

Economics

Ch-3

Money and Credit

→ Money as a Medium of Exchange:-

Importance of money → Situation before the invention of money

↓  
Barter Exchange

What a person desires to sell is exactly what the other wishes to buy

← Double Coincidence of wants was a prerequisite condition for barter exchange.

↓  
Challenge

∴ Money act as an intermediate in the exchange process

eliminates the need for D.C.W

↓  
Medium of exchange

→ Modern forms of Money :-

Money → Medium of exchange in a transaction

Evolution → Currency → Paper Notes and coins {Currency}

Then why do we accept it? { Modern currency is without any use of its own.

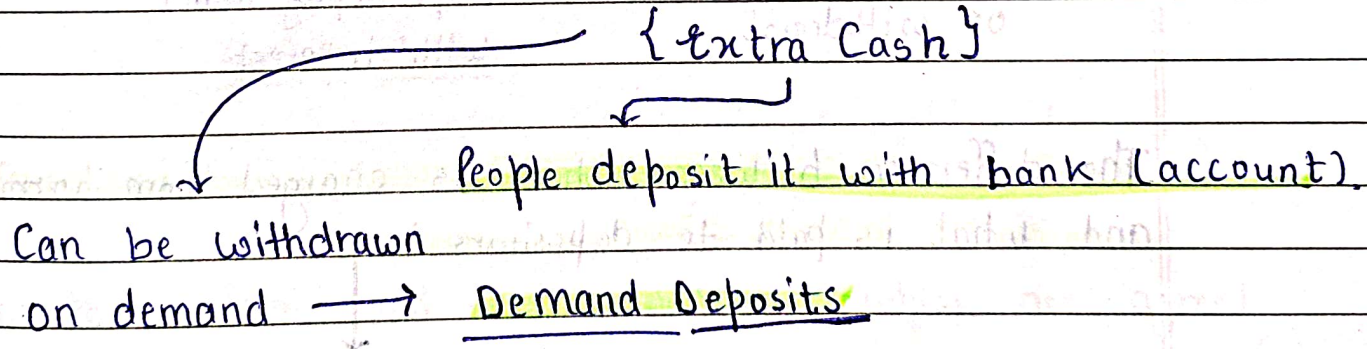
**KD Study Mantra**  
CLASS: 1ST TO 12TH,  
M.A., B.A., GEN. ENTRANCE EXAMS  
Mobile No. 8826565204

↓  
Because it is authorised by the government. (RBI).

Rupee ₹ is widely accepted as a medium of exchange.

- The Reserve Bank of India issues currency notes on behalf of the central government.
- No other individual or organization is allowed to issue currency.
- No individual in India can legally refuse a payment made in rupees.

→ Deposits with Bank: Also a type of money.



\* Demand deposits offer another interesting facility → Cheque

A cheque is 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.

→ Loan activities of Bank :-

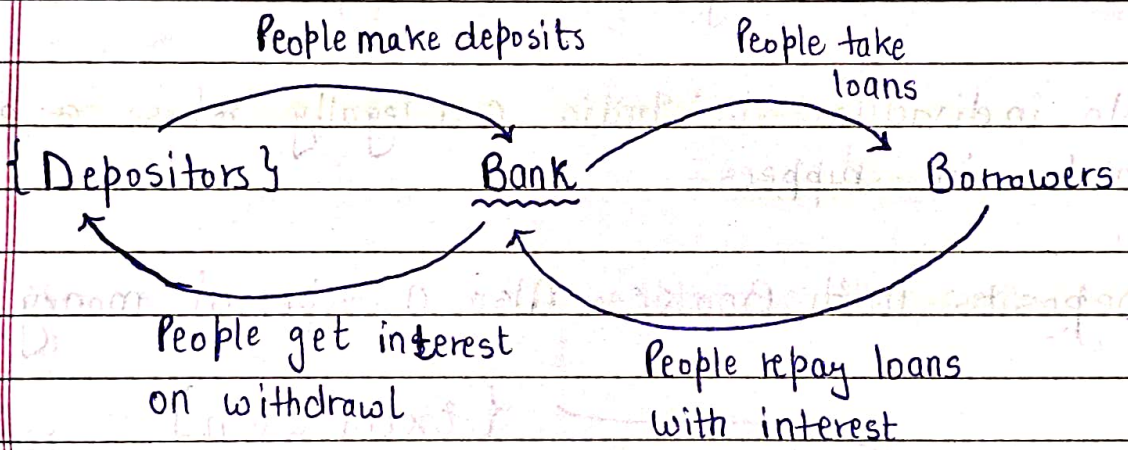
Banks keep a Cash Reserve



The major part of the deposit is used to extend the loan



Borrowers take loan



The difference between what is charged from borrowers and what is paid to depositors is



their main source of income

→ Two Different Credit Situation :-

Credit → loan → Need?  
↓

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

↓  
Credit plays a vital and positive role in this situation.

\* Swapna's problem -

↓  
In this situation, credit pushes the borrower into a situation from which recovery is painful

↓  
Debt Trap

→ Terms of Credit

All those terms and credit conditions which are agreed upon by the borrower and lender

\* Collateral



It is an asset that the borrower owns. {land, building, vehicle, livestock, deposits with banks} and uses this as a guarantee to a lender until the loan is repaid.

\* Terms of Credit



Docomo internet



- Documentation, Collateral, Mode of repayment and interest rate together comprises terms of credit.
- Terms of credit may vary depending on the nature of the lender and the borrower.

→ Variety of Credit Arrangement —

{ Small Farmers }



Money Lender — Advantages and Disadvantages.



Employers — " " and " "

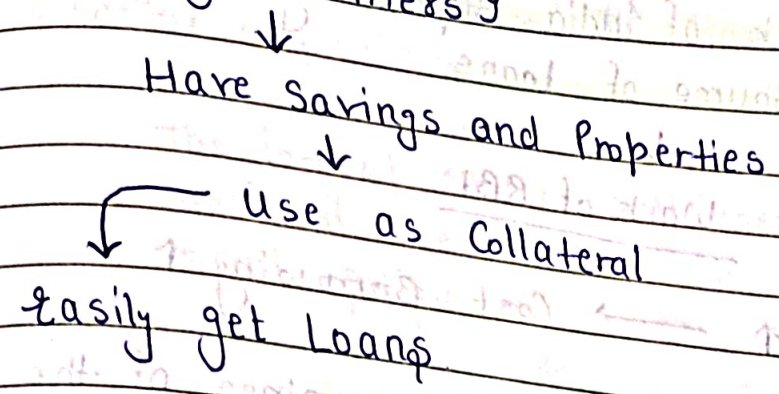


Loans from Cooperatives — " " and " "



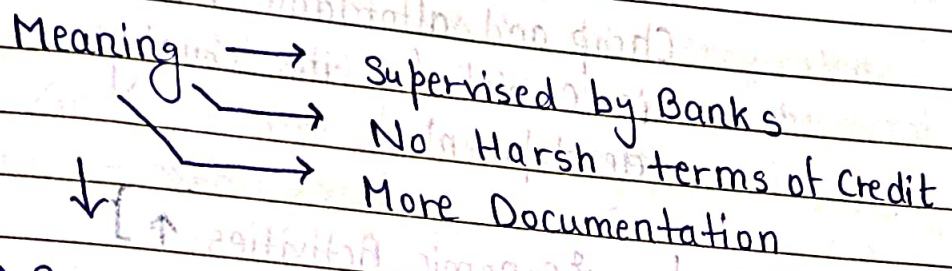
Banks — " " and " "

{ Large Farmers }



→ Formal Sector Credit in India -

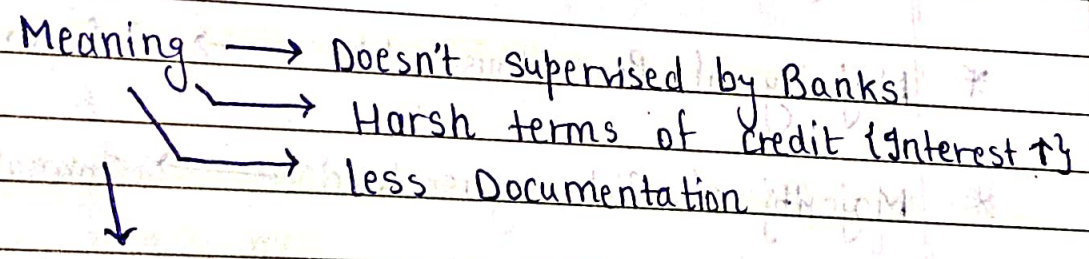
\* Formal Sector Loans ↓



- Banks
- Cooperatives

^ KD Study Mantra ^  
CLASS: 1ST TO 12TH,  
M.A., B.A., GEN. ENTRANCE EXAMS  
Mobile No. 8826565204

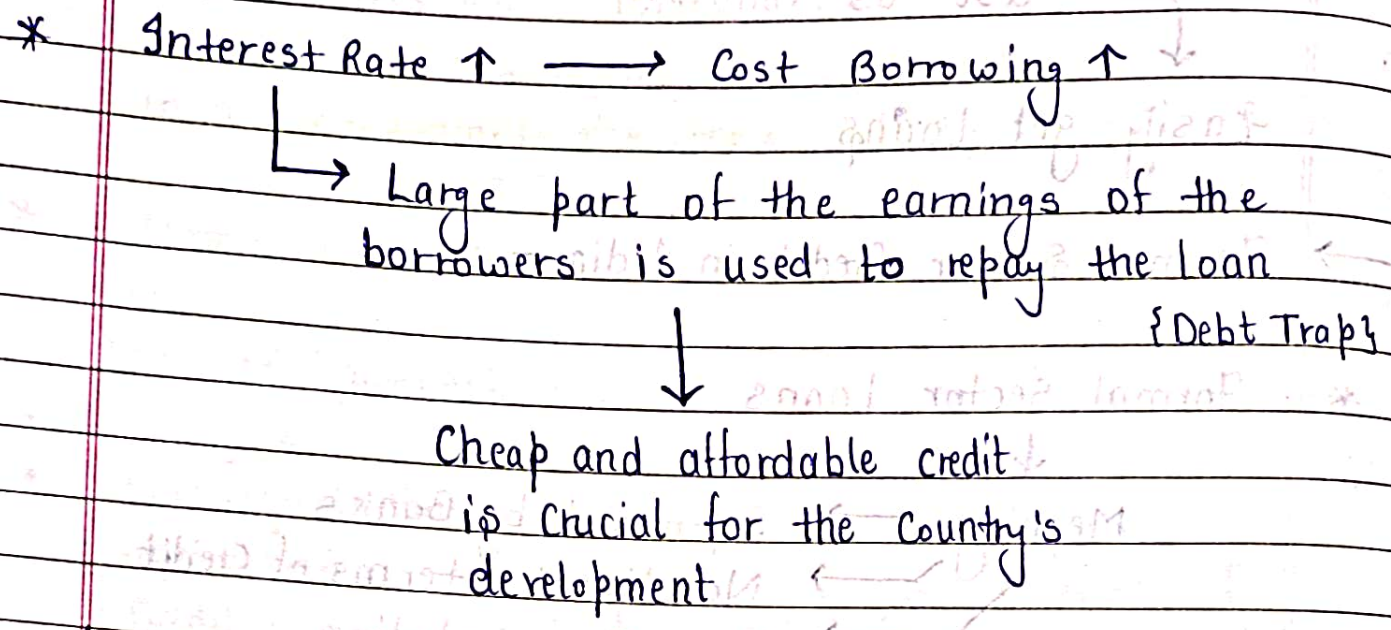
\* Informal Sector Loans ↓



- Moneylenders, traders
- Relatives and friends

Reserve Bank of India supervising the functioning of formal source of loans.

Work of RBI



{ Interest Rate  $\downarrow$  Economic Activities  $\uparrow$  }

$\rightarrow$  Formal and Informal Credit : Who get's what?

{Analysis}

- \* Majority of Poor Households  $\longrightarrow$  Informal Sector
- \* Majority of Rich House holds  $\longrightarrow$  Formal Sector

{ Why do poor household borrow from informal sector }

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

They don't have collateral, required knowledge and documentation.

Solution

It is necessary that banks and cooperatives increase their lending, particularly in the rural areas, so that the dependence on informal source of credit reduces.

- While formal sector loans need to expand, it is also necessary that everyone receives these loans.

→ Self Help Groups for the Poor -

↓  
Meaning  
↓

emerged as an alternative against the challenges of borrowing from banks.



\* Self Help Groups (SHGs) 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 100 or more, depending on the ability of the people to save. Members can take small loans from the group to meet their needs.

↓  
At a reasonable interest rate without any harsh terms of credit

\* Decisions regarding the savings and loan and activities are taken to meet their needs.

\* SHGs are the building blocks of organisation of the rural poor.

→ Grameen Bank of Bangladesh → Muhammad Yunus

“Need is the Mother of Invention”

Handwritten text at the bottom of the page, possibly a stamp or a note, including the words "CLASS" and "STUDY".

## Question Practice

### Money and Credit

#### → Question / Answers :-

**KD Study Mantra**  
CLASS: 1ST TO 12TH,  
M.A., B.A., GEN. ENTRANCE EXAMS  
Mobile No. 8826565204

- i) Features of Demand Deposits :-
  - i) Workers who receive a salary at the beginning of the month often open a bank account in their name. They deposit the extra cash into the bank and get an amount on the deposit as interest.
  - ii) Since, these can be withdrawn when required on demand therefore these are known as demand deposits.
  - iii) Demand deposits offer a facility of cheque. Cheque is an instructing paper for bank to pay an amount from the person's account to the person in whose name the cheque has been issued.
  - iv) Thus, Demand deposits and paper notes and coins constitute the currency in the modern economy.

2) We need to expand formal sources of credit in India due to the following reasons :-

- i) It provides cheap and affordable loans or credit.
- ii) To save people from the exploitation of informal sector of credit.

- iii) It saves the people from the painful recovery of loans called Debt Traps.
- iv) The formal sector of credit is supervised by the Reserve Bank of India through various rules and regulations which ensures that banks give loans to the small cultivators, small borrowers, etc and not just to profit making business and traders.
- v) Formal institutions charge a low rate of interest on loan in comparison to informal sector.

3) Banks and Co-operative societies need to move due to the following reasons:-

- i) ~~It provides~~ They provide credit on lower rate of interest.
- ii) People could borrow cheaply for a variety of needs.
- iii) Cheap and affordable credit is crucial for the country's development.
- iv) Since the income of people is high therefore they could grow crops, set up small scale industries etc.
- v) Lending of Banks and Cooperatives reduce the dependence of people on informal sources of credit.

4) Bad effects of informal sources of credit on borrowers are as follows:-

- † KD Study Mantra †  
 CLASS: 1ST TO 12TH,  
 M.A., B.A., GEN. ENTRANCE EXAMS  
 Mobile No. 8826565204
- i) This sector provides higher interest.
  - ii) Higher cost of borrowing means a large part of income of the borrowers is used to repay the loan.
  - iii) No organization supervises the functioning of informal sector of credit.
  - iv) Moneylenders, employees, traders implement harsh terms of credit to the borrowers.
  - v) Credit from this sector often led to the debt trap therefore the recovery of is very painful for borrower.

5) Money can be transferred to from one bank account to another account with the help of cheque. Cheque is a piece of paper instructing bank to pay an amount from the person's account to the person in whose name the cheque has been issued.

For instance, A friend person has to make payment to his/her friend and writes a cheque for a specific amount this means the person is instructing the bank to pay the amount from his account to his friend account. His friend takes the cheque and deposits it in his account in bank.

Thus, in this way money is transferred from one account to another.

6.7 Modern Currency accepted as a medium of exchange without any use of its own due to the following reasons:

- i. Modern currency is authorised by the government of the country.
- ii. In India, Reserve Bank of India issues all currency notes on the behalf of central government.
- iii. No other individual, institutions, organisations are allowed to issue the currency.
- iv. The law legalises the use of rupee as a medium of payment that cannot be refused in settling transactions in India.
- v. No individual in India can legally refuse a payment made in rupees.