

## Revision Notes

### Class - 10 Social Science (Economics)

### Chapter 3 - Money and Credit

#### MONEY AS A MEDIUM OF EXCHANGE

- Money is referred to as a medium of exchange because it serves as an intermediary in the exchange process.
- A person who has money can readily swap it for whatever commodity or service he or she desires.

**Double coincidence of wants:** It occurs when both parties agree to sell and buy each other's commodities at the same time in the trade. Double coincidence of wants is a key element of the barter system.

#### MODERN FORMS OF MONEY

Indians utilised wheat and livestock as currency in the past. Following that came the use of metallic coinage, such as gold, silver, and copper coins, which lasted well into the twentieth century. Currency - paper notes and coins – are now modern forms of money. The current kinds of money - currency and deposits – are inextricably related to the modern banking system's operation.

**Currency:** The Reserve Bank of India, on behalf of the Indian government, issues currency notes. No other person or organisation is permitted to print money. In India, the rupee is generally recognised as a medium of exchange.

**Deposit in Banks:** People might also keep their money in the form of bank deposits. People put their surplus money in the bank by opening a bank account in their own name. Banks not only accept deposits, but they also pay interest on them. Deposits in bank accounts that can be withdrawn on demand are referred to as demand deposits. Cheques are used instead of cash to make payments.

**Cheques:** It's a piece of paper that instructs the bank to transfer a specified amount from a person's account to the person named on the check.

## **LOAN ACTIVITIES OF BANKS**

- Banks only hold a small amount of their deposits in cash on hand. In India, banks now maintain approximately 15% of their deposits in cash. This is retained as a reserve to pay depositors who may come to the bank on any given day to withdraw money.
- The majority of deposits are used to extend loans by banks. Loans for numerous economic activities are in high demand. On loans, banks charge a greater interest rate than they do on deposits.
- Banks' major source of income is the difference between what they charge borrowers and what they pay depositors.

## **TWO DIFFERENT CREDIT SITUATIONS**

A credit (loan) arrangement is one in which the lender provides money, products, or services to the borrower in exchange for the promise of future payment.

There are two types of credit situations: one is where you have a lot of money and the other is where

- i. In the first scenario, a person borrows money for production purposes with the promise of repaying the loan at the end of the year when the work is accomplished. And by the end of the year, he or she has made a big profit from manufacturing operations and is able to repay the loan. As a result, the person is in a better position than previously.
- ii. In the second scenario, a person borrows money for production purposes with the promise of repaying the loan at the end of the year, when the production job is accomplished. And by the end of the year, he or she has fallen into a financial trap. As a result, that person is in a worse situation than before.

## **TERMS OF CREDIT**

Every loan agreement stipulates an interest rate that must be paid to the lender in addition to the principal repayment. Lenders also want collateral (security) in exchange for loans.

1. Collateral is an asset that a borrower holds, such as land, a building, a vehicle, livestock, or bank savings, that the borrower uses as a guarantee to a lender until the loan is returned. If the borrower fails to repay the loan, the lender has the authority to sell the asset or collateral to recover payment.
2. The terms of credit include the interest rate, collateral and documentation requirements, as well as the form of repayment. It varies depending on the lender's and borrower's personalities.

## FORMAL SECTOR CREDIT IN INDIA

Credit that is both cheap and accessible is critical for the country's prosperity. The numerous forms of loans can be divided into the following categories:

- 1. Formal sector loans:** Loans from the formal sector include those from banks and cooperatives. The Reserve Bank of India (RBI) is in charge of overseeing the operation of formal loan sources. Banks must report to the RBI how much they are lending, to whom, and at what interest rate, among other things.
- 2. Informal sector loans:** Loans from the informal sector include those from moneylenders, traders, employers, family, and friends, among others. There is no regulatory body that oversees the lending activities of informal lenders. There is no one to stop them from obtaining their money by unethical means.

### Formal and Informal Credit

**Formal credit:** The RBI oversees the operation of formal sources of loans, which includes banks and cooperatives. To ensure that the bank maintains a minimum cash balance and that loans are given not just to profit-making businesses and dealers, but also to small growers, small scale industries, small borrowers, and so on. Banks are required to report their actions to the RBI on a regular basis.

**Informal credit:** Money lenders, traders, employers, relatives, and friends are just a few examples. There is no one in charge of monitoring their credit operations. They can charge any interest rate they want. There is no one to stop them from obtaining their money by unethical means.

## SELF HELP GROUPS FOR THE POOR

Poor households continue to rely on informal sources of financing for the following reasons:

- In rural India, banks are not widely available.
- Even if banks are present, obtaining a bank loan is substantially more difficult because adequate documentation and collateral are required.

Self-Help Groups were formed to address these issues (SHGs). SHGs are small groups of poor people who encourage their members to save small amounts of money. A typical SHG includes 15-20 members who meet and save on a regular basis, usually from the same neighbourhood.

### Advantages of Self Help Group (SHG):

- It assists borrowers in overcoming the lack of collateral issues.
- SHGs are the foundations of the rural poor's organisation.
- People can receive loans on schedule and at a fair interest rate for a number of objectives.
- It assists women in becoming financially self-sufficient.
- The group's frequent meetings give a forum for discussing and taking action on a variety of social concerns such as health, nutrition, domestic violence, and so on.

## Important Questions and Answers

### 1. How does the use of money make it easier to exchange things?

**Ans:** Money is frequently characterised in terms of its three purposes or services. Money functions as a means of exchange, a store of value, and a monetary unit.

- Money's primary role is to facilitate transactions as a medium of exchange. All transactions would have to be handled via barter, which is the direct exchange of one commodity or service for another in the absence of money.
- Money must retain its worth over time in order to function as a medium of trade; it must be a store of value. Money would not solve the double

coincidence of desires problem if it could not be stored for a period of time and still be valued in exchange. As a result, it would not be adopted as a medium of exchange.

- Money also serves as a unit of account, allowing for the measurement of the worth of goods and services traded.

## **2. Can you think of some examples of goods/services being exchanged or wages being paid through barter?**

**Ans:**

1. In rural regions, food grains are frequently swapped for other crops. Even in certain government programmes, workers are paid in kind rather than cash, for example, 5 kg of wheat every day of work.
2. When money devalues rapidly i.e., hyperinflation, such as during the Venezuelan crisis during the Bolivarian Revolution, barter systems are occasionally used.
3. In exchange for their military duty, Roman soldiers were paid salt.

## **3. Why are demand deposits considered as money?**

**Ans:**

- Demand deposits are a type of deposit that acts as a means of exchange, similar to money.
- The individual who needs to be paid receives a check. The cheque orders the bank to deduct the needed sum from the individual issuing the payment's deposit.

In this case, a transaction has occurred without the use of currency, with the same result. As a result, demand deposits are seen as money.

## **4. Why do lenders ask for collateral while lending?**

**Ans:** Collateral is a borrower's asset, such as land or a building, that is used as a guarantee to the lender until the loan is returned.



Lenders require collateral for several reasons:

1. It serves as a guarantee for the loan.
2. If the borrower fails to repay the loan, the lender has the right to seize the collateral as compensation.

Collateral assures the lender that the loan will be repaid because the borrower will lose the collateral if the loan is not fully repaid.

### 5. What are the differences between formal and informal sources of credit?

**Ans:** The distinctions between formal and informal sources credit are summarised in the table below.

Formal sources of credit	Informal sources of credit
Laws and rules govern the official sources of credit that the government registers.	All small and dispersed units that are largely beyond the government's authority, yet must abide by its laws and regulations, are considered informal sources.
The primary motive for formal sources is social welfare.	For informal sources, profit is the prime motive.
The Reserve Bank of India (RBI) oversees the activity of formal credit sources.	Credit operations through informal sources are not regulated by any organisation.
Interest rates on formal sources are usually lower.	For informal sources, they charge substantially higher interest rates.
Banks and cooperatives are the two examples.	Moneylenders, merchants, labourers, family, and friends are just a few examples.

## **6. Why should credits at reasonable rates be available for all?**

**Ans:**

- To achieve equality of opportunity, everyone should have access to credit at a reasonable rate.
- Everyone who wants to help the economy by providing services should be given the opportunity to obtain the financial resources they need to establish their firms or purchase assets.
- To keep the country's inflation rate under control, everyone needs access to regulated credit. Money's time value must be managed.
- This must also be offered to reduce instances of unsecured credit with excessive interest rates that harm borrowers' livelihoods. If the borrower's entire earnings are used to repay high-interest informal credit, the borrower will be forced to close their business, which is not a good situation.

## **7. In a situation with high risks, credit might create further problems for the borrower. Explain.**

**Ans:**

1. A high-risk situation indicates that the borrower will have difficulty repaying the loan.
2. The loan is repaid with the profits generated by the borrower's business.
3. The loan is repaid with the profits generated by the borrower's business. The revenue generated in high-risk professions like agriculture is based on crop performance. In the event that crops fail due to insufficient rainfall, the agriculturist will be unable to profit from their crop yield. They will be unable to repay the loan on time, and the interest will continue to accrue. They will have to double the crop yield in the next phase to be able to repay a significant portion of the loan without losing money.

These kinds of circumstances put the borrower in a difficult situation.

**8. In what ways does the Reserve Bank of India supervise the functioning of banks? Why is this necessary?**

**Ans:** The Reserve Bank of India is a central bank that regulates bank lending and other financial activities. The Reserve Bank of India keeps a close eye on banks in the following ways:

1. The Reserve Bank of India (RBI) oversees formal bank loans and sets interest rates for these loans based on the economy's overall performance and people's purchasing power.
2. The RBI ensures that banks lend to profit-making businesses as well as smaller-scale borrowers for a variety of economic activities.
3. The Reserve Bank of India ensures that banks keep a cash reserve available for depositors who wish to withdraw funds.

**9. Fill in the blanks:**

**(i) Majority of the credit needs of the \_\_\_\_\_ households are met from informal sources.**

**Ans:** Poor

**(ii) \_\_\_\_\_ issues currency notes on behalf of the Central Government.**

**Ans:** The Reserve Bank of India

**(iii) Banks offer a higher interest rate on loans than what they offer on \_\_\_\_\_.**

**Ans:** Interest for money deposits.

**(iv) \_\_\_\_\_ is an asset that the borrower owns and uses as a guarantee until the loan is repaid to the lender.**

**Ans:** Collateral



**10. Choose the correct answer:**

- **In a SHG, most of the decisions regarding savings and loan activities are taken by**
  - i. Bank**
  - ii. Members**
  - iii. Non-Government Organization**

**Ans:** Members

- **Formal sources of credit do not include**
  - i. Banks**
  - ii. Cooperatives**
  - iii. Employers**

**Ans:** Employers