

## **Chapter 3**

### **Money and Credit**

#### **Let's Work these Out-Pg-40**

Q.1 How does the use of money market easier to exchange things?

Ans.: Money is accepted as a medium of exchange and it serves as a unit of value. Besides these two things the problem or the issue of double coincidence of wants is also sorted with the help of money and thus these are the reasons that the use of money market is easier to exchange things without facing any kind of struggle.

Q.2 Can you think of some examples of goods and services being exchanged or wages being paid through barter?

Ans.: There are many examples of goods and services which are being exchanged through barter. Some of these are as follows:

Let us take example of rural areas where in certain cases food grains are exchanged for other crops.

Also in many government schemes the labourers working there instead of getting paid with cash are provided with things like 4 kg of wheat per day of work.

#### **Let's Work these Out-Pg-42**

Q.1 M Salim wants to withdraw 20,000 in cash for making payments. How would he write on a cheque to withdraw money?

Ans.: The correct way to fill the cheque for withdrawing money is shown in the following diagram:

The image shows a sample cheque from the State Bank of India. The cheque is dated 'X Y 2002'. The payee is 'Self'. The amount is written in words as 'Twenty Thousands only' and in figures as '₹. Rs. 20,000'. The account number is '0318000400022378'. The bank's name is 'State Bank of India' and the address is '4, Mellford City, Rohta Road Meerut (U.P.)'. The signature 'M. Salim' is written at the bottom right.

Q.2 Tick the correct answer. After the transaction between Salim and Prem,

- A. Salim's balance in his bank account increases, and Prem's balance increases.
- B. Salim's balance in his bank account decreases and Prem's balance increases.
- C. Salim's balance in his bank account increases and Prem's balance decreases.

Ans.: After the transaction between Salim and Prem. It is quite natural that if a person is transferring money in the other person's account then his account balance will decrease and the receiver's balance increase. And the same is with Salim and Prem when Prem transfers money from his account to Salim's account then his own balance decreases and Salim's account balance increased.

Q.3 Why are demand deposits considered as money?

Ans.: Demand deposits are considered as money because as we know that money refers to the demand deposits and that can be withdrawn when one needs them. And also this withdrawn money can be used for making

payments. So if demand deposits are considered as money then there is no issue because both can be used as substitutes one at the place of the other.

### Let's Work these Out-Pg-44

Q.1 Fill the following table.

|                           | Salim | Swapna |
|---------------------------|-------|--------|
| Why did they need credit? |       |        |
| What was the risk?        |       |        |
| What was the outcome?     |       |        |

**Answer :**

The correct fill for the following table is as follows:

|                           | Salim                                  | Swapna                                           |
|---------------------------|----------------------------------------|--------------------------------------------------|
| Why did they need credit? | To fulfill the working capital needs.  | To purchase commodities used during cultivation. |
| What was the risk?        | Unknown risk or no risk at all.        | Crops failure risk.                              |
| What was the outcome?     | After earning profit repaid the debts. | Found her in the debt trap.                      |

Q.2 Suppose Salim continues to get order from traders. What would be his position after six years?

Ans.: If Salim continues to get order from traders then after six years by using his sales profit he can easily finance his future business. Due to the profit from the sales he has no need to borrow money from any source. Already he will be much able to afford this much money to start even a

new business after 6 years. His profit will be double and in case if he borrows then he would be able to pay easily all his debts in time.

Q.3 What are the reasons that make Swapna's situation so risky? Discuss factors – pesticides, role of money lenders, climate.

Ans.: The reasons for Swapna's situation being risky are as follows:

- (a) The failure of crop due to either poor rainfall or attack on the crop by pests.
- (b) Her situation is becoming worse day by day as money lenders charge high interest rates and if she can't pay her debts they will forfeit her land too which results in decrement of her earning or maybe she becomes solvent for future.

### **Let's Work these Out-Pg-45**

Q.1 Why do lenders ask for collateral while lending?

Ans. : Lenders ask for collateral while lending because if the payment of interest and payment of principal are not made on time then in that case the lenders can sell the collateral assets and recover their money. Collateral is used as a kind of mortgage when someone borrows money in bulk from the bank and in that case he has to assure the bank that its debt will be paid on time by him but if in case he couldn't then bank can sell that collateral and recover the money lent to that customer.

Q.2 Given that a large number of people in our country are poor, does it in any way affect their capacity to borrow?

Ans.: A large number of people in our country are poor and yes it affects the capacity to borrow in many ways. As we discussed in above question

about collateral and we all know that only the person who has money will have assets or collateral to keep as mortgage. But if the whole residents are poor then no one will be able to borrow as they don't have capacity to keep any mortgage or even borrow a penny from the bank. They mostly borrow from informal sectors like moneylenders, relatives and friends if the needed it.

**Q.3** Fill in the blanks choosing the correct option from the brackets.

While taking a loan, borrowers look for easy terms of credit. This means..... (low/high) interest rate,..... (easy/tough) condition; for repayment,..... (less/more) collateral and documentation requirements.

**Ans.:** While taking a loan, borrowers look for easy terms of credit. This means low interest rate, easy condition; for repayment, less collateral and documentation requirements.

### **Let's Work these Out-Pg-47**

**Q. 1** List the various sources of credit in Sonpur.

**Ans.:** Various sources are as follows:

- (i) Village moneylender
- (ii) Traders
- (iii) Landowner as moneylender
- (iv) Commercial banks
- (v) Krishak co-operative society

Q.2 Underline the various uses of credit in Sonpur in the above passages.

Loans from Co-operatives Besides banks, the other major source of cheap credit in rural areas are the co-operative societies (or co-operatives). Members of a co-operative pool their resources for co-operation in certain areas. There are several types of co-operatives possible such as farmer's co-operatives, weaver's co-operatives, industrial workers co-operatives, etc. Krishak Co-operative functions in a village not very far away from Sonpur. It has 2300 farmers as members. It accepts deposits from its members. With these deposits as collateral, the Co-operative has obtained a large loan from the bank. These funds are used to provide loans to members. Once these loans are repaid, another round of lending can take place. Krishak Co-operative provides loans for the purchase of agricultural implements, loans for cultivation and agricultural trade, fishery loans, loans for construction of houses and for a variety of other expenses.

Ans.: Members of cooperative societies contribute their resources in order to cooperate certain areas. Now there may be various kinds of cooperative such as farmer, weaver, industrial workers etc. Krishak Cooperative functions in a village not very far away from Sonpur. It has a total member of around 2300 farmers. And it collects the deposits from its members. With the help of this collected amount as collateral, the cooperatives have received a large loan from the bank. They use this fund to give loans to the needed people. After getting the payment of debt Krishak cooperative give loans for the purchase of agricultural implements, loans for cultivation and agricultural trade, fishery loans, loans for construction of hoses and for a variety of other expenditures. Besides getting loans from the cooperative banks, the other major sources of getting cheaper credit in rural areas are the cooperative societies only.

Q.3 Compare the terms of credit for the small farmer, the medium farmer and the landless agricultural worker in Sonpur.

Ans.: (a) For small farmers:

- High rate of interest.
- It promises to sell crops to traders at low prices as repayment of loan.

(b) For medium farmer:

- Low rate of interest.
- Loan of several banks can be easily paid in the next 2-3 years.

(c) For landless agricultural workers of Sonpur:

- Borrowers pay their debt by working on land of their moneylenders or landowners so that in future again they will be able to borrow from that person in need.
- The rate of interest for these workers is high.

Q.4 Why will Arun have a higher income from cultivation compared to Shyamal?

Ans.: Arun will have a higher income from cultivation compared to Shyamal due to following reasons:

Arun gets a loan from a commercial bank at the interest rate of 8.5% per annum, whereas Shyamal gets loan from a village moneylender at the interest rate of 5% per month (i.e., 60% per annum). Arun has more calibers to pay bank loan as compared to Shyamal and also he gets a fresh loan in next three years. As Shyamal he is not restricted to sell his product

to the moneylenders who provide him a low price. He has the benefit of selling his product at market rates.

Q.5 Can everyone in Sonpur get credit at a cheap rate? Who are the people who can?

Ans.: No, everyone cannot get credit at a cheap rate. Only the following people are able to get it

- People having some collateral with them.
- People who have organised themselves into a cooperative society.
- The person who can fulfill the bank's formalities at the time of loan borrowing.

Q.6A Tick the correct answer.

Over the years, Rama's debt

- A. Will rise.
- B. Will remain constant.
- C. Will decline.

Ans.: Over the years, Rama's debt will rise because we know that time to time the amount keeps increasing by summing up the interest rate and late fee.

Q.6B Tick the correct answer.

Arun is one of the few people in Sonpur to take a bank loan because

- A. Other people in the village prefer to borrow from the moneylenders.



B. Banks demand collateral which everyone cannot provide.

C. Interest rate on bank loans is same as the interest rate charged by the traders.

Ans.: Arun is one of the few people in Sonpur to take a bank loan because it is necessary to provide collateral to the bank while borrowing and everyone in the village cannot provide collateral as Arun is able to do, therefore he can easily borrow having the capacity of paying the debts in future.

Q.7 Talk to some people to find out the credit arrangement that exists in your area. Record your conversation. Note the differences in the terms of credit across people.

Ans.: I talked to many people living in my area and asked them what are the terms and conditions when they apply for loan and from where do they borrow. Answers were different.

Few said that they don't borrow money as they can't afford to repay the debts on time so they stay away from borrowing and lending.

Few of them said that they borrow money from relatives and friends as there is low rate of interest required and sometimes no rate of interest as well.

Few of them said that they borrow money from commercial banks and bank charges high rate of interest and also ask for some collateral and many more documentation formalities etc.

So, these are some views of people regarding credit borrowing from different areas or communities.

## Let's Work these Out-Pg-50

Q.1 What are the differences between formal and informal sources of credit?

Ans.:

| <b>Formal Sources of Credit</b>                                                                   | <b>Informal Sources of Credit</b>                                                                               |
|---------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------|
| Richer people can borrow easily as they have assets and guarantee of returning the debts on time. | Poorer people can't borrow because of lack of assets and any documents and incapability of returning the debts. |
| Interest rates are reasonably low                                                                 | Interest rate are very high.                                                                                    |
| Banks and co-operative societies                                                                  | Traders, moneylenders, landowners, etc.                                                                         |
| Main motive here is social welfare.                                                               | Main motive here is profit.                                                                                     |

Q.2 Why should credit at reasonable rates be available for all?

Ans.: The credit should be available at reasonable rates for all because through this reasonable rate and equality poor people would be able to borrow for their work of cultivation and other things too. This will make their life easy and far better than ever before. Suicidal attempts will be decreased as we know that because of inability of paying debts many farmers suicide. So credit at reasonable rates will put the life of farmers at ease.

Q.3 Should there be a supervisor, such as the Reserve Bank of India that looks into the loan activities of informal lenders? Why would its task be quite difficult?

Ans.: There must be a supervisor for checking the loan activities of informal lenders such as the Reserve Bank of India supervises other banks. The task would be quite difficult because informal sector includes several people who have their variety of business besides lending and the most important part to be noticed about these sectors are that they are not registered with the government and without registration there is a risk of fraud of any kind of mishappening with borrowers as well as with lenders of loan.

Q.4 Why do you think that the share of formal sector credit is higher for the richer households compared to the poorer households?

Ans.: The share of formal sector credit is higher for the richer households compared to the poorer households. There is a reason behind this statement that the richer households are in much better situation to give collateral and other necessary documents which the banks ask for while providing loan. Richer households also have a good capacity to pay the debts on time. They have means to exert pressure on the banks and the cooperatives to sanction loans.

## **Exercises**

Q.1 In situations with high risks, credit might create further problems for the borrower. Explain.

Ans.: In situations with high risks, credit might create further problems for the borrower because sometimes when we take loan in a huge quantity and then such kind of situation comes that under that circumstances we become unable to pay the loan and at that time instead of ameliorating the earnings the credit drives the borrower in a condition where convalescence is very tough and agonizing. This situation is known as debt-trap. And in this situation the borrower is pressurized to pay his debts

at any cost, either by giving his collateral or his assets which can be useful to the lender in form of guarantee.

Q.2 How does money solve the problem of double coincidence of wants? Explain with an example of your own.

Ans.: (i) In barter system usually double coincidence of wants is found in which the goods are exchanged without the use of money. In this system, goods and services are exchanged in return of goods and services needed by the other person without any exchange of money. But the main deal is that both parties must have the goods and services which the other party is ready to buy or it is useful for him.

(ii) Money solves the issue in such a way that there is no need for the person to have the same thing the other one wants to buy. If a person has money then there is no matter to having the same required commodity or not. A person can buy anything he wants to. He can easily get exchanged the service or commodity.

(iii) For example- A shoemaker wants to buy some rice. In this situation the shoemaker has to find a person who is interested in buying his shoes and in exchange he will provide him rice so that both will be able to exchange the goods and services which are related to their needs. But if shoemaker had money then he could purchase whatever he wanted to buy from the market and in this way, he would be able to solve the deal easily.

Q.3 How do banks mediate between those who have surplus money and those who need money?

Ans.: Banks mediate between those who have surplus money and those who need money in a very systematic way and in order to manage both of them it:

(i) Only keeps a very small amount of their deposits with them in form of cash so that they can pay to the depositors in case they wanted to withdraw the money at any point of time.

(ii) Keeps major proportions of deposits to use in extending the area of loan provided.

(iii) Charges higher rate of interest while providing loans than what they provide depositors at the time of deposits.

(iv) Differentiates between what is charged from borrowers and what is paid to depositors. This is the main source of their income earning.

Q.4 Look at a 10-rupee note. What is written on top? Can you explain this statement?

Ans.: If we take a look at a 10-rupee note, then we would find the following words written on it:

**RESERVE BANK OF INDIA**

Guaranteed by the Central Government

I promise to

Pay the bearer

The sum of

Ten Rupees

Signature of the Governor of the Reserve Bank of India.

Explanation: After looking at a 10 rupee note we notice that there is mentioned on the very top the “Reserve Bank of India” which is followed by a statement “Guaranteed by the Central Government”. All the written things show that it is a promissory note which cannot be issued by anyone but the Reserve bank of India which surpluses all money-related functions in the formal sector of India. This statement which is mentioned on the note of ten rupee connects to this idea that the RBI is the central organ in the working of money related issues.

Q.5 Why do we need to expand formal sources of credit in India?

Ans.: (i) After comparing to the formal lenders we found that the most of the informal lenders charge much higher interest on loans. Then informal loans cost borrowers much more high.

(ii) The higher cost of borrowing represents that a major proportion of the earning of the borrowers is used to repay the loans and due to which nothing has been left for their own.

(iii) High rate of interest of borrowing shows the amount to be rapid higher than income of the borrower and this way it leads increasing debt and debt-trap.

(iv) High cost of borrowing let not borrowers to start any kind of business even after wanting to do so.

(v) On looking at nation’s development we find that it is cheap and affordable credit which is essential for development. So, it is necessary for any country to expand its formal sources of credit.

Q.6 What is the basic idea behind the SHGs for the poor? Explain in your own words.

Ans.: SHG is self-help groups. It is an organisation having certain members who contribute their savings and constitute a fund. This fund is used in future for making finance and advances to other members, this process helps people to reduce the functioning of informal sectors of credit. It helps the borrowers to overcome their problem of lacking collateral, besides this it helps women also to become self-dependent and educated.

Q.7 What are the reasons why the banks might not be willing to lend to certain borrowers?

Ans.: Following are the reasons behind denial of lending loan to certain borrowers:

- a) The person who wants to borrow is unable to produce the certificate of earning that results in denying of his borrow request by the bank.
- b) Few people are not loyal and don't pay their debts on time.
- c) Few are unable to show their proper and complete documents to the bank at the time of borrowing that may later cause the problem.
- d) Few exhibit nothing to give as collateral to the bank.
- e) Few of them lacks witnesses as it is needed to assure the bank in case of non-availability of the person in future at the time of payment of his debts.

Q.8 In what ways does the Reserve Bank of India supervise the functioning of banks?

Ans.: Supervisory of the functioning of commercial banks is done by the Reserve Bank of India in following ways:

- (i) The functioning of formal sources of loans.
- (ii) It looks over the banks in maintenance of cash balance.
- (iii) It also keeps on checking that the banks instead of giving loans only to the profit making businesses and to the traders, they also provide loans to the small scale industries, small cultivators, small borrowers etc.
- (iv) With the passage of time the bank submits the information regarding lending and interest rates etc.

Q.9 Analyze the role of credit for development.

Ans.: Analysis of the role of credit for development:

- (i) It is a kind of agreement where a lender provides the money, goods and services to the borrowers in return of getting future payments on time.
- (ii) The credit is useful or not, it generally relies upon the risks and besides that some help in case of mishappening.
- (iii) If an individual borrows loan from the bank in order to increase the production of goods and services and to increase the boundary of his working area so that loan can be paid on time.

Q.10 Manav needs a loan to set up a small business. Manav will decide on whether to borrow from the bank or the moneylender? Discuss.

Ans.: Manav will decide on whether to borrow from the bank or the moneylender to set up his new business on the basis of various factors:

- (i) First of all he needs to have collateral or an asset through which guarantee could be provided of his loan. And in case he doesn't have any asset then loan can't be provided by the bank. In this situation he will have to pay a visit to moneylender even if the latter charges are of high interest rate.



(ii) If he is not aware of loan borrowing from the banks then he might not be able to borrow credit from it.

(iii) After many practices if he won't be able to find the loan then he has to visit any moneylender for this purpose of money borrowing.

Q.11 In India, about 80 per cent of farmers are small farmers, who need credit for cultivation.

(a) Why might banks be unwilling to lend to small farmers?

(b) What are the other sources from which the small farmers can borrow?

(c) Explain with an example how the terms of credit can be unfavorable for the small farmer.

(d) Suggest some ways by which small farmers can get cheap credit.

Ans.: (a) Banks might not be willing to lend to small farmers because it is aware of the situations and conditions a small farmer suffer from and in this case despite giving loan he won't be able to pay his debts and that will be the loss of bank. Neither a farmer has any such asset to put as mortgage nor would any kind of documental procedure be done by them.

(b) The farmers can borrow from moneylenders living nearby their villages or their relatives or friends. The other way is self-help groups, they too help them in lending loans to start any kind of small business if the farmer is suffering a lot and dying of starvation and some other issues. Cooperative banks may help them more in this matter.

(c) A small farmer may face the unfavorable conditions of credit in case if unfortunately the farmer has a bad crop, and is forced to either surrender his collateral or sell off a part of his land, in order to repay his loan. May

be because of weather or some natural disaster his all crop are destroyed and now he has not even a single penny to start any other business to repay his debts.

(d) Farmers can get a cheap credit at low interest rates or no interests from the self-help groups as they don't ask for any and cooperative banks shall be more helpful as they are their just to help the farmers their main motive of operating these banks is to help the farmers in bad situation.

Q.12 Fill in the blanks:

(i) Majority of the credit needs of the.....households are met from informal sources.

(ii) .....costs of borrowing increase the debt-burden.

(iii) .....issues currency notes on behalf of the Central Government.

(iv) Banks charge a higher interest rate on loans than what they offer on .....

(v) .....is an asset that the borrower owns and uses as a guarantee until the loan is repaid to the lender.

Ans.: (i) Poor

(ii) High

(iii) Reserve Bank of India

(iv) Deposits

(v) Collateral

Q.13A Choose the most appropriate answer.

In a SHG most of the decisions regarding savings and loan activities are taken by:

A. Bank

B. Members

C. Non-government organization

Ans.: In Self-help groups most of the decisions regarding savings and loan activities are taken by members because the funds are collected by the contribution of all the members of self-help groups so there is no any owner or worker, all are their own owner and own servants. They can just discuss and then take decisions where majority agree.

Q.13B Formal sources of credit does not include

A. Banks

B. Cooperatives

C. Employers

Ans.: Formal sources of credit do not include employers as there is no role of these employers all these works are related to banks and the cooperatives. Employers are there merely to serve the bank staff and do the work as it is asked to do by their owner. Lal the major decisions are taken by the cooperatives, employers have to just follow those rules and regulations set up by the banks.

Q.14 The following table shows people in a variety of occupations in urban areas. What are the purposes for which the following people might need loans? Fill in the column.

Ans.; Correct fill the given table is as follows:

| Occupations | Reason for needing a Loan |
|-------------|---------------------------|
|-------------|---------------------------|

|                                           |                                                   |
|-------------------------------------------|---------------------------------------------------|
| Construction worker                       | To meet living expenses                           |
| Graduate student who is computer literate | To pursue higher education                        |
| A person employed in government service   | For his/her daughter's wedding                    |
| Migrant labourer in Delhi                 | To buy a house                                    |
| Household maid                            | To meet living expenses                           |
| Small trader                              | To buy new machinery                              |
| Auto rickshaw driver                      | To buy a new auto rickshaw                        |
| A worker whose factory has closed down    | To meet living expenditure while still unemployed |

Next, classify the people into two groups based on whom you think might get a bank loan and those who might not. What is the criterion that you have used for classification?

| Those who might get a bank loan         | Those who might not get a bank loan    |
|-----------------------------------------|----------------------------------------|
| Graduate student                        | Construction worker                    |
| A person employed in government service | Migrant labourer in Delhi              |
| Small trader                            | Household maid                         |
| Auto-rickshaw driver                    | A worker whose factory has closed down |