

# Money & Credit

2016

## Very Short Answer Type Questions [1 Mark]

### Question 1.

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

#### Answer:

Banks use a major portion of deposits to extend loans. They charge a higher rate of interest on loans than what they offer on deposits. The difference between what is charged from borrowers and what is paid to the depositors is the main source of income for the banks.

### Question 2.

Why can one not refuse a payment made in rupees in India?

#### Answer:

One cannot refuse a payment made in rupees in India because it is authorised by the government of India. It is accepted as a medium of exchange all over the country.

### Question 3.

Compare formal sector loans with informal sector loans regarding interest only.

#### Answer:

In formal sector, the rate of interest is low. It is fixed by the Reserve Bank of India, who supervises the functioning of formal sources of loan.

In informal sector, the rate of interest is very high as there is no organisation to supervise the functioning of informal sources of loan.

### Question 4.

Why is the supervision of the functioning of formal sources of loans necessary?

#### Answer:

It is necessary to supervise the functioning of formal sources of loans because the banks have to maintain a minimum cash balance out of the deposits they receive. They should also provide loans to small cultivators, small scale industries etc.

### Question 5.

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

#### Answer:

**There is a great need to expand the formal sources of credit in rural India because:**

- There is no organisation to supervise credit activities of the informal sector. It could lead to increasing debt among the borrowers.
- The rate of interest is very high in informal sector.



**Question 6.**

Why are most of the poor households deprived from the formal sector of loans?

**Answer:**

Most of the poor households are deprived from the formal sector of loans because they do not have the collateral to keep with the banks.

**Question 7.**

How does money eliminate the need for double coincidence of wants?

**Answer:**

Money solves the problem of double coincidence of wants by acting as a medium of exchange.

**Short Answer Type Questions [3 Marks]**

**Question 8.**

How can money be easily exchange for goods or services? Give an example to explain.

**Answer:**

Transactions are made in money because a person holding money can easily exchange it for any commodity or a service. It solves the problem of double coincidence of wants by acting as a medium of exchange.

For example, a shoe manufacturer wants to sell shoes in the market and wants to buy rice. Under barter system, both parties selling shoes and rice have to agree to buy and sell each other's commodities and this creates a problem which is referred to as double coincidence of wants. This problem is overcome by the introduction of money. Now, the shoe manufacturer will sell the shoes for money and with that money he can buy rice.

**Question 9.**

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

**Answer:**

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

- There is no organisation to supervise the credit activities of the lenders in informal sector.
- The informal sector lends at a very high rate of interest and use unfair means to get the money back.
- Higher cost of borrowing means a large part of the earnings of the borrowers is used to repay the loan. Hence, the borrowers have less income left for themselves.
- Sometimes, due to higher rate of interest, the amount to be repaid becomes higher than the income of the borrower due to that there is always a risk for borrowers to fall in debt-trap.



### Question 10.

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

**Answer:**

**Cheap and affordable credit is crucial for a country's development because:**

- More lending would lead to higher incomes and encourage people to invest in agriculture, engage in business and set up small industries.
- Cheap credit will enable more investment. This leads to acceleration of economic activity.
- Cheap credit would also allow weaker sections of society to access formal sector of lending and get rid of from informal moneylenders.
- Affordable credit would also end the cycle of debt trap.
- Cheap and easy terms of credit would inspire better investment in technology and thus increase competition.

### Question 11.

"Deposits with the banks are beneficial to the depositors as well as to the nation."

Examine the statement

**Answer:**

**Deposits with the banks are beneficial to the depositors as well as to the nation in various ways. Some of them are:**

- They provide safe and secure deposits to a person's money.
- They provide excellent saving and investment options and also help in the growth of the nation.
- They provide interests on the deposited money to the depositors.
- Money can be easily withdrawn from the banks as and when required by the depositors.
- They provide easy loans on nominal rates that make it possible for the common man to build their own assets.

### Question 12.

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

**Answer:**

**Credit has a unique role in the economic development of the country. It is needed by all the three sectors of the economy.**

- In urban sector, big businessmen and small manufacturers need loans either to expand their enterprises, bring new technology or diversifying their businesses.
- In rural sector, the main demand for credit is for crop production. Crop production involves cost of seeds, fertilizers, pesticides, water, electricity, repair of equipments. Cheap credit would thus lead to increase in production.
- Even tertiary sector needs loans to buy the latest equipments and technology. Thus, we can say that credit has a unique role in the development of a country.

### Question 13.

How is money transferred from one bank account to another bank account? Explain with an example.

**Answer:**

For payment through cheque, the payer who has an account in the bank, draws out a cheque for a specific amount. The cheque is a statement asking the bank to pay a specific amount from the person's account to the person in whose name the cheque has been

issued.

For example, Aman has to pay a specific amount of money to Shruti, say ₹ 60,000. Aman will write a cheque in the name of Shurti. It means Aman instructs his bank to pay the money to Shurti. Shurti will deposit the cheque in her bank. After two or three days, the money will be transferred from Aman's account to Shurti's account.

#### Question 14.

"Poor households still depend on informal sources of credit." Support the statement with examples.

**Answer:**

**Poor households still depend on informal sources of credit because:**

- Bank loans require proper documentation and collateral which is rarely available with poor households.
- Informal sources of credit such as moneylenders know the borrowers personally and are often willing to give a loan without a collateral.
- Sometimes, if the borrowers are unable to return the loan, they can get additional loans from moneylenders.

### Long Answer Type Questions [5 Marks]

#### Question 15.

Describe the vital and positive role of credit with examples.

**Answer:**

**Credit plays a vital and positive role in the following ways:**

- It helps people from all walks of life in setting up their business, increase their income and provide support to their family needs.
- It makes it possible for the people to own or construct their own house and get relief from monthly rent.
- People often avail themselves of credit to purchase luxury items like vehicles, A.Cs, etc., which further raises their standard of living.
- It enables us to invest in human resource. People take credit for education, training, etc. which allows enrichment of human resource.
- For example, Salim availed credit facility to meet the working capital needs of production. It helped him to meet the ongoing expenses of production, complete production on time, thereby, increasing his income.

#### Question 16.

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

**Answer:**

**The formal sector loans can be made beneficial to poor farmers and workers in following ways:**

- The process of providing loans should be made easier and accessible to them.
- Large number of banks and cooperatives should be opened in the rural areas.
- Banks and cooperatives should expand their facility of providing loans so as to decrease dependence on informal sector.
- Special focus should be paid on poor and small farmers along with small scale industries.
- Loan processing should be simple, faster and timely.



### Very Short Answer Type Questions [1 Mark]

#### Question 17.

What is the meaning of barter system?

#### Answer:

A system where goods are directly exchanged without the use of money is called barter system.

#### Question 18.

What is meant by double coincidence of wants?

#### Answer:

Double coincidence of wants means owner of good X, say shoes, to find someone else with good Y, say wheat, and both being in need of each other's good

#### Question 19.

How does money act as a medium of exchange?

#### Answer:

Money acts as an intermediary in the process of exchange, thus it is called a medium of exchange.

#### Question 20.

What is a cheque?

#### Answer:

A cheque is a paper instructing the bank to pay a specific amount from a person's account to the person in whose name the cheque has been issued.

#### Question 21.

Who supervises the functioning of formal sources of loans?

#### Answer:

Reserve Bank of India

#### Question 22.

What are the two forms of modern currency?

#### Answer:

Paper notes and Coins

### Short Answer Type Questions [3 Marks]

#### Question 23.

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

#### Answer:

Banks and cooperatives should extend their lending activities in rural areas because:

- Rural poor and farmers have to borrow money from moneylenders at a very high rate of interest. Therefore, the cost to the borrower is very high.
- A large part of the earnings of borrower is used to repay the loans. Hence, they have less income.
- Sometimes, a higher rate of lending means that the amount to be repaid is more than the earnings of the borrower.



- To save the people from the clutches and exploitation by the moneylenders, it is necessary for the banks and co-operatives to extend their lending activities.
- It would lead to higher incomes and improve the condition of the rural poor.
- People can also start a business or set up a small scale industry

#### Question 24.

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

#### Answer:

**Modern money has been accepted as a medium of exchange because:**

- It is authorised by the government of a India.
- It is issued by the apex bank on behalf of the government.
- No other individual is allowed to issue currency.
- The law of the country legalises its use as a medium of payment and setting transactions.
- No one in a country can refuse payment made in the currency of that country.

#### Question 25.

"Money has made transactions easy." Justify.

#### Answer:

**Money has made transactions easy because:**

- It can be easily exchanged with any commodity or service.
- It solves the problem of double coincidence of wants.
- It is the perfect store of value.
- It makes economic activities quite independent from each other.

### Long Answer Type Questions [5 Marks]

#### Question 26.

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

#### Answer:

**Deposits with the banks are beneficial to the depositors as well as to the nation in various ways. Some of them are:**

- They provide safe and secure deposits to a person's money.
- They provide excellent saving and investment options and also help in the growth of the nation.
- They provide interests on the deposited money to the depositors.
- Money can be easily withdrawn from the banks as and when required by the depositors.
- hey provide easy loans on nominal rates that make it possible for the common man to build their own assets.

#### Question 27.

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

#### Answer:

Self-Help Groups are financial support groups that are formed at the village level particularly by women. These consist of around 15-20 members who meet and save their money regularly.



**The following points sum up the functioning of Self-Help Groups:**

- These groups help in pooling the savings of the members, especially who are poor women.
- All decisions regarding savings and loans are taken by the members of the group.
- These groups provide timely loans for a variety of purposes and at a reasonable rate of interest to its members.
- These groups help the borrowers to overcome the problem of lack of collateral.
- These groups provide a platform to discuss a variety of social issues of rural people.
- These groups are collectively responsible for the repayment of loan.

**Question 28.**

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

**Answer:**

**Banks play an important role in developing the economy of India by taking the following steps:**

- Banks keep money of the people in safe custody to be used by the depositors in future.
- Banks also increase the savings of the depositors by paying interest on the money deposited.
- Banks mediate between people who have surplus and those who need money. This is done through granting loans. People avail themselves of these loan facilities to increase production and income.
- Banks, being the formal source of credit, give loans at a very low rate of interest at flexible terms and conditions.
- Special provisions are made through banks for the upliftment of agriculture and industry like waiving of loans of the farmers.

**Question 29.**

What is credit? How does credit play a vital and positive role? Explain with an example.

**Answer:**

Credit 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 plays a vital and positive role in the following ways:**

- It helps people from all walks of life in setting up their business, increase their income and provide support to their family needs.
- It makes it possible for the people to own or construct their own house and get relief from monthly rent.
- People often avail themselves of credit to purchase luxury items like vehicles, A.Cs, etc., which further raises their standard of living.
- It enables us to invest in human resource. People take credit for education, training, etc. which allows enrichment of human resource.
- For example, Salim availed credit facility to meet the working capital needs of production. It helped him to meet the ongoing expenses of production, complete production on time, thereby, increasing his income.

2014

**Short Answer Type Questions [3 Marks]**



### Question 30.

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

#### Answer:

In a barter system, where goods are directly exchanged without the use of money, double coincidence of wants (i.e. a person desires to sell exactly what the other person wishes to buy) is an essential feature. But it, indeed, is a very cumbersome process.

By serving as a medium of exchange, money removes the situation of double coincidence of wants and the difficulties associated with the barter system. For example, it is no longer necessary for a shoe manufacturer to look for a farmer who will buy his shoes and at the same time sell him wheat. All he has to do is to find a buyer for his shoes, who will exchange his money for shoes. Now, he can purchase wheat or any other good in the market with the help of the money earned. Thus, the problem of double coincidence of wants gets solved with the use of money.

### Question 31.

How is money used in everyday life? Explain with examples.

#### Answer:

**In everyday life, money is used in following ways:**

- It is used as a medium of exchange and facilitates the buying and selling of goods like car, house, food, clothes etc.
- It is used as deposits with the banks or to keep it at home like fixed deposits, bonds etc.
- It is used for borrowing and lending like loan.

### Question 32.

Explain with examples, how people are involved with the banks.

#### Answer:

**People are involved with the banks in the following ways:**

- Depositors
- Borrowers
- The people with excess money deposit it in the banks for safety. In turn they earn interest on the amount deposited.

At the same time, there are people who need money for various activities. They approach the banks for credit. The bank charges interest from the borrowers.

### Question 33.

Explain with an example how credit plays a vital and positive role for development.

#### Answer:

**Credit plays a vital and positive role in the following ways:**

- It helps people from all walks of life in setting up their business, increase their income and provide support to their family needs.
- It makes it possible for the people to own or construct their own house and get relief from monthly rent.
- People often avail themselves of credit to purchase luxury items like vehicles, A.Cs, etc., which further raises their standard of living.
- It enables us to invest in human resource. People take credit for education, training, etc. which allows enrichment of human resource.
- For example, Salim availed credit facility to meet the working capital needs of production. It helped him to meet the ongoing expenses of production, complete





production on time, thereby, increasing his income.

#### Question 34.

Why do lenders ask for a collateral while lending? Give any three reasons.

**Answer:**

**The lenders ask for a collateral before lending because:**

- It is an asset that the borrower owns and uses this as a guarantee to the lender – until the loan is repaid.
- Collateral with the lender acts as a proof that the borrower will return the money.
- By keeping a collateral with the lender, the borrower is bound to be regular in paying the interest because the borrower does not want to lose the collateral.

#### Long Answer Type Question [5 Marks]

#### Question 35.

Why is it necessary for banks and cooperatives to extend their lending activities in rural areas? Explain.

**Answer:**

**Banks and cooperatives should extend their lending activities in rural areas because:**

- Rural poor and farmers have to borrow money from moneylenders at a very high rate of interest. Therefore, the cost to the borrowing is very high.
- A large part of the earnings of borrower is used to repay the loans. Hence, they have less income.
- Sometimes, a higher rate of lending means that the amount to be repaid is more than the earnings of the borrower.
- To save the people from the clutches and exploitation by the moneylenders, it is necessary for the banks and co-operatives to extend their lending activities.
- It would lead to higher incomes and improve the condition of the rural poor.
- People can also start a business or set up a small scale industry

2013

#### Short Answer Type Questions [3 Marks]

#### Question 36.

How is money used as a medium of exchange? Explain with examples

**Answer:**

Money is used as a medium of exchange because it serves as a common medium through which people can carry out buying and selling. Use of money makes economic activities independent of each other. At the same time, it removes the inconvenience caused by the barter system.

For example, a person wants to sell sugar and buy wheat. He has to look for a person who wants sugar and has wheat to sell. In contrast, if in an economy, where money is used, the person who wants to sell sugar only has to look for a buyer for his sugar. The money which he will get can be used to purchase the wheat or any other commodity in the market. Since, money is used in the exchange process it is called a medium of exchange.

#### Question 37.

What are the modern forms of money? Why is rupee widely accepted as a medium of exchange? Explain two reasons.



**Answer:**

Modern forms of money include paper notes and coins.

**Rupee is widely accepted as a medium of exchange because:**

- It is authorised by the government of India.
- The law legalises the use of rupee as a medium of payment and settling the transactions. Thus, no one can refuse a payment made in rupees.

**Question 38.**

What is a collateral? Why do lenders ask for collateral while lending? Explain

**Answer:**

A collateral is an asset such as land, building, livestock, vehicle or deposits with the banks that the borrower owns and uses this as a guarantee to the lender until the loan is repaid.

**The lenders ask for a collateral before lending because**

- It is an asset that the borrower owns and uses this as a guarantee to the lender – until the loan is repaid.
- Collateral with the lender acts as a proof that the borrower will return the money.
- By keeping a collateral with the lender, the borrower is bound to be regular in paying the interest because the borrower does not want to lose the collateral.

**Question 39.**

‘Cheap and affordable credit is essential for poor households both in rural and urban areas.’ In the light of the above statement, explain the social and economic values attached to it.

**Answer:**

The social value attached to cheap and affordable credit is that it helps in reducing the dependence of poor on informal sources of credit. The economic value attached to cheap and affordable credit is that it helps the poor in rural and urban households to start self-employment ventures. This helps in increasing their income earning capacity and standard of living.

**Question 40.**

What are demand deposits? How is money safe in the banks? Explain.

**Answer:**

Deposits in the bank account which are payable on demand are called demand deposits. Banks accept deposits from number of people. Some part of that money is given out as loan and the other part is kept with the banks for making payments. So, the money is safe with the banks. The depositors can withdraw their money whenever they want.

**Long Answer Type Questions [5 Marks]**

**Question 41.**

What are the two categories of sources of credit? Mention four features of each.

**Answer:**

**The two categories of sources of credit are:**

- Formal sources of credit
- Informal sources of credit

**The features of formal sources of credit are:**

- They charge low rate of interest and the mode of repayment is easy.



- They keep a collateral from the borrowers for granting loans.
- Reserve Bank of India supervises the functioning of formal sources of credit, (id) Urban households are largely depend on formal sources of credit.
- They include banks and cooperatives.

**The features of informal sources of credit are:**

- They charge higher rate of interest and the mode of repayment is very harsh.
- There is no need to keep a collateral in informal sources of credit.
- There is no organisation to supervise the functioning of informal sources of credit.
- Poor households are largely depend on informal sources of credit.
- They include moneylenders, relatives, friends etc.

**Question 42.**

What are Self-Help Groups? How are they emerging as an important source of credit? Explain.

**Answer:**

Self-Help Groups are a group of 15 to 20 poor villagers, especially women, who regularly pool money at regular intervals. When a member of the group is in need of money, he/she can get the loan from the group at a low rate of interest.

**Self-Help Groups are emerging as an important source of credit because:**

- They charge less interest on the loans than what the moneylenders charge.
- All decisions regarding savings and loans are taken by the members of the group.
- The members can take loans from the groups to meet their daily needs.
- If the group is regular in its savings, they can also take loan from the bank. Loan is sanctioned in the name of the group. The group is responsible for the repayment of loan.
- They help borrowers to overcome the problem of collateral.
- They have freed borrowers from the clutches of the moneylenders.

**2012**

**Short Answer Type Questions [3 Marks]**

**Question 43.**

What is money? Why is modern money currency accepted as a medium of exchange?

**Answer:**

Money is anything which has common acceptability as a means of exchange, a measure and a store of value.

**Modern money has been accepted as a medium of exchange because:**

- It is authorised by the government of a India.
- It is issued by the apex bank on behalf of the government.
- No other individual is allowed to issue currency.
- The law of the country legalises its use as a medium of payment and setting transactions.
- No one in a country can refuse payment made in the currency of that country.

**Question 44.**

Why is cheap and affordable credit important for the country's development?

Explain any three reasons.

**Answer:**

**Cheap and affordable credit is crucial for a country's development because:**

- More lending would lead to higher incomes and encourage people to invest in agriculture, engage in business and set up small industries.
- Cheap credit will enable more investment. This leads to acceleration of economic activity.
- Cheap credit would also allow weaker sections of society to access formal sector of lending and get rid of from informal moneylenders.
- Affordable credit would also end the cycle of debt trap.
- Cheap and easy terms of credit would inspire better investment in technology and thus increase competition.

**Question 45.**

"Whether credit will be useful or not, depends upon the situation." Give two different examples in support of this statement

**Answer:**

**The two examples showing whether credit will be useful or not, depends upon the situation are:**

- **Chirag** is a shoe manufacturer. During the festival season, he receives an order for 3,000 pair of shoes to be completed in a month. He employs two more workers for pasting and stitching. He takes an advance payment from a large trader for 1,000 pair of shoes. He asks the leather supplier to supply leather and payment would be made later. Chirag completes the order in a month, makes a good profit and repay all the money that he had borrowed.
- **Sapna**, a small farmer, grows groundnut in her three acres of land. She took a loan from the moneylender, hoping to repay the loan, once the crop is harvested. Being hit by the pest, the crop fails. Expensive pesticides did not make any difference. Sapna is unable to repay the moneylender and the other year, it becomes a bigger amount. Next year again, she took a loan for cultivation. It is not a bumper crop this year too. Sapna earns little, but it is not enough to repay the old loans. She had to sell a part of the land to repay the loan. She is caught in a debt. This situation is called debt-trap.
- Hence, we can say that it depends on situation whether credit will be useful or not.

**Question 46.**

"Most of the poor households still depend on the informal sector for loans, both in rural and urban areas of India." Support the statement with three examples.

**Answer:**

**Poor households still depend on informal sources of credit because:**

- Bank loans require proper documentation and collateral which is rarely available with poor households.
- Informal sources of credit such as moneylenders know the borrowers personally and are often willing to give a loan without a collateral.
- Sometimes, if the borrowers are unable to return the loan, they can get additional loans from moneylenders.

**Question 47.**

How do SHGs help borrowers to overcome the problem of lack of collateral? Explain with an example.



**Answer:**

**SHGs help borrowers to overcome the problem of lack of collateral in the following ways:**

- It is the group that is responsible for the repayment of loan.
- Any case of non-payment of loan by any member is followed up seriously by other members.
- The formal sector is willing to lend to the members of SHGs because of their good track record of managing the credit.

**Question 48.**

Why is there a great need to expand formal sector of credit in India? Explain any three reasons.

**Answer:**

**There is a great need to expand formal sector of credit in India because:**

- There is no organisation to supervise the credit activities of lenders in informal sector.
- The rate of interest charged by the informal sector is very high as compared to formal sector.
- People who might wish to start a business by borrowing may not do so because of high cost of borrowing in informal sector.
- The higher interest rate of borrowing can mean that the amount to be repaid is greater than the income of the borrower in informal sector.

#### Long Answer Type Question [4/5 Marks]

**Question 49.**

Which government body supervises the functioning of formal sources of loans in India? Explain its functioning.

**Answer:**

**Reserve Bank of India supervises the functioning of formal sources of loans in India.**

- It issues currency notes on behalf of the central government.
- It issues guidelines for fixing rate of interest on deposits and lending by banks. ,,
- It ensures that banks should maintain a minimum cash balance out of the deposits they receive.
- It ensures that the banks should give loans not only to profit making businesses but also to poor people and small traders.
- Periodically, the banks have to submit a report to the RBI on how much they are lending, to whom and at what interest rate.

2011

#### Long Answer Type Questions [4/5 Marks]

**Question 50.**

Describe any four advantages of Self-Help Groups for the poor.

**Answer:**

**The advantages of Self-Help Groups for the poor are:**

- They help the poor to become self-reliant in terms of savings and generating income as the decisions regarding savings are taken by the group members.



- They avail the facilities of loans from formal sources like banks at low rate of interest.
- They create self-employment opportunities by discussion within their group.
- They make it possible for the poor to avail timely finance without any collateral.

**Question 51.**

Explain any four terms of credit with examples.

**Answer:**

**The four terms of credit are:**

- **Interest rate.** The borrower has to pay a sum of money as interest along with the principal amount.
- **Collateral.** It is an asset that the borrower owns and uses this as a guarantee – to the lender until the loan is repaid.
- **Documentation.** Proper documents of borrowing with all the terms and conditions must be submitted.
- **Mode of repayment.** The mode through which the borrower will repay the loan must be clearly mentioned. Long-term loans can be repaid in annual, half yearly or monthly instalments.

**Question 52.**

Explain two points of differences between formal and informal sources of credit.

**Answer:**

Formal Sources of Credit	Informal Sources of Credit
(a) RBI supervises the functioning of formal sources of credit.	(a) There is no organisation which supervises the credit activities of these sources.
(b) They charge lower rates of interest.	(b) They charge higher rates of interest.
(c) Their main motive is social welfare.	(c) Their main motive is profit-making.
(d) These loans are generally provided by banks and cooperatives.	(d) These loans are provided by money-lenders, traders, relatives, friends etc.

2010

**Very Short Answer Type Questions [1 Mark]**

**Question 53.**

What is collateral?

**Answer:**

Collateral is an asset that the borrower owns such as land, building, vehicle, livestock, deposits with the banks and uses these as a guarantee to the lender until the loan is repaid.

**Question 54.**

Define credit.

**Answer:**

Credit refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payments with interest.

**Question 55.**

Which are the two major sources of formal loan for rural households?



**Answer:**

Banks and Cooperatives

**Question 56.**

Mention any three points of distinction between formal sector loans and informal sector loans.

**Answer:**

<b>Formal Sources of Credit</b>	<b>Informal Sources of Credit</b>
(a) RBI supervises the functioning of formal sources of credit.	(a) There is no organisation which supervises the credit activities of these sources.
(b) They charge lower rates of interest.	(b) They charge higher rates of interest.
(c) Their main motive is social welfare.	(c) Their main motive is profit-making.
(d) These loans are generally provided by banks and cooperatives.	(d) These loans are provided by money-lenders, traders, relatives, friends etc.

**Long Answer Type Questions [4/5 Marks]**

**Question 57.**

How does the use of money make exchange of things easier? Explain with examples.

**Answer:**

Money is used as a medium of exchange because it serves as a common medium through which people can carry out buying and selling. Use of money makes economic activities independent of each other. At the same time, it removes the inconvenience caused by the barter system.

For example, a person wants to sell sugar and buy wheat. He has to look for a person who wants sugar and has wheat to sell. In contrast, if in an economy, where money is used, the person who wants to sell sugar only has to look for a buyer for his sugar. The money which he will get can be used to purchase the wheat or any other commodity in the market. Since, money is used in the exchange process it is called a medium of exchange.

Let us take an example of a farmer who wants to sell wheat and wants to buy goat in lieu of that. If he opts for barter system, he will have to search a person who may be interested in giving off his goat and in taking wheat. But finding such a person can be difficult and time-consuming. On the other hand, if the farmer sells wheat and takes money for that, he can easily go and purchase goat with that money.

**Question 58.**

Why are the deposits in the banks called 'demand deposits'? What are the benefits of deposits with the banks?

**Answer:**

People deposit the surplus or extra money in the banks. The banks keep the money safe and provide interest on it. The deposits can be drawn at any time on demand by the depositors. That is why they are called demand deposits.

**The benefits of deposits with the banks are:**

- They can be encashed by issuing cheques in the name of the person to whom the payment is to be made.
- They make it possible to directly settle payments without the use of cash.
- Since demand drafts/cheques are widely accepted as a means of payment along with currency, they constitute money in the modern economy.

**Question 59.**

How does credit plays a vital and positive role? Explain with suitable example.

**Answer:**

**Credit plays a vital and positive role in the following ways:**

- It helps people from all walks of life in setting up their business, increase their income and provide support to their family needs.
- It makes it possible for the people to own or construct their own house and get relief from monthly rent.
- People often avail themselves of credit to purchase luxury items like vehicles, A.Cs, etc., which further raises their standard of living.
- It enables us to invest in human resource. People take credit for education, training, etc. which allows enrichment of human resource.
- For example, Salim availed credit facility to meet the working capital needs of production. It helped him to meet the ongoing expenses of production, complete production on time, thereby, increasing his income.

**Question 60.**

When does credit push the borrower into a debt-trap? Explain with the help of an example.

**Answer:**

In situation with high risks, credit might create problems and pushes the borrower into a debt-trap. He is much worse off than before. For example, crop production involves high costs on inputs such as fertilizers, pesticides, water etc. Farmers generally take loans at the beginning of the season and repay the loan after harvest. But the failure of the crop makes loan repayment impossible. They have to sell part of the land to repay the loan or a fresh loan may be required to repay the previous loan, and the borrower may find himself caught in a vicious circle and recovery from such a situation is very painful.