

MONEY AND CREDIT

- »» Money is a medium of exchange.
- »» Money is used to:
 - buy and sell goods } transactions
 - exchange services }
- »» Some cases - not actual transfer of money, but a promise to pay later

Why only money for transactions?

- »» Easier exchange for commodities wanted
- »» A fixed value for goods and services

Shoe manufacturer Case

»» Wants to sell shoes → buy wheat
»» He will have to exchange shoes for money, then use the money to buy wheat

easier

↓ Why?

»» He cannot directly exchange shoes for money

↓ because

1. He will have to find a farmer who wants to do both:

- Sell wheat
 - want shoes (not anything else)
- } rare to find

2. Then, they will have to agree to sell and buy each other's commodities

This is known as double coincidence of wants.
(both should get what they want, which is rare)

Olden Days - Barter System

- »» Goods and services exchanged directly without a common unit (money).
- »» Double coincidence of wants is a must.
↳ a person desires to sell something that other wishes to buy
⇓

Difficulty:

Conflicting wants

Hence, exchange becomes impossible

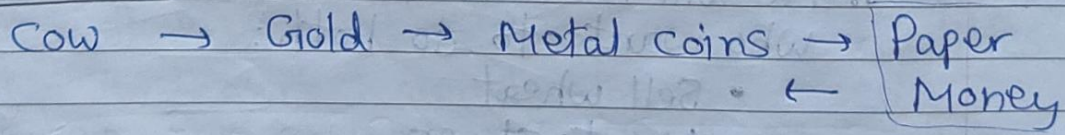
Benefits of Using MONEY

- »» Crucial intermediate step
↓
Eliminates the need for double coincidence of wants
- »» Payments in money is preferred.

MODERN FORMS OF MONEY

- »» Early ages - objects used as money
• Eg - grains and cattle (Indians)
↓
- »» Gold, silver, copper coins (metallic)

Evolution



Forms of Money

Currency

Deposits

Currency

»» Not a metal or any other objects

Why money is accepted as a medium of exchange?

- »» Authorized by govt.
- »» RBI issues notes on behalf of govt.
- »» Indian law - no other individual or organisation is allowed to issue currency

»» No individual can legally refuse a payment made in rupees.

Deposits with Banks

- »» People only need some amount of money. Where does extra cash go? (What do people do?)
 1. Deposit with banks
 2. Banks accept it and pays interest
 3. People's money is safe + earning by interest
 4. They can withdraw later when required.

Demand Deposits

~~Depos~~ Deposits can be withdrawn on demand

- »» Facility which lends essential characteristics of money.
- »» Cheques - paper instructing the bank to pay amount from one account to another.

»»»

LOAN ACTIVITIES OF BANKS

>>> Banks keep a small proportion (India - 15%) of deposits as cash.



To pay the depositors who come to withdraw money any time.

>>> Major portion is used to extend loans (high demand)



Meet loan requirements of people

>>> Bank mediate between those who have surplus funds (depositors) and those in need of these funds (~~withdrawers~~) (borrowers).

Main source of income

Difference between what is charged from borrowers and paid to depositors.

(Banks - Loans: ↑ interest charged
- Deposits: ↓ interest offered)

TWO DIFFERENT CREDIT SITUATIONS

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

① Positive Role of Credit - Festival Season

>>> Shoe manufacturer Salim got a large order for 3000 pairs of shoes in a month.

>>> Took loan to hire workers, buy raw materials [also took advance for 1000 pairs]

»» End of month - order delivered → profit
→ debt repayed [with profit]

② Negative Role of Credit - Swapna's Problem

»» Swapna (farmer) grows groundnut on 3 acres of land

»» Took loan from moneylender for cultivation

↓

»» Crop failure - unable to repay

»» Another loan - but earnings not enough to repay

↓

»» Sold a part of land

Credit can also push a person into a

DEBT TRAP. [loan after loan, never ending or ending worse]

TERMS OF CREDIT

»» Every loan agreement specifies interest rate

»» Lenders may demand collateral (security)

[an asset owned by borrower to use as a guarantee to pay back the loan to lender]

If borrower fails to repay, lender can sell the collateral for payment.

Terms of Credit

1. Interest rate

2. Collateral

3. Documentation requirement

4. Mode of repayment

These terms vary depending on nature of lender and borrower.

Loans from Cooperatives

- Cheap, rural areas
- Members pool resources
- Many types (for farmers, industrial workers, etc.)

Krishak Cooperative

- 2300 farmer members
 - accepts deposits from members
 - took large loan from banks with these deposits as collateral
 - funds used to provide loan to members
 - Once repaid, another lending round
- ↓
- Loans for
 - purchase of agricultural implements
 - cultivation and trade
 - fishery
 - construction

and many other expenses

FORMAL SECTOR CREDIT IN INDIA

[Analyze Graph]

Types of Loans

Formal sector loans

- banks
- cooperatives

Informal sector loans

- moneylenders
- traders
- employers
- relatives, friends

Reserve Bank of India (RBI) supervises the functioning of formal sources of loans.

RBI

» monitors that banks maintain the cash balance [15% for India]

» sees that banks gives loans to not only profit-making businesses & traders, but also to - small cultivators

- small-scale industries
- small borrowers etc.

» Banks submit information to RBI on ~~what~~ how much is lended, to whom, at what interest rate, etc.

No supervision in informal sector.

- charge any interest
- may use even unfair means to get money back

Interests: Informal > formal
[charged]

Why formal sector must lend more?

» High borrowing costs = large earnings (amount) used to repay

» High interest = reduced income

∴ formal sector necessary:

- higher income
- cheaper loans
- development of country [as agriculture, industries, businesses expand]

[Analyze Graph 2]

Observation:

Rich households are getting more cheap credit, whereas poor household pay large amounts for borrowing.



1. Formal sector meets only half credit needs of people → ~~an~~ increase needed
2. Everyone must receive these loans

SELF-HELP GROUPS FOR THE POOR

Why poor households are still dependent on informal sources of credit?

1. Banks not present in rural areas
2. Banks have difficult loan-taking procedure.
3. Absence of collateral. (major)
4. Relation between informal lender and borrower is good. - loans without collateral + approach lender without repaying [However, high interest rates charged and may harass the borrower]

Self-Help Groups (SHG)

- »» women pool their savings
- »» 15-20 members of neighbourhood
- »» Saving per member - ₹25 to ₹100
- »» members take small loans to meet requirements
- »» less interest charged
- »» After 1-2 years of regular savings, group

becomes eligible to avail loan from bank



»» Important decisions regarding Savings and loans taken by all members

- »» Decides - ~~per~~ purpose
- amount
 - interests charge
 - repayment schedule
- etc.

»» Whole group responsible to repay loans if one member takes it

↓ that's why

»» Banks lend loans to these women in SHGs even though they have no collateral.

Advantages of SHGs

- »» help borrowers overcome the problem of lack of collateral.
- »» get timely loans at reasonable interest.
- »» building blocks of organisation of rural poor
- »» women become self-reliant
- »» meetings leads to various discussions on social issues

Grameen Bank of Bangladesh

- »» biggest success story in reaching poor to meet credit needs at reasonable rates.
- »» started in 1970s (small project)
- »» 2018 →
 - 9 million members
 - 81,600 villages
- »» most borrowers are women
- »» Proved →
 1. Women are reliable borrowers
 2. Run many income-generating activities