Class 10th

ECONOMICS

CHAPTER - 03

MONEY AND CREDIT

MONEY AS A MEDIUM OF EXCHANGE

- Money acts as an intermediate in the exchange process & it is called Medium of exchange.
- In A BARTER SYSTEM, goods are directly exchanged without the use of money.
- Double coincidence of wants is an essential feature of barter system.
- Double coincidence of wants → what a person desires to sell is exactly what the other wishes to buy.

MODERN FORM OF MONEY

- During early ages, i.e., before introducing coins or currency notes → a variety of objects were used for exchange and settlement of transactions. In India → grains and cattle were used as money.
- After that, metallic coins → gold, silver & copper coins that lasted till the last century.

Currency

- In the Modern forms of currency → paper notes and coins are used as a medium of exchange.
- Money is accepted as a medium of exchange → because the currency is authorized by the government of the country.
- In India, the Reserve Bank of India issues currency notes on behalf of the central government
- According to the law no one can refuse payment made in rupees to settling transactions. Rupee is widely accepted as a medium of exchange.

Deposits with Banks-

- The other form in which people hold Money is as deposits with banks. Bank deposits are also a form of the modern economy.
- In this, people can open a bank account and deposit their extra cash with the Bank and Banks accept the deposits and also pay an amount as interest on the deposits.
- The deposits in the bank accounts can be withdrawn on demand; these deposits are called demand deposits.
- Demand deposits offer another interesting facility → The payments being made by cheques instead of cash.
- 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
- The facility of cheque against demand deposits makes it possible to directly settle payments without the use of cash.

LOAN ACTIVITIES OF BANK

- The majority of people deposit their money in banks. The banks only keep a small portion of these deposits with themselves. It is used when the depositors come to withdraw their money.
- Banks in India these days hold about 15 per cent of their deposits as cash. This is kept as provision to pay the depositors who might come to withdraw money from the bank on any given day.
- The other major portion of the deposits is used to offer loans to borrowers. People need loans for various economic activities like buying a house, vehicles etc.
- Thus, Banks act as a mediator between the depositors (those who have surplus funds) and Borrowers (those who need funds).
- These banks charge a higher rate of interest on the loans than what they offer on deposits.
- The difference between what is charged from borrowers and what is paid to depositors is their main source of income.

TWO DIFFERENT CREDIT SITUATIONS

- Credit (Loan): It is an agreement in which a borrower receives money, goods, or services from a lender for now and promises to return the resources or repay the lender in the future.

First Situation: A person (manufacturer) obtains credit to meet the working capital needs of production. The credit helps him to meet the on-going expenses of production, complete production on time, and thereby increase his earnings. Credit therefore plays a vital and positive role in this situation.

Second Situation: A person obtains credit for producing goods. For example, in rural areas, the main demand for credit is for crop production → involves considerable costs on seeds, fertilisers, pesticides, water, electricity, repair of equipment, etc.

There is a minimum of 3 to 4 months gap between the sowing and harvesting. Farmers usually take crop loans at the beginning of the season and repay the loan after harvest. Repayment of the loan is crucially dependent on the income from farming.

In case of the failure of the crop, loan repayment is impossible. One has to sell part of the land to repay the loan. Credit, instead of helping to improve one's earnings, leaves oneself worse off. This is an example of what is commonly called debt-trap. Credit in this case pushes the borrower into a situation from which recovery is very painful.

TERMS OF CREDIT

- Every loan agreement specifies an interest rate which the borrower must pay to the lender along with the repayment of the principal. In addition, lenders also demand collateral (security) against loans.
- Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock, deposits with banks) and given to the lender as a guarantee until the loan is repaid.
- If the borrower is unable to repay the loan then the lender has the right to sell it and get the money back.
- Interest rate, collateral and documentation requirement and the mode of repayment, together is called the terms of credit.

FORMAL SECTOR CREDIT IN INDIA

We have seen that people obtain loans from various sources. These sources can be grouped as Formal sector loans and Informal sector loans.

Formal sector loans:

- These are the loans from banks and cooperatives.
- Need proper documents and collateral before lending
- Loans are provided at Low rate of interest
- Supervised by Reserve Bank of India (RBI)

Reserve Bank of India:

- Reserve Bank of India supervises the activities of formal sector and keeps the track of their activities but there is no one supervises the functioning of informal sector.
- The RBI assures that banks provide loans to small cultivators, small-scale industries, etc., at cheap rates and not only to profit-making businesses and traders.
- The banks must periodically submit data about their interest rate, borrowers' information, etc., to the RBI.

Informal sector loans:

a. The informal lenders include moneylenders, traders, employers, relatives and friends, etc.
b. There is no need of documents and collateral for loans
c. In this loans are provided at very High rate of interest
d. There is No organisation supervises these credit activities like RBI in formal sector

Formal and Informal Credit: Who gets what?

- 85% of the loans taken by poor households in the urban areas are from informal sources.
- Urban households take only 10% of their loans are from informal sources, while 90% are from formal sources.
- 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.
- Because of this reason, the banks and cooperatives must make provisions to provide loans at cheaper rates in rural areas, which would enable people to set their own businesses, new industries, grow more crops, etc.
- It is important that the formal credit is distributed more equality so that the poor can benefit from the cheaper loans.
- The formal sector also needs to expand, and it should be accessible to everyone. Cheap and affordable credit is crucial for the development of the country.

SELF HELP GROUPS FOR THE POOR

- Poor households are majorly dependent on informal sector credits. This is because Banks are not available in rural areas.
- Banks require proper documentation and collateral for lending a loan. The absence of collateral prevents the poor from getting a loan.
- On the other hand, moneylenders willing to give loans to the poor at a much higher rate without any collateral. They keep no data of the transactions and harass the poor.
- To overcome these problems → Self Help Groups (SHGs) were created.
- SHGs are small groups of poor people which promote small savings among their members.
- A typical SHG 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.
- The group lends loans to its members at a comparatively low-interest rate than the moneylender without collateral.
- If the group is regular in savings, it becomes eligible to receive a loan from banks.
- Loan is sanctioned in the name of the group and is meant to create self-employment opportunities for the members.
- Most of the important decisions regarding the savings and loan activities are taken by the group members→ the purpose, amount, interest to be charged, repayment schedule etc.
- Any case of non-repayment of loan by any one member 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.
- SHGs are the building blocks of organisation of the rural poor. It helps women to become financially self-reliant.