

Chapter 3

Money and Credit

Content

- money – acts as an intermediate in the exchange process
- barter system – goods are directly exchanged without the use of money
- double coincidence – both parties have to agree to sell and buy each others commodities.
- Currency – paper and coins
- Demand Deposit – deposit in the bank accounts can be withdrawn on demand
- Cheque -
- loan activity - how bank mediate between depositor and borrowers
- Credit – salim and swapna credit situation
- Dept trap –
- Term of credit – interest rate, collateral, document and mode of payment
- RBI – reserve bank of India, control of RBI, function / role / supervision
- Formal – source and why do we need to expand
- Why credit is crucial for country development / cheap and affordable credit
- Informal – source and why still poor household depend on informal
- Self Help group – how SHG solve the problem of rural credit, mechanism

In a **barter system** where goods are directly exchanged without the use of money, double coincidence of wants is an essential feature.

both parties have to agree to sell and buy each others commodities. This is known as **double coincidence of wants.**



Barter System

Drawbacks of Barter Systems:

Limitation

- ❑ Lack of double coincidence of wants.
- ❑ Lack of a common measure of value.
- ❑ Indivisibility of certain goods.
- ❑ Difficulty in making deferred payments.
- ❑ Difficulty in storing value.

money acts as an intermediate in the exchange process, it is called a medium of exchange.

Currency

Modern forms of money include currency — paper notes and coins.



The **Reserve Bank of India** is India's central bank, which controls the issue and supply of the Indian rupee. RBI is the regulator of the entire Banking in India.



A **bank** is a financial institution that accepts deposits from the public and creates a **demand deposit** while simultaneously making loans.



Indian Overseas Bank

यूको बैंक



UCO BANK



People also have the provision to withdraw the money as and when they require, these deposits are called **demand deposits**.



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.

Mr. Payee

Pay PREM KUMAR

विनांक/Date 10/5/2016


या धारक को Or Bearer

रुपये Rupees *fifty seven thousand only.*

अदा करें **₹.Rs. 57000/-**

Account number

अ.सं.
A/c. No. 16137926023

 भारतीय स्टेट बैंक
State Bank of India
(01690) NCERT (NEW DELHI)
N.J.E. CAMPUS,
SRI AUROBINDO MARG,
NEW DELHI 110016

Bank branch code

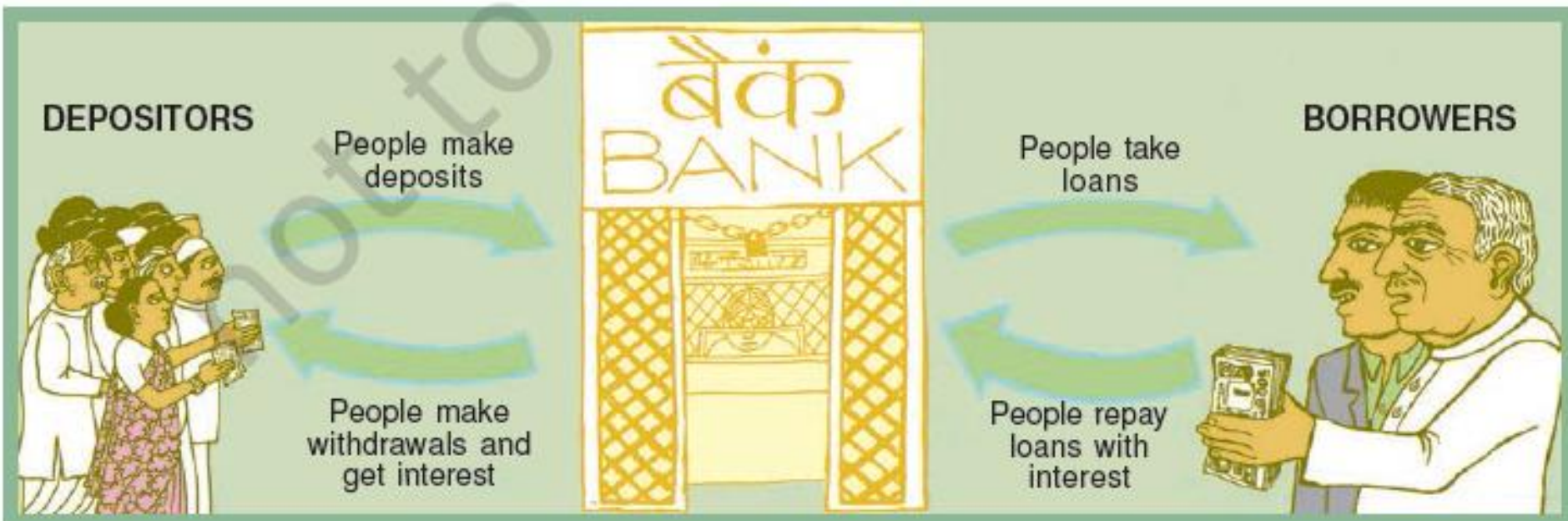
M. Salim.

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Cheque number Coding used by banks

banks **mediate** between those who have **surplus funds** (the depositors) and those who are in **need** of these funds (the borrowers). Banks charge a higher interest rate on loans than what they offer on deposits. The difference between what is charged from borrowers and what is paid to depositors is their main **source of income**.

LOAN ACTIVITIES OF BANKS



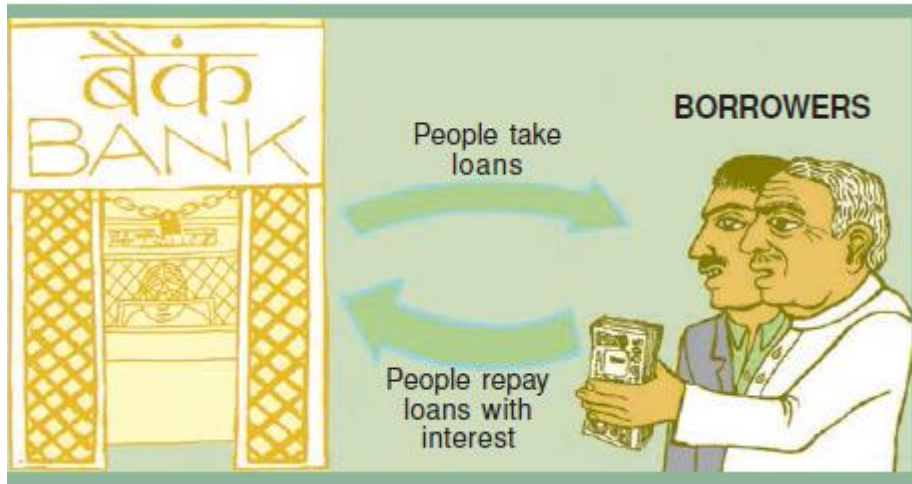


Example:

Depositor deposited 1 Lakh in saving account

Bank Interest rate: 8 %

Rs. 658 / per month



Example:

Loan amount 1 Lakh

Bank Interest rate: 13 %

Rs. 1068 / per month

Deposit Interest amount per month Rs 658

Loan Interest amount per month Rs 1068

Difference amount of deposit and loan Rs 410

Rs 410 is the source of income for bank

TWO DIFFERENT CREDIT SITUATIONS

(1) Festival Season

It is festival season two months from now and the shoe manufacturer, Salim, has received an order from a large trader in town for 3,000 pairs of shoes to be delivered in a month time. To complete production on time, Salim has to hire a few more workers for stitching and pasting work. He has to purchase the raw materials. To meet these expenses, Salim obtains loans from two sources. First, he asks the leather supplier to supply leather

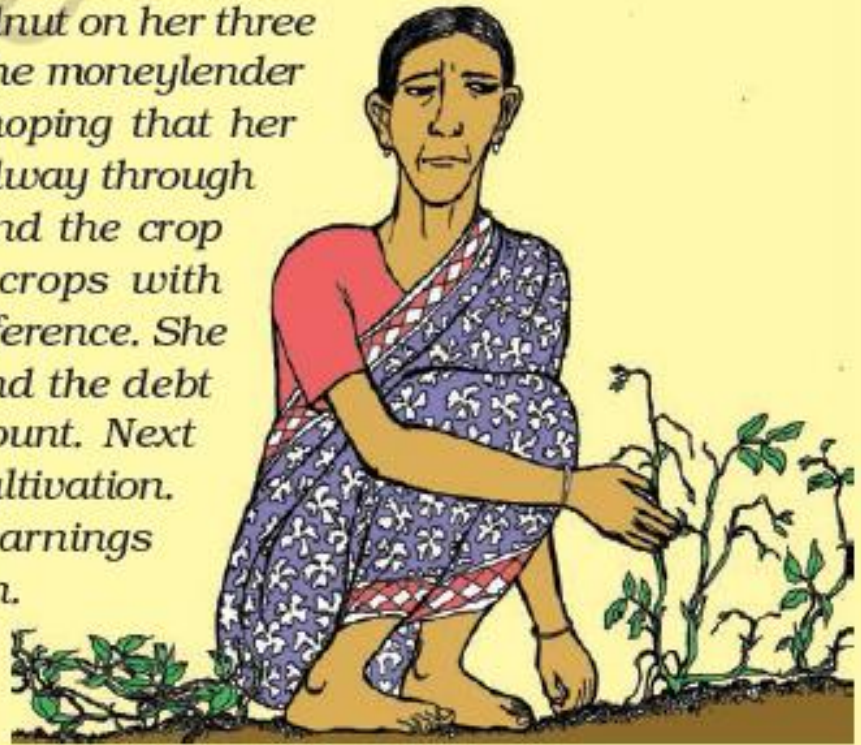
now and promises to pay him later. Second, he obtains loan in cash from the large trader as advance payment for 1000 pairs of shoes with a promise to deliver the whole order by the end of the month.

At the end of the month, Salim is able to deliver the order, make a good profit, and repay the money that he had borrowed.



(2) Swapna's Problem

Swapna, a small farmer, grows groundnut on her three acres of land. She takes a loan from the moneylender to meet the expenses of cultivation, hoping that her harvest would help repay the loan. Midway through the season the crop is hit by pests and the crop fails. Though Swapna sprays her crops with expensive pesticides, it makes little difference. She is unable to repay the moneylender and the debt grows over the year into a large amount. Next year, Swapna takes a fresh loan for cultivation. It is a normal crop this year. But the earnings are not enough to cover the old loan. She is caught in debt. She has to sell a part of the land to pay off the debt.



Dept trap Credit in this case pushes the borrower into a situation from which recovery is very painful.





Terms of Credit



Interest rate



Collateral



Document



Mode of payment

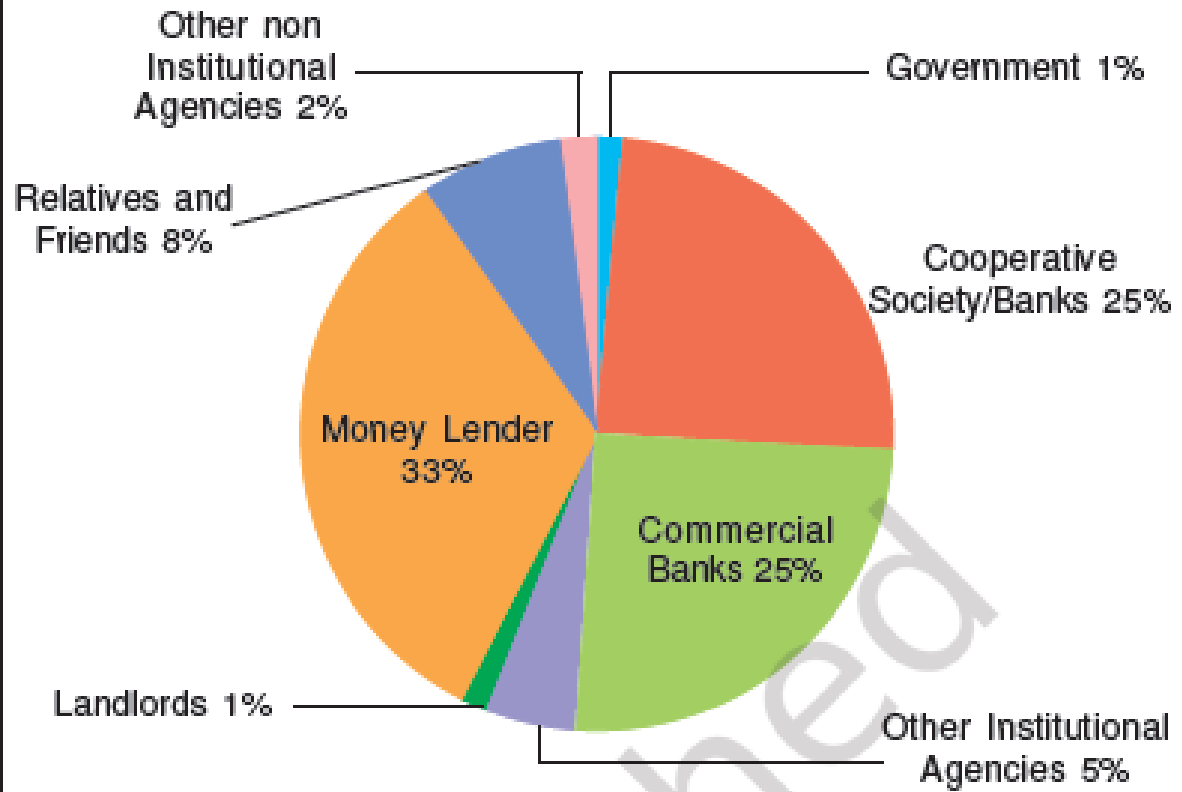


Collateral

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

Source of Credit

Graph 1 : Sources of Credit per Rs 1000 of Rural Households in India in 2012



Source of Credit

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graph TD; A[Source of Credit] --> B[Formal]; A --> C[Informal]; B --> D[Bank and cooperative]; C --> E["Moneylender, trader, employers, relatives and friends..etc"]
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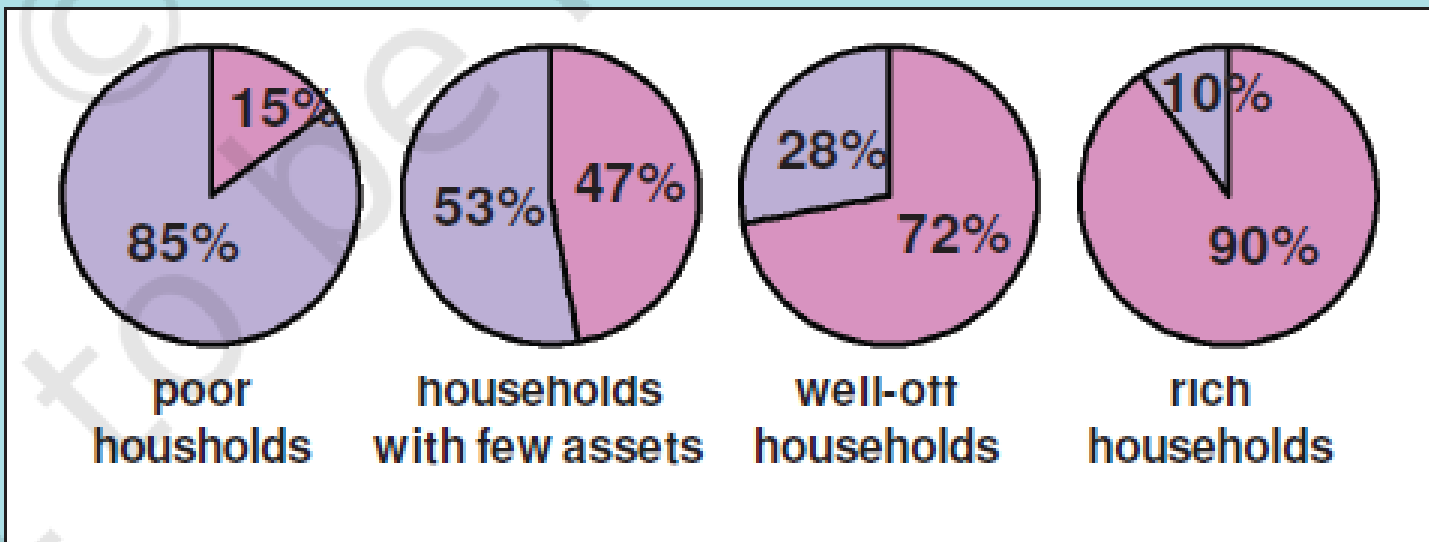
Formal

**Bank and
cooperative**

Informal

**Moneylender, trader,
employers, relatives
and friends..etc**

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



BLUE : Per cent of loans from the INFORMAL sector

PURPLE : Per cent of loans from the FORMAL sector

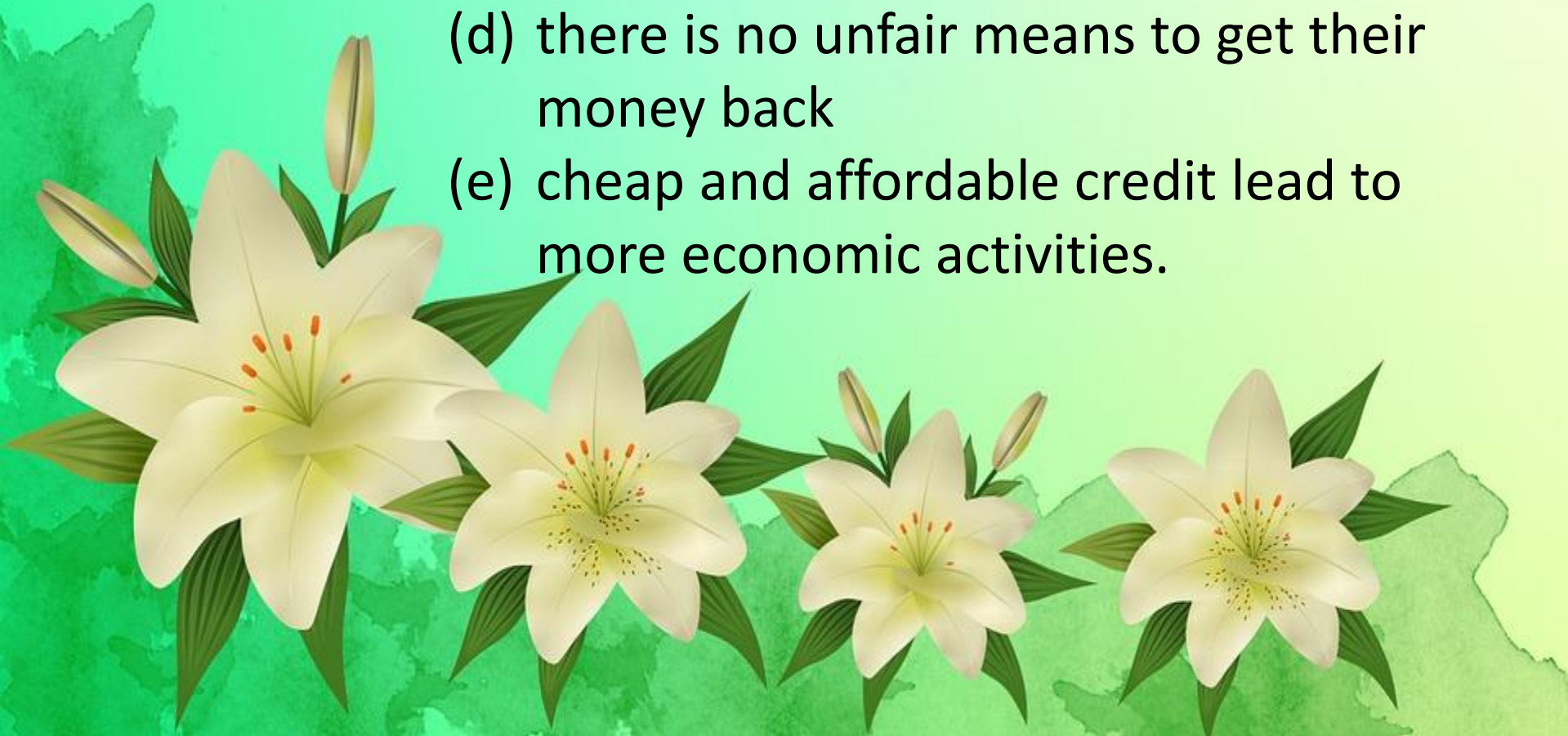
Function of **RBI**: to check and supervise the following:

- (a) Cash Reserve ratio 15%
- (b) Rules and regulation
- (c) Interest rate
- (d) Loan is given even to poor
- (e) Print, distribution and regulate the currency



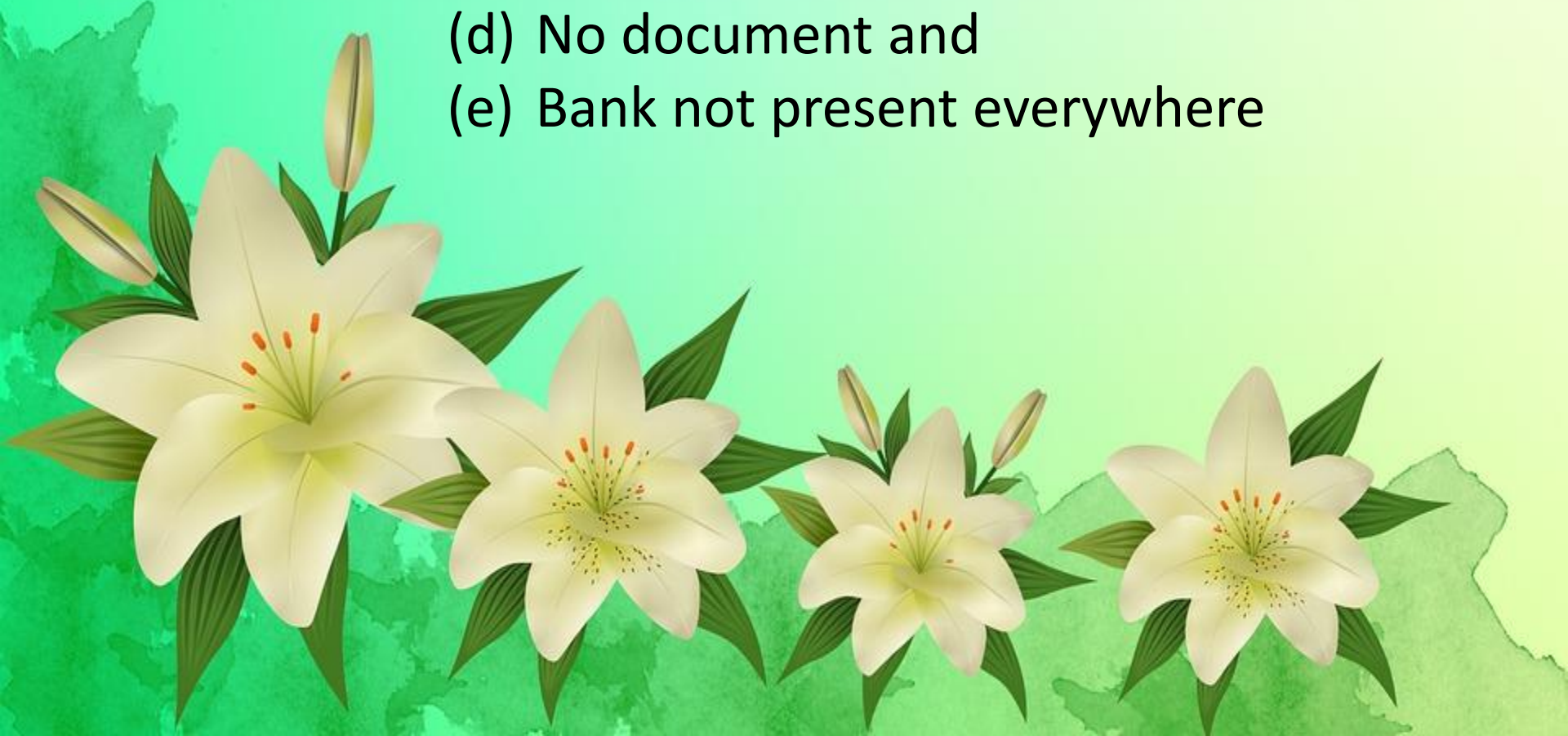
Why do we need to expand **formal source** of credit?

- (a) fixed and reasonable interest rate
- (b) less risk of dept trap
- (c) RBI supervise the function of bank
- (d) there is no unfair means to get their money back
- (e) cheap and affordable credit lead to more economic activities.



why still poor household depend on **informal** source of credit?

- (a) No collateral
- (b) No regular income
- (c) Illiterate
- (d) No document and
- (e) Bank not present everywhere



Why credit is crucial for country development ?

Why **cheap and affordable credit** is important?

- (a) This would lead to higher incomes and many people could then borrow cheaply for a variety of needs.
- (b) They could grow crops, do business, set up small scale industries etc.
- (c) They could set up new industries or trade in goods. Cheap and affordable credit is crucial for the country's development.



Self Help Groups

meeting in Gujarat



स्वयं सहायता समूह

(SHG : Self Help Group)



क्या है ??



- (a) Financial support for poor
- (b) Organised in rural
- (c) Particularly women, relative, same community, neighbourhood, 15 to 20 member in group
- (d) Saving per member varies from Rs 25 to Rs 100 or more,
- (e) provisional of small loan with less interest rate
- (f) most of the important decision regarding saving and loan activities are taken by the group members.



Thank You.....