



DIGNITY CLASSES

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Money and Credit

- ⇒ Money acts as an intermediate in the exchange process, it is called a medium of exchange.
- ⇒ A person holding money can easily exchange it for any commodity or service that he or she might want.
- ⇒ In the early ages, Indians used grains and cattle as money. Thereafter came the use of metallic coins – gold, silver, copper coins – a phase which continued well into the last century. Now, the modern forms of money include currency – paper notes and coins. The modern forms of money – currency and deposits – are closely linked to the workings of the modern banking system.
- ⇒ **Double coincidence of wants:** - When in the exchange, both parties agree to sell and buy each other's commodities it is called double coincidence of wants. In the barter system double coincidence of wants is an essential feature.
- ⇒ **Currency:** - In India, the Reserve Bank of India issues currency notes on behalf of the central government. No other individual or organization is allowed to issue currency. The rupee is widely accepted as a medium of exchange in India.
- ⇒ **Demand Deposits in Bank:** - Deposits in the bank account that can be withdrawn on demand. People need only some currency for their day to day needs. For instance workers, who receive their salaries at the end of each month, have some extra cash. They deposit it with the banks by opening a

bank account in their name. Banks accept the deposits and also pay an interest rate on the deposits.

- ⇒ **Cheque:** - Paper instructing the bank to pay a specific amount from a person's account to the person in whose name the cheque is drawn.
- ⇒ **Reserve Bank of India:** - It is the central bank of India which controls the monetary policy of the country. Reserve Bank of India supervises the activities of formal sector and keeps the track of their activities but there is no one who supervises the functioning of informal sector. Periodically banks have to submit information to the RBI on how much they are lending and to whom, at what interest rate, etc.
- ⇒ **Credit:** - The activity of borrowing and lending money between two parties.
- ⇒ **Collateral (Security):** - 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. Property such as land titles, deposits with banks, livestock are some common examples of collateral used for borrowing.
- ⇒ **Terms of Credit:** - Interest rate, collateral and documentation requirement, and the mode of repayment together comprise what is called the terms of credit. The terms of credit vary substantially from one credit arrangement to another. They may vary depending on the nature of the lender and the borrower.
- ⇒ **Formal sector:**
- ⇒ Includes banks & cooperatives; RBI supervises the functioning of formal sources of loans. To see that the bank maintains a minimum cash balance and monitors that these

banks give loans not just to profit-making business and traders but also to small cultivators , small scale industries , to small borrowers etc. periodically banks have to submit information to RBI of their activities.

⇒ Informal sector:

⇒ Includes money lenders, traders, employers, relatives & friends etc. There is no one to supervise their credit activities. They can charge whatever rate of interest. There is no one to stop them from using unfair means to get their money back.

⇒ Self Help Groups (SHG):

⇒ Poor households are still dependent on informal sources of credit because of the following reasons:

- (I) Banks are not present everywhere in rural India.
- (II) Even if banks are present, getting a loan from a bank is much more difficult as it requires proper documents and collateral.

⇒ To overcome these problems, people created Self Help Groups (SHGs). SHGs are small groups of poor people which promote small savings among their members. A typical SHG has 15-20 members, usually belonging to one neighbourhood, who meet and save regularly.

⇒ Advantages of Self Help Group (SHG)

- (I) It helps borrowers to overcome the problem of lack of collateral.
- (II) People can get timely loans for a variety of purposes and at a reasonable interest rate.
- (III) SHGs are the building blocks of organisation of the rural poor.
- (IV) It helps women to become financially self-reliant.

(V) The regular meetings of the group provide a platform to discuss and act on a variety of social issues such as health, nutrition, domestic violence, etc.

⇒ **Two Different Credit Situations :-**

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

(a) **Festive Season:** - In this case, Salim obtains credit to meet the working capital needs of production. The credit helps him to meet the ongoing expenses of production, complete production on time, and thereby increase his earnings. In this situation, credit helps to increase earnings and therefore the person is better off than before.

(b) **Swapna's Problem:-** In Swapna's case, the failure of the crop made loan repayment impossible. She had to sell part of the land to repay the loan. Credit, instead of helping Swapna improve her earnings, left her worse off. This is an example of debt-trap. Credit, in this case, pushes the borrower into a situation from which recovery is very painful. Whether credit would be useful or not, depends on the risks in the situation and whether there is some support, in case of loss.

THE END