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NCERT Class 10 Economics Chapter 3: Money & Credit Complete Notes Part 3

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Terms of Credit

- Interest + Principal = Repayment
- Collateral: asset that the borrower owns and uses this as a guarantee to a lender until the loan is repaid
- Interest rate + collateral + documentation + mode of repayment = Terms of Credit

Now let's understand how loans work or how the principal works? As we said you will repay the loan, it's the interest that you have over period of 6 months. In these cases, we talk about 6 months so it was interest and principal amount. When you repay the interest and principal amount you have the repayment of the loan and you are no more under any credit situation.

Now what are collateral? Collateral are any asset of security that you provide in lieu of a loan amount to take, so let's say a kid of 5 years goes to bank and ask for a loan will he be given a loan? He won't be given loan for and obviously reason is that he cannot provide any collateral, that means, he cannot provide any security. However, in a period of 1 year I would be able to repay my loan because either this is source of my income or I have some established infrastructure which I can give it as a security to the bank. Therefore, collaterals are assets and collateral are not provided to everyone.

The interest that has been changed now what would happens if the interest rate is very high, if the interest rate is let's say 25% so I'm taking a loan of 1000Rs. I'm paying a interest rate of 25%, that means I'm nearly paying 12,500 Rs, and the end of the day if I establish the industries and I'm earning out of these Rs. 13000. What would be the percentage of my profit margin? My profit margin remains only 500 Rs.

Formal Sector Credit

- Formal sector loan – bank & cooperative – 90% rich household
- Informal sector loan - moneylenders, traders, employers, relatives and friends – not supervised & charge any amount (usually higher) – 85% poor households
- Formal – Supervised by RBI – Looks into

  - Cash maintained by banks
  - Loan not only to profit making businesses but others
- High borrowing cost implies most money goes in loan repayment
- Need for cheap & affordable credit
- 50% rural credit needs by formal sector

Now as we said credit either by the formal sector or the informal sector, formal sectors is mainly the bank so you have kind of bank, cooperative society, which are the formal sector. And you have the 90% rich household which take credit only through the formal sector. The poor households 85% of them take loan through informal sector because for them it is hard to produce collaterals to the bank. As a result whatever do, they either go to moneylenders, traders, employers, relatives and friends or take loans from them and for the loan taking from informal sector they are usually charged much higher as compared to the formal sector now this formal sector is supervised by RBI in India.

What does RBI look in to? RBI look in to cash that the bank has maintained with itself, and again to make sure that it is not only providing loans for profit making businesses but also deriving loans to start and those who can repay the loan and really required it.

Now as we said, the high borrowing cost means most of the money goes in loan repayment and you have lesser profit margin. So what is required is a need for cheap & affordable credit and this comes to either self-help group or cooperative society and the 50% rural credit needs by formal sector.

Self-Help Groups

- Organize rural poor in groups and collect money
- Members take loan from group
- Group charges interest
- If group is regular in saving – can take bank loans
- Loan given in name of group – self employment opportunities
- Overcome problem of collaterals
- Grameen bank (Bangladesh) – 1970s – 6 million borrowers in 40,000 villages

Now what are self-help groups? Self-help groups are small groups which organize to gather, let’s say there is a village & 80 or 100 people in village come together, they all collect the money under a single hand whenever all those 100 people are putting in the money for that, say self-help groups, person 1 want a money or loan, he would ask the group to provide a loan and they would pay that amount in certain time like 1 year or 2 years.

Now when this self- help group gets bigger what happens is established for 1 or 2 years, it can establish itself with the bank and when there is a bank, it is associated at a regular saving account at the name of self-help group with the bank and whenever a person is taking a loan from the self-help groups that loans is ultimately taken from the bank in the name of self-help groups. So it provides kind of self-employment opportunity to small workers. It's overcome burden of collateral because the all this 100 peoples who are coming together cannot provide individual collaterals. Excellent example is Grameen bank in Bangladesh which started in 1970 and there are now 6 million borrowers and it is spread in more than 40,000 villages.