

Money And Credit

Barter System: Double coincidence of wants

- In a Barter system, goods are directly exchanged without the use of money.
- Double coincidence of wants is an essential feature of Barter system i.e. what a person desires to sell is exactly what the other person wishes to buy.
- In other words, both parties have to agree to sell and buy each others commodities.

Money-Medium of Exchange

- Money is anything which is generally acceptable in the exchange of goods or services.
- Since money acts as an intermediate in this exchange process, it is called a medium of exchange.
- Money eliminated the need for double coincidence of wants.

Money-Different forms in different times

- Before the introduction of coins, a variety of objects was used as money.
For example- Grains, Cattles etc.
- Thereafter came the use of metallic coins made of gold, silver and copper.
- Modern forms of currency includes currency notes, coins and demand deposits of Banks. A new concept of "Crypto Currency" has also been introduced recently.

Why money is accepted as a medium of exchange?

- Modern currency is without any use of its own, not made of precious metal, -not of everyday use like grain and cattle. Even then it is accepted as a medium of exchange because the currency is authorised by the government of the country.
- In India, Reserve Bank of India issues currency notes on behalf of the central government. As per Indian law, no other individual or organisation is allowed to issue currency.
- No individual in India can legally refuse a payment made in rupees.

Demand Deposits of Banks

- People deposit their extra cash or money in the Banks by opening a Bank account.
- Bank accept the deposits and also pay an amount as interest on the deposits.
- Since the deposits in the Bank accounts can be withdrawn on demand, these deposits are called demand deposits.
- On one hand, people's money is safe in the Bank accounts and on the other hand, they also earn an amount as interest.

Cheque facility against Bank deposits

- Demand deposits offer a cheque facility to the account holders.
- A cheque is a paper instructing the Bank to pay a specific amount from the depositor's account to the person in whose favour the cheque has been issued.
- Thus, cheque facility makes it possible for a person to directly settle payments without the use of cash.

Banks

- Bank is an institution which accept deposits from the people who have surplus funds.
- Modern forms of money- currency and demand deposits, are closely linked to the working of the modern banking system.
- Banks lend the money to those borrowers who need funds for the fulfillment of their various requirements.

Loan activities of Banks

- Banks keep only a small portion of their deposits as cash with themselves. For example, Banks in India these days hold about 15% of their deposits as cash to pay the depositors who might come to withdraw money from the Bank on any given day.
- Banks use the major portions of the deposits to give loans on which they charge a higher interest rate than what they give to the depositors.
- The difference between what is charged from the borrowers and what is paid to the depositors is the main source of income of the Banks.

Credit - two different situations

- Credit is also known as loan. It refers to an agreement in which the lender supplies to the borrower some money, goods or services in return for the promise of future payment.
- In one situation, credit helps to meet the ongoing expenses of production and accordingly, increases the earnings. Thus, the person is better off than before.
- In another situation, credit also pushes the borrower into a debt trap.

Crop loan

- Crop production involves considerable costs on seed, fertilisers, pesticides, water, electricity, equipments etc.
- There is a minimum stretch of 3 to 4 months between the time when the farmers buy these inputs and when they sell their crop.
- In order to meet the expenses of crop production, farmers usually take crop loans at the beginning of the season and repay the loan after harvest.

Terms of Credit

- Every loan agreement specifies certain conditions which are known as terms of credit.
- Terms of credit includes interest rate, collateral, documentation requirement, mode of repayment etc.
- These terms of credit vary substantially from one credit arrangement to another depending on the nature of agreement, lender and the borrower.

Collateral

- Collateral is also known as security. It is an asset that the borrower owns and use these as a guarantee to a lender until the loan is repaid.
- Collateral includes land, building, vehicle, live stocks, deposits with Banks etc.
- If the borrower fails to repay the loans, lender has the right to sell the asset or collateral to recover her loan amount.

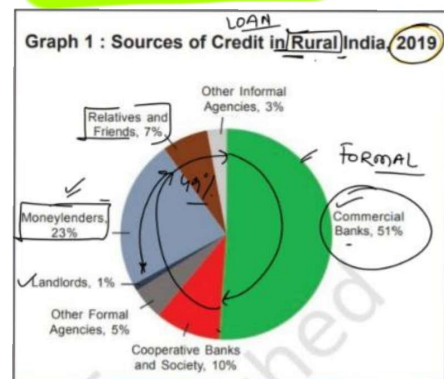
Different credit arrangements - Sources of credit

- Sources of credit or credit arrangements are classified into two categories - Formal sources and informal sources.
- Formal sector loan sources includes loan from Banks and Cooperatives.
- Informal sector loan sources includes moneylenders, traders, employers, relatives and friends.

Loan From Cooperatives

- Cooperative society is a major source of cheap credit in rural areas.
- Members of the society pool their resources for cooperation in certain areas such as farming, weaving, industrial workers etc.
- They use pooled money as collateral and obtains a large loan from the Banks which are used to provide loans to its members for the purchase of agricultural implements, cultivation, agricultural trade, fishery, construction of houses etc.
- Once these loans are repaid, another round of loaning takes place.

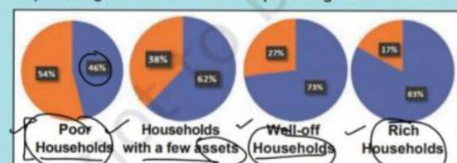
Credit in Rural Areas



Credit in Urban Areas

- In urban areas, people are divided into 4 groups - Poor household, households with few assets, well-off households and rich households.
- The credit situation in urban areas tells a different story-

Graph 2 : Of all the loans taken by urban households, what percentage was formal and what percentage was informal?



BLUE : Per cent of loans from the FORMAL sector

ORANGE : Per cent of loans from the INFORMAL sector

(1) Festival Season

It is festival season two months from now and the shoe manufacturer, Salim, has received an order from a large trader in town for 3,000 pairs of shoes to be delivered in a month time. To complete production on time, Salim has to hire a few more workers for stitching and painting work. He has to purchase the raw materials. To meet these expenses, Salim obtains loans from two sources. First, he asks the leather supplier to supply leather

now and promises to pay him later. Second, he obtains loan in cash from the large trader as advance payment for 1000 pairs of shoes with a promise to deliver the whole order by the end of the month.

At the end of the month, Salim is able to deliver the order, make a good profit, and repay the money that he had borrowed.

(2) Swapna's Problem

Swapna, a small farmer, grows groundnut on her three acres of land. She takes a loan from the moneylender to meet the expenses of cultivation, hoping that her harvest could help repay the loan. Withing through the season the crop is hit by pests and the crop fails. Though Swapna sprays her crops with expensive pesticides, it makes little difference. She is unable to repay the moneylender and the debt grows over that year into a large amount. Now Swapna takes a fresh loan for cultivation. It is a normal crop this year but the earnings are not enough to cover the old loan. She is caught in debt. She has to sell so part of the land to pay-off the debt.



Formal Sector Credit Monitoring - Role of RBI

- RBI supervises the functioning of formal sector loans. It ensures whether the Banks are actually maintaining the minimum cash balance or not.
- RBI also monitors that the Banks give loans not just to profit making business and traders but also to small farmers, small-scale industries and small borrowers etc.
- Bank submit their periodical reports to RBI on how much they are lending, to whom they are lending, at what interest rate they are lending etc.

No monitoring of informal sector credit

- No agency or institution to supervise the informal sector credit activities.
- Compared to formal sector, most of the informal sector lenders charge a much higher interest on loans. Thus, the cost of informal sector loan is much higher.
- There is no one to stop the informal lenders from using unfair means to get their money back.

Draw Backs of Informal Sector Credit

- Much higher interest rate affects the earning of the borrower because larger part of it is used for repayment.
- Higher interest rate also mean that the amount to be repaid is greater than the income of the borrower. This may lead to increase in debt and debt trap.
- Higher interest also discourage the people to start a new enterprise.
- Informal lenders use unfair means to get their loan back.
- Imposition of unreasonable terms of credit.

Formal Sector Credit - Why should be increased?

- To enable people to grow crops, to do business, to set-up small-scale industries etc. formal sector institutions like Banks, cooperative societies need to lend more and more, as it would lead to higher incomes and people could then borrow cheap for a variety of needs mentioned above.
- Cheap and affordable credit is crucial for the country's development.
- Should be increased particularly in rural areas so that the dependence on informal lenders may be reduced.
- It is equally important to monitor that formal sector loans are available to everyone and not to richer households only.

Why is it easier to take informal sector loan than the formal sector?

- Banks are not available everywhere in rural areas.
- Bank loans require proper documentation and collateral while informal lenders know the borrowers personally and they give loan without the documentation and collateral.
- In case of informal loans, the borrower can, if necessary, approach the money lender even without repaying the earlier loan. This is not possible in formal sector loans.

Self-Help Groups [SHGs]

- SHG is a new idea to organise rural poor particularly women.
- A typical SHG has 15 to 20 members usually belonging to one neighbourhood who meet and save regularly as per their capacity.
- Members can take small loans from the group itself to meet their needs on nominal interest even less than the money lender.
- After a certain period, if the group is regular in savings, it becomes eligible for availing Bank loan.
- Loan is sanctioned in the name of SHG. create self-employment opportunities for the members.
- Normally, SHG provides loan for releasing mortgaged land, for meeting working capital needs i.e., buying seeds, fertilisers, raw materials, housing materials, acquiring assets like sewing machine, cattle etc. in rural areas.
- All important decisions regarding savings and loans are taken by the members. amount of loan, purpose, interest rate, repayment schedule etc.
- Repayment of loan is followed up seriously by other members in the group, that is why, banks are willing to lend to the poor women SHG, even though they have no collateral as such.

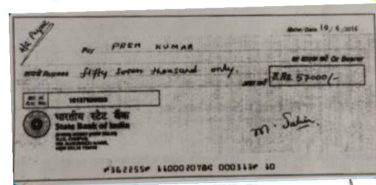
Advantage of SHG

- Helps in resolving the problem of collateral.
- Family loans for a variety of purposes and at a reasonable interest rate.
- Helps women to become financially self-reliant.
- 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.

Success Story of Grameen Bank of Bangladesh

- Founded by Professor Mohammed Yunus in 1976, winner of Nobel prize for peace in 2006.
- In 2018 - membership increased to 9 million in 81600 villages of Bangladesh - Almost all the borrowers are women belonging to poor sections of the society.
- Women proved themselves reliable borrowers - started many small income generating activities.

Q1 : Read the image of the cheque. Identify the cheque number from the given options: (1 Mark) (CBSE 2024)



- (a) 362255 (b) 110002078 (c) 000313 (d) 16137926023

Ans: (a)

Q2: Which one of the following banks in India controls the issuance of currency and regulates the credit system in the country? (1 Mark) (CBSE 2024)

- (a) Punjab National Bank (b) Indian Bank
(c) Reserve Bank of India (d) State Bank of India

Ans: (c)

Q3: Explain the role of 'Self Help Groups' in the rural society. (3 Marks) (CBSE 2024)

Justify the role of 'Self Help Groups' in the rural economy. (5 Marks) (CBSE 2023)

Self-Help Groups are the building blocks of organisation of the rural poor. Suggest any three ways to make them popular for social issues. (2020 C)

- They organise rural poor, in particular women, into small Self Help Groups to pool their savings.
- Provide a platform for the rural poor to interchange thoughts, ideas and opinions about various domestic and regional issues.
- Habit of saving and investing.
- Medium to borrow cheap loans easily from local banks. Loan is sanctioned in the name of the group and is meant to create self-employment opportunities for the members.
- Power of decision-making and develops political and social opinion among the members.

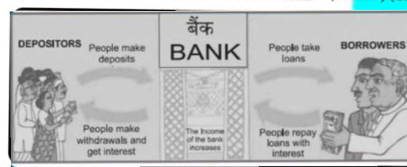
Q4: Why do lenders often require collateral before lending loan? Choose the most suitable option from the following. (1 Mark) (CBSE 2024)

- (a) To lower interest rates for borrowers.
(b) To establish personal relations.
(c) To increase their profit margins.
(d) To mitigate the risk of loan default.

Ans: (d) To mitigate the risk of loan default.

Q5: Explain the role of banks with regard to money which they accept from the public. (3 Marks) (2023)

Q6: Look at the given picture carefully and infer the income of the bank. (1 Mark) (CBSE 2024)



Choose the correct option from the following.

- The difference between the amount deposited and borrowed by the bank to Reserve Bank of India.
- The difference of amount of interest between what is charged from borrowers and what is paid to depositors.
- The difference of interest rate between what is charged from borrowers and what is charged from depositor.
- The difference between the amount deposited by the depositor and borrowed by the borrower.

Ans: (b) The difference of amount of interest between what is charged from borrowers and what is paid to depositors.

Q7: How is credit essential for economic activities? Explain with examples. (3 Marks) (CBSE 2024)

Q: Explain with an example the role of credit for development. (Term-II, 2021-22)

Ans: Credit is essential for economic activities because it provides the necessary financial resources for individuals, businesses, and governments to invest, grow, and expand.

- Boosting Business Investments:
- Supporting Consumption:
- Encouraging Innovation:
- Enabling Government Spending:
- Facilitating International Trade:

Q8: Explain any three functions of the Reserve Bank of India. (3 Marks) (2023, AI 2019)

Ans: The Reserve Bank of India has many important roles that affect the common public:

- Monitors the balance kept by the bank for day to day transactions, it monitors the banking activity, particularly the loan-giving activity of the banks.
- It ensures that the banks give loans to the priority sector like agriculture and not just to profit-making sectors.
- Undertakes the responsibility of controlling credit created by the commercial banks. RBI uses quantitative and qualitative techniques to control and regulate the credit flow.
- Gives guidelines to the bank about setting up the terms of credit that the bank may decide upon for the borrowers.

Q9: "Cheap and affordable credit is crucial for the country's development." Justify the statement. (5 Marks) (CBSE 2023)

Q10: Dhananjay is a government employee and belongs to a rich household, whereas Raju is a construction worker and comes from a poor rural household. Both are in need and wish to take a loan. Create a list of argument explaining who between the two would successfully be able to arrange money from a formal source. Why? (Term-II, 2021-22 C, 2016)

Ans: Dhananjay will be able to get a loan from a formal source.

- Banks are not present everywhere in rural India.
- Bank loans require proper documents and collateral.
- Informal lenders such as moneylenders, on the other hand, know the borrowers personally and hence, are often willing to give a loan without collateral.

Q11: The exchange of goods with a commodity is known as: (2021 C)

- (a) Double coincidence of wants (b) Local trade
(c) Domestic trade (d) Foreign trade

Ans: (a)

Q12: Which of the following authorities of India issues currency notes on behalf of the Central Government? (2021 C)

- (a) The State Bank of India (b) The Reserve Bank of India
(c) The Allahabad Bank (d) The Punjab National Bank

Ans: (b)

Q13: "The use of money spans a very large part of our everyday life". Support the statement. (2021 C)

- Ans: (i) To buy goods and services like in market,
(ii) To deposit in banks so that money can be saved and used for future use.
(iii) As a store value. For instance, we cannot store perishable goods like milk, grain etc. to exchange; but we can keep money for future use.

Q14: How do demand deposits have the essential features of money? Explain. (2020)

Ans:

- The facility of cheques against demand deposits makes it possible to directly settle payments without the use of cash.
- Banks accept the deposits and also pay an interest rate on the deposits.
- People's money is safe with the banks and it earns an interest.

Q15: Read the information given below and select the correct option. (2020 C)

Rohan has taken a loan of Rs.5 lakhs from the bank to purchase a house on 12% rate of interest. He has to submit papers of new house and salary record to the bank. What is this process called as?

- (a) Interest Rate (b) Collateral (c) Principal Amount (d) Installments

Ans: (b)

Q16: Krishna is working in a neighbouring field with very less wages. Expenses on sudden illnesses or functions in the family are also met through loans. The landowner charges an interest rate of 5 per cent per month. At present she owes the landowner Rs. 5,000.

Analyse the credit arrangements given above. (CBSE 2020)

Ans: Credit arrangement-informal sources of credit / No intervention of government in controlling the credit activities carried out by informal sources.

Q17: Why do lenders ask for collateral while lending? Explain. (CBSE 2020)

Q18: "The Reserve Bank of India supervises the functioning of formal sources of loans." Support the statement with examples. (2020)

Q19: "Bank plays an important role in the economic development of the country". Support the statement with an example. (2020)

Ans: (i) Capital formation : Banks offer very attractive schemes to attract the people to save their money with them and organised money market.

(ii) Mobilize the small savings of the people through their branches and make it available for productive purposes.

(iii) Credit creation leads to increased production, employment and caused faster economic development.

(iv) The banks help in the development of different type of industries by extending loans to concern persons.

(v) It ensures full utilisation of resources.

Q20: "Credit sometimes pushes the borrower into a situation from which recovery is very painful". Support the statement with examples. (2020)

Ans: (i) In rural areas, the main demand for credit is for crop production. Crop production involves considerable costs on seeds, fertilisers, pesticides, water, electricity, repair of equipment, etc.

(ii) There is a minimum stretch of three to four months between the time when the farmers buy these inputs and when they sell the crop.

(iii) Farmers usually take crop loans at the beginning of the season and repay the loan after harvest.

(iv) Repayment of the loan is crucially dependent on the income from farming.

(v) A farmer picks up the loan from a money lender to meet the expenses of cultivation. But unfortunately crops hit by the pests and fails. So, he is unable to repay the loan and ; debt grows larger with interest. Next year, he picks up a fresh loan and is able to have a normal crop that year. But earnings are not enough to pay the earlier loan. He can repay the loan, only after selling a part of the land. So we can say that "Credit sometimes pushes the borrower into a situation from which recovery is very painful".

Q21: Why are demand deposits considered as money? (AI2019)

Ans: Demand deposits are considered as money, because they can be withdrawn when required and the money withdrawn can be used for making payments. So, they are also considered as money in the modern economy.

Q22: How is 'double coincidence of wants' not appreciable in the contemporary scenario? (CBSE 2019)

Ans: For double coincidence of wants to work out, an individual must require what the other person is willing to give away and vice-versa. If this situation is not reached exchange of goods does not happen. This problem is eliminated by the use of money.