not an example of Collateral?

1. Jewelry 2. House 3. Agricultural Land 4. None of the above

Q.7 Who takes the major decision regarding savings and loans in SHG's?

1. Bank 2. Government 3. Members 4. NGOs

Q.8 How much cash do the bank have with its total cash amount?

1. 10% 2.20% 3.15% 4.30%

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Q.9 Which Currency is used as medium of exchange mostly at International Level?

1. American Dollar 2. Singaporean Dollar

3. Rupees 4. Taka

Q.10 Who is responsible for the establishment of Grameen Bank in Bangladesh?

1. Wasim Akram 2. Shoaib

3. Muhammad Yunus 4. Shahid Afridi

Q.11 Suppose you are living in ancient times, when money is not accepted as medium of transaction. What kind of problem you will find while purchasing and selling the things?

Q.12 What was the primitive methods of exchange in early ages in India?

Q.13 Bharti has a doubt that why one cannot refuse a payment made in rupees in India?

Q.14 Which government agency is authorized to issue notes and currency in India?

Q.15 Why a loan from Informal Sector is costlier than the formal sector?

Q.16 Give one example each of modern currency and older currency?

Answers

1. Paper note
2. Reserve Bank of India
3. To give loans
4. Employer
5. To unable to repay loan
6. All are wrong
7. Members
8. 15%
9. American Dollar
10. Muhammad Yunus
11. Doubles coincidence of wants
12. Grains and Cattles
13. It is authorized by Government of India
14. Reserve Bank of India
15. Interest Rate is higher.
16. Modern currency- Notes, coins etc. Older currency - Gold coins etc.

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Ans.4 Dollar

Ans.5 Reserve Bank of India

Ans.6 People deposit their money in the bank as it earns interest. Since the deposits in the bank accounts can be 'withdrawn on demand, these deposits are called demand deposits.

Ans.7
- Banks keeps only small proportions (15percent) of their deposits as cash with themselves.
- Major portion of money deposits are used to extend loans.

Ans. 8 Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock) and uses this as a guarantee to a lender until the loan is repaid.

Ans.9 Bank charge higher interest rate on loans that what they offer on deposits. The difference of interest is the main source of income of bank.

Ans.10 Interest rate is higher.

Long Answer Type Questions (3 or 5 MARKS EACH)

Q.1 Analyse the work of Reserve Bank of India?

Q.2 How do formal and informal sources of credit differ from each other?

Q.3 What is credit? How can credit be both an asset as well as a debt trap?

Q.4 What are the terms of credit? How it may vary for person to person?

Q.5 How is the concept of Self Help Group important for poor people? Give your view points.

Q.6 The credit activities of the informal sector should be discouraged. Support your statement with relevant arguments.

Q.7 Why the formal or informal sector does asks for collateral?

Q.8 How do farmers gets into debts trap?

Q.9 Review any three merits and any two demerits of 'formal sector of credits' in India.

Q.10 What are the reasons why the banks might not be willing to lend to certain borrowers?

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Answers

Ans.1
- Issue the currency on behalf of Government of India.
- Issues guidelines regarding working culture of Bank and SHG.
- Give directions regarding terms and interest on credits.
- To provide feedback regarding monetary policies to government of India.
- RBI holds a part of the cash reserve of the bank.

Ans. 2

Formal sector	Informal sector
Rate of Interest is lower.	Higher rate of Interest.
Collateral is must for getting loan.	Ready to give loans without any collateral too.
RBI supervises them.	No organization to supervise them.
More documentation is required. It involves many formalities.	Less documentation, less formalities.
Ex.: Banks and co-operatives.	Examples: Moneylender, traders, friends, retailers and so on.

Ans. 3 Credits refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment.

- Credit as an asset: During the festival season, a shoe manufacturer Salim has received an order of making shoes in bulk, within a month's time. To complete production, he hired extra workers and has to purchase the raw materials. He asks the supplier to supply leather now and, promise to pay him later. Then he took some advance payment from the trader. By the end, of the month, he is able to deliver the order, make a good profit and repay the money he had borrowed.
- Credit as debt trap: A farmer Swapna picks up loan from a moneylender to meet the expenses of cultivation. But unfortunately the crop is hit by the pests and fails. So, she is unable to repay the loan and debt grows larger with interest.

In Salim's case credit plays a vital and positive role, whereas in

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Swapna's case credit pushes the borrowers into a situation from which recovery is painful.

Ans.4

- Every loan agreement specifies an interest rate which the borrower must pay to the lender along with repayment of the principal.
- In addition, lender may demand collateral, i.e., as assert that the borrower owns and uses this as a guarantee until the loan is repaid.
- If the borrower fails to repay the loan, the lender has the right to sell the collateral to obtain payment.
- Terms of credit comprise interest rate, collateral and documentation requirement, and the mode of repayment.

Ans. 5

- SHG's basic idea is to provide financial resource for the poor through organizing the rural poor especially women, into small Help Groups.
- It organizes the rural poor, especially women, into small Self Help Groups.
- It collects saving of the members.
- it provides loans without collateral.
- It provides timely loans at reasonable rate of interest.
- It also provides a platform to discuss various social issue.

Ans. 6

- Informal lenders charge very high interest on their loans.
- There are no boundaries and restrictions.
- In certain cases, the high interest rate for borrowing can mean that the amount to be repaid is greater than the income of the borrowers.
- This could lead to increasing debt trap, therefore the credit activities of the informal sector should be discouraged.

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Ans.7 Lenders may demand collateral or an asset that the borrower owns to use it as a guarantee until he repays the loan. It may be sold if the borrower is not able repaid.

Ans. 8

- Failure of the crop makes loan repayment impossible.
- Downfall of crop prices also makes loan repayment impossible.
- Higher interest makes life difficult. Credit in such a condition pushes the borrowers into a situation from which recovery is painful and they get into the debt trap.

Ans.9 **Merits**

- Helps to meet the working capital needs of production.
- Helps in completing production on time.
- Low interest rate.
- Helps in increasing earnings.

Demerits

- Difficulty in obtaining loans.
- Collateral issues.
- Documentation could be a problematic issue for few.

Ans.10

- Banks require proper and legal documentations and collateral as security against loans. The borrowers who have not repaid previous loans, the banks might not be willing to lend them further.
- Those entrepreneurs, who are going to invest in a business with high risks, the might not be willing to lend money.

Practice Questions

Q.1 Why is it necessary to increase a large number of banks mainly in rural areas? Explain.

Q.2 Explain any three reasons for the banks and cooperative societies to increase their lending facilities in rural areas.

Q.3 Describe the importance of formal sources of credit in the economic development?

Q.4 Describe the bad effects of informal sources of credit on borrowers.

Q.5 Why is it that most of people in Indian still dependent on informal sector of credit for loan?

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