

Ch 3 Money and Credit

Money as a medium of exchange

* Money is an item which is used as a medium of exchange. In modern economy, money is work as an intermediary. It is used as a medium of exchange for goods and services. It is also used for payment of debts.

* Introduction of money replaced the batter system. Before the introduction of money, Indians used grains and cattle as money. In a barter system, selling and purchasing of goods and services was done with “double coincidence of wants” i.e by fulfilling mutual wants without the use of money. In this system goods and services was exchanged for another goods and services. It was also known as CC economy i.e commodity for commodity economy.

Modern form of money

(i) Currency

* Modern forms of money include currency — paper notes and coins. The modern coins are not made with the precious metals like gold, silver. The real values of the modern coins are less than its face value. Currency notes are also used as a medium of exchange in modern economy. The currency notes are made with paper. The real values of the currency notes are less than its face value.

* The currency is authorized by the government of the country. So, it is used as a medium of exchange and accepted by the others. In India, Reserve bank of India has authority to issue currency notes on behalf of the central government. In India, no individual can legally refuse to accept the rupees issued by the Reserve bank of India.

(ii) Deposits with Banks

* Deposits with Banks are also a form of money. A person can deposit in the bank by opening an account on his/her name. People need only some money at a point of time. So, people can deposit extra money and earn extra money, which is given on money already depositing in bank.

* A facility of payment through cheque is also provided by the bank to their customers. Cheque work as an instrument for payment which is made by the paper. A person can directly transfer money to another person through cheque rather than in cash.

Loan activities of bank

- * Bank work as mediator between the depositors and the borrowers. People deposit their money in bank and get some rate of interest as extra income. Banks hold only some percentage of their deposit in bank.
- * A major portion of the deposited money is provided to those people who are needy of money for economic activities. In this case, money is provided as a loan with a higher rate of interest. The difference between interest on borrowing money and the interest of deposited money is the income for the bank.

Two different credit situations

- * Credit is an agreement in which is created when a person gives money and goods to the needy person with the promise of to repay that with some rate of interest.
- * There are two types of credit situation
 - (i) In the first situation, a person borrows money for production activities with the promise to repay the loan at the end of the year when production work will be completed. And at the end of the year, he/she makes a good profit from production activities and he/she is able to pay the amount of loan. Therefore, that person becomes better off than before.
 - (ii) In the second situation, a person borrows money for production activities with the promise to repay the loan at the end of the year when production work will be completed. And at the end of the year he/she unable to repay the loan due to loss in production. For this term, he/she come under the situation of debt trap. Therefore, that person becomes worse off than before.

Terms of credit

- * The interest rate, collateral and some documents fulfill the requirements of the terms of credit. Interest rate is specified when a lender provides loan to the borrowers. A borrower will have to repay the amount taken from the lenders with the amount of interest. In some case, lenders may demand collateral against loans.
- * Collateral is an asset of the borrowers which is given to the lenders as security for the specified period. A lender can use the assets which are held by him as security until the amount of loan is repaid. The lender has right to sell the assets or collateral when the borrower fails to repay the amount of loan in a specified period.

Formal sector credit in India

- * There are two types of sources of credit in an economy.

- (i) Formal sector
 - (ii) Informal sector

*** Formal sector**

In the formal sector, loans from banks and cooperatives are included.

*** Informal sector**

In the Informal sector, loans from moneylenders, traders, employers, relatives and friends are included.

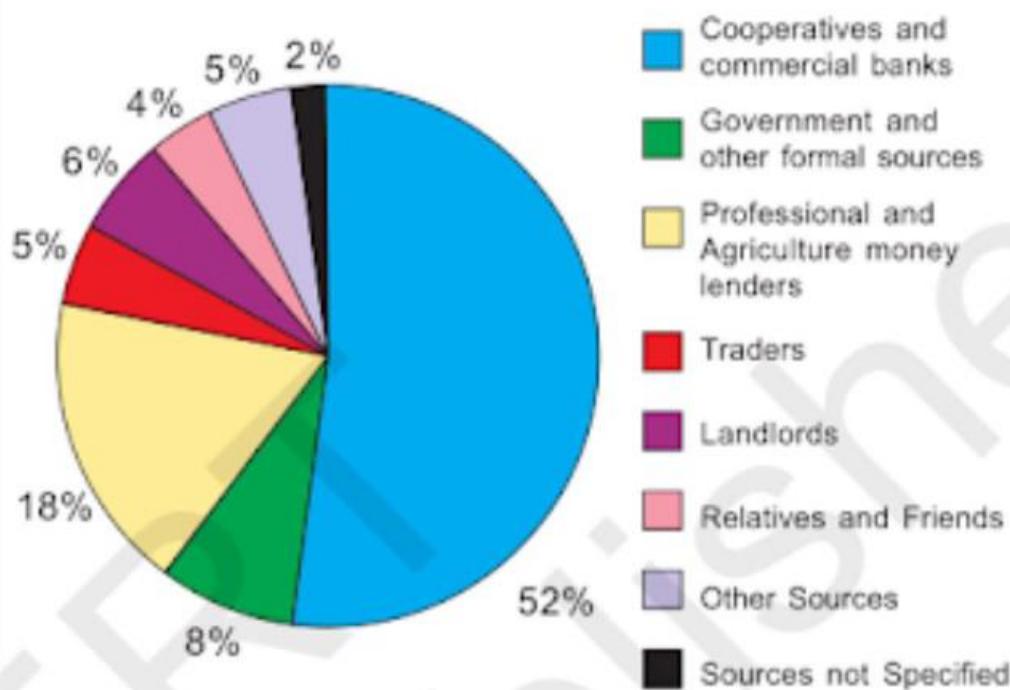
As we know that major portion of the deposited money is provided to those people who are needy of money for economic activities. In India Reserve bank of India is supervised the functioning of loan activities in formal sectors. In India, the rate of interest in informal sector is greater than the rate of interest in formal sector. Rate of interest in formal sector is supervised by the legal authorities.

* In the Informal sector, the rate of interest is supervised by moneylenders, traders, employers who are provided money. The rate of interest is varying from person to person. There is no organization for supervising loan in informal sector. Lenders can use any method to get back their money from the borrowers. Sometimes, the incomes of the borrowers become less compare than the amount which has to pay due to the high rate of interest.

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**Graph 1 : Sources of Credit
for Rural Households in India in 2010**



* In this chart, we can see sources of credit in rural areas are mostly dependent on professional and agriculture moneylenders in case of informal sources of loan. For the development of a country, cheap and affordable credit is crucial. Therefore, the government should facilitate formal sources of credit basically in rural areas.

Self-help groups for the poor

* Facilities of banks are not available in all rural areas. So, the poor are dependent on informal sector for borrowing loan. The poor have to pay a high rate of interest to the moneylenders. It is difficult to borrow loan from the bank. Because of the absence of the collateral and documents. And documents and collateral are required for a bank loan. Informal lenders like, moneylenders are often willing to give a loan without collateral because they personally knew the borrowers.

* An organisation constituted to collect the savings of the poor which is known as self-help group. The aim of the organisation is to lend loan at less rate of interest compared to the rate of interest specified by the moneylenders. A self-help group has 15 – 20 members. Savings vary from member to member i.e Rs. 25 to Rs. 100 depending on the ability of the person to save.

* The organisation also provides self-employment opportunity for the member by the way of sanctioning the group. For example, small loans are provided to the members for releasing mortgaged land, for meeting working capital needs, for housing materials, for acquiring assets. There is also a group for repayment of loan. In case of any non-repayment by the one member is followed by the other member of the organisation.