TOPICS to be covered

1. Money and Credit


paisa hi paisa hoga

Why Transactions Are Made in Money?

- A person holding money can easily exchange it for any commodity or service that he or she might want.
- Thus, everyone prefers to receive payments in money and then exchange the money for things that they want.

Barter System

- Both parties have to agree to sell and buy each others commodities. This is known as **double coincidence of wants**.
- What a person desires to sell is exactly what the other wishes to buy.
- **Barter system** goods are directly exchanged without the use of money

- Money by providing the crucial intermediate step eliminates the need for double coincidence of wants

- Since money acts as an intermediate in the exchange process, it is called a medium of exchange.

What Was Used Before Money?

- Indians used grains and cattle as money.
- Thereafter came the use of metallic coins — gold, silver, copper coins — a phase which continued well into the last century.

10 → Fiat value

→ intrinsic value

intrinsic > Fiat

Currency

- Modern forms of money include currency — paper notes and coins.
- Modern currency is not made of precious metals.
- They are neither of everyday use.
- Without any use of its own.

Why is the modern currency used as a medium of exchange?

- Why is it accepted as a medium of exchange?
- In India, the Reserve Bank of India issues currency notes on behalf of the central government.
- As per Indian law, no other individual or organisation is allowed to issue currency.
- No individual in India can legally refuse a payment made in rupees.
- Why can one not refuse a payment made in rupees in India?

RBI

Deposits with Banks

- Form - people hold money is as deposits with banks.
- At a point of time, people need only some currency for their day-to-day needs.
- They deposit it with the banks by opening a bank account in their name.
- Banks accept the deposits and also pay an amount as interest on the deposits.

- People also have the provision to withdraw the money as and when they require.
- These deposits are called demand deposits.
- Why are demand deposits considered as money?

Cheque Payments

- 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.


Date: —

Pay Suresh OR BEARER

Rupees

...Only ₹.

A/c No. : 123456789000

BANK NAME

IFS CODE - 0123

Ramesh

Signature

⑈012345⑈ 0123456789⑆ 012345⑈ 01


Paisa Laya?


money ₹1000
10%
BANK
₹1000
20%
DEPOSITOR
1100
1200
BORROWER
Loan Activities of the Bank

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

Borrowers

Depositors.

❖ The difference between what is charged from borrowers and what is paid to depositors is their **main source of income.**

HOTS: What do you think would happen if all the depositors went to ask for their money at the same time?

How do the deposits with the banks become their source of income?

Two Different Credit Situations

- Credit (loan) refers to an agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment.

- Festival Season - STORY OF SALIM
- Swapna's Problem.

Credit

favourable?

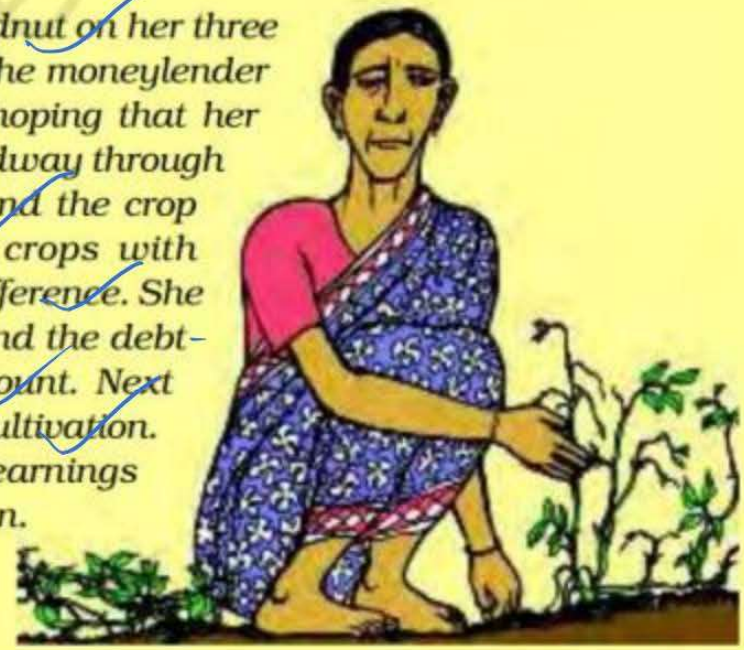
(1) Festival Season

It is festival season two months from now and the shoe manufacturer, Salim, has received an order from a large trader in town for 3,000 pairs of shoes to be delivered in a month time. To complete production on time, Salim has to hire a few more workers for stitching and pasting work. He has to purchase the raw materials. To meet these expenses, Salim obtains loans from two sources. First, he asks the leather supplier to supply leather now and promises to pay him later. Second, he obtains loan in cash from the large trader as advance payment for 1000 pairs of shoes with a promise to deliver the whole order by the end of the month.

At the end of the month, Salim is able to deliver the order, make a good profit, and repay the money that he had borrowed.

(2) Swapna's Problem

Swapna, a small farmer, grows groundnut on her three acres of land. She takes a loan from the moneylender to meet the expenses of cultivation, hoping that her harvest would help repay the loan. Midway through the season the crop is hit by pests and the crop fails. Though Swapna sprays her crops with expensive pesticides, it makes little difference. She is unable to repay the moneylender and the debt grows over the year into a large amount. Next year, Swapna takes a fresh loan for cultivation. It is a normal crop this year. But the earnings are not enough to cover the old loan. She is caught in debt. She has to sell a part of the land to pay off the debt.



Unfavourable

Terms of Credit

Documentation Req.

In DO CO MO

Interest Rate

Mode of Repayment

- Loan agreement specifies an interest rate which the borrower must pay to the lender along with the repayment of the principal.
- Collateral is an asset that the borrower owns (such as land, building, vehicle, livestocks, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid.

In MCD.

What is called the terms of credit?

Explain the meaning of "collateral." Why do lenders ask for collateral while lending?

Loans from Cooperatives

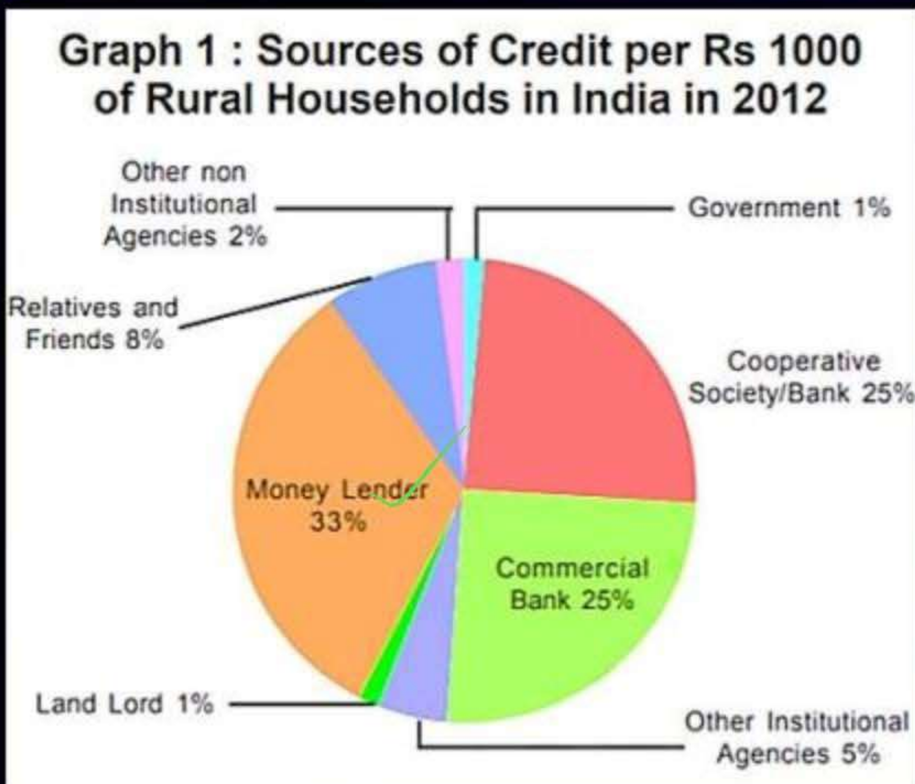
- Members of a cooperative pool their resources for cooperation in certain areas.
- There are several types of cooperatives possible such as farmers cooperatives, weavers cooperatives, industrial workers cooperatives, etc.

- Krishak Cooperative functions in a village not very far away from Sonpur. It has 2300 farmers as members. It accepts deposits from its members.
- With these deposits as collateral, the Cooperative has obtained a large loan from the bank.
- These funds are used to provide loans to members.
- Once these loans are repaid, another round of lending can take place.

→ Formal Sector

Formal Sector Credit in India

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



FORMAL SECTOR CREDIT

Ex. Banks, Cooperatives.

- The RBI regulates the activities of formal credit sources.
- Formal sources typically charge lower interest rates.

INFORMAL SECTOR CREDIT

Ex. Moneylenders, Traders, Relatives, Friends etc.

- There is no organization that controls credit activities in informal sources.
- They charge much higher interest rates for informal sources. no one to stop them from using unfair means to get their money back.

Reserve Bank of India

- The RBI monitors the banks in actually maintaining cash balance
- Sees that the banks give loans not just to profit-making businesses and traders but also to small cultivators, small scale industries, to small borrowers etc.
- Periodically, banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.

Drawbacks of Informal Sources of Credit

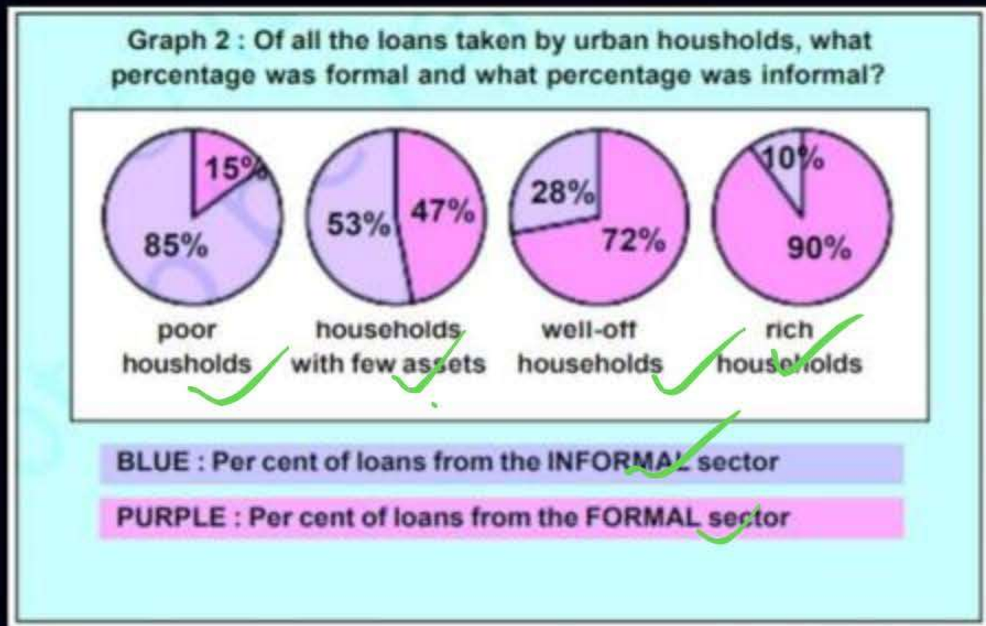
R.O.I ↑

- Cost to the borrower of informal loans is much higher.
- Higher cost of borrowing means a larger part of the earnings of the borrowers is used to repay the loan.
- In certain cases, the high interest rate for borrowing can mean that the amount to be repaid is greater than the income of the borrower.
- Lead to increasing debt and debt trap
- People who might wish to start an enterprise by borrowing may not

Give two reasons why cheap and affordable credit is important for the country's development.

- Cheap and affordable credit is crucial for the country's development.

Formal and Informal Credit: Who gets What?



Why do you think that the share of formal sector credit is higher for the richer households compared to the poorer households?

Self-help Groups for the Poor

- Banks are not present everywhere in rural India.
- Even when they are present, getting a loan from a bank is difficult

What is the basic idea behind the SHGs for the poor?

- The idea is to organise rural poor, in particular women, into small Self Help Groups (SHGs) and pool (collect) their savings.
- 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, depending on the ability of the people to save.
- Members can take small loans from the group itself to meet their needs.
- The group charges interest on these loans but this is still less than what the moneylender charges.

- If the group is regular in savings, it becomes eligible for availing loan from the bank.
- 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 group decides as regards the loans to be granted — the purpose, amount, interest to be charged, repayment schedule etc.

- Group → responsible for the repayment of the loan.
- Case of non repayment followed up seriously
- 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.
- Example- Grameen Bank of Bangladesh

Advantages of SHGs

What are the four advantages of 'Self Help Groups' for the poor? Explain.

I. Help borrowers overcome the **problem of lack of collateral**.

II. Loans at a **reasonable interest rate**

III. Help women to become **financially self-reliant**.

IV. 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.

Homework

- How does the use of money make it easier to exchange things?
- What do you think would happen if all the depositors went to ask for their money at the same time?
- Explain the meaning of "collateral." Why do lenders ask for collateral while lending?