

## Long Answer Type Questions

### Money and Credit



#### LONG ANSWER TYPE QUESTIONS (4 MARKS)

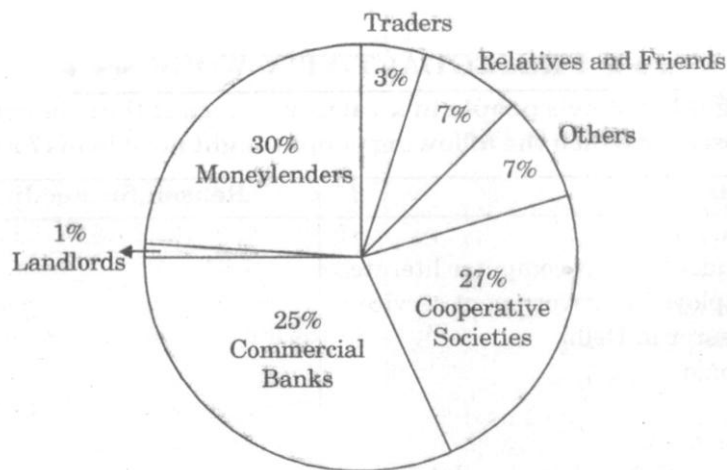
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##### Previous Year's Questions

1. What are the modern form of money currency in India ? Why is it accepted as a medium of exchange ? How is it executed ? [Delhi 2008]

**Ans.** Modern forms of money currency in India are paper notes and coins. It is accepted as a medium of exchange because currency is authorised by the government of the country. Reserve Bank of India issues currency notes on behalf of the central government. No other organisation or individual can issue currency. Everybody is bound to accept it. Its non-acceptance is an offence.

2. Study the diagram given below and answer the questions that follow:  
Source of Credit for Rural Households in India in 2003



(a) Which are the two major sources of credit for rural households in India ?

(b) Which one of them is the most dominant source of credit for rural households ?

(c) Why is it the most dominant source of credit ? Give two reasons.

**Ans.** (a) Moneylenders and cooperative societies. (b) Moneylenders. (c) Moneylenders are ready to give a loan without collateral. (d) Borrowers can get loans even without repaying their earlier loans.

3. What are 'demand deposits' ? Describe any three salient features of demand deposits.

[Foreign 2008]

**Ans. Demand deposit :** Deposits in the bank account which are payable on demand are called demand deposits. Features of demand deposits are ;

- (i) People have the provision to withdraw the money as and when they require.
- (ii) Interest is paid by the bank on these deposits (If they come under saving account deposits - i.e. personal accounts and not business account/ current account).
- (iii) Bank allows the owner of demand deposits to make out a cheque for a specific amount.

### NCERT Questions

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

**Ans.** Before giving loan a bank ensures about the financial capacity of the borrower to repay the loan. For this certain conditions/ requirements have to be fulfilled. Suppose, person X applies for a home loan to a particular bank then he has to submit documents showing his employment records and salary before the bank agree to give him the loan. Bank can retain the papers of new house as collateral. If a bank is not satisfied with the paying capacity of a person and if a person does not submit anything to be considered as collateral, then banks might not be willing to lend to certain borrowers.

**5. In what ways does the Reserve Bank of India supervise the functioning of banks ? Why is this necessary?**

**Ans.** RBI supervises the functioning of banks.

(a) It ensures that the banks actually keep a certain percentage of their deposits as cash balance/cash reserve with the Central bank.

(b) It observes that banks give loans to small activators, small scale industries, small borrowers also and not become a profit-making business.

(c) Report has to be submitted periodically by the banks to RBI containing details such as how much they have lent, to whom and at what rate of interest, etc.

(d) Central Bank is the lender of last resort. Whenever banks are short of funds, they can take loans from the Central Bank. Thus it is source of great strength to the banking system.

(e) It acts as a bank of central clearance, settlements and transfers.

It is necessary for Central Bank to supervise the working of banks. The paper currency standard which is in operation in every country now has to be directed by some central authority (i.e., RBI). There are hundreds of banks in a country. Sometimes banks due to profit motive and competition do not follow a common policy according to national requirements. Therefore, RBI, which will compel them to follow the appropriate policy under economic situation is necessary.

**6. 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.**

**Ans.** If Manav has all the necessary documents showing his paying capacity and collateral security then he will go for formal sources of credit, i.e., bank. Bank will be the best option as he can get loan at a reasonable rate of interest. If he cannot provide necessary documents required for loan from the bank then he has to depend on the informal sources of credit like money lender who sometimes lends at higher rate of interest and uses unfair means to get their money back.

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

**Ans.** (a) As the farmers find it difficult to provide necessary documents/formalities and collateral security required for loan these banks might be unwilling to lend to small farmers.  
 (b) These farmers usually borrow from informal sources of credit like moneylenders, employers, relatives, friends, etc.  
 (c) Terms of credit for small farmers if they borrow from informal sources may carry a very high rate of interest which means that larger part of the earnings is used to repay loan. {d} Farmers can get cheap credit through cooperatives and SHGs.

#### **8. 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.**

**Ans.** (i) Rural (ii) Higher (iii) RBI (iv) Deposits (v) Collateral

#### **Additional Questions**

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- 9. Write a note on formal and informal credit in India.**

**Ans.** Refer to pts. 12 and 13 (Important Term-and Concepts).

**10. Explain the inconvenience of barter-system/exchange.**

- Ans.** (i) **Lack of double coincidence of wants**— Here, a seller has to find out a person who wants to buy seller's goods and at the same time who must have what the seller wants. This is the main drawback of barter exchange.
- (iii) **Absence of common measure of value**—When thousands of articles are produced and exchanged, these will be unlimited number of exchange ratios. Absence of a common denominator in order to express exchange ratios create many difficulties.
- (ii) **Lack of divisibility**—If a person wants to purchase wheat equal to the value of half of his horse, he cannot do so without killing his horse. Thus lack of divisibility makes barter exchange impossible.
- (iii) **Difficulty in storing wealth**— Holding of stocks of goods like cattle, wheat, potatoes, etc. involve costly storage and deterioration.
- (v) **Lack of satisfactory unit to engage in contracts**—It is difficult to engage in contracts which involve future payments due to lack of any satisfactory unit.

**11. Describe the functions of money.**

- Ans.** (i) **Money as the Medium of exchange**—Refer to Ans. 7 (3 Marks).
- (ii) **Money as a unit of Account**— Money is the measuring rod. Values of all goods and services can be expressed in a single common unit called money,
- (iii) **Money as the standard of deferred payments**—Money is the link which connects the values of today with those of the future. Loans are taken and repaid in terms of money-
- (iv) **Money as a store of value**—Money can store value of goods in liquid form. Holding money is equivalent to keeping a reserve of liquid assets because it can be easily converted into other things.
- (v) **Liquidity of Money**—Money is the most generally accepted commodity, it is also the most liquid of all resources. Possession of money enables one to get hold of almost any commodity in any place and money never locks a buyer.

**12. Define Bank. Also explain the functions of commercial bank.**

**Ans.** Any institution which accepts deposits from the public withdrawable by cheques and advances loans of various sorts is called a bank.

**Commercial Bank** : It is a financial institution which performs the functions of accepting deposits from the general public and giving loans for investment with the aim of earning profit.

**Functions of Commercial Banks.** (a) It accepts/collects the deposits from its customers. It can be in the form of saving account deposits, current account deposits, fixed term deposits.

(b) It gives loans and advances.

(c) It provides overdraft facility.

- (d) It discounts bills of exchange.
- (e) It provides agency functions like transfer of funds, collection of funds, payments of various items, purchase and sale of shares and securities, acts as trustee, etc.
- (f) It finances foreign trade.
- (g) It performs general utility services like issue of traveller's cheques and gift cheques, locker facility, etc. (h) It creates credit through loans.

**13. Give the meaning of central bank. Describe the functions of central bank.**

**Ans. Central Bank:** It is the apex institution of monetary system of a country. It is banker to the other banks and to government, it issues notes, controls money supply and credit, and maintains monetary stability.

**Functions of Central Banks.**

- (a) It has the sole monopoly of issuing currency.
- (b) **It acts as a banker to the government**— both central and state governments. It carries out all banking business of the government.
- (c) It acts as an agency to regulate and supervise the proper functioning of other banks in a country.
- (d) It controls credit and money supply through its monetary policy like bank rate, CRR, etc.
- (e) It is a lender of last resort for commercial banks.
- (f) It maintains the external value of currency.
- (g) It is the custodian of foreign exchange resources and nation's gold.
- (h) It performs the clearing house function. (i) It collects and compiles statistical information relating to banking and other financial sectors of the economy.