

MONEY AND CREDIT

The chapter throws light upon the history of money and its various forms. It is also an effort to make students understand the social situation in which these forms were used. Modern forms of money are linked to the banking system. The newer forms of money are slowly spreading with computerisation of the banking system. This chapter also talks about digital transactions which started by using bank-to-bank transfer through the internet or mobile phones, cheques, ATM cards, credit cards, and Point of Sale (POS) swipe machines at shops.

Credit is a crucial element in economic life and this chapter talks about how it affects every group.

TOPIC 1

MONEY AS A MEDIUM OF EXCHANGE

The use of money spans a very large part of our everyday life. Goods are bought and sold by using money. Services are availed with money. A person holding money can easily exchange it for any commodity or service. Payments in money are thus most sought after.

When money had not been invented, people employed barter systems to buy and sell their items.

The major problem was about finding a willing buyer or seller. To buy and sell products in turn, both parties have to agree to sell and buy each other's commodities. This is known as double coincidence of wants. This happens only when a person desires to sell is exactly what the other wishes to buy.



Frequently Asked

➤ In a barter system where goods are directly exchanged without the use of money, double coincidence of wants is an essential feature. In contrast, in an economy where money is used, there is no need for a double coincidence of wants.

Money acts as an intermediate in the exchange process and is called a medium of exchange.

Before the introduction of coins, Indians used grains and cattle as money. Other civilisations all across the world also used different objects as a medium of exchange.

With time, metallic coins such as gold, silver, copper coins began to be used as currency. The modern currency is without any use of its own. It is accepted

as a medium of exchange because the currency is authorised by the government of the country.



Frequently Asked

➤ Modern forms of money include currency — paper notes and coins. Modern currency is not made of precious metal such as gold, silver and copper. They are not everyday objects like grains either.

The Reserve Bank of India issues currency notes on behalf of the central government in India. Indian law does not authorise any other individual or organisation to issue any currency. Indian Constitution and Indian law legalises the use of rupee as a medium of payment that cannot be refused in settling transactions in India.

Digital transactions are the newest forms of currency that are being encouraged and widely used these days. Bank-to-bank transfer through the internet or mobile phones, cheques, ATM cards, Credit Cards and Point of Sale (POS) swipe machines at shops.

Digital transactions are taking over cash in markets because they are hassle free and quick.



Important

➤ No individual in India can legally refuse a payment made in rupees.

➤ In India, during November 2016, currency notes in the denomination of Rs. 500 and Rs. 1,000 were declared invalid. People were asked to surrender these notes to the banks by a specific period and receive new Rs. 500, Rs. 2,000 or other currency notes. This was called 'demonetisation'.

MOST LIKELY Questions

Very Short Answer Type Questions

[2 marks]

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

Ans. Examples of modern currency are paper bills/notes, coins, credit cards etc., whereas examples of older currency are coins made

of precious metals like gold or silver and also terracotta coins, etc.



Related Theory

➤ Money can be defined as anything that acts as medium of exchange, store of value and unit of accounting to facilitate the economic activities and transactions.

2. Explain the inherent problem of the 'barter system'.

Ans. The inherent problem of the barter system is that it is not necessary that when one person is willing to exchange his/her goods, the person he/she wants to exchange with is also willing to do the same.



Related Theory

For a barter trade to function, both parties have to agree to sell and buy each others commodities. This is known as double coincidence of wants. In a barter system where goods are directly exchanged without the use of money, double coincidence of wants is an essential feature.

3. Why is money called a medium of exchange?

Ans. Money is accepted as a 'medium of exchange' because it acts as an intermediary in the process of exchange. A person holding money can easily exchange it for any commodity or service.



Related Theory

Money helps to facilitate trade because people in the economy generally recognise it as valuable. Earlier, barter system was used as a medium of exchange and later, gold was adopted as an intermediary.

4. What can be the alternative mode of payment in place of cash money?

Ans. Cheques and demand deposits' are two alternative modes of payment that can be used in place of cash money.



Related Theory

Digital payment through internet and mobile wallets is also a good alternative for cash. Plastic money like credit and debit cards are also used instead of cash in market.

5. Explain the meaning of 'Currency'.

Ans. Currency is the form of money: paper notes and coins.

6. How is double coincidence of wants not appreciable in the contemporary scenario?

Ans. Double coincidence of wants not appreciable: What a person desires to sell is exactly not what the other wishes to buy.

Short Answer Type Questions (SA)
[3 marks]

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

Ans. Modern currency is accepted as a medium of exchange without any use of its own because:

- (1) Modern currency is authorized by the government of a country.
- (2) In India, the Reserve Bank of India issues all currency notes on behalf of central Government.
- (3) No other individual or organization is allowed to issue currency.
- (4) The law legalises the use of rupee as a medium of payment that cannot be refused in settling transactions in India.
- (5) No individual in India can legally refuse a payment made in Rupees.

(Any three points to be explained)

TOPIC 2

DEPOSITS WITH BANKS

The other form in which people hold money is deposits with banks. Most people have a surplus amount of currency after they have used up their wages for their monthly expenditure. This extra cash is deposited by them in banks in an account of their name. Banks accept the deposits and also pay an amount as interest on the deposits to the people.

People can withdraw the money from these accounts as and when they require. These deposits are called demand deposits because they can be withdrawn on demand.

Demand deposits can also serve as a medium of exchange instead of cash. It is this facility which lends it the essential characteristics of money.



Important

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

Demand deposits share the essential features of money making it possible to directly settle payments without the use of cash. They constitute money in the modern economy. Modern currencies are closely linked to the working of the modern banking systems.

Banks keep only a small proportion of deposits from people with themselves. Banks in India hold about 15 per cent of their deposits as cash currently as a reserve to pay the depositors who want to withdraw.

Banks mediate between depositors and borrowers.

Long Answer Type Questions (LA)

[4 & 5 marks]

15. "Deposits with the banks are beneficial to the depositors as well as to the nation." Examine this statement.

Ans. Deposits with the banks are beneficial to the depositors as well as to the nation. This can be asserted through the following arguments:

- (1) Banks accept the deposits and pay interest to the depositor. They help keep the money of the people safe.
- (2) Demand deposits can be withdrawn at any point of time.
- (3) Banks use these deposits to extend loans further.
- (4) Banks mediate between those who have surplus funds and those who are in need of these funds through these deposits. Thus it helps in the economic development of the nation.

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

Ans. "Banks play an important role in the economic development of the country". This statement can be supported by:

- (1) Loan is provided by banks to workers of the agriculture sector for all stages of crop production which results in the development of many households.
- (2) Employment opportunities are created when banks provide loan to create fixed assets like buildings, industries and factories.
- (3) Banks act as a link between savers and investors. They mediate between those who have surplus money and those who are in need of it.
- (4) One can easily rely and trust banks when it comes to keeping money safe. Banks provide a percentage of interest on the deposited money to the people which boosts their demands as well.
- (5) Banks encourage entrepreneurs, native craftsmen and industrialists to work, produce and develop without worrying about capital or credit which in turn helps to make the country economically sound.
Banks help to distribute money allotted by various government schemes to beneficiaries in the remotest areas of the country.

Case Based Questions (VSA Type)

[4 & 5 marks]

17. Read the source given below and answer the questions that follow:

The other form in which people hold money is as deposits with banks. At a point of time, people need only some currency for their day-to-day needs. For instance, workers who receive their salaries at the end of each month have extra cash at the beginning of the month. What do people do with this extra cash? They deposit it with the banks by opening a bank account in their name. Banks accept the deposits and also pay an amount as interest on the deposits. In this way people's money is safe with the banks and it earns an amount as interest. People also have the provision to withdraw the money as and when they require. Since the deposits in the bank accounts can be withdrawn on demand, these deposits are called demand deposits.

- (A) Why are demand deposits called so?
- (B) How can people deposit their money in the bank?
- (C) Why do people deposit money?

Ans. (A) Demand deposits are so called because they can be withdrawn from the bank at any point of time on demand.

- (B) They can deposit their money in the bank by opening an account in the bank.
- (C) They deposit their surplus cash for security and to earn interest.

18. Read the source given below and answer the questions that follow:

Thus we see that demand deposits share the essential features of money. The facility of cheques against demand deposits makes it possible to directly settle payments without the use of cash. Since demand deposits are accepted widely as a means of payment, along with currency, they constitute money in the modern economy. You must remember the role that the banks play here. But for the banks, there would be no demand deposits and no payments by cheques against these deposits. The modern forms of money — currency and deposits — are closely linked to the working of the modern banking system.

- (A) What characteristic of money is primarily being mentioned in the source?
- (B) What are cheques?
- (C) How are cheques used?

Ans. (A) Demand deposits can also act as a medium of exchange like money.

Banks charge a higher interest rate on loans than what they offer on deposits. The difference between the two rates is the source of revenue for banks.

Important

↳ Banks use the major portion of the deposits to extend loans for various economic activities.

MOST LIKELY Questions

Very Short Answer Type Questions

[2 marks]

8. Why are demand deposits considered as money?

Ans. Demand deposits are considered as money because they can be withdrawn from the bank as and when needed. Also, they are accepted widely as a means of payment by way of a cheque instead of cash.



Related Theory

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

9. How do deposits with banks become their source of income?

Ans. They charge different rates of interest on the money they loan and the deposits of the customers. The difference forms their revenue and source of income.

10. What is a cheque?

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

Short Answer Type Questions (SA)

[3 marks]

11. Explain with examples how people are involved with the banks?

Ans. People are involved with the banks in the following ways:

- (1) Banks safeguard the deposits of the people. They provide interests to people on their deposits and help increase the value of their money.
- (2) People can easily withdraw money from these banks when need arises.
- (3) Banks also perform an important function of providing loans to the people for a variety of purposes.
- (4) People can engage in lending activities from banks with convenient modes of repayment in easy installments.

(Mention any 3)

12. How do demand deposits have the essential features of money? Explain.

Ans. The most essential feature of money is that it becomes a medium of exchange to buy things. Demand deposits, like cheque, also fulfill this role.

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 account holder.

Thus this facility involving cheques makes the settlement of payments possible without using cash. Since they are widely used alongside money as a medium of exchange, demand deposits have this feature, which is similar to money.

13. Describe the utility of cheque.

Ans. The utility of cheque is as follows:

- (1) Cheques have the same features as money.
- (2) They settle payments without the use of cash.
- (3) They are widely accepted as a means of payment.
- (4) They pose the least risk in transactions.
- (5) In a fair dealing, it is the most appropriate means of money transactions.



Related Theory

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

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

Ans. Banks are efficient medium of exchange because:

- (1) Demand deposits share the essential features of money.
- (2) The facility of cheque against demand deposit makes it possible to directly settle payment without use of cash.
- (3) Demand deposits are accepted widely as a means of payment.



Related Theory

↳ In today's time, digital money is also used in the form of mobile wallets, and plastic money in the form of credit or debit cards is also a medium of exchange that is linked directly to a person's bank account.

(B) A cheque is a document which instructs the bank to pay a specific amount from the person's account to the person in whose name the cheque has been issued.

(C) Cheques are issued by account holders to withdraw money from their bank accounts to pay someone or against their demand deposits to settle payments without the use of cash.

TOPIC 3

CREDIT AND ITS IMPLICATIONS

Most transactional activities involve credit. 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 might play a vital and positive role or a negative and destructive role in lives depending upon its source and terms.

Credit is mainly required for crop production in rural areas which involves considerable costs on seeds, fertilisers, pesticides, water, electricity, repair

of equipment etc. Farmers take crop loans at the beginning of the season and repay the loan after harvest because of the time period of 3-4 months between crop sowing and harvesting seasons.

Repayment of the loan is crucially dependent on the income from farming. Failure of the crop might delay loan payments for which then a person has to sell his assets or even take another loan to repay. This is an example of debt-trap. The usefulness of credit depends upon the risks in the situation and whether there is some support, in case of loss.

MOST LIKELY Questions

Very Short Answer Type Questions

[2 marks]

19. Why do farmers require credit?

Ans. Farmers require credit to buy seeds, fertilisers or other equipment related to farming apart from personal or family needs.

20. What is credit?

Ans. Credit (loan) refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment.

Short Answer Type Questions (SA)

[3 marks]

21. Explain the role of credit for economic development.

OR

⊕ "Credit can play a positive role." Support the statement with arguments.

Ans. Credit plays a crucial role in a country's development in the following ways:

- (1) Credit or loans sanctioned by banks help industrialists as capital investments to revive their failing industry or start up a completely new venture without worrying about the lack of cash. This in turn leads to

increase in employment opportunities and economic development of a country.

(2) For farmers, loans help them buy new seeds before the sowing season and becomes their only source of capital in times of urgent need. This helps them grow more and earn more.

(3) Credit also helps to boost various other sectors. It helps to buy houses, vehicles and generate demands which in turn helps to boost economy. The borrower is able to repay this loan in installments.



Related Theory

↳ 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.

22. "Credit can play a negative role." Support the statement with arguments.

Ans. The following points elucidate how credit can play a negative role:

- (1) The cost of informal loans is much higher and often leads to a debt-trap. In addition budding entrepreneurs who might wish to start a new enterprise by borrowing may not do so because of the high cost of borrowing.
- (2) Most loans from informal lenders carry

⊕ Same Answer, different question style.

a very high interest rate and do little to increase the income of the borrowers.

- (3) Credit does no good to the borrower if he/she doesn't utilise that money in a profitable manner. Sometimes, farmers borrow money to buy raw material to grow crops but due to some factors, the crop turns out to be a failure. The farmer is not able to repay the amount and thus falls into a debt-trap.

23. Examine any three situations in which credit pushes the borrower into a debt-trap.

Ans. Credit and debt-trap:

- (1) Loans from informal sector could lead to debt trap.
 - (2) Lack of planning results in debt.
 - (3) Difficulty in repaying loans due to certain circumstances.
 - (4) Higher interest rate.
- (Any three points to be examined.)

Long Answer Type Questions (LA)

[4 & 5 marks]

- 24. "Credit sometimes pushes the borrower into a situation from which recovery is**

very painful." Support the statement with examples.

Ans. Yes, it is true that credit sometimes pushes the borrower into a situation from which recovery is very painful. It can be further understood through the following points:

- (1) Sudden calamities cannot be predicted. In rural areas, if crops fail due to any natural factors, then it becomes difficult for the borrower to repay the loan. For example, thunderstorms, hailstorms, etc. destroy crops and farmer's source of income. Loan repayment becomes impossible for the farmer.
- (2) In informal sectors, the rate of interest is not fixed and is usually very high. In case the credit is not repaid then the interest rates further mounts leading the borrower in a debt trap.
- (3) There are cases when people have to sell their land and fixed assets to repay loan.
- (4) The borrower is often pushed into painful situation in case of high risk activities failure and specially when there is no support.
- (5) Some borrowers also commit suicide if they fail to repay the loan.

TOPIC 4

TERMS OF CREDIT

Every loan agreement specifies an interest rate. This rate calculates the interest to be paid back to the lender along with the repayment of the principal. Most lenders demand collateral against loans.



Frequently Asked

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

➤ The lender can sell the collateral to reimburse his loan in case the borrower fails to repay the loan.

Property such as land titles, deposits with banks, livestock are some common examples of collateral.

Interest rate, collateral and documentation requirement, and the mode of repayment together comprise terms of credit. The terms of credit vary substantially from one credit arrangement to another. Those vary depending upon the lender and the borrower.



Important

➤ The other major source of cheap credit in rural areas are the cooperative societies (or cooperatives). Members of a cooperative pool their resources for cooperation in certain areas. Some examples of cooperatives are farmers cooperatives, weavers cooperatives, industrial workers cooperatives, etc.

People obtain loans from various sources like employers, agricultural traders, relatives, banks and local money lenders. These loans can be categorised as formal sector loans and informal sector loans. Among the former are loans from banks and cooperatives. The informal lenders include moneylenders, traders, employers, relatives and friends, etc.

Reserve Bank of India

The Reserve Bank of India plays multiple roles:

- (1) The Reserve Bank of India supervises the functioning of formal sources of loans.
- (2) The RBI monitors the banks in actually maintaining cash balance for emergency purposes.
- (3) The RBI keeps a check on the banks and ensures they give loans to small cultivators, small scale industries, to small borrowers and not just to traders, merchants etc.
- (4) Banks have to submit details about their lending practices to the RBI including the interest rates.

Banks and cooperative societies need to lend more. This would lead to higher incomes and it would encourage people to borrow cheaply for their needs. Cheap and affordable credit is crucial for the country's development.

Higher cost of borrowing entails that a larger part of the earnings of the borrowers will be used to repay the loan. The amount to be repaid is greater than the

income of the borrower. This leads to an increasing debt and debt trap. This makes people hesitant to borrow.

MOST LIKELY Questions

Very Short Answer Type Questions

[2 marks]

25. What do terms of credit include?

Ans. The terms of credit include interest rate, collateral, documentation requirement, mode of payment.

26. Should there be a supervisor, such as the Reserve Bank of India, that looks into the loan activities of informal lenders? Why would its task be quite difficult?

Ans. There is no organisation to monitor and regulate the credit activities of lenders in the informal sector. They lend at interest rates of their choice. They can use unfair means to get their money back. Compared to the formal lenders, they charge a higher interest on loans. Thus borrowers of informal loans have greater chances of falling into a debt trap. It renders the poor people even more vulnerable.

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

Ans. People hesitate to borrow due to the high rates of interests of the informal sector. Because there are not many formal sector source to give credit, they are unable to depend on anyone to fulfill their needs hence it needs to be expanded in rural areas

Short Answer Type Questions (SA)

[3 marks]

28. Explain any three functions of the Reserve Bank of India.

Ans. Functions of the Reserve Bank of India are:

- (1) The RBI is the only authorized body that can issue currency in the country.
- (2) They print, distribute and regulate the flow of currency in the economy.
- (3) The RBI provides central and state governments with banking facilities.
- (4) The Reserve Bank of India also supervises all other commercial banks in the country. It provides financial assistance to these banks, like short-term loans and advances.
- (5) To maintain the value of the rupee in the global economy, the RBI acts as the

custodian of foreign exchange reserves in the country.

- (6) The primary function of the Reserve Bank of India is the control of credit and money in the market.

(Any 3 of the 6 points can be written to get full marks)



Related Theory

The Reserve Bank of India is a very important part of the Indian economy. The RBI dictates interest rates and CRR limits to commercial banks. It makes advances and provide loans to the government whenever necessary.

29. Explain the three important terms of credit.

Ans. The important terms of credit are as follows:

- (1) **Collateral:** Collateral refers to an asset like a building or vehicle owned by the borrower, which acts as a guarantee against which the loan is given to the borrower.
- (2) **Documentation:** Before lending money, the lender checks all the documents, like income and employment records, etc.
- (3) **Interest rate:** While borrowing or lending money, both the parties decide the rate of interest on which the amount is being lent. The borrower pays the principal amount added to the interest amount while repaying the loan. Document is specified for the same.
- (4) **Mode of payment:** It refers to the mode of payment in which the borrower will return the money to the lender. The duration of time for which the amount is being given also comes under this term.

(Any 3 of the 4 points can be written to get full marks)



Related Theory

The terms of credit may vary from one credit arrangement to the other, depending upon the nature of the borrower or lender. These are essential to discuss and decide before borrowing money from an organised source of credit. These terms ensure that the lender is not being exploited.

30. Which organisation supervises the functioning of the banks in India and how? Explain.

Ans. The Reserve Bank of India supervises the functioning of the banks in India in the following ways:

- (1) The banks maintain a minimum cash balance out of the deposits they receive. The RBI monitors the banks in actually maintaining cash balance.
- (2) The RBI sees that the banks give loans not just to profit-making businesses and

- traders but also to small cultivators, small scale industries, to small borrowers etc.
- (3) Banks have to submit information to the RBI periodically on how much they are lending, to whom, at what interest rate etc.

TOPIC 5

FORMAL AND INFORMAL CREDIT

Eighty-five per cent of the loans taken by poor households in the urban areas are from informal sources. Compared to this the rich households borrow only 10 per cent of their loans from informal sources, while they borrow 90 per cent from formal sources.

The formal sector meets only half of the total credit needs of the rural people. The remaining credit needs have to be met by the informal sectors. Most loans from informal sectors do little to increase the income

of the borrowers. Banks and cooperatives should increase their lending particularly in the rural areas to reduce the dependence on the informal sector.

The formal sector needs to diversify its lending activities because it is only the rich households who receive formal credit; whereas the poor have to depend on informal sources. It is important that the formal credit is distributed more equally so that the poor can benefit from the cheaper loans.

MOST LIKELY Questions

Very Short Answer Type Questions

[2 marks]

- 31. Why do lenders ask for collateral while lending? Explain.**

Ans. A collateral is any physical or monetary asset like a building, vehicle, jewellery or cash deposits which a lender uses as a guarantee against the money he/she has lent to the borrower.

In case, a borrower fails to repay his/her loan, collateral can be used in turn to generate the amount the borrower owes.

Thus collateral becomes a legal guarantee that the borrower will repay the cash by all means. It encourages the lender to lend money without worrying about repayment.

- 32. Why are service conditions of formal sector loans better than those of the informal sector? Explain.**

Ans. The formal sector works under the supervision of the Reserve Bank of India. The rate of interest is very low. Commercial banks and cooperative societies are the main sources of the formal source of credit. They provide ensured services and also have a set protocol for deliverance of loan activities. In the formal sector, the interest rate, collateral and documentation requirement, and the mode of repayment together comprise what we call the terms of credit. The terms of credit vary substantially from one credit arrangement to another. They

may also vary depending on the nature of the lender and the borrower.

- 33. Why are formal sources of credit preferred over the informal source of credit? Give three reasons.**

Ans. Formal sources of credit preferred over Informal sources of credit because:

- (1) Formal sources have low cost of borrowing
- (2) Higher Income through cheap borrowing
- (3) No exploitation and debt trap.

(All three points to be explained.)

Long Answer Type Questions (LA)

[4 & 5 marks]

- 34. Review any three merits and any two demerits of 'formal sector of credit' in India.**

Ans. Merits :

- (1) Formal sector of credit helps to meet the working capital needs of production.
- (2) It also helps in completing production on time.
- (3) It offers loans at low rates of interest.
- (4) It helps in increasing earnings by making more investment.
- (5) It helps in meeting on going expenses of production activities.

(Any 3 of 5 points can be written to get full marks)

Demerits:

- (1) The formal sector of credit lacks credibility in rural areas.
- (2) People face difficulty in obtaining loans.
- (3) People don't always have collateral or required documents.

(Any 2 of 3 points can be written to get full marks)

35. Describe any five informal sources of loans in India.

Ans. The informal sources of loan in India are:

- (1) **Moneylenders:** They charge a high rate of interest, because of which many borrowers fall into a debt trap.
- (2) **Employers:** Many people prefer taking loans from their boss or employer who cuts a fixed amount from their salary on monthly basis as repayment.
- (3) **Informal institutions:** They give loans easily but are not authorised by the government. They charge a high rate of interest.
- (4) **Family and friends:** They give loans easily but if a person is unable to repay then it causes distress in the relation.
- (5) **Big landlords:** They charge a high rate of interest and also force small farmers who take loans from them to sell their produce at low prices to them, as they gave money to them when they needed.

36. What are the differences between formal and informal sources of credit? Mention five points.

Ans. The difference between formal and informal sources of credit is as follows:

S. No.	Formal Sources of Credit	Informal Sources of Credit
(1)	These include banks and cooperatives.	These sources include moneylenders, friends, traders, employers, relatives, neighbours etc.
(2)	The RBI supervises the lending activities of formal sources of credit.	There is no organisation to supervise lending activities of informal sources of credit.
(3)	These charge less interest on loans.	These sources charge high interest on their lending activities.
(4)	These sources do not pressurize borrowers nor impose any unfair condition on them.	These sources impose their own conditions which are at times very difficult for borrowers to fulfil.
(5)	The lending activities are concentrated around the social well being of each individual in the society.	Making profit is the only aim of lending activities in informal sources of credit.

TOPIC 6**SELF-HELP GROUPS FOR THE POOR**

Rural areas are heavily dependent upon informal Sectors for lending. This is because banks are not present everywhere. Lending from formal sectors is a little complicated as well. Bank loans require proper documents and collateral. Absence of collateral prevents the poor from borrowing from the bank. Informal lenders know the borrowers personally and give loans without collateral or paperwork. Moneylenders are ready to give more loans to these people without repaying any prior loans. Moneylenders charge very high rates of interest, manipulate the borrowers and have no documentation for proof.

Another way to lend more money through the formal sector is to organise rural poor, in particular women, into small Self Help Groups (SHGs) and pool their savings. A typical Self Help Group has 15-20 members, usually belonging to one neighbourhood, who meet and save regularly. Saving per member varies from Rs. 25 to Rs. 100 or more, depending

on the ability of the people to save. Members can take small loans from the group itself to meet their needs. The group charges interest on these loans but less than what the moneylender charges. The group becomes eligible for availing loan from the bank if they have been regular in paying back and saving.

Loan is sanctioned in the name of the group. It helps in creating some self employment opportunities for the members. Small loans are lent for releasing mortgaged land, for meeting working capital needs, for housing materials and acquiring logistics like sewing machines, handlooms, cattle, etc.

All important decisions are taken by the members. The group judges the purpose, amount, interest to be charged, repayment schedule and grants the loans. The group is also responsible for the repayment of the loan.

Defaulters are taken and dealt with seriously in the group. This makes banks willing to lend to the

poor women when organised in SHGs, even without collaterals. SHGs help these borrowers to borrow without any collateral. Timely loans at a reasonable interest rate are facilitated through this.



Frequently Asked

→ SHGs are the building blocks of organisation of the rural poor. Not only does it help women to become financially

self-reliant, the regular meetings of the group provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.



Important

→ Started in the 1970s as a project, Grameen Bank in 2018 had over 9 million members in about 81,600 villages spread across Bangladesh. Majority borrowers are women from the poorest sections of society.

MOST LIKELY Questions

Short Answer Type Questions (SA)

[3 marks]

37. How is the concept of self help groups important for poor people? Give your view point.

Ans. Self help groups for poor people:

- (1) Help borrowers overcome the problem of lack of collateral.
- (2) Get timely loans for a variety of purposes (releasing mortgaged land, buying seeds, fertilizers, cattle, etc.) and at a reasonable interest rate.
- (3) Help women to become financially self-reliant.
- (4) The regular meetings of the group provide a platform to its members to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.



Related Theory

→ Self help groups (SHG) are the organisations of rural people that help them come together in a group and help each other financially and domestically by saving regularly out of their earnings. There are a limited numbers of members in these groups and these groups are supported by the government in many ways.

Long Answer Type Questions (LA)

[4 & 5 marks]

38. Self help groups help borrowers overcome the problem of the lack of collateral." Examine the statement.

Ans. Following are the ways through with self help groups (SHGs) help borrowers overcome the problem of the lack of collateral:

- (1) Self-help group is able to solve collateral problem. Members can take small loans from the group itself to meet their needs without any collateral.
- (2) The Group charges interest on their loans but this is less than what the money lenders charge.
- (3) Most of the decisions regarding savings and loan activities are taken by the group members. The group decides as regards the loans to be granted the purpose amount, interest to be charged, repayment schedule, etc. The group is responsible for the repayment of the loan. Any case of non-repayment of loan by any one member is followed up seriously by other members in the group.
- (5) Because of these mentioned features, banks are willing to lend to poor women when organised in SHGs, even though they have no collateral as such. Groups meet regularly and provide a platform to discuss and act on variety of social issues.



Glossary

- (1) **Cooperatives:** Cooperative society refers to that type of business organization, wherein people work together, for a common goal, i.e. welfare of its members.
- (2) **Currency:** System of money
- (3) **Transactions:** Act of buying and selling
- (4) **Authorise:** Officially approve something
- (5) **Terms of Credit:** Terms on which credit is given
- (6) **Debt trap:** A trap where debt keeps increasing
- (7) **Mortgage:** A legal agreement by which a formal sector financing institution lends money against a collateral
- (8) **Self-reliant:** Self dependent.