

Formal and Informal Sources of Credit

Chapter 20: Money and Credit · Topic 2

Key Concept

Formal sources of credit, like banks and cooperative societies, are regulated by the Reserve Bank of India, offering relatively lower interest rates and legal protections for borrowers.

Informal sources of credit, like moneylenders, relatives, or traders, often provide easier access to loans but typically charge much higher interest rates and offer fewer protections.

Many poor and rural households still depend heavily on informal credit sources due to limited access to formal banking or difficulty meeting formal loan requirements.

Government efforts, like promoting microfinance and expanding rural banking access, aim to increase formal credit availability, reducing dependence on costly informal credit sources.

Quick Revision Notes

- Formal credit sources include banks and cooperatives.
- Formal sources are regulated by the Reserve Bank of India.
- Formal credit typically offers lower interest rates.
- Informal sources include moneylenders and relatives.
- Informal credit is easier to access but has higher interest rates.
- Informal sources offer fewer legal protections.
- Many poor and rural households depend on informal credit.
- Government efforts aim to expand formal credit access.

Practice Questions

- 1 Compare formal and informal sources of credit.
- 2 Discuss why informal credit often has higher interest rates.
- 3 Research a formal credit institution, like a cooperative bank.
- 4 Explain why rural households might depend on informal credit.
- 5 Research microfinance and how it helps borrowers.
- 6 Debate the risks of relying on informal credit sources.