

## Exercise

- 1) In situations with high risks, credit might create further problems for the borrower. Explain.

This statement is also known as debt-trap. Taking credit involves an interest rate on the loan & if this is not paid back, then the borrower is forced to give up his collateral or asset used as the guarantee, to the lender.

If a farmer takes a loan for crop production and the crop fails, loan payment becomes impossible. To repay the loan the farmer may sell a part of his land.

making the situation worse than before. The farmer had taken a loan to improve his situation but his situation worsens due to nonpayment of loans.

Since farming is associated with high uncertainty, debt trap is common. Thus, in situations with high risks, if the shock affect a borrower badly, then he ends up losing more than he would have without the loan.

2) How does money solve the problem of double coincidence of wants?

In a barter system where goods are directly exchanged without the use of money, the double coincidence of wants is an essential feature. By serving as a medium of exchange, money removes the needs for double coincidence of wants and difficulties associated with the barter system.

E.g. - It is no longer necessary for the farmer to look for a book publisher who will buy his cereals at the same time sell his books. All he has to do is find a buyer for his cereals. If he has exchanged his cereals for money, he can purchase any goods or service which he needs. This is because money acts as medium of exchange. Medium of exchange is one of the three fundamental functions of money in mainstream economics. It is widely accepted token which can be exchanged for goods and services.

3) How do banks mediate between those who have surplus money and those who need money?

Banks accept deposits from people who have surplus money, paying interest on these deposits. The banks use the major portion of the

deposits to extend loans to those who need money, charging them slightly higher interest than what they pay to the depositor. It is with the banks, help both the people benefit, person having surplus money, and the person in need of money. In this way, banks mediate those who have surplus money and those who need money.

- 4) Look at a 10 rupee note. What is written on top? Can you explain this statement.

Reserve Bank of India  
Guaranteed by the Central Govt. of India  
I promise to pay the bearer the sum  
of Ten rupee.

A 10 rupee note is acceptable as a medium of exchange, because it is authorized by the government of India. In India, Reserve Bank of

India issues currency notes on behalf of the central govt. The statement means that the currency is authorized or guaranteed by the central Government. That is, Indian law legalizes the use of rupee as a medium of payment that can not be refused in setting transaction in India. As a promise written on a promissory note, the RBI promises the bearer to pay the given sum of money.