

Chapter 3 Money and Credit

ACTIVITY AND IN-TEXT QUESTIONS

Let's Work these out

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

Ans 1: In a barter system, where goods are exchanged directly without involving money, the "double coincidence of wants" is essential, meaning both parties must have what the other desires. Money simplifies this process by acting as a medium of exchange, eliminating the need for mutual wants to coincide. This way, money overcomes the limitations of the barter system, making trade more straightforward and efficient.

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

Ans 2: Yes, in rural areas, it's common for crops and food grains to be traded directly without money. Similarly, agricultural workers are often compensated not with cash but with goods, such as 4–5 kg of wheat or rice per day.

Let's Work these out

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

Ans 1: To withdraw cash, M. Salim would start by entering the date in the designated area on the cheque. Instructing the bank to "Pay Self," he would then write "Twenty thousand only" next to "Rupees" and enter the numerical amount "20,000" in the specified box. Additionally, he would fill in his account number, for example, "1512000100310360," in the appropriate space. Finally, he would sign on the lower right corner of the cheque and submit it at the bank's withdrawal counter.

Q. 2. Tick the correct answer:

After the transaction between Salim and Prem,

(i) Salim's balance in his bank account increases, and Prem's balance increases.

(ii) Salim's balance in his bank account decreases and Prem's balance increases.

(iii) Salim's balance in his bank account increases and Prem's balance decreases.

Ans: (ii) Salim's balance in his bank account decreases and Prem's balance increases.

Q. 3. Why are demand deposits considered as money?

Ans 3: Demand deposits are widely accepted as a payment method alongside currency, so they are also regarded as money in today's economy.

In-text Questions

Q 1. What do you think would happen if all the depositors went to ask for their money at the same time?

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Ans 1: If all depositors tried to withdraw their money simultaneously, the bank would be unable to fulfill these requests. This limitation arises because banks typically allocate around 85% of their deposits to provide loans.

Let's Work these out

Q 1. Fill the following table:

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

Ans 1:

	Salim	Swapna
Why did they need credit?	To complete production on time.	To meet the expenses of cultivation.
What was the risk?	If he would not deliver shoes in a month, he will lose the order.	Failure of the crop.
What was the outcome?	He delivered the shoes on time and earned profit.	The crop failed and she fell in debt-trap.

Q 2. Supposing Salim continues to get orders from traders. What would be his position after 6 years?

Ans 2: If Salim keeps receiving orders from traders, he could earn a substantial profit and achieve financial success within six years.

Q 3. What are the reasons that make Swapna's situation so risky? Discuss factors: pesticides; role of moneylenders, climate.

Ans 3: Swapna faces a risky situation due to pest attacks, exploitation by moneylenders, and the lack of a reliable monsoon.

Pesticides: Pests often attack crops while they're still growing. These pests can be managed using pesticides to protect the crops.

Role of Moneylenders: Moneylenders tend to exploit farmers by charging high-interest rates, which often leads to a cycle of debt.

Climate: Approximately 60% of agricultural land in the country still lacks irrigation. Farmers rely heavily on rainfall, making climate a critical factor in agriculture.

In-text Question

A House Loan Megha has taken a loan of Rs 5 lakhs from the bank to purchase a house. The annual interest rate on the loan is 12 per cent and the loan is to be repaid in 10 years in monthly instalments. Megha had to submit to the bank, documents showing her employment records and salary before the bank agreed to give

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her the loan. The bank retained as collateral the papers of the new house, which will be returned to Megha only when she repays the entire loan with interest.

Q. Fill the following detail of Megha's housing loan.

<i>Loan amount (in Rupees)</i>	
<i>Duration of loan</i>	
<i>Documents required</i>	
<i>Interest rate</i>	
<i>Mode of repayment</i>	
<i>Collateral</i>	

Ans:

<i>Loan amount (in Rupees)</i>	5,00,000
<i>Duration of loan</i>	10 years
<i>Documents required</i>	Employment records and salary certificates
<i>Interest rate</i>	12% per annum
<i>Mode of repayment</i>	Monthly instalments
<i>Collateral</i>	The paper of the new house.

In-text Questions

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

Ans 1: Lenders require collateral as a form of security when granting loans. In the event that the borrower cannot repay, the lender has the authority to sell the collateral or asset to recover the owed amount.

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 2: Yes, poverty impacts people's ability to borrow. This is because borrowing often requires collateral as security, which is an asset. People living in poverty usually lack such assets, limiting their borrowing capacity.

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) conditions for repayment, _____ (less/more) collateral and documentation requirements.

Ans 3: While taking a loan, borrowers look for easy terms of credit. This means **low** interest rate, **easy** conditions for repayment, **less** collateral and documentation requirements.

Let's Work these out

Loans from Cooperatives

Besides banks, the other major source of cheap credit in rural areas are the cooperative societies (or cooperatives). Members of a cooperative pool their resources for cooperation in certain areas. There are

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several types of cooperatives possible such as farmers cooperatives, weavers' cooperatives, industrial workers cooperatives, etc. Krishak Cooperative 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 Cooperative 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 Cooperative 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.

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

Ans 1: The different sources of credit in Sonpur include:

1. Local moneylenders
2. Agricultural merchants
3. Banks
4. Cooperative societies
5. Landowner-employers

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

Ans 2: The passages indicate the following uses of credit in Sonpur:

- (i) For Agricultural Cultivation or Input Procurement
- (ii) For Trade in Agricultural Products
- (iii) For Financing Fisheries
- (iv) For Family-Related Functions
- (v) For House Construction

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

Ans 3: The distinctions in credit terms for small farmers, medium farmers, and landless agricultural workers in Sonpur can be observed in the table below:

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

Ans 4: Arun is likely to earn a greater income from farming than Shyamal for several reasons:

1. Arun possesses 7 acres of land, while Shyamal only has 1.5 acres.
2. Arun obtained a bank loan with an annual interest rate of 8.5%, whereas Shyamal's loan has a significantly higher rate of 36% per year.
3. Arun is required to repay his loan within the next three years, but Shyamal must settle his loan within a span of 3 to 4 months.
4. Unlike Arun, who has no restrictions, Shyamal is obligated to sell his crops to a trader at a lower price.

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

Ans 5: (1) No, not everyone in Sonpur can access credit at low interest rates. This is primarily because banks require collateral to offer loans at more favorable rates.

(2) Individuals who can meet the collateral and documentation requirements are the ones who can secure loans from banks at these lower rates.

Q. 6. Tick the correct answer

(i) Over the years, Rama's debt

- will rise.
- will remain constant.
- will decline.

Ans (i) will rise.

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

- other people in the village prefer to borrow from the moneylenders.
- banks demand collateral which everyone cannot provide.
- interest rate on bank loans is same as the interest rate charged by the traders.

Ans (ii) banks demand collateral which everyone cannot provide.

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

Ans7: I spoke with three people in my area about their credit arrangements:

1. **Person A:** Uses a local bank for a personal loan. They mentioned a fixed interest rate of 8% with a repayment period of five years. They appreciated the bank's customer service and flexible payment options.
2. **Person B:** Relies on a credit union, offering lower rates (6%) but requiring membership. They highlighted the community focus and better rates compared to traditional banks.
3. **Person C:** Uses a buy-now-pay-later service with no interest if paid within three months. They liked the ease of online access but noted the risk of overspending.

Differences Noted:

- Interest rates ranged from 6% to 8%.
- Credit options varied (loans, credit union membership, buy-now-pay-later).
- Customer experience differed, with personal relationships emphasized in credit unions compared to banks.

Let's Work these out

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

Ans 1: This table highlights the key differences between formal and informal sources of credit:

Aspect	Formal Sources of Credit	Informal Sources of Credit
Definition	These are credit sources registered with the government and adhere to its regulations, such as banks and cooperatives.	These include small, unregulated units operating largely outside government oversight, such as moneylenders and personal loans from friends or family.
Supervision	The Reserve Bank of India (RBI) oversees the operations of formal credit sources.	No specific organization supervises credit activities in the informal sector.
Motivation	Formal sources aim for profit but also have a social welfare objective.	Informal lenders primarily focus on profit maximization.
Interest Rates	Generally, charge lower interest rates compared to informal sources.	Tend to impose significantly higher interest rates on loans.
Conditions	Do not impose unfair conditions on borrowers.	Often impose stringent conditions in addition to high-interest rates.

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

Ans 2:

(1) Access to credit at fair interest rates is essential for everyone. Credit is crucial in contemporary commerce and significantly contributes to a nation's growth.

(2) Many of our daily transactions utilize credit in various ways. For instance, credit enables farmers to cultivate their crops and supports entrepreneurs in starting businesses. It also assists them in covering ongoing production costs, ensuring timely completion of projects, and ultimately boosting their income.

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 3:

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(1) It is essential to establish a supervisory body, similar to the Reserve Bank of India, to oversee the lending practices of informal lenders. This oversight is crucial for safeguarding the interests of small depositors and underprivileged borrowers. By implementing such regulation, it would be possible to prevent exorbitant interest rates on loans and the use of unethical tactics to recover debts.

(2) The responsibilities of this supervisory entity would be challenging due to several factors:

- (i) Informal lenders operate without registration from the government or recognized institutions.
- (ii) Their operations are typically small-scale and widely dispersed.
- (iii) Many small borrowers lack education and awareness of their rights.
- (iv) They often do not require documentation or collateral for loans.
- (v) The lending process is frequently based on personal relationships with the borrower.

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

Ans 4:

(1) It is evident that wealthier households tend to access a larger portion of credit from formal financial institutions compared to their less affluent counterparts.

(2) This disparity arises primarily because poverty limits the borrowing capacity of low-income households. Access to formal credit typically necessitates adequate documentation and collateral, which is often an asset. As a result, individuals from poorer backgrounds frequently struggle to meet these requirements, hindering their ability to secure loans.

(3) Additionally, due to their ongoing daily financial demands, these households may face challenges in timely loan repayment. Consequently, formal lenders are often reluctant to extend credit to poorer households, resulting in a significantly lower share of formal sector credit for them compared to wealthier families.

EXERCISES

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

Ans 1: (1) In certain circumstances, access to credit can enhance earnings, leaving an individual in a better financial position than previously. However, in situations characterized by high risk, credit can lead to significant challenges and may trap the individual in a cycle of debt, ultimately worsening their financial situation.

(2) Take, for instance, the use of credit in agriculture. Crop production often requires substantial investment in resources like high-yield seeds, fertilizers, pesticides, and water. Farmers typically secure loans at the beginning of the growing season, planning to repay them after the harvest. However, if the crop fails, they may find themselves unable to repay the loan, leading to the necessity of selling portions of their land. This scenario can leave them in a much worse position than before. The alarming rise in farmer suicides, particularly in Maharashtra, highlights the severity of this issue.

In conclusion, the effectiveness of credit depends largely on the inherent risks of the specific situation.

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

Ans 2:

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(1) In a barter system, where goods are traded directly without any currency involved, the concept of double coincidence of wants is vital. However, in a monetary economy, money serves as a medium of exchange, which eliminates the need for this double coincidence.

(2) For instance, a farmer no longer needs to seek out a book publisher who is willing to buy his cereals and also sell him books for his children. Instead, he simply needs to find someone to purchase his cereals. Once he has exchanged his cereals for money, he can use that money to buy any goods or services he requires.

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

Ans 3:

(1) Banks play a crucial role in the economy by accepting deposits from individuals who have extra funds and providing interest on those deposits.

(2) However, banks only retain a small percentage of these deposits—about 15% in India—as cash reserves. This reserve is maintained to ensure they can meet withdrawal requests from depositors at any given time. The majority of the deposits are utilized to offer loans to individuals or businesses in need of funds.

Thus, banks serve as intermediaries between those with surplus capital and those requiring financial assistance.

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

Ans 4: At the top, it states 'Reserve Bank of India' along with 'Guaranteed by the Central Government.' In India, the Reserve Bank of India is responsible for issuing currency notes on behalf of the central government. This statement signifies that the currency is officially sanctioned or backed by the central government. Essentially, Indian law recognizes the rupee as a legitimate means of payment that must be accepted for settling transactions within the country.

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

Ans 5: Expanding formal credit sources in India is essential for several reasons:

1. **High Interest Rates:** Informal lenders typically charge significantly higher interest rates compared to formal lenders.
2. **Stringent Conditions:** In addition to high interest, informal lenders often impose strict conditions on borrowers. For instance, they may require farmers to agree to sell their produce at a reduced price, which is not a requirement when dealing with formal institutions.
3. **Borrower Treatment:** Borrowers often face poor treatment from informal lenders, whereas formal lenders generally maintain more professional standards.
4. **Regulation and Oversight:** The Reserve Bank of India regulates formal credit institutions, ensuring their proper functioning. In contrast, informal lending lacks any regulatory body overseeing its practices.
5. **Entrepreneurial Barriers:** Potential entrepreneurs may be deterred from starting businesses due to the prohibitive costs associated with borrowing from informal credit sources.
6. **Unmet Credit Needs:** Currently, formal credit sources only fulfill about half of the rural population's total credit requirements.

To decrease reliance on informal credit, it is crucial for formal lending institutions to broaden their services, especially in rural regions.

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

Ans 6: The primary concept of Self-Help Groups (SHGs) for impoverished individuals is to bring together rural communities, particularly women, into small collectives to encourage savings among members. These groups also offer timely loans at competitive interest rates without requiring collateral.

The main goals of SHGs include:

1. Organizing rural women and other marginalized individuals into small Self-Help Groups.
2. Encouraging the accumulation of savings among members.
3. Providing loans without the need for collateral.
4. Facilitating timely loans for various needs.
5. Offering loans at affordable interest rates.
6. Creating a platform to address and engage with a range of social issues, including education, health, nutrition, and domestic violence.

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

Ans 7: Banks may hesitate to extend loans to certain borrowers for several reasons:

1. Lack of Collateral: Financial institutions are often reluctant to lend to individuals without collateral, particularly those from low-income backgrounds. Loan agreements necessitate proper documentation and secured assets, as banks do not have personal knowledge of the borrower. If the borrower defaults, the lender needs the option to liquidate the collateral to recover the loan amount.

2. Poor Repayment History: Banks may be unwilling to provide additional loans to borrowers who have previously defaulted on their repayments.

3. High-Risk Ventures: Financial institutions might also be cautious about lending to entrepreneurs planning to invest in high-risk businesses, as these ventures pose a greater likelihood of failure.

4. Profit Motive: A primary goal of banks is to maximize profits. Like any corporation, they are responsible for paying corporate taxes, distributing dividends to shareholders, compensating employees, and covering other operational costs. To achieve this, banks must implement careful lending and investment strategies that ensure a stable and reasonable return on their financial resources.

Q 8. In what ways does the Reserve Bank of India supervise the functions of banks? Why is this necessary?

Ans 8: (1) The Reserve Bank of India (RBI) oversees banking operations in several key ways:

(i) Commercial banks are mandated to maintain a portion of their cash reserves with the RBI. This means they must keep a minimum cash balance from the deposits they collect.

(ii) The RBI monitors banks to ensure they extend credit not only to profitable enterprises and traders but also to small-scale farmers, small industries, and individual borrowers.

(iii) Commercial banks are required to provide the RBI with details regarding their lending activities, including the amounts lent, the recipients, and the applicable interest rates.

(2) This oversight is essential for safeguarding the interests of small depositors, farmers, small industries, and individual borrowers.

Q 9. Analyze the role of credit for development.

Ans 9: Access to low-cost credit is essential for the development of a nation. There is significant demand for loans to support various economic activities. Credit enables individuals to cover ongoing production costs, complete their projects promptly, and ultimately boost their income. People can borrow funds for a wide range of purposes, such as cultivating crops, engaging in commerce, or starting small-scale industries. This financial support also allows for the establishment of new enterprises and trading ventures. Thus, credit plays a vital role in fostering a country's growth.

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

Ans 10: Manav will choose between borrowing from the bank or a moneylender based on the following credit terms:

- (i) A lower interest rate.
- (ii) Fewer collateral and documentation requirements.
- (iii) A more convenient repayment process.

Manav will favor the institution that offers him a loan with these more favorable conditions.

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 11:

(a) Obtaining bank loans necessitates the provision of adequate documentation and collateral for security. However, small-scale farmers often lack both. Additionally, due to unpredictable crop yields, they may struggle to repay loans punctually. Consequently, banks may be reluctant to extend credit to these farmers.

(b) In addition to banks, small farmers have alternative borrowing options such as local moneylenders, agricultural traders, wealthy landowners, and cooperatives.

(c) The credit terms can be quite disadvantageous for small farmers. For instance, consider Ramu, a small farmer who borrows from a local moneylender at a steep interest rate of 3% per month to cultivate rice. Unfortunately, if a drought strikes and his crop fails, he may be forced to sell a portion of his land to settle the debt, leaving him in a significantly worse financial situation than before.

(d) Small-scale farmers have access to affordable credit from various sources, including:

- (i) Financial institutions (Banks)
- (ii) Agricultural cooperatives
- (iii) Self-help groups (SHGs)

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 12: (i) rural, (ii) High, (iii) Reserve Bank of India, (iv) deposits, (v) Collateral.

Q 13. Choose the most appropriate answer:

- (i) In a SHG most of the decisions regarding savings and loan activities are taken by

- (a) Bank.
- (b) Members.
- (c) Non-government organisation.

Ans (i): (b) Members

- (ii) Formal sources of credit do not include

- (a) Banks.
- (b) Cooperatives.
- (c) Employers.

Ans (ii): (c) Employers

Additional Project/Activity

Q 1. 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.

Occupations	Reason for Needing a Loan
Construction worker	
Graduate student who is computer literate	
A person employed in government service	
Migrant labourer in Delhi	

Household maid	
Small trader	
Autorickshaw driver	
A worker whose factory has closed down	

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?

Ans 1:

Occupation	Reason for Needing a Loan
Construction worker	For day-to-day needs
Graduate student who is computer literate	To establish a computer learning center
A Person employed in government service	For heavy expenses like marriages, death, etc.
Migrant labourer in Delhi	For day-to-day expenses
Household maid	For daily expenses
Small trader	For working capital
Autorickshaw driver	For heavy family expenses
A Worker whose factory has closed down	For day-to-day needs

I have categorized individuals into two groups based on their eligibility for bank loans, which is presented in the table below:

Category	Individuals
Might Get a Bank Loan	1. Graduate student who is computer literate
	2. A person employed in government service
	3. Small trader
	4. Autorickshaw driver
Cannot Get a Bank Loan	1. Construction worker
	2. Migrant labourer in Delhi
	3. Household maid
	4. A worker whose factory has closed down

"The classification is based on the presence of appropriate documentation and collateral."