

# Money and Credit

## Short Answer Questions

**1.** Give an example to show that double coincidence of wants is necessary in a barter system.

Ans. A shoe manufacturer wants to sell shoes in the market and buy wheat.

The shoe manufacturer will first exchange shoes that he had produced for money, and then exchange the money for wheat. Imagine how difficult it would be if the shoe manufacturer had to directly exchange shoes for wheat without using money. He would have to look for a wheat growing farmer, who not only wants to sell wheat but also wants to buy the shoes in exchange.

That is, both parties have to agree to sell and buy each other's commodities.

This is known as double coincidence of wants.

**2.** How is modern form of currency accepted as a medium of exchange?

Ans. (i) Modern forms of money include currency—paper notes and coins.

(ii) Modern currency is not made of precious metals such as gold, silver and copper.

(iii) The modern currency is without any use of its own.

(iv) In India, Reserve Bank of India issues currency notes on behalf of the Central government.

(v) As per the Indian law, no other individual or organisation is allowed to issue currency.

(vi) No individual in India can legally refuse a payment made in rupees.

**3.** What are 'demand deposits'?

Ans. (i) Workers who receive their salaries at the end of each month have extra cash at the beginning of the month.

(ii) This extra cash is deposited with the bank by opening a bank account in their name.

(iii) Banks accept the deposits and also pay an interest rate on the deposits.

(iv) In this way, people's money is safe with the banks and it earns an interest as well.

(v) People also have the provision to withdraw the money as and when they require.

(vi) Since the deposits in the bank accounts can be withdrawn on demand, these deposits are called demand deposits.

**4.** How are demand deposits accepted as a means of payment?

Ans. (i) Demand deposits offer another interesting facility. It helps in making the payment in cheque.

(ii) A cheque is a paper instructing the bank to pay a specific amount from the person's account to the other person or to the accountholder.

(iii) Thus, we see that demand deposits share the essential features of money.

(iv) The facility of cheques against demand deposits makes settlement of payments possible without using cash.

(v) Since demand deposits are accepted widely as a means of payment, along with currency, they constitute money in the modern economy.

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

Ans. RBI supervises the Indian banks in the following manner:

(i) The commercial banks are required to maintain a minimum cash balance out of the deposits they receive.

- (ii) The RBI monitors that the banks actually maintain the cash balance.
- (iii) The RBI sees that the banks give loan not just to profit-making businesses and traders but also to small cultivators, small-scale industries, small borrowers, etc.
- (iv) Periodically, banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.

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

- Ans. (i) Banks do not wish to give loans to the poor as they have no collateral.  
Bank loans require proper documents and collateral, as security against loans.
- (ii) The borrowers who have not paid any previous loans are defaulters, and banks might not be willing to lend them again.
- (iii) The banks might not be willing to lend those entrepreneurs who are going to invest in the business with high risks.

**7.** Analyse the role of credit for development.

- Ans. (i) It helps in increasing economic activities of the country; thus, helps in its development.
- (ii) If credit is made available to the poor people at reasonable rates, they can improve their economic condition. It will further improve their standard of living and overall development.
- (iii) Credit helps in the development of secondary sector or manufacturing sector.

**8.** State three disadvantages of the barter system.

- Ans. (i) In a barter system, double coincidence of wants is required.
- (ii) Here, the person is required to sell only what the other wishes to buy.
- (iii) If both parties do not agree, the goods cannot be exchanged for goods.

**9.** Why are terms of credit required for a loan or credit?

- Ans. (i) Terms of credit are required so that the borrower knows the conditions to take the loan.
- (ii) The collateral, in the form of security or guarantee, is given to the lender until the loan is repaid.
- (iii) If the borrower fails to repay the loan, the lender has all the rights to sell the assets or collateral to obtain the payment.

**10.** Why does the formal or informal sector ask for a collateral?

- Ans. (i) Every loan agreement specifies an interest rate which the borrower must pay to the lender along with the repayment of the principal.
- (ii) In addition, lenders may demand a collateral or an asset that the borrower owns to use it as a guarantee until he repays the loan.
- (iii) Interest rate, collateral and documentation requirement and the mode of repayment are the terms of credit required for formal or informal sectors for loans.

**11.** How are cooperatives functioning in the rural areas to solve the problem of credit?

- Ans. (i) Besides banks, the other major source of cheap credit in rural areas are the cooperatives.
- (ii) Members of a cooperative, pool their resources for cooperation in certain areas.
- (iii) Cooperatives form members, who accept deposits from its members.
- With these deposits as collateral, the cooperative obtains a large loan from the bank. These funds are used to provide loans to members. Once these loans are repaid, another round of lending can take place.

**12.** Identify transactions involving money in our day-to-day life.

Ans. There are several transactions involving money in any single day.

(i) In many of these transactions, goods are being bought and sold with the use of money.

(ii) In some of these transactions, services are being exchanged with money.

(iii) For some, there might not be any actual transfer of money taking place now but a promise to pay money later.

**13.** Why are transactions made in money?

Ans. (i) A person holding money can easily exchange it for any commodity or service that he or she might want.

(ii) Thus, everyone prefers to receive payments in money and then exchange the money for things that they want.

(iii) Take the case of a shoe manufacturer. He wants to sell shoe in the market and buy wheat. The shoe manufacturer will first exchange shoe that he has produced for money, and then exchange the money for wheat.

**14.** How does the use of money make it easier to exchange things?

Ans. In an economy where money is in use, it eliminates the need for double coincidence of wants by providing the crucial intermediate step.

**15.** Which objects were used as money?

Ans. (i) Before the introduction of coins, a variety of objects were used as money.

For example, since the very early ages, Indians used grains and cattle as money.

(ii) Thereafter, came the use of metallic coins—a phase which continued well into the last century.

**16.** How do farmers get into debt trap?

Ans. (i) Farmers usually take crop loans at the beginning of the season and repay the loan after harvest.

(ii) Sometimes, the failure of the crop makes loan repayment impossible.

(iii) So, the farmers have to sell a part of their land to repay the loan. Credit in such a condition pushes the borrowers into a situation from which recovery is painful and they get into the debt trap.