

Chapter-3 MONEY AND CREDIT

Barter System: Exchange of goods for goods.

- No means of exchange. In a barter system goods are directly exchanged without the use of money
- Exchanging goods have no unit value
- No common measure of value.
- Problem of double coincidence of wants.

Double coincidence of wants: Exchange take place when both seller and buyer have to agree to (willingness to sell and buy) each others commodities. Eg: A shoe manufacturer has to look for a wheat growing farmer who not only wants to sell wheat but also wants to buy the shoes in exchange.

M-O-N-E-Y

"Money is what money does" - says Walker

It is anything which is commonly accepted as a medium of exchange and in discharge of debts. People exchange goods and services through the medium of money. Money by itself has no utility. It is only an intermediary. Before the introduction of currency a variety of objects was used as money. Ancient Indian kings used metallic coins-gold, silver, copper coins

Functions of Money

- **Medium of exchange:** Money acts as an intermediate in the exchange process. Shoe manufacturer can exchange his shoes for money. No need to wait for a wheat growing farmer to exchange his shoes for wheat.
- **Store of value**
- **Common measure of value**
- **Unit value:** e.g. Indian currency is available in different units 5, 10, 100 etc...
- **Standard of deferred and future payment.**

Why is rupee (Indian currency) accepted as a medium of exchange in India?

- In India, the Reserve Bank of India issues currency on behalf of the government of India.
- No other individual or organization is allowed to issue currency.
- Law legalizes the use of rupee as a medium of payment that cannot be refused in settling transactions in India.
- No individual in India can legally refuse a payment made in rupee.

Deposits with Banks: Accepting deposits from the individuals and providing loans to their customers are the two main functions of commercial banks.

People need only some money to meet their day to day needs.

What do they do with the extra cash? They deposit it with bank by opening an account in their name.

Advantages: 1. Banks pay an interest rate on the deposits.

2. People's money is safe. 3. Provision to withdraw the deposit as and when they require. 4. Saving to meet future needs.

What are demand deposits? Deposits with banks in account which can be withdrawn as and when a customer needs (withdrawal on demand), are called demand deposits.

What is a cheque? Why is it useful for transactions?

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 made. It is a facility which enables the holders demand deposits to directly settle payments without the use of cash

"Demand deposits share the essential features money"- Explain

Medium of exchange- A cheque makes possible to settle payments directly without the use of cash.

Store of value - People's money is safe by depositing it with banks.

Standard of deferred and future payment: Banks settle such payment.

Thus demand deposits share the essential features of money.

Loan Activities of Banks: The major function of a bank is to give loan, particularly to businessmen, entrepreneurs and farmers and thereby earn interest. Banks provide loans by accepting deposits from their customers. They keep only a small proportion of their deposit as cash with themselves. Banks use the major portion of the deposits to extend loans. Thus Banks mediate between the depositors and the borrowers (those who are in need of the loan).

"Credit plays a vital and positive role in the economic development of an individual"- (please read the case study 'festival season' Page 43).

"Credit pushes the borrower into a situation from which recovery is very painful"- (please read the case study 'Swapna's problem. page 43)

Terms of Credit: Collateral (an asst that the borrower owns- e.g. land, vehicle - and uses as a guarantee to a lender until the loan is paid), Interest rate, documentation requirement and the mode of repayment together comprise what is called the terms of credit. They vary from one bank to another depending on the nature of the lender and the borrower.

FORMAL SECTOR CREDIT IN INDIA

Various sources of loans can be conveniently grouped as formal sector loans and informal sector loans (Pl. see the pie chart - page No. 48)

Formal Sector Loans

- Formal sources of credit are generally provided by commercial banks, cooperative societies and co operative banks.
- Interest rate for repaying loans is cheaper is cheaper than the interest rate in informal sector.
- Motive is both service and profit making.
- The Reserve Bank of India supervises the functioning of formal sources of loans.
- The RBI sees that the banks give loans not just to profit making businesses and traders but also to small cultivators, small borrowers. etc.
- Banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.
- The formal sector still meets only about half of the total credit needs of the rural people.

Informal Sector Loans

- Informal sources credit are generally provided by money lenders, traders, employers, relatives and friends.
- There is no organization which supervises the credit activities of lenders in the informal sector.
- The main motive is profit making
- Most of the informal lenders charge a much higher interest on loans.
- There is no one to stop them from using unfair means to get their money back.

"Commercial Banks and Cooperative societies (formal sector) need to lend more particularly in the rural areas" Why?

- Half of the credit needs of the rural people are met from informal sources. (Pl. draw the pie chart- page no.49)
- The cost to the borrower of informal loans is much higher. They lend at whatever interest they choose. In certain cases the amount to be repaid is greater than the income of the borrower. This could lead to debt trap. People who might wish to start a business by borrowing may not do so because of the high cost of borrowing.
- Formal sources of credit in India provide loans to individual at for cheaper rates than informal sources of credit. This would lead to higher incomes and

many people could then borrow cheaply for a variety of needs. They could grow crops, do business, set up small scale industries etc. Cheap credit help to increase their income and they are able to repay the principal amount as well interest. Cheap and affordable credit will lead to more production. This helps in the economic development of a country(Cheap and affordable credit is crucial for the country's development)

- To reduce the dependence on informal sources of credit banks and cooperatives should increase their lending particularly in rural areas.

Suggestion to Improve Credit scenario: (1).Commercial banks and cooperative societies must increase their lending in rural areas. (2) They should liberalise the terms of credit and loan made available to poor house holds also.

(3) Malpractices adopted by money lenders should be curbed. (4) Informal sector credit should be brought under the supervision of the RBI. (5) Promotion of Self Help Groups (SHGs)

SELF GROUPS FOR THE POOR

In recent years, people have tried out some newer ways of providing loans to the poor. eg. Self Help Groups (SHGs).

- The idea is to organize rural poor, in particular women into small self help groups and pool their savings.
- SHG has 15-20 members usually from the neighborhood, who meet and save regularly (weekly/**fortnightly**) in the range of Rs25 to Rs100.
- Members can take small loans from the group. The group charges a **meager** interest.
- If the group is regular in saving, after a year or two, it becomes eligible for availing loan from the bank to create self employment for the members of the group.
- Most of the important decisions regarding the savings and loan activities are taken by group members.

Advantages:

- It helps in pooling the savings of the members, who are poor women.
- Members can get timely loans for a variety of purposes and at a reasonable rate of interest.
- It helps to overcome the problem of lack of collateral.
- It helps women to become financially self-reliant.
- Regular meetings of the groups provide a platform to discuss variety of social issues of their concern.