

Long Answer Questions

Q. 1. Review any three merits and any two demerits of 'formal sector of credit' in India.

[CBSE (F) 2016]

Ans. Merits and Demerits of Formal Sectors of Credit

Merits

- (i) Helps to meet the working capital needs of production.
- (ii) Helps in ongoing expenses of production.
- (iii) Helps in completing production on time.
- (iv) Helps in increasing earnings.
- (v) Low interest rates.
- (vi) Easy access of loans to small cultivators and small scale industries.

Demerits

- (i) Difficulty in obtaining loans.
- (ii) Collateral issues.
- (iii) Documentation could be a problematic issue for few.
- (iv) Lack of credibility in rural areas.

Q. 2. Why are poor households still dependent on informal sources of credit?

OR

“Poor households still depend on informal sources of credit.” Support the statement with examples. [CBSE (F) 2016]

Ans. Reasons:

Banks are not present everywhere in rural India.

Even if they are present, getting a loan from a bank is much more difficult than taking a loan from informal sources.

Bank loans require proper documents and a collateral. Absence of collateral is one of the major reasons which prevents the poor from getting bank loans.

Informal lenders like moneylenders know the borrower personally and hence, are often willing to give a loan without a collateral.

The borrowers can, if necessary, approach the moneylender even without repaying their earlier loans.

However, the moneylenders charge very high rates of interest, keep no records of the transactions and harass the poor borrowers.

Q. 3. What are the advantages of SHGs?

Ans. Advantages of SHGs:

- (i) The SHGs help the borrower to overcome the problem of lack of collateral.
- (ii) They can get timely loans for a variety of purposes and at a reasonable interest rate.
- (iii) SHGs are the building blocks of organisation of the rural poor.
- (iv) Not only do they help women 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.

Q. 4. What are the differences between formal and informal sources of credit?

Ans. Formal sources:

- (i) These sources of credit are registered by the government and have to follow its rules and regulations.
- (ii) RBI supervises the functioning of formal sources of credit.
- (iii) They generally charge lower rates of interest.
- (iv) Their main motive is social welfare.

Example: Banks and cooperatives.

Informal sources:

- (i) These include those small and scattered units which are largely outside the control of the government.
- (ii) There is no organisation which supervises the credit activities.
- (iii) They charge much higher rates of interest.
- (iv) Their main motive is profit-making.

Example: Moneylenders, traders, employees, relatives and friends, etc.

Q. 5. What is a cheque? How does it replace currency?

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 drawn.

(i) The facility of cheque against demand deposits makes it possible to directly settle the payments without the use of withdrawal.

(ii) For payment through cheque, the payer who has an account with the bank, makes out a cheque of a specific amount.

(iii) The money is transferred from one bank account to another in a couple of days. The transaction is complete without any payment of cash.

Q. 6. What is credit? How can credit be both an asset as well as a debt trap?

Ans. 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.

(i) Example of credit as an asset: During the festival season, a shoe manufacturer has received an order of making shoes in bulk, within a month's time. To complete production, he hired some extra workers and has to purchase the raw materials. He asks the supplier to supply leather now and promises to pay him later. Then he took some advance payment from the trader. By the end of the month, he is able to deliver the order, make a good profit and repay the money he had borrowed.

(ii) Example of credit as debt trap: A farmer picks up the loan from a moneylender to meet the expenses of cultivation. But unfortunately the crop is hit by the pests and fails. So, he is unable to repay the loan and debt grows larger with interest. Next year, he picks up a fresh loan and is able to have a normal crop that year. But earnings are not enough to pay the earlier debt. So, he is caught in a debt trap. He can repay the loan, only after selling a part of the land.

In shoemaker's case, credit plays a vital and positive role, whereas in farmer's case credit pushes the borrower into a situation from which recovery is very painful.

Q. 7. What are the terms of credit?

Ans. (i) Every loan agreement specifies an interest rate which the borrower must pay to the lender along with repayment of the principal.

(ii) In addition, lender may demand collateral, i.e., an asset that the borrower owns and uses this as a guarantee until the loan is repaid.

(iii) If the borrower fails to repay the loan, the lender has the right to sell the collateral to obtain payment.

(iv) Terms of credit comprise interest rate, collateral and documentation requirement, and the mode of repayment.

(v) The terms of credit vary substantially from one credit arrangement to another. They may vary depending on the nature of the lender and the borrower.

Q. 8. "The rich households are availing cheap credit from formal lenders whereas the poor households have to pay a heavy price for borrowing." Comment.

Ans. The formal sector still meets only about half of the total credit needs of the rural people.

The remaining credit needs are met from informal sources.

Most loans from informal lenders carry a very high interest rate and do little to increase the income of the borrowers.

Thus, it is necessary that banks and cooperatives increase their lending particularly in the rural areas, so that the dependence on informal sources of credit reduces.

While formal sector loans need to expand, it is also necessary that everyone receives these loans.

At present, it is the rich households who receive formal credit whereas the poor have to depend on the informal sources.

Q. 9. Who takes the important decisions of SHGs and why?

OR

“‘Self Help Groups’ help borrowers to overcome the problem of lack of collateral.” Examine the statement. [CBSE (Delhi) 2016]

Ans. Most of the important decisions regarding the 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.

It is the group which is responsible for the repayment of the loan.

In case of default by any one member, it is followed up seriously by other members in the group.

Because of this feature, banks are willing to lend to the poor women when organised in SHGs even though they have no collateral as such.

Q. 10. Write a note on the success story of ‘Grameen Bank of Bangladesh’.

Ans. Grameen Bank of Bangladesh was founded by Prof. Muhammad Yunus (a recipient of Nobel Peace Prize for the year 2006) in year 1970. Over the last 42 years i.e., from 1976 to 2017, the operations of the bank spread to a large area of Bangladesh. The bank was started with a very small project and in year 2005, it spread across 40,000 villages with 6 million borrowers in various parts of Bangladesh. Most of the borrowers of this bank are women and belong to poor sections of society. These poor women have started ‘self-employment’ projects by taking credit from this Grameen bank. This credit has positive impact on these women as they started a gainful employment, which helped them not only to repay their loan but also to earn a good living for themselves and their family.

Q. 11. How can the formal sector loans be made beneficial for poor farmers and workers? Suggest any five measures. [CBSE (AI) 2016]

Ans. Formal sector loans can be made beneficial for poor farmers and workers in the following ways:

- (i) It is required to create awareness among farmers about formal sector loans.
- (ii) Process of providing loans should be made easier.
- (iii) It should be simple, fast and timely.
- (iv) More number of Nationalised banks/cooperative banks should be based in rural sector.
- (v) Banks and cooperatives should increase facility of providing loans so that dependence on informal sources of credit reduces.
- (vi) The benefits of loans should be extended to poor farmer and small scale Industries.
- (vii) While formal sector loans need to expand, it is also necessary that everyone receives these loans.