Exercises

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

Answer

In situations with high risks, credit might create further problems for the borrower. This is also known as a debt-trap. Taking credit involves an interest rate on the loan and if this is not paid back, then the borrower is forced to give up his collateral or asset used as the guarantee, to the lender. If a farmer takes a loan for crop production and the crop fails, loan payment becomes impossible. To repay the loan the farmer may sell a part of his land making the situation worse than before. Thus, in situations with high risks, if the risks affect a borrower badly, then he ends up losing more than he would have without the loan.

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

Answer

In a barter system where goods are directly exchanged without the use of money, double coincidence of wants is an essential feature. By serving as a medium of exchanges, money removes the need for double coincidence of wants and the difficulties associated with the barter system. For example, it is no longer necessary for the farmer to look for a book publisher who will buy his cereals at the same time sell him books. All he has to do is find a buyer for his cereals. If he has exchanged his cereals for money, he can purchase any goods or service which he needs. This is because money acts as a medium of exchange.

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

Answer

Banks keep small portion deposits as cash (15%) for themselves (to pay the depositors on demand). They use the major portion of the deposits to extend loans to those who need money. In this way banks mediate between those who have surplus money and those who need money.

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

Answer

“Reserve Bank of India” and “Guaranteed by the Government” are written on top.
In India, Reserve Bank of India issues currency notes on behalf of the central government. The statement means that the currency is authorized or guaranteed by the Central Government. That is, Indian law legalizes the use of rupee as a medium of payment that can not be refused in setting transaction in India.

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

Answer

We need to expand formal sources of credit in India due to:→ To reduce dependence on informal sources of credit because the latter charge high interest rates and do not benefit the borrower much.

- Cheap and affordable credit is essential for country's development.
- Banks and co-operatives should increase their lending particularly in rural areas.

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

Answer

The basic behind the SHGs is to provide a financial resource for the poor through organizing the rural poor especially women, into small Self Help Groups. They also provide timely loans at a responsible interest rate without collateral.
Thus, the main objectives of the SHGs are:

- To organize rural poor especially women into small Self Help Groups.
- To collect savings of their members.
- To provide loans without collateral.
- To provide timely loans for a variety of purposes.
- To provide loans at responsible rate of interest and easy terms.
- Provide platform to discuss and act on a variety of social issues such education, health, nutrition, domestic violence etc.

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

Answer

The banks might not be willing to lend certain borrowers due to the following reasons:

- Banks require proper documents and collateral as security against loans. Some persons fail to meet these requirements.
- The borrowers who have not repaid previous loans, the banks might not be willing to lend them further.
- The banks might not be willing to lend those entrepreneurs who are going to invest in the business with high risks.
- One of the principle objectives of a bank is to earn more profits after meeting a number of expenses. For this purpose it has to adopt judicious loan and investment policies which ensure fair and stable return on the funds.

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

Answer

The Reserve Bank of India supervises the functions of banks in a number of ways:

- The commercial banks are required to hold part of their cash reserves with their RBI. RBI ensures that the banks maintain a minimum cash balance out of the deposits they receive.
- RBI observes that the banks give loans not just to profit making businesses and traders but also to small cultivators, small scale industries, small borrowers etc.
- The commercial banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate etc.
  This is necessary to ensure equality in the economy of the country and protect especially small depositors, farmers, small scale industries, small borrowers etc. In this process RBI also acts as the lender of the last resort to the banks.

9. Analyse the role of credit for development.

Answer

Cheap and affordable credit plays a crucial role for the country's development. There is a huge demand for loans for various economic activities. The credit helps people to meet the ongoing expenses of production and thereby develop their business. Many people could then borrow for a variety of different needs. They could grow crops, do business, set up industries etc. In this way credit plays a vital role in the development of a country.

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.

Answer

Manav will decide whether to borrow from the bank or the money lender on the basis of the following terms of credit:

- Rate of interest
- Requirements availability of collateral and documentation required by banker.
- Mode of repayment.
- Depending on these factors and of course, easier terms of repayment, Manav has to decide whether he has to borrow from the bank or the moneylender.

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 unfavourable for the small

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farmer.
(d) Suggest some ways by which small farmers can get cheap credit.

Answer

(a) Bank loans require proper documents and collateral as security against loans. But most of the times the small farmers lack in providing such documents and collateral. Besides, at times they even fail to repay the loan in time because of the uncertainty of the crop. So, banks might be unwilling to lend to small farmers.

(b) Apart from bank, the small farmers can borrow from local money lenders, agricultural traders, big landlords, cooperatives, SHGs etc.
(c) The terms of credit can be unfavorable for the small farmer which can be explained by the following –
Ramu, a small farmer borrows from a local moneylender at a high rate of interest i.e. 3 per cent to grow rice. But the crop is hit by drought and it fails. As a result Ramu has to sell a part of land to repay the loan. Now his condition becomes worse than before.
(d) The small farmers can get cheap credit from the different sources like – Banks, Agricultural Cooperatives, and SHGs.

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.

Answer

(i) poor
(ii) high
(iii) Reserve Bank of India
(iv) deposits
(v) Collateral

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.

✓(b) Members.

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(ii) Formal sources of credit does not include
(a) Banks.
(b) Cooperatives.
(c) Employers.

✓(c) Employers.

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