

Money And Credit

Check Point 01

Q. 1. Before the advent of money, people used to follow which system of exchange.

Answer: Barter system

The barter system was used as a mode of exchange before the advent of money in which a good is transferred for another good. It was done because no goods had the money or monetary value. Therefore, the goods were exchanged with each other.

Q. 2. Currency consists of which two things?:

Answer: Paper notes and coins

According to RBI, the currency consists of two things paper notes and coins. RBI is the sole authority that issues the notes and coins. Since it is issued by the RBI, it accepted as a medium of exchange in the country.

Q. 3. How payment can be settled without the use of cash?

Answer: Payments through cheque and digital money can be made without cash.

Currently, there are many modes in which transactions can be made without the use of cash. Cheque system, e-wallet, demand draft, and many other modes can be made without cash.

Q. 4. How the bank gets money to advance loan?

Answer: They accept deposit from account holders and advance the portion of the deposit as a loan.

They accept the deposit from the account holders and by keeping a portion of deposit as the ratio in RBI as cash reserve ratio (CRR) and portion keeping in the bank itself as statutory liquidity ratio (SLR), after reserving these two ratios they advance the remaining part as a loan to borrowers.

Q. 5. Give two examples of collateral security.

Answer: Collateral is an asset that borrower owns. The collateral can be anything that has monetary value in it. The lender uses that collateral as a guarantee for that which borrower will repay the amount in future.

Example land and gold

Check Point 02

Q. 1. Write any two problems face while talking credit from informal sources.

Answer: A higher rate of interest and the huge cost of borrowing

The credit from the informal source is the getting loans from the money lenders, relatives and many other therefore it will not have any code of conduct and they will charge any rate of interest which will lead to huge cost the borrowers to repay, and lenders can easily exploit the borrowers.

Q. 2. Write anyone benefit of SHGs?

Answer: SHGs helps reduces the borrowing from the informal sources.

Self Help Groups (SHGs) are small institutions for women to help themselves and make them self-reliant.

Q. 3. What kinds of issues are discussed in SHGs?

Answer: They discuss social issues such as health, nutrition, domestic violence, etc., and also the problems faced by the group members family and try to help them.

Q. 4. Who founded the Grameen Bank of Bangladesh?

Answer: Grameen Bank of Bangladesh was founded by Professor Muhammad Yunus, and he was also the recipient of the 2006 Nobel Prize for Peace.

Self Assessment

Q. 1. What are the difficulties of the Barter system?

Answer: • Double coincidence of wants: One of the most difficult of barter system is the double coincidence of wants in which the buyer and seller should agree to sell each other's commodity in exchange even if they are not interested

• Difficulty in finding buyer and seller: It is very difficult to find the buyer who is need of commodity which the seller wants to sell.

• Store of value: the Barter system lacks the property of storing of value because the sold commodities cannot be saved for future use whereas money can be easily saved as a deposit.

Q. 2. State one advantage of SHGs.

Answer: Self Help Groups (SHGs) are small institutions for women to help themselves and make them self-reliant.

One of the biggest advantages of SHGs is women in both the rural and urban areas become self-sufficient and also helps the poor families to overcome from the collateral for loans.

Q. 3. What are the formal sources of credit?

Answer: Banks and cooperatives are the main formal sources of credit. The financial institutions that lend according to guidelines of RBI can be termed as a formal source.

A formal source is a source for raising the credit from the institutions which are under RBI or which are performed with a specific format. Therefore it can be more reliable than informal sources.

Q. 4. Which institution in India does authorize, money as a medium of exchange?

Answer: Reserve Bank of India (RBI) is the institution that authorizes the money as a medium of exchange. RBI is the central bank of India.

RBI is the central authority that can authorize and issue the currency note and coins which are widely accepted as the medium of exchange. They act on behalf of the central government in most of the financial perspective of the country.

Q. 5. Mention the sources of informal credit.

Answer: Credit from these sources moneylenders, friends, relatives, traders, employers, etc. can be said as informal sources of credit.

The credit from the informal source is the getting loans from the money lenders, relatives and many other therefore it does not have any code of conduct, and they charge any rate of interest which leads to huge cost the borrowers to repay, and lenders can easily exploit the borrowers.

Q. 6. How do currency notes act as a medium of exchange?

Answer: It is the authorization of the RBI of currency notes and coins which makes it act as a medium of exchange.

In India, the RBI issues the currency on behalf of the central government. It is the law in India that legalizes the currency notes as a medium of exchange.

Q. 7. What are the different types of bank deposits?

Answer: Deposit is the form of savings in which the account holders save their money in their bank account by depositing. Bank also accept the deposit from the account holders and also provide interest rate for depositing, this makes the people save as deposit instead of holding extra cash in hand.

- **Demand deposit:** Deposit in the bank can be withdrawn by the customer on demand is called demand deposit.

- **Fixed deposit:** In fixed deposit, the deposit cannot be withdrawn before the term specified. The rate of interest for a fixed deposit will be higher than the demand deposit.
- **Recurring deposit:** When the depositor deposits the fixed amount every month for a certain period is known as recurring deposit.

Q. 8. Why do bank demand collateral while issuing a loan?

Answer: Collateral is an asset that borrower owns. The collateral can be anything that has monetary value in it. The bank demands the collateral for the guarantee against their repayment for the credit. Collateral can be land, building, gold, vehicle, etc.

Q. 9. Write a short note on terms of credit.

Answer: The interest rate, collateral, documents required and mode of repayment altogether comprises terms of credit. The terms of credit may vary from one lender to another lender. The interest rate which is specified in terms of credit must be paid by the borrower till the end of the loan agreement. Collateral is an asset that borrower owns. The collateral can be anything that has monetary value in it. The bank demands the collateral for the guarantee against their repayment for the credit. Collateral can be land, building, gold, vehicle, etc. Documents required can be any document that bank needs from the borrower to advance him a loan; it can be income certificate, voter ID card, etc. Mode of repayment must be as per the specification of the bank. Currently, there are many easy modes of payment such as online transfer, UPI payment, bank deposit etc.

Q. 10. Explain loans from cooperatives.

Answer: Loans from the bank cannot be availed by all the citizens. The poor farmers cannot get the loan from the bank by mortgaging the collateral and afford all the credentials prescribed in terms of credit. The cooperatives is a voluntary organization which includes certain groups; they remove the problem by advancing the loan to the farmers with a low-interest rate. The cooperative is not only for the farmer society but there also many societies which have formed societies but only a few have registered under RBI. One of the major sources of raising credit in the rural area is cooperatives; there are several types of cooperatives such as

- Farmer cooperatives
- Workers cooperatives
- Weavers cooperatives

For example:

In a farmer cooperative, there will be many farmers as members, and they discuss the common issues faced in agriculture. These cooperatives help the farmers to buy the equipment, seed and other essential goods that are needed for agriculture. The loan process will not be rigid as per the banks.

Q. 11. 'The Rupee is widely accepted as a medium of exchange'. Explain.

Answer: In India, the rupee is widely accepted as a medium of exchange because of the authentication of the Reserve Bank of India (RBI). RBI plays an essential role in printing the currencies, there is no other authority other than RBI has the power to issue the currency and it has the sole authority. RBI is the central bank of India which on behalf of the central government in financial matters. It is the law that legalizes the use of rupee as a medium of exchange anywhere in India. No person can refuse the Rupee for the transaction; if he refuses, then he can be sued by law. Therefore it is the law that makes the rupee as a widely accepted as a medium of exchange in the country.

Q. 12. From where can small farmers get cheap loans?

Answer: Most of the formal sources of credit are cheap compared to the informal sources. Even though banks advance the loans with cheaper interest rate many farmers are not able to avail that loan due to terms of credit (formalities), therefore in cooperatives and Self Help Groups (SHGs) advance the loans with lesser formalities. The cooperatives and SHGs have lesser formalities because these are formed by the farmer groups itself, and they know who is actually in need of the loans. The cooperatives are voluntary organizations which include certain groups; they remove the problem by advancing the loan to the farmers with a low-interest rate. Self Help Groups (SHGs) is the small institution for the women to help themselves and make the women self-reliant, these small institutions may help to overcome the problem of farmers family.

Q. 13. Why is it important to have control over the formal sector loans by the Government of India?

Answer: RBI is the central government institution that controls all formal sector loans. All the commercial banks and many other financial institutions are supervised under RBI. RBI is the central bank of India, and it is the apex bank in the country. One of the main function of the central bank is to supervise all the commercial banks. It is important to have control because

- When commercial banks advance the credit without any ratios and then loans will become cheaper which will lead increase in the borrowers, and that will increase the credit in the economy which in turn will lead to inflation. Therefore mere control over credit is essential for the economy.
- To control the credit, the central bank increases or decreases the cash reserve ratio (CRR) which is kept as a reserve by all commercial banks in the central bank. When the economy is in inflation (continuous rise in the price level), then the central bank will increase the CRR which will reduce the lending capacity of the commercial bank and the process is reversed when there is deflation.
- The control of the central bank also reduces the exploitation. When it is not monitored by any authority, then start exploiting by charging a higher interest rate, advancing less value for the mortgage, etc. as the exploitation done by the informal sector.

Q. 14. Distinguish Between modern and traditional forms of money.

Answer: Modern money

Modern money is anything that is widely accepted for a transaction and which has a monetary value. A modern form of money includes paper notes and coins. Other than these two there are many types of money there are e-money, mobile wallet are some types which are as money currently in our economy. Best fit example of new forms of money that is e-money is Paytm which is widely accepted nowadays. New forms of e-money are not accepted in rural areas by the person who has lack of knowledge of the internet. Paper notes and coins are accepted everywhere in India because of it the promissory note issued by the RBI. All the modern money have the function of the store of value.

Traditional money

Before the advent of paper notes and coins, people used different types of coins such as gold, silver, copper which was issued by the government and have a seal of the government in it. Before the use of coins, goods such as cattle and grains were used for the transaction purpose by the people. The traditional money had less store of value than modern money. The store of value means the money which we save for our future use; goods cannot be saved since it perishes. Therefore, it lacks the store of value function.

Q. 15. “Cheap and affordable credit is essential for poor households both in rural and urban areas”. In the light of this statement explain the social and economic values attached to it.

Answer: **Loan** is an essential element that is involved in a poor household's families. Loans are taken to improve the standard of living, to afford the things which are costly, to attain a better health facility, procure the better agricultural equipment, etc. Loans help them to solve these common problems, but loans are received by paying an interest rate against it. The rate of interest must be small and affordable for the poor households so that they can pay back the loan amount with their incomes. When the interest rates are very high, then the credit becomes very expensive that poor households may not be able to pay the amount with their small income.

Cheap loans will provide the opportunity to poor families to pursue higher education by educational loans, increase the production in agriculture by providing farmers loan, likewise, there are business loans, vehicle loans, gold loan, etc. These loans provide an opportunity for the poor people to procure the items which they cannot buy due to low income.

Q. 16. Explain the role of Self Help Groups in empowering women.

Answer: **Self Help Groups** are voluntary organizations formed by women to enhance the microcredit for the members in it, and the women members get to indulge in the

entrepreneurial activities such as run a canteen, small shops, etc. This self-help group was established to empower the women, and the empowerment of women will not only improve her, but it also improves the family as a whole which also contributes to the economic development of the country. Basics of self-help groups for women:

- It helps women to create new small enterprises with low capital investment and by employing the members itself.

- It improves the women employment opportunity, increases the income of the family and also GDP of the country.

- It is one of the easiest ways of microcredit. Credit will be given to a person who is actually in need of it.

- Due to this programme, the women group start to get aware of the social issues, and they will try to educate the girl child in the family which will increase the female literacy rate.

Q. 17. Modern banking system plays an important role in the country's economic development. Briefly explain.

Answer: Banks play a very crucial role in the country's economic development. Banks are an important link between the savers and investors. Banks accept the excess savings from the people, and they lend to investors after keeping a fraction of ratio with the central bank. The producers and manufacturer borrow the money from the bank, and they invest the amount in their business. They expand the business or create new enterprises in which a number of people will be employed which will, in turn, increase the employment opportunity. The banks provide the interest for the deposit we keep in the bank which is better than holding the cash in hand. But the lending rate of interest will always higher than saving interest because that is the only profit for the bank. The new investments create new capital formations, employment, and infrastructure and so on. The importance of the banking system through further points is discussed below:

- **Credit creation**

One of the main functions of the banking system is credit creation. It is the banks that create credit for the producers to invest in the economy. The banks make the credit available by accepting the deposit from the people. The investment of the investors makes the economy better off, and investment is made available by the bank.

- **Capital formation**

The essential part of economic development is capital formation which can be efficiently done by the banking system. Capital formation means the increase in the capital stock of the country. Capital stock is one of the indicators that will provide the growth of the country.

- **Transfer the fund from unproductive to productive channel**

Banks help transfer the fund which is kept idle with people as excess money to investment which is a productive channel. The saving is pulled from the various sources to increase the productivity of the economy.

- **Governments bank**

The government gets the loan for introducing new schemes and financing debt from the Reserve Bank of India (RBI). The RBI acts as the bank for the government for proposing the developmental activities.

- **Special banks**

Modern banking has emerged with a wide range of network throughout the country. There are some banks which are specialized for some sectors of the economy such as National Bank for Agriculture and Rural Development (NABARD) which is especially for agriculture and rural development, Industrial Development Bank of India (IDBI) which is only for industrial development and so on. These type of sector banks concentrate on their sectors activities which lead to growth in all the sectors simultaneously.

Q. 18. How does a Self Help Group function?

Answer: Currently, in India, the banking system has emerged as an important link between savers and investors. The main motive of the bank is to accept the deposit and lend that deposit as a loan to investors. In a country like India, an ordinary person does not have any excess money to save as a deposit in the bank especially in rural areas. Apart from that, the banks charge the customer if a minimum balance is not maintained in the account.

Self Help Groups help to overcome the problem of saving for the ordinary person. Self Help Group is a voluntary organization formed by the women or men to enhance the microcredit for the members in it. The members of the organization save their money by fixing an amount to be deposited weekly, the amount will be such everyone can afford that. That deposited money can be advanced as a loan to any of the member in the group who is actually in need of it, but the loan will be advanced by the consent of the group members. There is transparency in the working of the organization because all the group members are from the same village and all of them will be neighbours.

When the Self Help group is registered, they can be linked to the bank through the 'SHGs linkage programme' under NABARD. When they are linked, they can get loans with the low-interest rate from the commercial banks in which they can accumulate the capital on their own. They accumulate capital by investing the money in small enterprises in which all the members can be employed in which they get self-sustained, and their standard of living rises. Currently, there are 2.2 million SHGs, representing 33 million members according to the estimates of the NABARD. These estimates are only those which have linked through the Linkage Programme, the southern region of India is well functioning in SHGs through this programme.

Q. 19. How can rural poor be encouraged to take loans from the formal sectors of credit? Explain.

Answer: Rural poor depends more on the informal source of credit due to lack of awareness and ease of availability. There are steps that can encourage them to take loans from the formal sectors. The major steps are discussed below:

- **Bring awareness**

Make aware to rural poor that formal source of credit can be obtained with much lower interest rate than the informal sources. They must also be aware of the debt trap they are facing, and the exploitation done by the informal source lenders.

- **Cooperatives**

Establishing the cooperative banks in all the rural areas will help the rural poor to get rid of the informal source lenders as there will be more options for taking a loan. The employees in the bank must be sensitized to deal with a poor, uneducated rural person.

- **SHGs**

Promoting more number of Self Help Groups (SHGs) which will promote the rural poor to save the money by depositing it weekly and when the SHGs are registered, they will be aware of the formal source of credit. Members of the SHGs should also take an initiative to bring awareness about the formal source of credit throughout the village.

- **Imposing law**

A law must be enacted to control the informal sources of credit via money lenders. Those money lenders who lend money for higher interest must be punished under the law.

- **Terms of credit**

The interest rate, collateral, documents required and mode of repayment altogether comprises of terms of credit. The terms of credit for advancing a loan from the banks should not be very rigid. The documents required must be such that the rural poor can afford it.

Q. 20. Describe four major sources of credit for households in India.

Answer: There are different sources of credit available for the households in India that too with an affordable interest rate. The major sources of credit for households in India are:

- **Commercial banks**

It is one of the formal sources of credit. Commercial banks make up a significant role for the source of credit. The banks accept deposit from the households who have excess

money advance loans to the households who are in need of it. It is one of the easiest ways of getting a loan for the households.

- **SHGs**

Self Help Group is a voluntary organization formed by the women to enhance the microcredit for the members in it, and the women members get to indulge in the entrepreneurial activities such as run a canteen, small shops, etc.

- **Cooperatives**

The cooperatives is a voluntary organization which includes certain groups; they remove the problem by advancing the loan to the farmers with a low-interest rate. The cooperative is not only for the farmer society, but there are many societies, but only a few have registered under RBI. One of the major sources of raising credit in the rural **area is cooperatives**

- **Regional Rural Banks**

These banks are also known as Grameen Bank. These banks are mainly set with concentrating the rural areas in India. It is being regulated by the National Bank for Agriculture and Rural Development (NABARD). Grameen Bank of Bangladesh was founded by Professor Muhammad Yunus, and he also received the 2006 Nobel Prize for Peace.

- **Money Lenders**

The money lender is the informal source of credit which is not encouraging in India. The money lends their money to the households for the higher interest rate for making a profit for them.