

# MONEY AND CREDIT

## Economics Class-10

### Money

Since the beginning of known history, humans have directly exchanged goods and services with one another in a trading system called barter system. The limitations of barter system led to the evolution of currency system that is part of modern economies today.

#### Barter System

- A system of buying and selling where direct exchange of goods for goods and services takes place.
- No money is involved in bartering
- Double coincidence of wants is an essential feature of barter system of exchange.

**Double coincidence of wants:** The situation of barter exchange in which both the parties or persons agree and are ready to sell and buy each other's goods.

*Example of exchanging shoes for wheat:* The shoe maker wants to buy wheat in exchange of shoes. Here the two coincidences are:

- (i) A person who wants to buy shoes
- (ii) The same person wants to sell wheat

#### Money and its different forms

Money is an intermediate common measure of value that is accepted as a medium of economic exchanges by both the sellers and the buyers. The countries have their own national currency system issued as *legal tender* by their governments.

#### Functions of money:

- Money acts as a common measure of value for different goods and services.
- Money acts as a medium of exchange in an economic system.
- Removes the need for double coincidence
- Money has store of value

#### Modern Forms of money:

##### Currency:

Modern currency includes *coins and paper notes*. In earlier times the Indians used cattle and grains as money. Later coins of gold, silver and copper came into use. The problem associated with metallic coins led to evolution of paper notes.

##### Deposits with bank (bank money)

- People open bank accounts to deposit their surplus money with bank.

#### Board Questions:

1. "Banks are efficient medium of exchange." Support this statement with arguments. *(Delhi 2017)*
2. What are demand deposits? Explain any three features of it. *(2016)*
3. What are modern forms of money? *(2013)*

- Bank pays interest on their deposits. So, depositor earns extra amount on their deposits in the form of interest.
- The deposits in the bank accounts can be withdrawn on demand and are called demand deposits.
- Along with currency, demand deposits also constitute money as they are accepted means of payment via the following different modes.

**Cheque facility:**

- Cheque facility is provided by bank to the depositors to make payment without the use of cash.
- Cheque can be issued against demand deposits to transfer money from the account of the issuer of the cheque to the person in whose name the cheque has been issued.

**Online transfer of bank money:**

- The demand deposits are also used to settle payments through online transfer of bank money through NEFT, RTGS, UPI, bank debit and credit cards.
- Online mode of transfer of demand deposits has increased since the demonetization of Indian economy in the year 2016.

**Deposits with the banks are beneficial for individual as well as for the nation****Beneficial for the individual**

- People's money is supposed to be safe with banks.
- Bank pays interest on deposits made by people
- People can get loan from banks in the form of house and education loans or agricultural loans.
- Cheque and online transfer facilities make transaction easy and secure without the use of cash.

**Board Questions:**

1. 'How deposits with the banks are beneficial for the individual as well as for the nation.' Examine the statement. (2015, 2016)
2. How do banks play an important role in the economy of India? (2011, 15)

**Beneficial for the nation**

- Banks extend loan facility at cheaper and reasonable rates for different economic development purposes.
- Credit from banks help in the agricultural, industrial and infrastructural development of the nation.
- Banks play major role in promotion of international trade.

**Modern currency as accepted medium of exchange**

- Modern currency is authorised by the government of a country.
- In India, Reserve Bank of India (RBI) issues currency notes on behalf of Central Government of India.
- No other individual or organisation is allowed to issue currency.
- The law legalises 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 rupees in India.

**Board Questions:**

1. Why is modern currency accepted as medium of exchange without any use of its own? (Delhi 2015)
2. Why is rupee widely accepted as a medium of exchange? (2013)

## Loan activities of banks

- Banks act as mediators between the depositors (who have surplus money) and the borrowers (who need money).
- Banks keep only a small proportion of their deposits to pay the depositors who may come to withdraw money from their saving accounts.
- In India, banks keep about 15% of their deposits.
- The major portion of the deposits is used by banks to extend loans to the people for various economic needs.
- Banks charge higher rate of interest on loans and pays comparatively less interest on deposits. The difference between the interest received from borrowers and the interest paid to the depositors is the income of the bank.

### Board Questions:

1. Explain any three loan activities of banks in India. (2017)
2. How do banks mediate between those who have surplus money and those who need money? (2011)

## Credit (loan) arrangements

Credit refers to agreement in which the lender supplies the borrower with money, goods or services in return for the promise of future payment. Credit arrangements can differ in different situations of lending and borrowing.

## Two different credit situations

### Vital and positive role of credit

- Credit helps people in establishing and running their business.
- It helps in promoting agricultural production and small-scale industries.
- House loans and education loans help people in construction of houses and promoting education of their children.
- In rural areas, farmers need credit to buy seeds, fertilizers, pesticides etc. They take loan in the beginning of the crop season and repay the loan after harvest.
- Credit is supposed to increase income and raise standard of living.
- *Example:* Salim (in textbook) obtained loans from two sources to meet the expenses of production and completed the production in time. This way he increased his earnings. Credit made his life *better off than before*.

### Board Questions:

1. Explain with examples the role of loan in business. (2017)
2. What is credit? Describe the vital and positive role of credit. (2015, 16)
3. 'Credit has its unique role in for development.' Justify the statement with arguments. (2016)

### Bad and debt-trap effect of credit

- Usefulness of credit depends on the risk in the situation and may worsen the condition. There should be some support in cases of loss.
- Farmers in rural areas take loan mostly from informal sources like money lenders.
- Loans from informal sources are costly and eats up larger part of income of the borrowers.
- Crop failure or inability to repay loan worsens the situation and the borrower has to sell his or her assets like land.

### Board Questions:

Describe the bad effects of informal sources of credit on borrowers. (2019)

- *Example from textbook:* Swapna had to sell part of her land to pay off the loan she had taken from the moneylender because the debt had grown over the year into a large amount. Credit left Swapna worse off than before.

## Terms of credit

- Terms of credit refers to conditions and requirements that need to be fulfilled to obtain loan.
- A specified rate of interest that the borrower must pay along with the principal amount.
- Lender may demand collateral as security against loan.
- The formalities of formal sector loans require proper documents to sanction loan.
- Mode of payment of loan is also a part of credit arrangement in which the loan is being sanctioned.
- The terms of credit are not always same and vary depending upon the nature of lender and the borrower.

## Collateral and its importance

- Collateral is asset that the borrower owns (such as land, building, vehicle, livestock, deposits with bank).
- Collateral is demanded by the lender because collateral acts as security against loan.
- Collateral helps in ensuring that the borrower is financially strong to repay the loan.
- If the borrower fails to repay the loan then the lender has the right to sell the asset or collateral to recover the due amount.

### Board Questions:

1. Explain the importance of collateral. (2019)
2. Why do banks and lender demand collateral? (2016, 19)

## Formal and informal sectors of credit (loan)

Formal Sector Credit	Informal Sector Credit
1. Formal process is required like collateral and proper documents.	1. No proper formal process and collateral may not be a condition for loan
2. A reasonable rate of interest is charged.	2. Unreasonably high rate of interest is charged and may lead the borrower into debt trap.
3. Objective of social welfare is a part of formal loaning	3. Maximisation of profit is the motive
4. Reserve Bank of India supervises the functioning of banks	4. Reserve Bank of India does not supervise the informal sector
5. Rich urban households mostly seek loan in formal sector.	5. Poor households depend mostly on informal sector
6. Example: Banks and cooperatives	6. Example: Moneylenders, traders, employers, friends and relatives.

### Board Questions:

1. Why are service conditions of formal sector loans better than informal sector? Explain. (2019)
2. Mention three points of difference between formal and informal sector loan. (2012, 2016)

## Supervision of banks by Reserve Bank of India (RBI)

- RBI monitors and ensure that minimum cash balance is maintained by banks.
- RBI sees that banks distribute credit not only to big businessmen but also to small cultivators and small-scale industry.
- Banks have to periodically submit report regarding their lending, their borrowers and rate of interests charged.
- RBI also sees that banks also consider the welfare of public and provide cheaper and affordable credits.

## Loans in informal sources should be discouraged

- Around 85% of poor households in urban areas take loan from informal sources like moneylenders, traders, employers, friends and relatives.
- Borrowings from informal sources are costly because the informal sector charges high rate interests.
- Most part of the borrowers goes in paying off debt and they are left with less income.
- In certain cases, amount to be repaid is greater than the income of the borrower. Such a situation leads to debt trap and painful conditions.
- *Example from textbook:* Swapna had to sell part of her land to pay off the loan she had taken from the moneylender because the debt had grown over the year into a large amount.

### Board Questions:

'The credit activities of informal sector should be discouraged'. Support this statement with arguments. (2016)

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

- The high cost of borrowing in informal sector exploits the poor people and their earnings. Inability to pay loans lands the borrower in debt trap and they have to sell their asset to pay off the debt.
- To prevent people from seeking loans from informal sector, formal sector banks and cooperative societies should be accessible to people and need to lend more and more particularly in rural areas.
- It would reduce dependence on informal sources of credit.
- The people could borrow cheaply for variety of needs. People could grow crops, do business, setup industries or trade in goods. All this ultimately contribute to infrastructure and economic development of the country.
- Formal credit sector need to expand so that everyone receives the loans and credit is distributed equally to provide benefits of cheap credit to small borrowers also.

### Board Questions:

1. Describe the importance of formal sources of credit in the economic development. (2019)
2. Why is it necessary to increase large number of banks in mainly in rural areas? Explain. (2019)
3. Explain any three reasons for banks and cooperative societies to increase their lending facilities in rural areas. (2019)
4. How can the formal sector loan be made beneficial for poor farmers and workers? Suggest any five measures. (2016)
5. Why is it necessary that banks and cooperatives increase their lending in rural areas? Explain. (2012, 16)

- The income of people would rise as they will not have to pay high rate of interests as they have to do for informal sector loans.
- We can say that the formal sector of credit goes well with the concept of welfare government and helps in the economic development of the country.

### Poor households are still dependent on informal sources of credit

- Banks are not present everywhere in rural India whereas informal sources are present everywhere in the form of moneylenders, traders, employers, friends and relatives.
- Getting loan from banks is comparatively much more difficult than taking loan from informal sources.
- Absence of collateral is a major reason that prevents people from approaching banks to apply for loan. In formal sector the lender knows the borrower and is ready to give loan without collateral.
- The borrowers in formal sector have to clear due amounts before applying for fresh loans while borrowers can ask for repeated loans even before paying off the earlier loans. *Example:* Swapna took another loan from the moneylender before repaying the earlier loan.
- Moneylenders exploit the exigencies of people by charging high rate of interests on their loans and also harass the poor borrowers.

#### Board Questions:

'Most of the poor households are still dependent on informal sources of credit.' Explain the statements. (2012)

## Self Help Groups (SHGs)

Self Help Groups (SHGs) are the building blocks of organisations of poor people particularly women who come together to pool their savings, provide loans to borrowers at reasonable rates and make women self-reliant and generate employment opportunities for women.

### Organisation of SGHs

- Women in near neighbourhood areas organise themselves into small Self Help Groups.
- A typical membership of a SHG ranges from 15 to 20.
- Regular saving of group members ranges from Rs 25 to 100 or more depending on the ability to save.
- Meeting of the group is held regularly.

### Loan system in SGHs

- The SGHs help borrowers overcome the problem of collateral by giving loan to its members but the interest rate is less than the charge of moneylenders.
- Regular savings increase the credibility and eligibility of the groups to avail loan from bank.
- Loan is sanctioned in the name of the group to create self-employment opportunities for members.

#### Board Questions:

“Self help Groups’ help borrowers overcome the problem of lack of collateral.” Examine the statements. (Delhi 2016)

- Borrowers can use small loans from the banks for releasing mortgaged land, meeting working capital needs (e.g. buying seeds, fertilisers, raw materials like bamboo and cloth), for housing construction materials, for acquiring assets like sewing machines, handlooms, cattle etc.

### Decision process and disciplined repayment of loans in SGHs

- The group as a whole decides as on matters like – which loans to be granted, purpose and amount of the loan, rate of interest and schedule of repayment of loans etc.
- Group members have to strictly follow the schedule of repayment. Any case of non-repayment of loans by any member is seriously followed up by other group members.
- Banks consider the discipline of repayment record of SGHs and are willing to lend more even in the absence of collateral as such.

### Advantages of SGHs

- SGHs are the building blocks of organisations of the rural poor and women in particular.
- SGHs help borrowers overcome the lack of collateral.
- Members can get timely loans for variety of purposes and at reasonable interest rate.
- SGHs are an example of organisational and collective efforts toward their self-reliance.
- Regular meetings also provide a platform to discuss and decide some action on different social issues such as health, nutrition, domestic violence, etc.

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