Chapter 3 - Money and Credit

In CBSE Notes Class 10 Economics Chapter 3 - Money and Credit, you will learn modern forms of money and how they are linked with the banking system. In the second half of the chapter, you will know about credit and how it impacts borrowers depending upon the situation. So, go through these notes to understand these topics in-depth.

10 Economics Chapter 3 - Money and Credit PDF

Money as a Medium of Exchange

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.

Modern form of Money

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 working of the modern banking system.

Currency
In India, the Reserve Bank of India issues currency notes on behalf of the central government. No other individual or organisation is allowed to issue currency. The rupee is widely accepted as a medium of exchange in India.

Deposits in Banks
The other form in which people hold money is as deposits with banks. People deposit their extra cash with the banks by opening a bank account in their name. Banks accept the deposits and also pay an amount as interest on the deposits.

The deposits in the bank accounts can be withdrawn on demand, these deposits are called **demand deposits**. The payments are made by cheques instead of cash.

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.

Loan Activities of Banks

Banks keep only a small proportion of their deposits as cash with themselves. These days banks in India hold about 15% of their deposits as cash. This is kept as a provision to pay the depositors who might come to withdraw money from the bank on any given day. Banks use the major portion of the deposits to extend loans. There is a huge demand for loans for various economic activities.

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 for banks.

Two Different Credit Situations

Chapter 3 - Money and Credit

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.

Here are 2 examples which help you to understand how credit works.

1. ***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

2. ***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.

Terms of Credit

Every loan agreement specifies an interest rate which the borrower must pay to the lender along with the repayment of the principal. In addition, lenders also demand collateral (security) against loans.

Collateral (Security) is an asset that the borrower owns (such as land, building, vehicle, livestocks, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid. If the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to obtain payment.

Interest rate, collateral and documentation requirement, and the mode of repayment, together is called the **terms of credit**. It may vary depending on the nature of the lender and the borrower.

Formal Sector Credit in India

Cheap and affordable credit is crucial for the country's development. The various types of loans can be grouped as:

Formal sector loans:
These are the loans from banks and cooperatives. The Reserve Bank of India supervises the functioning of formal sources of loans. Banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.

Informal sector loans:
These are the loans from moneylenders, traders, employers, relatives and friends, etc. There is no organisation which supervises the credit activities of lenders in the informal sector. There is no one to stop them from using unfair means to get their money back.

Chapter 3 - Money and Credit

Formal and Informal Credit

The formal sector meets only about half of the total credit needs of rural people. The remaining credit needs are met from informal sources. It is important that the formal credit is distributed more equally so that the poor can benefit from the cheaper loans.

1. It is necessary that banks and cooperatives increase their lending, particularly in rural areas, so that the dependence on informal sources of credit reduces.
2. While the formal sector loans need to expand, it is also necessary that everyone receives these loans.

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). SHG 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)

1. It helps borrowers to overcome the problem of lack of collateral.
2. People can get timely loans for a variety of purposes and at a reasonable interest rate.
3. SHGs are the building blocks of organisation of the rural poor.
4. It helps women to become financially self-reliant.
5. 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.