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CLASS-10TH

(BASED ON N C E R T PATTERN)

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MONEY AND CRIDIT

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.

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

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.

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.

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.

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