



NOTES

SOCIAL SCIENCE

(ECONOMICS)

MONEY AND CREDIT



**REVISION NOTES
CHAPTERWISE &
TOPICWISE**

Chapter 3: Money and Credit

Concepts Covered:

1. **Money as a medium of exchange**
 - Meaning
 2. **Modern Forms of Money**
 - Currency
 - Deposits with Banks
 - Cheque
 3. **Loan Activities of Banks**
 4. **Two Different Credit Situations**
 - Story of Salim
 - Story of Swapna
 - Terms of Credit
 - Interest Rate
 - Collateral
 - Documentation requirement
 - Mode of Payment
 5. **Variety of Credit Arrangement**
 - 3 Stories
 - Loan from Co-operatives
 6. **Formal Sector Credit in India**
 - Formal sector loans
 - Informal sector loans
 - Supervision of Reserve bank of India
 - Credit activities in Informal sector
 - How to improve the situation in informal sector?
 - Formal and Informal credit: Who gets what?
 7. **Self Help groups for the poor**
 - Meaning
 - Importance
 - Grameen bank of Bangladesh
 8. **Mind Map**
(Colourful & Interactive/ Complete All Concept Covered)
- Practice Questions (All Topics Available)**

MONEY AS A MEDIUM OF EXCHANGE

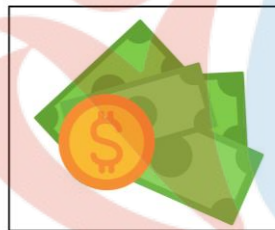
Meaning

Money is an item which is used as a medium of exchange. In modern economy, money works 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 barter 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.



Money as Medium of Exchange



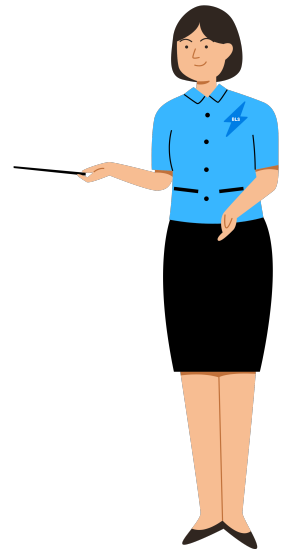
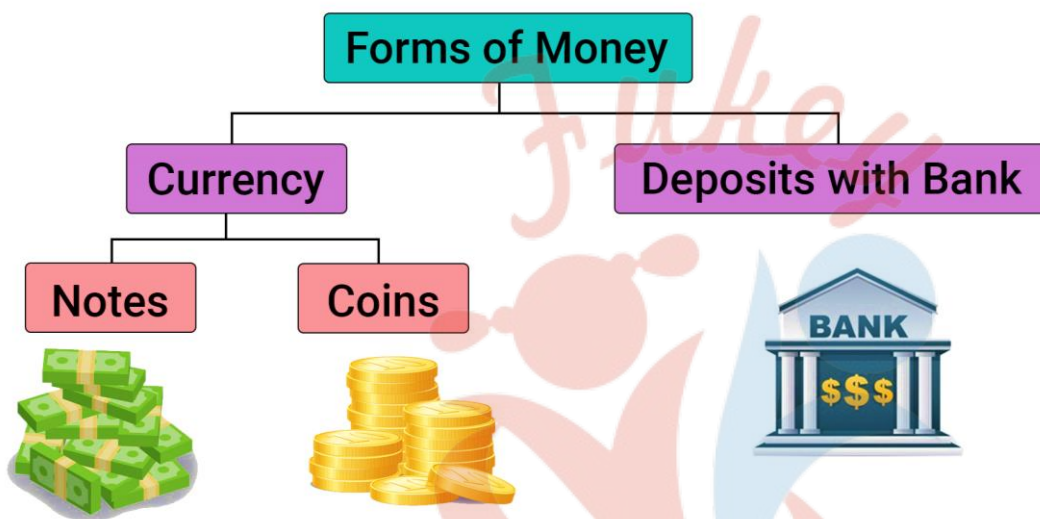
Barter



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.

Modern Forms of Money



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 with 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.

Cheque

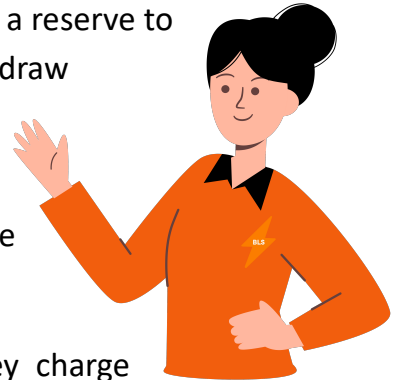
It's a piece of paper that instructs the bank to transfer a specified amount from a person's account to the person named on the check.

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.



Fukey Education

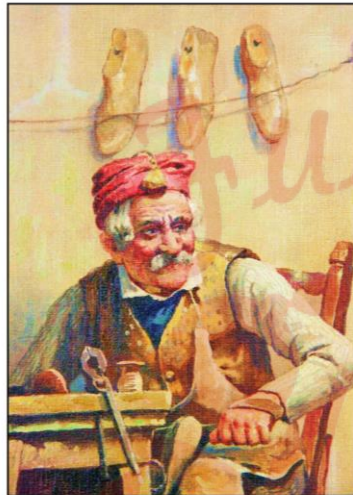
TWO DIFFERENT CREDIT SITUATIONS

Credit - Loan

It means the lender supplies the borrower with money, goods, or services in return for the promise of future payment.



Story of Salim



Story of Swapna



Story of Salim

Credit - Helped him

- Helps him to meet the ongoing expenses of production, complete production on time, and thereby increase his earnings.
- Credit therefore plays a vital and positive role in this situation.

Story of Swapna

Credit - Pushed her in debt trap

- The failure of the crop made loan repayment impossible.
- She had to sell part of the land to repay the loan.

Whether credit would be useful or not, depends on the risks in the situation and whether there is some support, in case of loss.

MONEY AND CREDIT**TWO DIFFERENT CREDIT SITUATIONS****TERMS OF CREDIT**

Terms of credit comprises of Interest rate, Collateral and documentation requirement, and the mode of repayment together.

Interest Rate

Borrower must pay some extra amount to the lender along with the repayment of the principal. The extra amount depends upon the interest rate charged on principal.

Collateral

Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock's, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid.

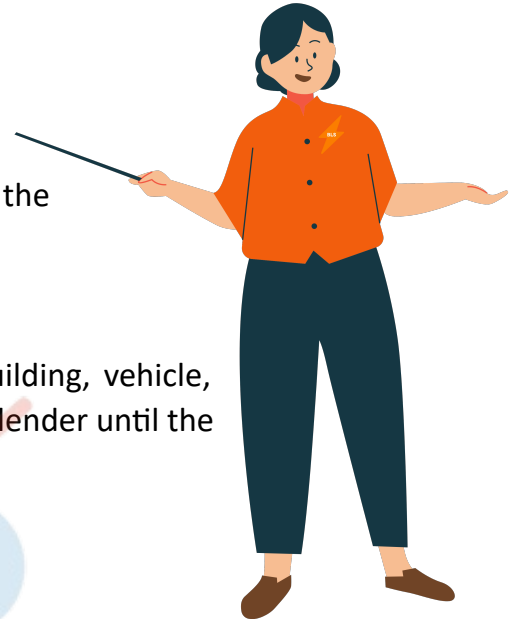
Documentation requirement

All the Paperwork which is done before granting loans.

Mode of Payment

It could be Instalment/Lump Sum Cash/ Gold/ Property

Terms of credit may vary depending on the nature of the lender and the borrower.



Future's Key
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VARIETY OF CREDIT ARRANGEMENT

3 Stories



Rama is working in a neighboring field. She works as an agricultural labourer. There are several months in the year when Rama has no work, and needs credit to meet the daily expenses. Expenses on sudden illnesses or functions in the family are also met through loans. Rama has to depend on her employer; a medium landowner in Sonpur, for credit. The landowner charges an interest rate of 5 per cent per month. Rama repays the money by working for the landowner. Most of the time, Rama has to take a fresh loan, before the previous loan has been repaid.

At present, she owes the landowner Rs 5,000. Though the landowner doesn't treat her well, she continues to work for him since she can get loans from him when in need. Rama tells us that the only source of credit for the landless people in Sonpur are the landowner-employers.



MONEY AND CREDIT**VARIETY OF CREDIT ARRANGEMENT**

Shyamal tells us that every season he needs loans for cultivation on his 1.5 acres of land. Till a few years back, he would borrow money from the village moneylender at an interest rate of five per cent per month (60% per annum).

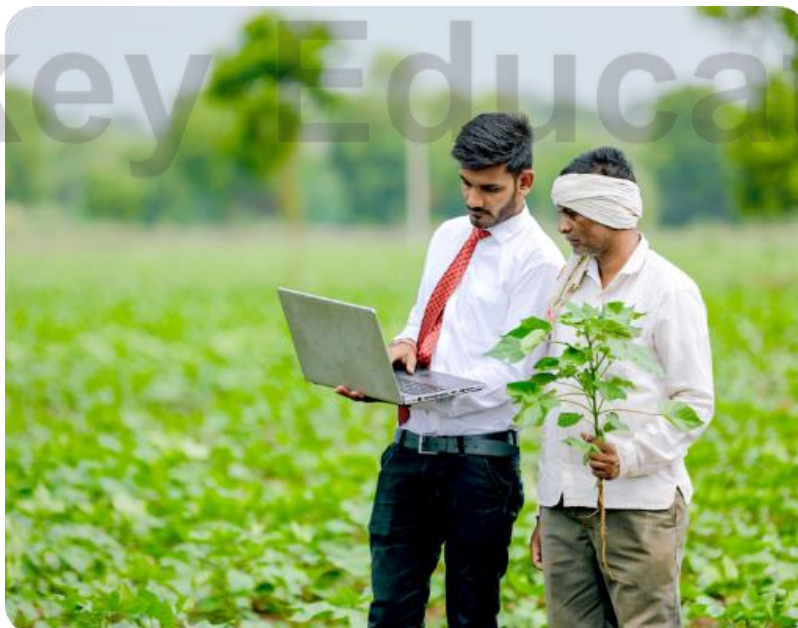
For the last few years, Shyamal has been borrowing from an agricultural trader in the village at an interest rate of three per cent: per month. At the beginning of the cropping season, the trader supplies the farm inputs on credit, which is to be repaid when the crops are ready for harvest.

Besides the interest charge on the loan, the trader also makes the farmers promise to sell the crop to him. This way the trader can ensure that the money is repaid promptly. Also, since the crop prices are low after the harvest, the trader is able to make a profit from buying the crop at a low price from the farmers and then selling it later when the price has risen.





We next meet Arun who is supervising the work of one farm labourer. Arun has seven acres of land. He is one of the few persons in Sonpur to receive bank loan for cultivation. The interest rate on the loan is 8.5 per cent, per annum, and can be repaid anytime in the next three years. Arun plans to repay the loan after harvest by selling a part of the crop. He then intends to store the rest of the potatoes in a cold storage and apply for a fresh loan from the bank against the cold storage receipt. The bank offers this facility to farmers who have taken crop loan from them.



Loan from Co-operatives (image to text Create Loans from cooperatives)

Loans from Cooperatives

Besides banks, the other major source of cheap credit in rural areas are the cooperative Societies (or 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. Krishak Cooperative provides loans for the purchase of agricultural implements, loans for cultivation and agricultural trade, fishery loans, loans for construction of houses and for a variety of other expenses.



FORMAL SECTOR CREDIT IN INDIA

Formal sector loans

- Loans from banks and cooperatives are called formal sector loans.
- The Reserve Bank of India supervises the functioning of formal sources of loans.

Informal sector loans

- Loans from Moneylenders, traders, employers, relatives and friends, etc. comes under informal sector loans.
- There is no organisation which supervises the credit activities of lenders in the informal sector.

Supervision of Reserve bank of India

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



Credit activities in Informal sector

There is no organisation which supervises it, therefore it has some problems like: -

- Interest rate is high.
- Lender use unfair means to get their money back.

MONEY AND CREDIT**FORMAL SECTOR CREDIT IN INDIA****Interest rate**

Large part of the earnings of the borrowers is used to repay the loan which is also known as cost of borrowing. People who might wish to start an enterprise by borrowing may not do so because of the high cost of borrowing or high interest rates.

How to improve the situation in informal sector?

Banks and cooperative societies need to lend more.

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

**Formal and Informal credit: Who gets what?**

- Majority of poor household gets loans from informal sector.
- Majority of rich household gets loan from formal sector.

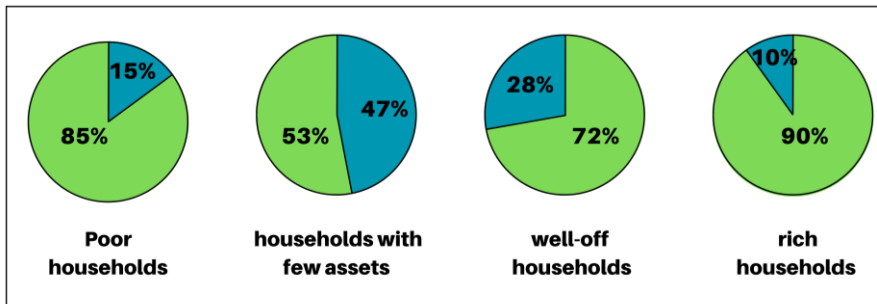
The formal sector still meets only about half of the total credit needs of the rural people.

The remaining credit needs are met from informal sources. Most loans from informal lenders carry a very high interest rate and do little to increase the income of the borrowers.

Graph 2 of all the loans taken by urban households, what percentage was formal and what percentage was informal?

MONEY AND CREDIT

FORMAL SECTOR CREDIT IN INDIA



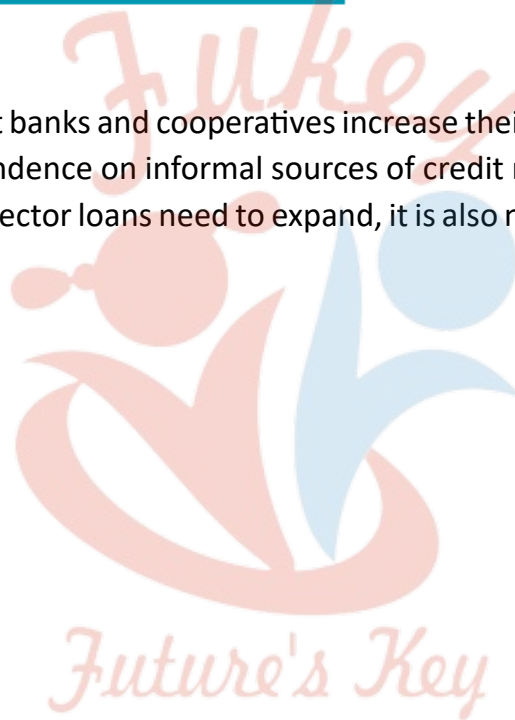
BLUE : Percent of loans from the INFORMAL sector

PURPLE : Percent of loans from the FORMAL sector



Solution

- Thus, it is necessary that banks and cooperatives increase their lending particularly in the rural areas, so that the dependence on informal sources of credit reduces.
- Secondly, while formal sector loans need to expand, it is also necessary that everyone receives these loans.



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SELF HELP GROUPS FOR THE POOR

Meaning

The reason why poor households are still dependent on informal sources of credit: -

- In rural India, banks are not present everywhere.
- Even if banks are present, getting a loan from a bank is much more tedious as proper documents & collateral are required.

To overcome these problems, Self Help Groups (SHGs) are created by people. These are small groups of poor people who promote small savings among their members. Usually, an SHG has 15-20 members, who belong to one neighbourhood, they meet & save regularly.



Importance

- 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.
- Moreover, SHGs are the building blocks of organisation of the rural poor.
- Not only does it help women to become financially self-reliant, but the regular meetings of the group also provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.

Grameen bank of Bangladesh

- It was started by Professor Muhammad Yunus, the founder of Grameen Bank, and recipient of 2006 Nobel Prize for Peace.
- Started in the 1970s as a small project, Grameen Bank in 2018 had over 9 million members in about 81,600 villages spread across Bangladesh.
- Almost all of the borrowers are women and belong to poorest sections of the society.



Professor Muhammad Yunus

03

MONEY AND CREDIT

MIND MAP

