MONEY AND CREDIT

Trade before invention of money

Before the invention of money Barter system was prevalent. Barter system was a system in which one good and service is exchanged for another good and service, here third medium such as money is not used for exchange of goods and services. Problems associated with barter system are ***double coincidence of demand, valuation of product is difficult, it is time consuming, hard to control economic activity.***

I want medicine but I have Papads with me, now I have to look for a person who has medicine and who also wants papad. This exchange system is hard to practice because both the requirements has to be fulfilled i.e other person must have the products I am looking for and he/she must be interested in the product that I am selling, only then exchange can take place. This is known as double coincidence of demand.

This problem of double coincidence of demand was solved by the invention of money. Money can be used as exchange of medium and value of all available products is adjusted in terms of money.

What money do for us-

1. Money is the medium of exchange and solves problem of double coincidence of demand.
2. Money provided economic freedom to the people as they can buy variety of goods using money.
3. Money also allows governments to control the economic activities of a country.
4. Money promotes international trade.

Currency-Currency is a unit of exchange that facilitates the exchange of goods and services.

1. It is authorized by the government of country.
2. Demand and supply of currency is regulated by central bank of the country.
3. It is legally binding for people to accept currency as a medium of exchange.
4. Value of each commodity is measured in currency.

Because of above mentioned feature money is widely accepted as a medium of exchange.

RBI- Reserve bank of India is the central bank of India. It was established in the year 1935. Headquarter of RBI is located in Mumbai.

Modern form of money	Traditional forms of Money
1. It includes paper notes and coins.	1. It includes precious metals like gold, silver, copper etc.
2. Money gets its value from government laws and regulations.	2. Precious metals also has their own value.

Money with Bank

1. Money in bank is not owned by bank, it's the money of people who have deposited their extra money with banks.
2. Bank use this money to offer loans and earn interests.
3. Deposits are of two type-
   A. Demand deposit- These are the deposits that can be withdrawn by depositor at any point of time. Ex Saving accounts, current accounts. Most of the payment facilities are provided by banks on demand deposits.
   B. Term deposits- These are the deposits that cannot be withdrawn before a specific time period. Ex- Fixed deposits.

Some ***advantages*** of money in Bank-

1. Safe place to keep money.
2. You can earn money on your extra money.
3. You can use bank facilities like cheque, credit card, online banking etc.
4. Loans offered by banks are used for development of nation.

Cheque- Cheque is a paper that instructs a bank to pay specific amount to a person whose name is mentioned on the cheque. It is safe mode of payment. It is easier to carry than money.

Loan activities of bank

- ✓ Banks keep only 15% of their total deposits as cash to meet the day-to-day withdrawal demands.
- ✓ Rest of the cash is extended as loans to those who need it (borrowers) at a specific rate of interest.
- ✓ The interest provided by banks to depositors is less than the interest charged by banks from borrowers on loans. This is major source of income for banks.
- ✓ Banks provide housing loans, vehicle loans, farm loans, education loans, personal loans etc. to meet the specific requirements of borrowers.

Formal credit source

- These sources works under the supervision of RBI
- They charge low rate of interest.
- They follow rules and regulations formed by the government.
- Ex- Commercial banks, cooperative banks.

Informal credit source

- These are not regulated by any agency.
- They charge very high interest rates.
- They are not bounded by rules and regulations formed by government.
- Example- Relatives, money lenders etc.

Most of the houses are still dependent on informal source of credit-

1. Banks are not available everywhere, whereas informal sources are easily available.
2. One has to go through a lot of formalities for taking loan from banks.
3. Moneylenders provide loan without collateral, whereas banks requires details of either source of income or collateral.
4. Formal sources provide loan only for productive purpose.
5. Entire banking system is very complex for a common man to understand.

Debt Trap- It is a situation in which a person is caught in the vicious cycle of debts. He/she takes loans for meeting his/her requirements and on being unable to pay back the loan they takes a fresh loan to repay the old loan. This leaves him/her indebted all through his/her life.

Cheap and affordable credit is crucial for development because-

1. Farmers and small businessmen require short term loans to meet temporary expenses, high interest rates makes it hard to repay loans.
2. Cheap credit is also important for manufacturing industries so that price of goods can be controlled.
3. Cheap credit also helps in increasing demand for products leading to economic development.
4. Cheap loans taken for startups can help in expansion of industries and creation of jobs.
5. Cheap credit is also required to decrease dependency on informal sector.

Why more formal loans facilities must be provided in rural India-

1. Most of the farmers in India are small scale farmers and they require loan before every cropping season.
2. They are more prone to natural calamities.

3. Farmers also have lesser knowledge of using formal sectors for taking loans.
4. Moneylenders and other informal sources are more active in rural areas.
5. Cheap loans are very essential for improving standard of living of people living in rural areas.

Collateral- It is an asset owned by the borrower such as land, building, vehicle, livestock etc., which is kept with the bank as a guarantee against a loan until the loan is repaid. In case of failure in repaying the loan, the bank would have the right to sell the collateral to recover the loan amount.

Terms of credit- interest rate, collateral, documents and mode of repayment together comprise what is called term of credit.

Self Help Groups for the Poor

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

- Banks are not present everywhere in rural India.
- 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)

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

Sources of credit in rural India-

1.Banks 2. Money lenders 3. Government and other agencies 4. SHGs 5. Friends and relatives