

AGLASEM.COM

CLASS X ECONOMICS NOTES

Money and Credit

Key Notes and Important Questions with Answers

Chapter 3

MONEY AND CREDIT

Key Points to Remember:

- When goods are directly exchanged for goods and there is no use of money, it is called **barter system**.
- Money is something that can act as a medium of exchange in transaction. It eliminates the need for **double coincidence of wants**.
- When both the parties have to agree to sell and buy each other's commodities. This is known as the **double coincidence of wants**.
- 'Modern forms of money include currency — paper notes and coins.
- **Currency is accepted** as a medium of exchange because it is authorized by the **government** of the country.
- **Reserve Bank of India (RBI)** issues currency notes on behalf of the central government.
- The RBI is India's **central banking and monetary authority.** RBI regulates loans offered by banks and non-banking institution in India.
- A bank is a financial institution licensed to receive deposits and creates loans.
- An order to a bank to pay a stated sum from the drawer's account, written on a specially printed form is called **Cheque.**
- A thing that is borrowed, especially a sum of money that is expected to be paid back with interest is called **Loan.**
- A person or organization that takes and uses something belonging to someone else with the intention of returning it is known as **borrower.**
- Money paid regularly at a particular rate for the use of money lent, or delaying the repayment of a debt known as **Interest.**
- **Formal sector** which encompasses all jobs with normal hour and regular wages, and are recognized as income sources on which income taxes must be paid.

- **Informal sector** also known as 'grey economy', is the part of an economy that is neither taxed, nor monitored by any form of government. It is not accounted for official statistics.
- **Self Help Groups** are groups of people who provide mutual support to each other. A voluntary association preferably from the same socio-economic background promotes small savings among its members.
- Professor **Muhammad Yunus** is the founder of **Grameen Bank** in Bangladesh. He won the **Nobel Prize** for Peace in 2006.

Very Short Answer Type Questions (1 Mark Each)

Q.1 Suppose you are living in ancient times, when money is not accepted as medium of transaction. What kind of problem you will find while purchasing and selling the things?

Q.2 What was used as money in early ages in India?

Q.3 Bharti has doubt that why one cannot refuse a payment made in rupees in India?

Q.4 Which currency is used as medium of exchange at International Level?

Q.5 In India, who is authorized to issue notes and currency?

Q.6 What are the demand deposits?

Q.7 What do the banks do with the deposits which they accept from the public?

Q.8 What is, collateral?

Q.9 How do the deposits with banks become their source of income?

Q.10 Why a loan from Informal sector is costlier than the formal sector?

Answers

Ans.1 Double coincidence of Wants

Ans.2 Grains and Cattles

Ans.3 It is accepted as a medium of exchange. The currency is authorized by the government of the country.

Ans.4 Dollar

Ans.5 Reserve Bank of India

Ans.6 People deposit their money in the bank as it earns interest. Since the deposits in the bank accounts can be 'withdrawn on demand, these deposits are called demand deposits.

Ans.7
- Banks keeps only small proportions (15percent) of their deposits as cash with themselves.
- Major portion of money deposits are used to extend loans.

Ans. 8 Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock) and uses this as a guarantee to a lender until the loan is repaid.

Ans.9 Bank charge higher interest rate on loans that what they offer on deposits. The difference of interest is the main source of income of bank.

Ans.10 Interest rate is higher.

Long Answer Type Questions (3 or 5 MARKS EACH)

Q.1 Analyses the work of Reserve Bank of India?

Q.2 How do formal and informal sources of credit differ from each other?

Q.3 What is credit? How can credit be both an asset as well as a debt trap?

Q.4 What are the terms of credit? How it may vary for person to person?

Q.5 How is the concept of Self Help Group important for poor people? Give your view points.

Q.6 The credit activities of the informal sector should be discouraged. Support your statement with relevant arguments.

Q.7 Why the formal or informal sector does asks for collateral?

Q.8 How do farmers gets into debts trap?

Q.9 Review any three merits and any two demerits of 'formal sector of credits' in India.

Q.10 What are the reasons why the banks might not be willing to lend to certain borrowers?

Answers

Ans.1
- Issue the currency on behalf of Government of India.
- Issues guidelines regarding working culture of Bank and SHG.
- Give directions regarding terms and interest on credits.
- To provide feedback regarding monetary policies to government of India.
- RBI holds a part of the cash reserve of the bank.

Ans. 2

Formal sector	Informal sector
Rate of Interest is lower.	Higher rate of Interest.
Collateral is must for getting loan.	Ready to give loans without any collateral too.
RBI supervises them.	No organization to supervise them.
More documentation is required. It involves many formalities.	Less documentation, less formalities.
Ex.: Banks and co-operatives.	Examples: Moneylender, traders, friends, retailers and so on.

Ans. 3 Credits refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment.

- Credit as an asset: During the festival season, a shoe manufacturer Salim has received an order of making shoes in bulk, within a month's time. To complete production, he hired extra workers and has to purchase the raw materials. He asks the supplier to supply leather now and, promise to pay him later. Then he took some advance payment from the trader. By the end, of the month, he is able to deliver the order, make a good profit and repay the money he had borrowed.
- Credit as debt trap: A farmer Swapna picks up loan from a moneylender to meet the expenses of cultivation. But unfortunately the crop is hit by the pests and fails. So, she is unable to repay the loan and debt grows larger with interest.

In Salim's case credit plays a vital and positive role, whereas in

Swapna's case credit pushes the borrowers into a situation from which recovery is painful.

Ans.4

- Every loan agreement specifies an interest rate which the borrower must pay to the lender along with repayment of the principal.
- In addition, lender may demand collateral, i.e., as assert that the borrower owns and uses this as a guarantee until the loan is repaid.
- If the borrower fails to repay the loan, the lender has the right to sell the collateral to obtain payment.
- Terms of credit comprise interest rate, collateral and documentation requirement, and the mode of repayment.

Ans. 5

- SHG's basic idea is to provide financial resource for the poor through organizing the rural poor especially women, into small Help Groups.
- It organizes the rural poor, especially women, into small Self Help Groups.
- It collects saving of the members.
- it provides loans without collateral.
- It provides timely loans at reasonable rate of interest.
- It also provides a platform to discuss various social issue.

Ans. 6

- Informal lenders charge very high interest on their loans.
- There are no boundaries and restrictions.
- In certain cases, the high interest rate for borrowing can mean that the amount to be repaid is greater than the income of the borrowers.
- This could lead to increasing debt trap, therefore the credit activities of the informal sector should be discouraged.

Ans.7 Lenders may demand collateral or an asset that the borrower owns to use it as a guarantee until he repays the loan. It may be sold if the borrower is not able repaid.

Ans. 8

- Failure of the crop makes loan repayment impossible.
- Downfall of crop prices also makes loan repayment impossible.
- Higher interest makes life difficult. Credit in such a condition pushes the borrowers into a situation from which recovery is painful and they get into the debt trap.

Ans.9 **Merits**

- Helps to meet the working capital needs of production.
- Helps in completing production on time.
- Low interest rate.
- Helps in increasing earnings.

Demerits

- Difficulty in obtaining loans.
- Collateral issues.
- Documentation could be a problematic issue for few.

Ans.10

- Banks require proper and legal documentations and collateral as security against loans. The borrowers who have not repaid previous loans, the banks might not be willing to lend them further.
- Those entrepreneurs, who are going to invest in a business with high risks, the might not be willing to lend money.