ATOMIC ENERGY CENTRAL SCHOOLS
Revision Notes
Economics(Std 10)
Chapter-3 Money and Credit (Module -2)

TERMS OF CREDIT:

1. Every loan agreement specifies an interest rate which the borrower must pay to the lender along with the repayment of the principal addition, lenders may demand collateral against the loan.
2. Collateral is an asset that the borrower owns and uses this as a guarantee to a lender until the loan is repaid.
3. The interest rate, collateral and documentation requirement, and the mode of repayment together comprise what is called the terms of credit.

FORMAL SECTOR CREDIT IN INDIA:

1. We have seen that people obtain loans from various sources.
2. The various types of loans can be conveniently grouped as formal sector and informal sector loans.
3. Among the former are loans from banks and cooperatives.
4. The informal lenders include moneylenders, traders, employers, relatives and friends, etc.
5. The Reserve Bank of India supervises the functioning of formal sources of loans.
6. For instance, we have seen that the banks maintain a minimum cash balance out of the deposits they receive.
7. The RBI monitors the banks in actually maintaining a cash balance.
8. Periodically, banks have to submit information to the RBI on how much they are lending, to whom, at what interest rate, etc.
9. There is no organization that supervises the credit activities of lenders in the informal sector.
10. They can lend at whatever interest rate they choose.
11. There is no one to stop them from using unfair means to get their money back.
12. Compared to the formal lenders, most of the informal lenders charge a much higher interest on loans.
13. Thus, the cost to the borrower of informal loans is much higher.
14. The Higher cost of borrowing means a large part of the earnings of the borrowers is used to repay the loans.
15. Cheap and affordable credit is crucial for the country’s development.

Formal and Informal Credit: Who gets what?

1. 85% of the loans taken by poor households in the urban areas are from informal sources.
2. Urban households take only 10% of their loans are from informal sources, while 90% are from formal sources.
3. The rich households are availing cheap credit from informal lender whereas the poor households have to pay a large amount of borrowing.
4. The formal sector still meets only about half of the total credit needs of the rural people.
5. The remaining credit needs are met from informal sources.
6. Thus, it is necessary that banks and cooperatives increase their lending particularly in the rural areas so that the dependence on informal sources of credit reduces.
7. While formal sector loans need to expand, it is also necessary that everyone receives these loans.
8. It is important that the formal credit is distributed more equality so that the poor can benefit from the cheaper loans.

SELF-HELP GROUPS FOR THE POOR:

1. In the previous section, we have seen that poor households are still dependent on informal sources of credit.
2. Banks are not present everywhere in rural India.
3. Even when they are present, getting a loan from a bank is much more difficult than taking a loan from informal sources.
4. The absence of collateral is one of the major resources which prevent the poor from getting the bank loans.
5. Informal lenders such as moneylender, on the other hand. Known the borrowers personally and hence are often willing to give a loan without collateral.
6. However, the moneylenders charge very high rates of interest, keep no records of the transactions and harass the poor borrower.
7. In recent years, people had tried out some newer ways of providing loans to the poor.