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STUDY CIRCLE

UNIT OF ACCENTS EDUCATIONAL PROMOTERS

MONEY AND CREDIT

IIT-JEE

CBSE

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MONEY AND CREDIT

Objective Section

(1 mark each)

Q. 1. Which among the following issues currency notes on behalf of the Central Government ?

- (a) State Bank of India
(b) Reserve Bank of India

- (c) Commercial Bank of India
(d) Union Bank of India

[CBSE OD, Set 1, 2020]

Ans. (b)

Very Short Answer Type Questions

(1 mark each)

Q. 1. Give one example each of modern currency and older currency.

[CBSE OD, Set 1, 2019]

Ans. An example of modern currency is the plastic money that we use in the form of debit and credit cards.

An example of older currency is the gold/copper coins that were used in earlier times.

Q. 2. Give any one example of the methods to make payment without using cash.

[CBSE OD, Set 2, 2019]

Ans. Use debit card to book movie tickets, or use online transfer through payment apps to purchase bread and milk from grocery shop is one example of cashless transaction.

Q. 3. Why do banks or lenders demand collateral against loans?

[CBSE Delhi, Set 1, 2019]

OR

Explain the importance of 'collateral'.

[CBSE Delhi, Set 2, 2019]

Ans. Collateral is something of value – an asset or property that the borrower pledges when getting a loan, such as land, building, vehicle etc. This is used as a guarantee by the lender until the loan is repaid. If the borrower fails to repay the loan, the lender is free to sell the collateral and reimburse his amount. Thus, collateral acts like a guarantee against loan.

Q. 4. Explain the importance of formal sector loans in India.

[CBSE Delhi, Set 3, 2019]

Ans. Formal sector of credit refers to the loans taken from banks and cooperative societ-

ies monitored by RBI or some governmental institution. Formal sector charges fixed rates of interest, seeks repayment within a stipulated time with a degree of flexibility with proper documentation.

Q. 5. Give any two examples of informal sector of credit. [CBSE, 2018]

Ans. The two informal sectors of credit are:

- (i) Moneylenders
(ii) Traders

Q. 6. How does the use of money make it easier to exchange things? Give an example.

[CBSE OD, Term 2, Set 1, 2017]

Ans. Money makes exchanging things easier as:

- (i) It is in the form of authorised paper currency which gives the guarantee of the mentioned price to the owner.
(ii) It has general acceptability.
(iii) Its price remains constant compared to other commodities.
(iv) It can be stored easily and doesn't need much space.

Q. 7. Highlight the inherent problem in double coincidence of wants.

[CBSE Delhi, Term 2, Set 1, 2017]

Ans. The inherent problem in double coincidence of wants is that both parties must agree to sell and buy each other's commodities at the same time.

Q. 8. Why is the supervision of the functioning of formal sources of loans necessary?

[CBSE OD, Term 2, Set 1, 2016]

Ans. Supervision of the functioning of formal sources of loans is necessary because banks have to submit information to the RBI on how much they are lending, to whom they are lending and what interest rate.

Q. 9. Prove with an argument that there is a great need to expand formal sources of credit in rural India.

[CBSE OD, Term 2, Set 2, 2016]

Ans. To expand formal sources of credit in rural India, dependence on informal sources of credit has to be reduced.

Q. 10. Why are most of the poor households deprived from the formal sector of loans? [CBSE OD, Term 2, Set 3, 2016]

Ans. They are deprived from the formal sector of loans because of:

- (i) Lack of collateral
- (ii) They are illiterate.

Q. 11. How do the deposits with banks become their source of income?

[CBSE Delhi, Term 2, Set 1, 2016]

Ans. The deposits with banks become their source of income. Because money deposited by depositors is used by banks for giving loans to people in need of credit. Banks charge high rate of interest on the money they lend. However, the interest provided by banks to their depositors is quite low. It is the difference in these two interest rates that forms the income of banks.

Q. 12. Why one cannot refuse a payment made in rupees in India?

[CBSE Delhi, Term 2, Set 2, 2016]

Ans. One cannot refuse a payment made in rupees in India because rupees is officially accepted as medium of exchange. The currency is authorized by the government of the country.

Q. 13. Compare formal sector loans with informal sector of loans regarding interest only. [CBSE Delhi, Term 2, Set 3, 2016]

Ans. Usually informal sector charges a much higher amount of interest on loans than the formal sector charges on its loans.

Q. 14. What is meant by Double Co-incidence of wants?

[CBSE OD, Term 2, Set 1, 2015]

Ans. Double Co-incidence of wants refers to situation when both the parties agree to sell and buy each other's commodities.

Q. 15. How does money act as a medium of exchange?

[CBSE OD, Term 2, Set 1, 2015]

Ans. Money acts as a medium of exchange because it acts as an efficient link between the exchange of commodities.

Q. 16. What is the meaning of 'barter system'?

[CBSE Delhi, Term 2, Set 1, 2015]

Ans. Barter is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money.

Short Answer Type Questions-II

(3 marks each)

Q. 1. Describe the significance of the Reserve Bank of India. [CBSE OD, Set 1, 2020]

Ans. The significance of the Reserve Bank of India is discussed below :

- (i) It issues currency notes on behalf of the central government.
- (ii) It supervises the functioning of formal source of loans. RBI monitors the banks and ensures that they maintain minimum reserves as per the guidelines of Central Bank.
- (iii) It also sees that banks give loans not just for profit making to traders but also to small borrowers, small cultivators etc.
- (iv) Periodically banks have to submit information to RBI on how much

they are lending, to whom, at what interest rate, etc.

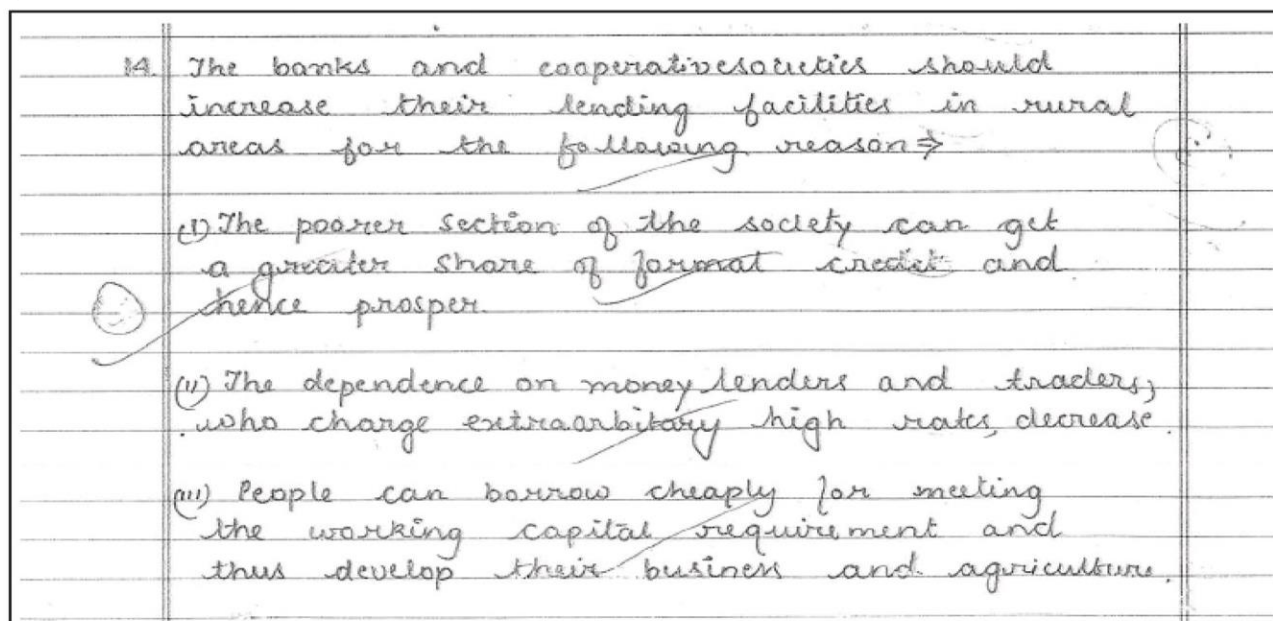
- (v) When commercial bank fails to get financial accommodation from any where, it approaches Central Bank as a last resort. Central Bank advances loan to such banks against approved securities. It ensure that the banking system of the country does not suffer from any setback and money market remains stable.
- (vi) It acts as a banker to the government and is the custodian of the foreign exchange reserves of the economy.

Q. 2. Explain the role of Self Help Groups in the rural economy. [CBSE OD, Set 2, 2020]

- Ans. Self-Help Groups consist of certain members who pool their savings and constitute a fund which is further used in making finance and advances to other members. A typical Self-Help Group has 15 to 20 members. The members pool their savings and after some time, it becomes a large amount which is used to give loans to the needy ones at a very nominal rate of interest. This helps to reduce the functioning of informal sectors of credit.
- Q. 3. Explain any three reasons for the banks and cooperative societies to increase their lending facilities in rural areas. [CBSE, 2019]



Topper's Answers



- Q. 4. Why is it necessary to increase a large number of banks mainly in rural areas? Explain.
OR
Why are service conditions of formal sector loans better than informal sector? Explain. [CBSE OD, Set 1, 2019]
- Ans. It is important to open more banks in the rural areas as formal sector of credit is missing. The practise of borrowing from the informal sector that currently exists in rural areas, for example local moneylenders, has a number of disadvantages.
- (i) The informal sector charges a higher rate of interest. Informal sector make loans very expensive as there are no external organizations controlling the credit activities of lenders.
- (ii) Informal sector involves high degree of risk as there are no proper set of rules for repayment and there is a lot of exploitation of poor farmers.
- (iii) Lenders may exploit the borrowers, they may engage in threats and intimidation to ensure repayment of loans. There is no written agreement between the lender and the borrower. There is no legal recourse in case of informal sources of credit.
- OR
- Formal sector:
- (i) This sector is mainly supervised by the RBI.

- (ii) It includes banks and cooperatives, thus every clause is in writing and clear to comprehend.
- (iii) In this sector of credit, collateral is required.
- (iv) It provides loans comparatively at lower rates.
- (v) It doesn't lead to a debt trap.

Informal sector:

- (i) No external organisation supervises this sector.
- (ii) The lenders are mainly moneylenders, friends, relatives, traders and landowners etc.
- (iii) Collateral is not required, thus it involves risk.
- (iv) This sector charges higher interest rates without any rules or regulation.
- (v) This could lead to a debt trap.

Q. 5. Describe the importance of formal sources of credit in the economic development.

OR

Describe the bad effects of informal sources of credit on borrowers.

[CBSE Delhi, Set 1, 2019]

Q. 6. Why is cheap and affordable credit important for the country's development? Explain any three reasons. [CBSE, 2018]



Topper's Answers

<p><u>Introduction</u> : Cheap affordable credit is important for country's development :-</p> <p>(a) It creates opportunities of self employment eg:- women in <u>Bangladesh</u>, through cheap affordable credit, set up various jobs like sewing for themselves</p> <p>(b) It helps the poor people to invest in <u>new technology and resources</u> like farmers to implement: buy <u>machines, fertilizers</u>, etc and increase their earning and help in <u>economic development</u> also increasing <u>per capita income</u> of country.</p>
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Ans. Importance of formal sources of credit in economic development are as follows:

- (i) It is monitored by the Reserve Bank of India or regulated by the Government of India and thus helps in bringing order to the system of lending and borrowing in the country.
- (ii) Provides fixed interest rate to all sections of society.
- (iii) Limits the scope of using unfair means to repay the payment.
- (iv) Less interest rate and accessible to all, rich or poor.

OR

Following are the bad effects of informal sources of credit:

- (i) They are not subordinate to any government organisation like RBI, thus there is no official backing or monitoring agency.
- (ii) Absence of a fixed interest rate increases the scope of exploitation.
- (iii) Increases the probability of scope of using unfair means to get back their payment.
- (iv) Higher interest rates, with no official records, often lead to debt traps.

(c) It helps to expand trade and commerce, development in industries, agriculture, and other sectors, thus leading to increase in GDP and foreign exchange earnings.

Conclusion - Hence, it is an index of country's development.

Ans. Cheap and affordable credit plays a crucial role for the country's development. Reasons are:

- (i) Credit helps people to meet the on going expenses of production and thereby develop their business in agricultural and industrial areas.
- (ii) For middle class people, loans help a lot in constructing their houses and to get rid of monthly rents.
- (iii) It raises the standard of living and social status of the common man by enabling them to buy automobiles, electronic items etc.

Q. 7. Explain any three loan activities of banks in India.

[CBSE OD, Term 2, Set 1, 2017]

Ans. Activities of banks in India who are involved in providing loan:

- (i) Banks provide loans for various economic activities.
- (ii) Banks intermediate between those who have surplus funds and those who are in need of these funds.
- (iii) Banks offer very less interest on deposits than what they demand on loans.

Q. 8. "Banks are efficient medium of exchange." Support the statement with arguments.

[CBSE Delhi, Term 2, Set 1, 2017]

Ans. We agree with the statement that "Banks are efficient medium of exchange" because:

- (i) Demand deposits share the essential features of money.
- (ii) The facility of cheque against demand deposit makes it possible to directly settle payments without the use of cash.
- (iii) Demand deposits are accepted widely as a medium of payment.

Q. 9. Why do lenders ask for 'collateral' while lending? Analyse the reasons.

[CBSE Delhi, Term 2, Set 3, 2017]

Ans. Lenders ask for collateral while lending to borrowers because:

- (i) Lenders demand collateral (security) against loans. A collateral is an asset that the borrower owns (such as land, building, vehicles, livestock, deposits with bank)
- (ii) Lenders use the collateral as a guarantee until the loan (with interest if applicable) is repaid.
- (iii) If the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to obtain repayment.

Q. 10. "Deposits with the banks are beneficial to the depositors as well as to the nation." Examine the statement.

[CBSE OD, Term 2, Set 1, 2016]

Ans. Deposits with banks are beneficial to the depositors as well as to the nation because:

- Benefit to the depositor
- (i) Bank accepts the deposits and pays interest to the depositor.
 - (ii) People's money is safe with the bank.
 - (iii) People can withdraw the money as and when they require.

Benefits to the nation

- (i) Banks use the major proportion of the deposit to extend loans.
- (ii) There is a huge demand for loans for various economic activities.
- (iii) Banks mediate between those who have surplus funds and those who are in need of these funds, thus it helps in the economic development of the nation.

Q. 11. 'Credit has its own unique role for development'. Justify the statement with arguments.

[CBSE OD, Term 2, Set 2, 2016]

Ans. Role of credit in development:

- (i) It creates better facilities for agriculture and industrial activities.
- (ii) It helps people from all ways of life in setting up their business, increase their earnings and support their families.
- (iii) To some people, loans help a lot in constructing their homes and get rid of monthly rents.
- (iv) To others, loan or credit helps a lot in raising their social status by purchasing luxury commodities.

Q. 12. How can money easily exchange it for goods or services? Give example to explain.

[CBSE Delhi, Term 2, Set 1, 2016]

Ans. Money can be easily exchanged for the goods and services as money is acceptable as the medium of exchange by the Indian government and money also reduces double coincidence of wants. If somebody, has surplus vegetables and he needs wheat in lieu of that, then he could find a person who has surplus wheat and needs vegetables. Earlier, the major drawback of the barter system was double coincidence of wants. However, now people can purchase any good in exchange of money.

Q. 13. "The credit activities of the informal sector should be discouraged." Support the statement with arguments.

[CBSE Delhi, Term 2, Set 1, 2016]

Ans. The credit activities of the informal sector should be discouraged because:

- (i) 85% of loans taken by the poor households in the urban areas are from informal sources.
- (ii) Informal lenders charge very high interest on their loans.
- (iii) There are no boundaries and restrictions.
- (iv) Higher cost of borrowing means a larger part of the earnings of the borrowers is used to repay the loan.
- (v) In certain cases, the high interest rate for borrowing can mean that the amount to be repaid is greater than the income of the borrower.
- (vi) This could lead to increasing debt and debt trap, therefore the credit ac-

tivities of the informal sector should be discouraged.

Q. 14. "Cheap and affordable credit is crucial for the country's development." Assess the statement.

[CBSE Delhi, Term 2, Set 2, 2016]

Ans. Cheap and affordable credit is crucial for the country's development:

- (i) Many people want to start an enterprise by taking loans may not do so because of high cost of borrowing.
- (ii) Banks and cooperative societies need to lend more money on low interest.
- (iii) This would lead to higher income and many people could then borrow cheaply.
- (iv) People in villages could grow crops, or set up small scale industries.

Q. 15. Why is modern currency accepted as a medium of exchange without any use of its own? Find out the reason.

[CBSE OD, Term 2, Set 1, 2015]

Ans. The modern currency *i.e.* rupee, does not have any value of its own because it is not as precious as gold and silver, it is made up of paper. However it is used for transaction in exchange for some good and services. But it is still considered as a medium of exchange, as it is authorized by the Government of India.

Q. 16. Why is it necessary for the banks and cooperative societies to increase their lending facilities in rural areas? Explain.

[CBSE Delhi, Term 2, Set 1, 2015]

Ans. In the rural areas, people are often found to borrow moneylenders which comprise the unorganized sectors. This usually increases the cost of borrowing which means a larger part of the earning of the borrowers is used to repay the loan. Hence, borrowers have less income left for themselves. This could lead to an increasing debt. Thus, it is necessary that banks and cooperatives increase their lending particularly in the rural areas, so that, the dependence on informal sources of credit reduces.

Borrowing from the organised sectors like-banks and co-operatives would lead to the higher incomes and many

people could then borrow cheaply for a variety of needs. They could grow crops, do business, set up small-scale industries etc. They could set up new industries or trade in goods. Cheap and

affordable credit is crucial for the country's development. Thus, the formal sector loans need to expand moreover, it is also necessary that everyone receives these loans.

Long Answer Type Questions

(5 marks each)

Q. 1. "Bank plays an important role in the economic development of the country." Support the statement with examples.

[CBSE Delhi, Set 1, 2020]

Ans. Bank plays an important role in the economic development of the country in many ways:

- (i) Bank provides loan in rural area for crop production ultimately resulting in the development of many places.
- (ii) Bank provides loan to create fixed assets that will create employment opportunities.
- (iii) It acts as a link between savers and investors.
- (iv) Banks accept the deposit and pay an amount as interest on the deposit which mobilises savings.
- (v) Bank uses major portion of these deposits to extend loan for various profitable events.

Q. 2. "Credit sometimes pushes the borrower into a situation from which recovery is very painful." Support the statement with examples. [CBSE Delhi, Set 1, 2020]

Ans. Bank usually referred as a formal source of credit and in some situations the borrower would not be able to repay loan. This pushes them in the situation of debt trap. Example :

- (i) In case of rural areas if crop fails due to natural factors it will be difficult for the farmers to pay loan.
- (ii) In case of failure of a business. It will be difficult for the businessman to repay the credit.
- (iii) In case of informal sector, rate of interest is very high. If due to crop failure previous loan is not repaid interest rate further mounts.
- (iv) In case of high risk activities failure without some support can push borrower in painful situation.

(v) In many cases people have to sell their land and fixed assets to repay loan.

Q. 3. "Self Help Groups" help borrowers to overcome the problem of lack of collateral" Examine the statement.

[CBSE Delhi, Term 2, Set 1, 2017]

Ans. "Self Help Groups" help borrowers to overcome the problem of lack of collateral. The system of working can be explained by "Self Help Groups" in the following ways:

- (i) In a "Self Help Group" most of the important decisions regarding savings and loan activities are taken by the group members.
- (ii) Group members are well known to each other. They belong to the same society.
- (iii) Also, it is the group which is responsible for the repayment of the loan.
- (iv) In case of non-repayment of loan by any member is followed up seriously by other members in the group.
- (v) Due to this feature, banks are willing to lend to the poor woman. When organised in SHGS, even though they have no substantial collateral.

Q. 4. How can the formal sector loans be made beneficial for poor farmers and workers? Suggest any five measures.

[CBSE OD, Term 2, Set 1, 2016]

Ans. People obtained loans from various sources. The various sources of loans are categorised into:

- (i) Formal sector loan.
- (ii) Informal sector loan

The formal sector loans are given by banks and cooperatives. The informal lenders include money lenders, traders, employers, relatives, friends etc.

Poor people and workers get much of their loans from the informal sectors,

which is not only exploitative but also charges very high interest rate. These make the poor people and workers to fall back in poverty.

The measures to make formal sector loan beneficial for poor farmers and workers are as follows:

- (i) The formal sector like, banks and cooperatives should lend more to poor people and workers, particularly in rural areas.
- (ii) The formal sector should provide cheap and affordable credit.
- (iii) The formal sector should ensure that everyone receives loans.
- (iv) Providing Self Help Group (SHG) bank linkage.
- (v) There should be more number of co-operatives and banks in rural areas.

Q. 5. Describe the vital and positive role of credit with example.

[CBSE Delhi, Term 2, Set 1, 2016]

Ans. Credit plays a vital and positive role in following ways:

- (i) Credit helps people in meeting the ongoing expenses of production.
- (ii) It also helps people to complete tasks in given period of time.
- (iii) It helps people to earn more profits.
- (iv) By earning profits, the standard of living of people rises.

Q. 6. How do banks play an important role in the economy of India? Explain

[CBSE OD, Term 2, Set 1, 2015]

Ans. Banks play an important part in India's economy by providing a safe foundation for individuals and businesses to invest or deposit their money, which allows the bank to use the money in its possession for loans. The ability for the public to receive these loans enables them to make purchases, which drives the economy at higher level. The bank is able to take the deposits, which start out as liabilities, and turn them into assets. This is accomplished by the banks investing the money that is deposited in a way that gains them higher returns that what is being paid to the depositor's account when they receive interest. This allows the banks to loan money and still have the funding to cover any withdrawals that an account holder may make.

Q. 7. How are deposits with the banks beneficial for individual as well as for the nation? Explain with examples.

[CBSE Delhi, Term 2, Set 2, 2015]

Ans. The deposits with banks are beneficial for individual as well as for the nation as:

- (i) Banks accept deposits and pay an amount as interest and in this way people earn money.
- (ii) People's money is safe with banks.
- (iii) It is easy for individuals to get credit who have saving and current accounts in the banks.
- (iv) Poor people who are engaged in production, crucially need credit.
- (v) Credit provided by the banks for government projects helps in the development of the nation.
- (vi) Banks provides loans for the promotion of International trade.
- (vii) Development of infrastructure is usually with the loans provided by the banks.

Q. 8. What are Self Help Groups? How do they work? Explain.

[CBSE Delhi, Term 2, Set 3, 2015]

Ans. Self help groups are the organizations of the rural poor, people of same socio-economic background to pool their savings to provides loans to their members.

Work of self help groups:

- (i) Generally self help groups consist of 15–20 members.
- (ii) Members belong to the same neighbourhood.
- (iii) They meet regularly.
- (iv) Their savings varies form ₹ 25–₹ 100 or more.
- (v) Only members can take loans from the group itself.
- (vi) The group charges interest less than the money lenders.
- (vii) All the important decisions regarding savings and loans are taken by the members of the group.
- (viii) The group is collectively responsible for the repayment of the loan.
- (ix) The regular meeting of the group provides a platform to discuss and act as a variety of social issues such as health, nutrition, domestic violence etc.