

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

- Ans.** (i) Credit taken by the borrower always doesn't play a positive role. Sometimes it also creates a situation where the credit creates further problem for the borrower. Lets justify this with the help of an example:
- (ii) *Example:* Swapna a small farmer grows groundnut on her three acres of land. She takes a loan from the money lender to meet the expenses of cultivation hoping that her harvest would help to repay the loan. Mid way through the season the crop is hit by pest and the crop fails. Though swapna sprays her crops with expensive pesticides it makes little difference. She is unable to repay the money lender and the debt grows over the year into large amount. Next year 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 a part of her land to pay off the debt. Thus it is proved that the credit taken always doesn't play a positive role. Sometimes in situation with high risks the the credit might create further problems for the borrower.
2. How does money solve the problem of double coincidence of wants? Explain with an example of your own?

- Ans.** (i) Double coincidence of wants was the biggest defect of the barter system and this defect was overcome by money. Lets take an example to understand.
- (ii) *Example:* Take the case of the cloth manufacturer. He wants to sell cloths in the market and buy rice. The cloth manufacturer will first exchange the cloth that he has produced for money and then exchanged the money for rice. This is how a normal transaction goes now-a-days. But in barter system imagine how difficult it would be if the cloth manufacturer had to directly exchange clothes for rice without the use of money. He would have to look for a rice growing farmer who not only wants to sell rice but also wants to buy clothes in exchange, i.e. both the parties have to agree to sell and buy each others commodities. This problem is solved by money. A person holding money can easily exchange it for any commodity or service that he/she might want. Thus everyone prefers to receive payment in money and then exchange the money for things that they want.

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

- Ans.**
- (i) Mainly two types of people go to the bank one who has surplus money to deposit and the other who wants loan. Banks use the major portion of deposits to extend loans. There is a huge demand for loans for various economic activities.
  - (ii) Banks make use of deposits to meet the loan requirement of the people. Bank charges higher interest on loans than what they offer on deposits. The difference between what is charged from the borrowers and what is paid to the depositors is a main source of income.
  - (iii) In this way banks mediate between those who have surplus funds (the depositors) and those who are in need of these Funds (the borrowers).

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

- Ans.** If we look at 10 rupee note, we find the following words written on top.

**NOTE**

**RESERVE BANK OF INDIA**

Guaranteed by the Central Government

I Promise to pay the bearer the sum of  
Ten Rupees

Signed

Governor of the Reserve Bank



**Explanation of this statement :** The above statement means that the central government has given the authority to the Reserve Bank of India to issue 10 Rupee note and the governor of this bank promises the bearer to pay Rupees 10 of this note. Without the authority of the central government this note is just a piece of paper. It is the authority of the central government which makes it a legal currency.

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

- Ans.**
- (i) There is no organisation which supervises the credit activities of the lenders in the informal sector. They can lend at whatever interest they want. Compared to formal lenders, most of the informal lenders charge a much higher interest on loans and there is no one to stop them from using unfair means to get their money back. Thus the cost of the borrowing of informal loans is much higher.
  - (ii) Higher cost of borrowing means a large part of the earnings of the borrowers is used to repay the loan. Hence borrowers have less income left for themselves.

- (iii) In certain cases the high interest of borrowing can mean that amount to be repaid is greater than the income of the borrower.
- (iv) This could lead to increase in debt and debt trap.
- (v) Also people who might wish to start an enterprise by borrowing money may not so, because of the higher cost of borrowing. If cheap credit is made available to people then it would lead to higher incomes and many people could then borrow cheaply for variety of needs. Cheap and affordable credit is crucial for the country's development. Hence there is a need to expand formal sources of credit in India.

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

**Ans.**

- (i) The major problem faced by poor household is that still they are dependent on informal sources of credit. This is because either banks are not present every where or if they are present, then to take a loan from bank is very difficult.
  - (ii) The reason is, these bank loans require proper documents and collateral. Due to absence of collateral poor household don't get loans from bank. As a result they have to approach to the money lenders who charges a very high rate of interest, keeps no record of the transaction and harasses the poor borrowers. As a result of this in recent years people have tried out some newer ways of providing loans to the poor.
  - (iii) The idea is to organise poor people, in particular women into Self Help Groups (SHGS) and collect their savings. A SHG has 15-20 members who meet and save regularly. Saving per members varies from 25 to Rs. 100 which is a very small amount. But saving this amount regularly for months makes it a large amount. Members can take small loans from the group itself to meet their needs.
  - (iv) The group charges interest but it is less compared to money lenders. After a year or two if a group is regular in savings it becomes eligible for availing loans from the bank.
  - (v) Hence the basic idea behind the SHGs for the poor, is to prevent them from the harassment of money lenders and help them with proper credit facilities.
7. What are the reasons why the banks might not be willing to lend to certain borrowers?

**Ans.** The reasons why the banks might not be willing to lend certain borrowers are.

- (i) Some people are not in a position to produce their salary certificates. Under such circumstances the bank doesn't lend them.
- (ii) Some people have no collateral, no house, no land etc. So the bank doesn't lend to persons who don't have collateral and also don't have two persons who can stand as a guarantor in case if he is unable to repay the loan.

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

**Ans.**

- (i) The Reserve Bank of India supervises the functioning of formal sources of loan. For instance the bank has to maintain a minimum cash balance out of the deposits they receive.
- (ii) The RBI monitors the banks in actually maintaining cash balance.
- (iii) Similarly the RBI sees that banks give loans not just to profit making business and traders but also to small cultivators, small scale industries and small borrowers.
- (iv) Periodically banks have to submit information to RBI on how much they are lending to whom and at what rate of interest.
- (v) This supervision is quite necessary to keep the banks under control and to see that their management is appropriate and there is no misappropriation in their working.

**9.** Analyse the role of credit for development.

**Ans.** Credit plays a very important role for development of agriculture and industries in the following ways.

- (i) Availability of credit will help the farmers to buy modern machinery, hybrid seeds, chemical fertilizers which will help in boosting the agricultural production leading to development of agriculture.
- (ii) Credit will help the industrial owners to purchase modern machineries which will help in boosting the industrial production resulting in the development of the country.
- (iii) It also helps people to set up their business and increases their monthly earnings.
- (iv) With the help of credit people can also buy vehicles, electrical appliances for their home etc. which helps to increase their social status.

(v) With the help of credit a person can build his own house which will be an asset for a person.

**10.** Manav need a loan to set up a small business. On what basis will Manav decide whether to take it from the bank or the money lenders? Discuss.

- Ans.**
- (i) Whenever a loan is taken the rate of interest plays a very important role. Formal sector of loan consists of Banks whereas the informal sector of loans consists of money lenders and landlords.
  - (ii) The main aim of banks is to provide borrower a loan at a cheap rate of interest. Whereas the main aim of money lenders is to gain maximum profit. Generally in case of informal sector of loan the rate of interest is very high. They charge 3 to 5 % interest per month which accounts to 36 to 60% a year which is a very high interest rate.
  - (iii) On the hand the interest rate charged by the bank is 10% in a year. The main aim of formal sector is development of people, whereas in case of informal sector their main aim is to earn profit and to fulfil the motive of earning profit they exploit people.
  - (iv) On the basis of this Manav will try to take a loan from formal sector i.e. is a bank rather than from a money lender.

**11.** In India about 80% of farmers are small farmers, who need credit for cultivation?

- (a) Why might Banks be unwilling to lend to small farmers?
- (b) What are other sources from which the small farmers can borrow?
- (c) Explain with an example how the terms of credit can be unfavourable for the small farmers.
- (d) Suggest some ways by which small farmers can get cheap credit.

- Ans.**
- (a) The banks be not be willing to lend to small farmers because of following reasons :
    - (i) The farmers do not have any proof of their income.
    - (ii) The farmers don't have any security to pledge. For e.g. They don't have their own land. They don't have their own house.
    - (iii) Nobody comes forward to stand as a guarantor for the farmer.
  - (b) The sources from which small farmers can borrow money are the money lenders, the landlords and the traders.
  - (c) The terms of credit can be unfavourable for the small farmers if he borrow from money lenders. The main aim of the money lenders is to earn money or profit. So in order to earn profit they may exploit

