Money and Credit (Notes: very simple and comprehensible)

Description

Introduction:

Money is everybody's need. Since, every single day we purchase one thing or another to meet consumption needs. No one can even imagine spending a day without money. So how money took place and why we prefer money over old system of exchange. These are the things you will know about money in elaboration in this chapter. Let's begin with the earlier system of exchange.

How was the exchange system in old times?

Earlier when there was no use of money, people would exchange commodities with each other. It is what we call **barter system.** In those days, people could directly exchange things they needed. But It was a difficult task for people to find their exchange partners. Since there was a problem of **double coincidence of wants.**

Now, you may ask what is double coincidence of wants. In barter system, both parties have to agree to sell and buy each others commodities. It means what a person desires to sell is exactly what the other wishes to buy. This is what we call double coincidence of wants. **It is an essential feature of Barter System**

.

In modern times, We have started using **money** as **a medium of exchange** in order to eliminate the problem of Double coincidence of wants. We can buy anything easily from the market with the use of money. **Since Money acts as an intermediate in the exchange process**. It has become the medium of exchange all over in the world.

Modern Forms Of Money:

You have read that money acts as medium of exchange. And you are already familiar with the use of money. It include currency– **paper notes and coins**. However, money has no use of its own. This might have put another question in your mind. **Why money is widely accepted as a medium of exchange?** Logic is simple. 1. It is accepted as a medium of exchange because the currency is ***authorized by the government of the country.***

You may ask, **Do government itself issue notes?** It is Reserve Bank of India which has given authority to issue currency notes on behalf of Central govt.

2. ***Reserve Bank of India:*** It is the apex bank. And Indian law says, only RBI is allowed to issue currency.

3. Moreover, the ***law legalizes the use of rupee as a medium of payment***. It means, no one can refuse to make use of money in settling transactions in India.

Deposits with Banks: Another form to hold money.

1. Banks are the place where people **deposit money** (currency),
2. Demand for **withdrawal** when need arises,
3. And also get **loans**.
4. Banks **keep the money safe** by accepting the deposits. And they (Banks) also pay an amount as interest on the deposits.

- Since, we know that a person can withdraw his or her deposited money from the bank on demand, we call it **demand deposits.**
- The payment on demand deposits can either be made by **cheques or cash.** We are already familiar with cash. Let's see what does a cheque means.
    - **Cheque:** A cheque is a paper instructing the bank to pay a specific amount to the person in whose name the cheque has been issued.
        - Benefit: The facility of cheques that banks provide, make it possible to directly settle payments without the use of cash.
- But, Banks cannot ask for demand deposits and payments by cheques.
- The modern forms of money- currency and deposits- are closely linked to the working of the modern banking system.

Loan Activities of Banks:

Do this question come to your mind as well that why banks deposit our money? What they do with our deposits? Is there any benefit to them in doing so? or they just do it for social cause? Well, i already know the answer but you need to read the points given below in order to understand the mechanism of banks better.

1. **Banks keep only a small proportion of their deposits as cash with themselves.** For example, Out of 100% deposits banks just hold 15% as cash. Since they know that not all people will ask for withdrawal at the same time.
2. **They use major portion of the deposits to extend loans.** As people demand loans for various economic activities.
3. **Banks mediate between** those who have surplus funds (**depositors**) and those who are in need of these funds (**the borrowers**).
4. Banks charge a higher interest rate on loans than what they offer on deposits.

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

Two Different Credit Situations:

Before knowing about credit situations, let's see what is meant by the word credit.

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

You must have read about the two stories which shows two credit situations. Therefore, Credit can have different impact in different situation. These credit situations are:

1. Credit can play a vital and positive role in helping a person to get better. As it did in the case of Salim.
2. Also, it can put the person in risk or push him/her into a debt trap. For instance, Swapna's case.

Terms of Credit:

In order to take loan, it is must for borrower to agree on the terms and conditions of lender.

- Every loan agreement specifies an **interest rate** which borrower must pay to the lender along with the repayment of the principal.
- Secondly, lenders may demand for **collateral** (security) against loans. *Now you might ask why collateral?* but first let's read what is collateral.
    - Collateral: It 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.
- If the borrower fails to repay the loan, the lender has the **right to sell the asset** or collateral to obtain payment.

Therefore, *Interest rate, collateral and documentation requirement and the mode of repayment*together comprise **terms of credit.**

Formal Sector Credit In India:

You learnt about different credit situations and terms of credit. Now let's talk about the various sources from where people get credit.

- Sources of credit are categorized into two types:-
  1. Formal sources: Banks and cooperatives.
     - Features/ functions: The Reserve Bank of India supervises the functioning of formal sources of loans.
     - The RBI monitors the banks in actually maintaining cash balance.
     - RBI sees that the banks give loans not just to profit-making 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.
  2. Informal sources: Moneylenders, traders,employers, relatives and friends, etc.
     - Features: There is no organisation which supervises the credit activities of lenders in the informal sector.
     - They can lend at whatever interest rate they choose.
     - There is no one to stop them from using unfair means to get their money back.
     - They charge a much higher interest on loans as compare to formal lenders.

Is more credit coming from the formal sector or the informal sector. and why?

- It is **informal sector** from where most of the rural population and poor people of urban sector take loan. This is **due to various reasons**:
  1. Banks are not present everywhere.
  2. Bank loans require proper documents and collateral.
     - Absence of collateral is one of the major reasons which prevents the poor form getting bank loans.

Thus, these reasons make them take loans from money lenders or other informal sources, who charge **high rate of Interest**. In certain cases, taking loans from informal sector become more worse and lead to **debt trap.**

- For these reasons, banks and cooperative societies ***need to lend more***, particularly in rural areas.
- It is necessary that ***everyone receives these loans***.
- Therefore, **Cheap and affordable credit** is crucial for the country's development.

Self-Help Groups For The Poor:

- Due to above given reasons, people have tried out some newer ways of providing loans to the poor.
- The idea is to organize rural poor, in particularly women, into small **self help groups** and pull (collect) their savings.

Self-Help Groups:

1. A typical SHG has 15-20 members, usually belonging to one neighborhood.
2. These groups meet and save regularly.
3. Saving per member varies from Rs 25 to Rs 100 or more, depending on the ability of the people to save.
4. Members can take small loans form the group itself to their needs.
5. The group charges very less interest as compare to moneylenders.
6. After a year or two, if the group is regular in savings, it becomes eligible for availing loan from the bank.
7. Loan is sanctioned in the name of the group and is meant to create self-employment opportunities for the members.

Features Of Self-Help Groups:

- 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.
- It is the group which is responsible for the repayment of the loan.

Advantages of SHGs:

- The SHGs help borrowers overcome the problem of lack of collateral.
- They can get timely loans for a variety of purposes and at a reasonable interest rate.
- SHGs help women to become financially self-reliant.
- 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.

  https://www.youtube.com/watch?v=1_avHZdsXqo
  Economics (Money and Credit) Class 10th

Category

1. Class 10th

Date
2025/02/05