CHAPTER II

CONCEPTS AND REVIEW

2.1 Introduction

The basic objective of this dissertation is to assess the progress of banking and the impact of PSL on the economic development of Pondicherry. Several theoretical concepts are freely used in the course of this study and an exploration of these concepts may provide a proper understanding of the situation. Further, the area of banking is already a trodden area and researchers have done considerable work. A review of these related research would help to formulate a framework for this study, indicate the deficiencies of the existing work and show lines of improvement. Therefore a review of past work becomes imperative. This chapter purports to provide a discussion on the concepts and literature which are germane to the present study.

2.2 CONCEPTS

2.2.1 Banking

The word “Bank” is said to have been derived from the Italian word “Banco,” meaning a bench. The early bankers, the Jews in Lombardy, transacted their business at benches in the market place. A bank may be defined as an establishment that performs one or more of the functions like accepting custody of money, lending money,
extends credit, issuing currency or facilitating the transfer of funds by means of cheques, drafts, bills of exchange or other instruments of credit. The broad functions of a commercial bank are borrowing (deposit) and lending (advance), agency functions like collection and payment of cheques and bills on behalf of the customers and finally general utility services like receiving valuable securities for safe custody besides underwriting of shares and debentures.

In the opinion of Sayers\(^1\) the concept of modern banking, has shifted from the traditional passive commercial role towards the active role of contributing to the social welfare of the country by accelerating the process of economic development.

According to Sharma\(^2\) the role of commercial banks lies in accelerating investment and growth in a developing economy. The banks are considered as the nerve centres of economies and finance of a nation and the barometer of its economic perspective.

According to Mishken\(^3\) banks play the most important role in financial systems throughout the world because they are so well suited in reducing adverse selection and moral hazards problems in the financial markets. Banks also have advantages in reducing moral hazards because they can use the threat of cutting off future lending. Government safety net for depositors is the added advantage of banks.

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Indian banks came to be established primarily in the wake of the swadeshi movement in 1905 and the growth of the Indian Joint Stock banks followed an altogether different pattern. With the financing of foreign trade in the hands of foreign exchange banks, owned outside India, especially in the United Kingdom, the best medium for bank investment, namely trade bills was not available to others. It was difficult for the Indian banks to get into their business which was protected by established and not easily accessible advantages. The course that monetary management took in the pre-independence years, following the establishment of the RBI, was guided by the prevailing policy of the Government. With the beginning of planned economic development, central banking policies and practices needed to be attained to the objectives and assumptions of successive Five Year Plans.

Banking in India falls mainly under two categories (a) Commercial banks and (b) Co-operative banks. Commercial banks are the important agencies for financing credit requirements of industry and trade while co-operative banks have played a major role in financing agriculture. The nationalisation of scheduled commercial banks has been responsible for the development of the country right from 1969 according to Ramachandra Rao.

According to Srinivasan, banks are the most important financial intermediaries and as such they intermediate between the savers and users of funds. Banks also act as an essential link between people who have savings and those who require money for investment in business activity.

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Radhaswamy⁶ says that banks in India merely acted as repositories of community savings and lent such savings to needy investors who were acceptable to them according to certain criteria. Banks were mainly guided by the objectives of profit maximisation which in turn depended on the ability to ensure the maximisation of savings of the community flowing through banking and lending such funds to investors who would safely and efficiently use them.

The role of banks is a very critical input in the economic development of any nation as indicated by Gerschenkron⁷ in his seminal work which shows the important role that the banking system had played during the 18th and 19th centuries in the economic development of Europe.

2.2.2 Credit

Credit means the ability to buy or borrow in consideration of a promise to pay within a specified time period following delivery. Bank credit means the loans (advances) made by banks to customers. Credit is a transaction in which command over resources is obtained in the present in exchange for a promise to repay in the future normally with a payment of interest as compensation to the lender. Credit transactions can occur between individuals as simple personal arrangement as and when money is loaned to a friend, but its importance as an economic institution lies in formalised transactions carried out in highly developed financial markets under a carefully formulated contract.


Schumpeter spoke of credit as a phenomenon of development and regarded the banking system along with entrepreneurship as being the key agent in the process of development.

2.2.3 Deposit

Deposit means a credit to an individual or to a firm. The two main kinds of bank deposits are: (a) Demand Deposit – this may be withdrawn at any time (on demand) and (b) Time Deposit – this stipulates that when withdrawals should be made. Bank deposits represent the principal kind of money in circulation. Deposits are three types (a) Demand Deposits, (b) Saving Deposits and (c) Fixed Deposits. One of the main indicators to measure the expanding Commercial banking structure is the growth of bank deposits.

2.2.4 Credit Deposit Ratio (CDR)

The CDR is nothing but the quantum flow of advances to the deposits mobilised by banks in terms of percentage. This ratio explains about the bank’s credit deployment and mobilisation capacity of the banks. Banks are required to maintain a CDR of at least 60 per cent particularly in rural and semi-urban branches so as to ensure that the financial resources mobilised from rural pockets are fruitfully utilised without diverting the same to urban and metropolitan centres.

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2.2.5 Sources of Credit

2.2.5.1 Money Lenders

The conventional banker must have existed as early as the vedic period. His main activity was one of money lending in the ancient days. The laws of Manu by George Buhler\(^9\) provide greater details besides the references to the views of other law makers. The Sanskrit and English versions of other Dharmasastras are also referred to with a view to understand the perceptions of the vedic law makers relating to money. Money lending was one of the recognised occupations under Manu’s laws. Money lender is called “Uttamarna” and the borrower is called “Adhamarna”. A money lender may stipulate an increase of his capital for the interest allowed by Vasishta, and take monthly, the eighteenth part of a hundred. This works out to be one and one quarter per cent per month or 15 per cent per annum. This is the interest rate for secured advances where the debtor signs a deed known as ‘Lekhya’ specifying the rate of interest. For unsecured loan, the creditor can charge two per cent per month or 24 per cent per annum. This shows the net work of credit operations in a conventional way in India unlike the present organised form of lending by Commercial banks or Co-operative institutions under the supervision of Central Bank, namely RBI.

2.2.5.2 Co-operative Bank

Co-operative bank is a small local institution, which is generally organised by a group of individuals with a common bond or purpose, designed to give members easier and cheaper access to credit. Co-operatives in all walks of life are forms

of organisation whose purposes are to gain for producers or consumers, the profits or savings that would otherwise accrue to middlemen.

2.2.5.3 Regional Rural Bank

Regional Rural Bank (RRB) is one which provides credit mainly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs. RRB has come to form as the third component (besides Co-operatives and Commercial banks in India) of the multi agency credit system for agricultural and rural development.

2.2.5.4 Commercial Bank

Commercial bank means a bank whose principal functions is to accept demand deposits and to make short term loan mainly to business firms, thereby facilitating the transfer of funds in the economy. Commercial banks are also financial institutions chartered by Federal or State Government primarily engaged in making short term industrial and commercial loans by creating demand deposits. It may also perform other functions such as holding time or savings deposits and making long-term mortgage loans.

According to Jha10 Commercial banks are both the repositories of the community savings and the purveyors of credit for economic activity. They provide to the saver a convenient avenue for investment of surplus funds and to the investor of source of finance. The banks are purveyors of change. Deposit mobilisation constitutes

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one of the major functions of banking. Deposits are both a component of the monetary stock and a part of the community savings of the economy. As the level of transactions increase in an economy, the proportion of deposits to national income also increases. Similarly as savings increase, deposits also increase. The growth of deposits is directly related to the level of increase in financial transactions and also to the volume of household and institutional savings.

Goldsmith has studied that in 1860, the western type financial superstructure in India was limited to about a half-a-dozen Commercial banks with assets in the order of one fourth of one per cent of the country’s national product, which coexisted with hardly any direct contacts, with hundreds of indigenous bankers and many thousands of rural money lenders. By 1913, the assets of western type financial institutions, which then numbered well over 100 and included, in addition to Commercial banks, Savings banks, Credit co-operatives and Insurance companies, had risen to around 10 per cent of national product. The credit co-operatives have been regarded as an important instrument for breaking together with debt relief legislation, the stranglehold that local money lenders were supposed to have had over cultivator owners and tenants. The Co-operative Credit Societies Act of 1904 dealt with the Primary Societies and the Co-operative Societies Act of 1912 dealt with the Central (District or Provincial) institutions.

After setting up of RBI in 1st April 1935, metamorphic changes began to take place in the entire banking structure. Indian planning exercise coupled with the

goal of socialistic pattern of society made the banking sector to move forward. The credit needs of the rural segments were not adequately met by the existing co-operative institutions. This has further accelerated the cause for social control of banks in 1968 and nationalisation of 14 scheduled commercial banks in July 1969.

Prior to bank nationalisation, the interests of industry and commerce were mostly served by banks thereby neglecting the rural segments in general and the weaker sections in particular. Bank advances were skewed towards industry and commerce. The share of industrial advances rose from 34 per cent in 1951 to 64 per cent in 1968. The share of flow of funds to agriculture stood at an insignificant level of only two per cent as per RBI.

The credit gaps in respect of key sectors of the economy such as agriculture were identified systematically for the first time by NCC and felt that the gaps were glaring.

Ghosh felt that the Prime Minister’s broadcast to the Nation on 19th July 1969 on the decision to nationalise banks was a complete break from the past. It was an explicit recognition by the Government that it could not absolve itself of its responsibilities of controlling directly the banking system if it was to be shaped as an instrument of furthering economic development in accordance with the national objectives and priorities.

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As a result of bank nationalisation, the branch network has increased. After nationalisation, the very concept of banking has undergone a sea-change. Government has got a leverage to put its rural and poor oriented socio-economic policies through these banks as far as credit needs of the target groups are concerned. These banks have expanded their branch network, volume of business and also meeting the social objectives.

2.3.6 Lead Bank Scheme

As a prelude to meet the social needs of the economy, RBI has introduced the concept of LBS towards the end of 1969 after giving careful consideration to the recommendations of the Nariman Committee and after taking into account the comments received from the custodians and Chairmen of various banks and suggestions of the Study group of the NCC. The Lead Bank is expected to participate in all the developmental programmes which are implemented in the district as the leader of the commercial banks operating in the district. Initially 338 districts were allotted under LBS and this has increased to 567 by March 1999. The LBS in India was evolved to give concrete shape to the idea of area approach in the development of banking, to enable the banks to assume the role of leadership in an effective and systematic manner. All the districts of the country have been allotted in a phased manner among the public sector banks and a few private sector banks. Each of these banks is expected to provide financial leadership to the other banks and financial institutions located in the districts allotted to it.

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Credit Plan

Credit plan relates to the management of credit systems of a country, namely, in relation to both the Government and the private sector. There are micro and macro aspects of credit planning. The macro aspect has to take into account the overall credit expansion to meet the requirements of the economy in the context of certain broad considerations like the overall increase in money supply and the trends in real output. The micro level credit plan has to be translated at the micro level, namely, at the individual bank's level.

Shanbhag\textsuperscript{17} says that the Lead Bank has initiated credit planning at micro level and prepared DCP in 1973. The second round of DCP covered the period of 1980 to 1982. The DCP for the third round 1983-85 was formulated in the year 1982 which had been declared as the productivity year. While planning for deployment of their resources, banks have to keep in view the directives issued by Government of India and RBI, from time to time.

Khusro\textsuperscript{18} had gone into the problems and deficiencies in the implementations of DCP. The committee under him felt the importance of credit planning for (a) foreseeing and forecasting credit demand, (b) providing resources to meet the demand, (c) avoidance of waste and deployment of surplus fund and (d) effective formulation of schemes and projects.


\textsuperscript{18}A.M. Khusro, \textit{The Report of the Agricultural Credit Review Committee}, (Mimeograph), Government of India, New Delhi, August 1989, pp.419-429.
RBI has devised a few common formats to obtain information from Lead Banks on the implementation of DCP / ACP in the respective district. Under Service Area approach, branches are required to prepare credit plan on an Annual basis.

2.2.8 Priority Sector Lending

Priority sector is one which has got the order of precedence over other sectors by the target groups in availing bank credit as per the directives of RBI. According to Desai\textsuperscript{19}, the Preamble to the Bank Nationalisation Act, 1970 clearly lays down that the banking system has to function in alignment with national priorities and objectives. Banks have been conceived as an active instrument of economic growth for securing a reduction in inequalities of income and wealth and in narrowing down the regional disparities in development. These disparities are to be bridged through adequate deployment of credit to the critical sectors of the economy by opening more number of bank branches and prioritising certain segments for apportioning a part of the credit from the total. The concept of priority sector was developed during the era of the social control of banks. Priority sector was the one wherein banks had not ventured earlier because it was not considered credit-worthy. A reorientation of banks' attitude and increased involvement in these sectors were brought about mainly through policy directives and exhortations. Though the concept of priority sector was introduced towards the end of 1969 and started implemented by nationalised banks, the composition of the priority sector remained somewhat vague even after nationalisation.

A target of 33.3 per cent of net bank credit had been stipulated by RBI for commercial banks to be reached by March 1979. Subsequent upward revision in the priority sector was made in March 1980 when the Union Finance Minister at the meeting of the chief executives of the commercial banks announced that banks should aim to increase the priority sector lending to 40 per cent of net bank credit.

The working group under the chairmanship of Krishnaswamy has endorsed the target of 40 per cent and felt the need for continued preferential treatment to the priority sector in bank credit and the maximum benefit should invariably be available to the weaker sections. This marked the beginning of the emergence of weaker section as a distinct sub-category within the priority sector and the system of stipulating sub-targets for banks lending to the latter. Over a period of two and half decades, the composition of priority sector has undergone some modifications in the activities covered such as the addition of housing for weaker sections and pure consumption loans under the priority sector. Sub-targets for each broad category under priority sector lending was fixed. RBI has stipulated that net bank credit to agriculture should reach a level of 15 per cent by March 1985, 16 per cent by March 1987 and 18 per cent by March 1989.

The weaker section classification is one of the major outcomes of the Ghosh working group. There are five weaker section categories a) small and marginal farmers, b) artisans under village and cottage industries, c) IRDP

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beneficiaries. d) Scheduled castes / Scheduled tribes and e) beneficiaries under DRI Scheme.

The guidelines for advances to priority sector were brought out by RBI in a consolidated form in March 1984. Since then there have been a number of developments in the area of priority sector lendings. Government of India have introduced several schemes with focus on flow of credit to the weaker sections. The Agricultural Credit Review committee, the Committee to examine the adequacy of Institutional Credit to the SSI Sector, the Committee on the Financial System (Narasimham Committee) and Expert committee on Integrated Rural Development Programme appointed by RBI and Government of India have reviewed lendings to the priority sector. The implementation of the recommendations made by these committee has necessitated the required changes in the guidelines on PSL.23

2.2.9 Economic Growth and Development

According to Higgins24 economic growth is a sustained increase over a significant period in the quantity of material goods and services produced in an economy. Simon Kuznets25 says that economic growth is the capacity to sustain rapidly increasing numbers at the same or slightly lower levels of living. Simon Kuznets26 elucidates that modern economic growth reflects a continuing capacity to

23 Reserve Bank of India, Guidelines for Advances to Priority Sector, Mumbai, April 1997.


supply a growing population with an increased volume of commodities and services per capita. Economic growth is measured by comparing the total output of the economy at different times. Modern economic growth is characterised by shifting from agriculture to industry and then to services sector.

Rostow's stages of economic growth is a foray into positioning the sweep of modern economic history under capitalisation into neat and hopeful epoch. The five stages of economic growth are: (a) the traditional (b) the preconditions for take off (c) the take off (d) the drive to maturity and (e) the age of mass consumption.

2.3 REVIEW

2.3.1 Banking and Economic Development

The economic history of many advanced countries reveal that economic development and growth of financial infrastructure go hand in hand. Banks, thus constitute an important segment of the financial infrastructure of any country. There is always a constant and continuous interaction between these two. If we see historically, there have been many countries like Great Britain where banking development preceded industrial development. But in vast majority of the countries including India, the development has almost been simultaneous. The one peculiar feature about the banking development in India is that it was started by big business houses and closely associated with such houses. For instance, the Central Bank of India was associated with Tatas, United Commercial Bank with Birlas, Indian Bank with Rajahs of Chettinad, Punjab

National Bank with Jains. But the fact remains that banking development is the major catalytic factor in promoting the economic growth and development.

According to Xenophon Zolotas\textsuperscript{28} in a free economy, the basic means by which private initiative can be influenced are monetary and credit policies, fiscal and commercial policies. Banks in less developed countries have to play an important role in the process of economic development and they should be properly organised and oriented towards the specific objectives that they are expected to achieve.

According to Chadha\textsuperscript{29} in a developing economy like India, commercial banks assume an extraordinary and useful role in economic development. Developing countries normally will have low living standards coupled with much dependence on primary sector, population explosion, high propensity to consume and low level of savings. The limited supply of loanable funds is indeed the first and the foremost problem that is reflected in general shortage of capital in developing countries. For financing huge investment programmes and for building other infrastructural facilities for facilitating the growth process, the domestic savings mostly from households play a vital and leading role. There are not many well developed money markets except commercial banks to tap the domestic savings for channeling the same for investment. The emphasis has to be a supply leading active phenomenon rather than demand following passive role, namely, the supply of financial services in advance of demand for them. New access to supply leading funds may in itself, have substantial, favourable, expectational and psychological effects on entrepreneurs where lack of entrepreneurship

\textsuperscript{28}Xenophon Zolotas, \textit{Role of the Banks in a Developing Country}, 1963.

is a major constraint on development. This may induce real and innovative type investment and present an opportunity to induce real growth by financial means.

Patrick\textsuperscript{30} spoke of the historical profile of the Japanese economy, its growth owes very much to commercial banking. The active participation of banking sector has built Japan on a solid foundation. Ehrlich and Tamagaua\textsuperscript{31} had indicated that the industrialisation in Japan has been activated by commercial banks in a predominant way.

According to Whittlesay\textsuperscript{32} the aim of the public policy is to facilitate the beneficial use of credit with respect to growth of employment opportunities and social justice.

According to Cameron\textsuperscript{33}, whether banking sector makes a positive contribution in igniting the process of growth or not would appear to depend on how banking policies are pursued and on the emerging pattern of banking structure. Banking system may make a positive contribution to economic growth and development, but its effect may be offset or counteracted by other factors such as unfavourable resources endowment, population that grows either too slowly or too rapidly or inept Government policies. A sound, progressive and dynamic banking system is a fundamental requirement for economic development. In the modern economy, bankers are to be

\begin{itemize}
\item \textsuperscript{31}Edna E. Ehrlich and Frank M.Tamagaua, “Japan” in \textit{Banking Systems} edited by Backhart, Benjamin Haggot, Times of India Press, Bombay, 1967, pp.629-630.
\item \textsuperscript{33}R.Cameron (Ed.), \textit{Banking and Economic Development}, Oxford University Press, New York, 1960, p.6.
\end{itemize}
considered not merely as dealers in money, but more radically the dealers in
development. They are not just the store houses of wealth but reservoirs of resources of
money and credit to the factors of production.

Economists have expressed a wide variety of opinions on the effectiveness
of banking systems in promoting or facilitating economic development. Schumpeter\(^{34}\),
regarded the banking system as one of the two key agents (the other being
entrepreneurship) in the whole process of development.

2.3.2 Social Control of Banks and Nationalisation

The major objective of social control was clearly a more purposeful
distribution of available credit in terms of accepted priorities of development elsewhere
mainly to ensure in the immediate future, an equitable and purposeful distribution of
credit within the resources available, keeping in view the relative priorities of
developmental needs. According to Ghosh\(^{35}\) the decision of July 1969 was a complete
break from the tradition; it was an explicit recognition by the Government that it could
not absolve itself of responsibilities of controlling directly the banking system if it was
to be shaped as an instrument of furthering economic development in accordance with
national objectives and priorities. It was established for the purpose of assessment of
demand for bank credit from various sectors of the economy and also for determining
priorities for grant of loans and advances for investment, having regard to the availability
of resources and requirements of the priority sectors, in particular agriculture, small
scale industries and exports.

\(^{34}\)J.A. Schumpeter, op. cit.

Ltd, Madras, 1979, p.227.
Anjaria on social control of banks said that it would take time, the traditional dichotomy between organised and unorganised economic sectors and the hiatus between modern and traditional money markets, to disappear. But the setting up of the NCC and the scheme of social control of banking developments could open up new vistas in Central banking and indeed for banking service as a whole.

Desai stated that the main objective of nationalisation is to control the commanding heights of the economy and to meet progressively the needs of development of the economy in conformity with the national policy and objectives. The bank nationalisation has paved the way for the opening of many more branches in hitherto unbanked rural areas. This also has enabled the new type of borrowers to cultivate the banking habits.

2.3.3 Studies on Lead Bank

Viswanathan has undertaken a study of LBS. He has analysed the CDR of the Lead bank and Non-Lead banks in Coimbatore district of Tamil Nadu besides branch expansion in rural, semi-urban and urban areas. He has not spoken about the PSL under the LBS. His study was confined to the banking developments in terms of branch expansion and functional aspects of commercial banks without analysing the impact of the LBS in terms of economic development. The major conclusion drawn by Viswanathan was that the relative share of agriculture under the LBS has declined.
whereas a substantial increase was witnessed in small scale industries and other sectors. There was wide gap between target allotted and the actual performance under the DCP of the Lead Bank. The study has not analysed the impact of credit allocation.

A study was attempted by Ranganathan\textsuperscript{39} on the progress of LBS in Salem district. He had analysed the branch expansion, deposit mobilisation and credit deployment. The advances to priority sector was also analysed. His emphasis was more on the Lead Bank in Salem district than on the operation of the banking system under the LBS.

The priority sector financing by banks with special reference to LBS was analysed by Ram Vichar Sinha\textsuperscript{40}. According to him the infrastructural inadequacy always stood in the way of effective credit deployment. Hence the outcome of LBS was disappointing.

2.3.4 Studies on Priority Sector Lending

According to Jacob Kurien\textsuperscript{41} the steady upward revision of Cash Reserve Ratio and Statutory Liquidity Ratio and also the reduction in the share of priority sector advances are due to structural reforms introduced in financial sector. The Agricultural Rural Debt Relief Scheme, 1990 has accentuated the increasing number of Non Performing Assets (NPA) under priority sector advances.


\textsuperscript{40}Ram Vichar Sinha, “Priority Sector Financing by Banks with Special Reference to the Lead Bank Scheme”, \textit{Southern Economist}, Vol.21, No.23, April 1, 1983, pp.19-23.

According to Srinivasan\(^\text{42}\) during 1969-1989, the PSL has considerably increased due to increase in branch network. A radical transformation has taken place in the allocation pattern of credit. The PSL ratio has surpassed the stipulated 40 per cent in 1989. The share of large and medium scale industries has been progressively reduced. The trend analysis over the two decades, namely, from 1969 - 89 indicates that the banking system has achieved a good blend of social and commercial banking.

Majumdar\(^\text{43}\) says that the PSBs have defaulted on the priority sector target of 40 per cent of net bank credit and also on the sub-target of credit to agriculture. The share has declined from nearly 41 per cent in the pre-reform period to 37 per cent in 1995-96. In fact the share of rural branches in total bank credit declined from more than 15 per cent in the second half of the 1980's to 11 per cent in 1996. The CDR of rural branches which had risen above the targeted level of 60 per cent declined to lower than 48 per cent in 1996. These are unmistakable indicators of the sizeable decline in the resources flowing to the rural sectors since commercial banks account for 40 per cent of the total institutional credit to the rural sector.

2.3.5 Priority Sector Lending and Economic Development

There is a direct relationship between the PSA and the economic development. The availability of cheap credit is a sine qua non for any development.

\(^{42}\)R. Srinivasan, op. cit., p.141.

Cheap credit is not possible for all the people in general in a developing country like India where paucity of fund is a major constraint. The availability of credit should be put into different competing uses. There are certain neglected or forgotten segments in our economy which need to be pushed through. The identified activities under priority sector will not only provide employment to the people but also help the economic development which is an integral part of nation building activity. If adequate and cheap credit is extended by commercial banks to this neglected segment, then the economic development would vastly accrue and add to the national kitty. There is a direct relationship between banking development and the economic development. A developing country like India which has been woven by various social fabrics, the role of banks in promoting the social harmony through economic development is considerable through PSL programmes.

According to Shahjahan\textsuperscript{44} the PSL was an active instrument of our financial policy to restore sectoral imbalance with credit disbursement and to channel credit to the weaker sections. The position of the poorer states in regard to priority sector bank credit have worsened because of the manner in which priority sector targeting had been done by linking to the total bank credit taken than to bank deposit. The linking of priority sector credit to total bank credit is not proper when credit deployment itself is coming down in relation to deposit mobilisation. The question of ensuring stipulated credit towards priority sector cannot be ensured by banks in the context of decline in CDR since 1990's. The inter-state differences in priority sector bank lending as proportion of total bank deposits has declined. The position of poorer states in regard

to priority sector bank credit seems to have deteriorated because of the manner in which priority sector targeting has been done by linking it to the total bank credit advanced rather than to total bank deposits mobilised. The approach adopted by RBI right from the beginning has led to regressive outcomes towards the target groups.

2.3.6 Credit Deposit Ratio (CDR) – Trends and Causes for slow down

CDR is nothing but the ratio of flow of credit to various segments in relation to deposits expressed in percentage terms. The desirable CDR is 60 per cent as per RBI norm. The CDR is determined by factors like the availability / non-availability of finance adequately with the individuals, the absorbing capacity of the economy to utilise the credit for various productive purposes, the attitude of the people in availing bank credit, the financial climate in an economy. The absorbing capacity of the economy is also a major factor in determining the CDR. Apart from this, the industrial climate coupled with entrepreneurial ability will be an added factor to determine the CDR. There are factors like recovery climate which affect the flow of credit. From the bankers' point of view, all the above mentioned factors will be taken into account before sanctioning of any loan / project. The CDR is also determined by the quantum of funds mobilised by banks in a particular State / Union Territory.

While analysing Inter-State changes in relative shares of deposits and advances Brahmananda⁴⁵ says that the different States in India were not constituted on the basis of any rational region-wise economical basis. But commercial banks were asked to aim at gradual equalisation of CDR in different States. The efforts by the

⁴⁵P.R. Brahmananda, 50 years of Free Indian Economy, Indian Economic Association Trust for Research and Development, pp.142-146.
authorities to equalise CDR have not been successful. But it would be a useful exercise to analyse the broad shifts in the shares of different States in deposits and advances. For example, West Bengal has been losing its share in advances very heavily and this has been a continuous process. West Bengal had a share of 19 per cent in total advances in 1969. Eight per cent in 1990 and to 7.4 per cent in 1997. The CDR was 100 per cent in West Bengal in 1969, whereas it was only 50 per cent in 1997.

Das and Maiti\textsuperscript{46} while analysing the trend in CDR in West Bengal have attempted variations in CDRs of commercial banks in different States in India during 1972-73 to 1993-94. They have noted that the CDR displays a downward trend in respect of many States besides considerable variations in CDRs not only across different States but also across different regions. The major findings of their study on West Bengal is that bank credit affects output of different sectors like agriculture and manufacturing.

Rashmi Mehrotra\textsuperscript{47} says that the CDR of scheduled commercial banks varies substantially across the States with the industrially advanced or traditionally well banked States enjoying higher ratios as compared with relatively backward States having lower ratios. He says further that by all accounts, the performance of banks in bringing about a better regional distribution of bank credit can be said to be significant. If underdeveloped regions and States continue to lag behind the industrially advanced and relatively well banked states in their CDRs, the obvious explanation is to be found in the


\textsuperscript{47}Rashmi Mehrotra, “Credit-Deposit Ratio, Current Status and Future Corrections, RBI Staff Studies”, \textit{Department of Economic Analysis and Policy}, Reserve Bank of India, Bombay, June 1992.
former's relative backwardness in regard to infrastructural development and the general inadequacy of their absorbing capacity for bank credit.

The growth and development of banks as compared to 1969 was dealt in length (on branch opening, deposits and credits mobilised and advances to different regions) in Banking Services Review\textsuperscript{48}. The southern region had the highest number of bank offices (27 per cent) and has experienced more utilisation of credit than the sanctioned amount.

2.3.7 Financial Sector Reforms and their Impact on Priority Sector Lending

After starting the implementation of various recommendations of the Report of the Committee\textsuperscript{49} on Financial Sector Reforms measures were carried out at a hectic pace in the financial sector of which scheduled commercial banks constitute the dominant part.

According to Rangarajan\textsuperscript{50} the financial sector reforms initiated in 1991 had two broad objectives in view: one was to strengthen monetary policy and the other was to improve the soundness of financial institutions and more particularly banks. There were four building blocks which form part of the banking sector reforms at the first stage. These were: a) modifying the policy framework b) improving the financial


\textsuperscript{49}M. Narasimham, ibid.

soundness and credibility of banks c) creating a competitive environment and d) strengthening the institutional framework.

According to Kurup\textsuperscript{51} over the last four years, that is, from 1991 to 1995, reform measures have undermined the social commitments though reforms in the banking sector have not derailed the system.

It was observed in the special statistics\textsuperscript{52} that a conspicuous aspect of the performance of scheduled commercial banks was particularly noticed in the PSBs. In recent years there has been attempt to reduce the importance of PSA in the total loan portfolio of commercial banks even though the relative importance of priority sector such as agriculture, small-scale industries and small business in terms of employment, output and export performance in the economy is said to have grown over the years. Almost all PSBs had not only attained but crossed the 40 per cent target for PSAs by the middle of the 1980s. But once the liberalisation process began, banks started to backtrack on their avowed commitments. The performance of the SBI and its group of banks is typical of the banking industry in this respect. By December 1985, the share of the priority sectors in their total advances had touched 42.8 per cent, but by March 1991 it had slipped to 30.2 per cent (partly due to the loan waiver scheme). After fluctuating between 31 per cent and 36 per cent, it remained at 31.1 per cent at the end of March 1995.

The general impression is that the NPAs are always higher in small loans. This is not so. The priority sector has always been an area of discomfort for


banks. But now this sector is slowly coming down the risk scale. The latest figures\textsuperscript{53} indicate that there has been a rise in the share of non-priority sector in the banking books. And with the economy going through a rough pace and analysts are not very hopeful about the next year, NPAs in the non priority sector is expected to rise. The priority sector share, which stood at 50 per cent of all NPAs in 1994-95, has come down to 46.4 per cent in 1997-98. This does not, however, take away the fact that the priority sector continues to be dreaded by bankers.

2.3.8 Critical Approach to Financial Sector Reforms

Financial sector reforms introduced as a part of liberalisation process have done more harm than good to the economy according to Majumdar\textsuperscript{54}. Any reforms that we introduce must be judged by the test of their relevance to the specific Indian socio-economic milieu and the 1991 – 1996 reforms fail this test.

Following the recommendations of the Narasimham Committee, a series of reforms including a move towards international accounting standards namely income recognition, asset classification, provisioning and capital adequacy, were introduced. The fact that lending beyond Rupees 25,000 is subject to commercial rate of interest is proof enough of the dilapidated condition of the social lending concept. It is interesting to see that the reforms introduced since 1992-93 in the banking system have had a heavy toll of small borrowers. Between March 1992 and March 1996, a number of


\textsuperscript{54} N.A. Majumdar, "Public Policy and the Financial System - A Dilemma of Two Cultures", \textit{Economic and Political Weekly}, 14th December 1996, p.3237.
borrowal accounts\textsuperscript{55} has declined sharply from 65.9 million to 56.7 million. Between March, 1989 and March, 1992, the number of borrowal accounts had actually increased from 52.1 million to 65.9 million. This clearly shows that the increasing number of credit disbursal, to a large number of small borrowers has come down with the introduction of financial sector reforms in banks. It was not only altered, but the number of small borrowers getting financial facilities sharply declined during 1992 and 1996. Yet another impact of the banking sector reforms which has capped the attention is the substantial expansion of foreign banks in the country.

Mishken\textsuperscript{56}, spoke that de-regulation and liberalisation of the financial system have been strongly promoted for developing countries in recent years. Although these are all desirable objectives, de-regulation and liberalisation can be disastrous if not managed properly. Developing countries may need to move slowly in financial liberalisation in order to keep a lending boom from getting out of hand and extending the capabilities of banks’ management and supervision.

2.3.9 Need to Continue Directed Credit Programme

Satish and Gopalakrishnan\textsuperscript{57} say that in the last two and half decades, the rural banking structure has expanded spatially throughout the country. However, it has not been characterised by robust financial health over the years, the structure of rural

\textsuperscript{55} Reserve Bank of India, Banking Statistics 1972 – 95 (Basic Statistical Returns) and March '96, Mumbai.

\textsuperscript{56} Fredric S. Mishken, \textit{op. cit.}

banking itself has been viewed as an unviable one. Many of the analysis made on the viability of rural banking jump to the conclusion that majority of the rural banks are non-viable and this view is not based upon proper understanding of the Indian rural scene. Some of the view points on the non-viability of rural banking has been based on ill founded notions.

Majumdar\textsuperscript{58} focuses on the twin problems confronting the rural credit delivery system: a) high transaction cost and b) poor repayment performance. In the new economic culture introduced, it has been indicated that banks have no funds to support the production of sugar in Maharashtra but they have enough resources to extend sizeable bridge loans to enterprises such as M.S. Shoes.

Majumdar\textsuperscript{59} says that since priority sector is critical to high and sustained growth of Gross Domestic Product, it should be the business of public sector banks to support this sector irrespective of whether there are credit targets or not. The credit policy needs to be reoriented so as to reverse the neglect of this sector in the recent past. Credit flow towards priority sectors has dwindled due to regressive interest structure and reform measures. With the freeing of banks' lending and deposit rates, the new interest rate that has emerged has become highly regressive and biased against priority sector. Neglect of priority sector at the macro level has aggravated the problem at micro level.

\textsuperscript{58}N.A. Majumdar, "Overhauling the Somnolent Rural Credit System", \textit{Economic and Political Weekly}, October 18-24, 1997, pp.2707-2710.

Renu Kohli\textsuperscript{60} spoke that selective provision of credit in India and East Asian countries like Japan, South Korea and Taiwan indicate that most of the credit provided in these economies have been translated into equipment investment that acted as the vehicle for economic growth. Though this study has confined itself largely to lending to the small scale industry, this can also be extended to Indian agriculture. Hence there is a case to continue the directed credit programme.

It is now being felt more and more that while profit is the necessary objective of a bank, it must also view its operation in the overall context of the need of the community. It is logically felt for banks to adopt the twin objectives of profit and fulfilment of social obligations. Hence it is felt that PSL should continue to be operated to the targeted groups and banks should try to fulfil their social obligations.

2.3.10 Issue of Non Performing Assets

According to Shahjahan\textsuperscript{61} between March 1996 and 1997, NPAs of PSBs were brought down by almost one half. The proportion of NPA represented by the priority sector is 47 per cent to the total NPA of PSB. RBI has not indicated the method of netting done. Because of the netting procedure adopted by RBI, the proportion of total NPA accounted for by priority sector appears to be so inflated.

According to Kurup\textsuperscript{62}, the NPAs of PSBs as at the end of March, 1994 stood at Rs.39553 crores or 23.6 per cent of gross credit as against Rs.39746 crores or

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23.2 per cent in 1992-93. The data for 1992-93 for small loans and others can be computed based on RBI Report on Trends and Progress of Banking 1992-93. NPA formed only 16.9 per cent as against much higher ratio of 24.2 per cent for loans of Rs.25000 and above.

2.4 Review of Banking Developments in Pondicherry

The Gazetteer of India for the Union Territory of Pondicherry has dealt at length about the history of indigenous banking and the general credit facilities available during the pre-merger period of this Territory. The co-operative movement and the growth and expansion of co-operative and commercial banks in the Union Territory of Pondicherry were also amply dealt.

Ramadass found that the withdrawal of Indo-China bank in March, 1955 has paved the way for the establishment of Indian Banks in the Union Territory. United Commercial Bank, Indian Overseas Bank, SBI and Indian Bank have established their offices in Pondicherry between late 1940’s and 1950’s. He has analysed in detail about the branch expansion and indicates that the size of population served by a bank branch has been reduced over a period of time as compared to the All India average.

Based on Abstract of Statistics it is found that the number of bank branches in the Union Territory of Pondicherry was seven in 1962 which increased to

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63 Francis Cyril Antony (Editor), Gazetteer of India, Union Territory of Pondicherry, Pondicherry, Vol.1, 1982, pp.637-657.

64 M. Ramadass, Pondicherry Economy, Applied Inter Disciplinary Development Research Institute, Madras 1990, pp.444.

12 in 1969. The deposits have grown up from Rs.215 lakhs in 1961 to Rs.552 lakhs in 1969. The total advances has increased from Rs.203 lakhs to Rs.480 lakhs for the corresponding period. The CDR in 1961 was 94.42 per cent and in 1969 it was 86.96 per cent. The CDR in March, 98 was 39.13 per cent. This shows that over a period of time, the flow of bank credit in terms of percentage towards Pondicherry economy has come down.

The Union Territory of Pondicherry which is a single revenue district has been allotted to the Indian Bank to function as a Lead Bank. According to the Agenda Notes for SLBC\(^6\) meeting of the Lead Bank, 78 bank branches are in operation in March '99 as against 12 bank branches in 1969.

Kothai\(^7\) has evaluated the Lead bank in Pondicherry making a reference to Priority sector advances. Her study is confined only to understand the working of the LBS and its progress in the Union territory of Pondicherry without taking into account the impact of PSL upon the economic development of Pondicherry.

Reserve Bank of India\(^8\) gives region-wise disbursal of bank branches in the Union Territory of Pondicherry. As against 10,100 population per bank branch in 1983, now a bank branch serves 10000 population. In Karaikal region as against 12001 population in 1983, it is now 11207 population. In Mahe region a bank branch serves 6689 population as against 7103 in 1983. Population per bank in Yanam region is now

\(^{6}\) Indian Bank (Lead Bank), Agenda Notes for the 59th State Level Bankers' Committee Meeting, August 1999, Pondicherry.


\(^{8}\) Reserve Bank of India, Report on Trends and Progress of Banking in India 1997-98, Mumbai.
10150 as against 11063 in 1983. This shows that the regional distribution of bank branches is very favourable in the Union Territory of Pondicherry as against the All India Average of 15,000 population per bank branch. Among all regions in the Union territory of Pondicherry, Mahe is well served by intensive bank network.

The deposits of banks in the Union Territory of Pondicherry have increased from Rs.552 lakhs in 1969 to Rs.96661 lakhs in March'98 indicating an increase of 175.11 times and the credit has increased from Rs.480 lakhs to Rs.34733 lakhs indicating an increase of 72.36 times. RBI figures show that the CDR in the Union Territory of Pondicherry has started declining since 1991 and has come to an abysmally low level with less than 35 per cent by 1998. There is a widening gap between the deposits and credit and also per capita deposit and per capita advance in 1998 as compared to 1983.

Based on various materials from Lead Bank, it is found that 19 public sector banks, including SBI and its associates besides 10 private sector banks, participate and implement the ACP. Out of these 29 banks, only 9 public sector banks have considerable share in deposit mobilisation and credit deployment. There is slackening trend in the deployment of credit from March, 1991 in the Union Territory of Pondicherry due to low CDR which in turn has affected the flow towards priority sector.

Agenda Notes for the SLBC of the Indian Bank bring to the fore that the percentage flow of advances towards agriculture, weaker section and DRI beneficiaries has declined.

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70 Indian Bank (Lead Bank), District Credit Plan and Annual Credit Plan, 1980 to 1997-98.
71 Indian Bank (Lead Bank), Agenda Notes for State Level Bankers' Committee Meetings, Pondicherry, August – November, 1999.
RBI\textsuperscript{72} gives an account of top 100 centres arranged according to size of deposits and credit. Pondicherry occupies 81\textsuperscript{th} place in respect of deposits whereas it occupies only 88\textsuperscript{th} place in the availment of credit.

Kanagasabai\textsuperscript{73} has stated that a number of problems are faced by the Pondicherry administration from the banking industry. Major problems are low CDR, allotment of inadequate outlay under ACP, low level of credit facilities to fisheries sector, inadequate industrial finance and undue delay in disposing loan applications. Various remedial measures have been suggested by him to increase the CDR to the stipulated level of 60 per cent.

Committee on CDR for the Union Territory of Pondicherry\textsuperscript{74} constituted by RBI has called upon to a) identify the causes for low CDR b) review the performance of the banks with a relatively larger share of business in the Union Territory and c) make recommendations for improvement in the CDR in a time bound manner.

While studying the nature, scope and trends of agricultural credit in a futuristic way by 2005, Manivannan\textsuperscript{75} says that 60 per cent of credit stipulation has not been met by banks in Pondicherry.

\begin{thebibliography}{9}
\bibitem{74} Indian Bank (Lead Bank), \textit{Report of the Committee on Credit Deposit Ratio in the Union Territory of Pondicherry}, Oct'94.
\bibitem{75} S. Manivannan, "Institutional Finance for Agriculture – A Futuristic Appraisal with Special Reference to Public Sector Banks in Pondicherry Union Territory", \textit{Ph.D. Thesis}, Pondicherry Central University, 1996.
\end{thebibliography}
The recovery position of the priority sector advances under LBS has been analysed for various years to find out the reasons for low CDR and inadequate flow of credit towards priority sector. It is found that the recovery position has improved under industries and services sectors, whereas marginal reduction has been noticed in primary sector. The overall increase in the recovery climate indicates that there is no let up in recovery and this is not a hindering factor in the flow of credit towards the economy in general and towards the priority sector in particular.

2.5 Planning and Development in Pondicherry

The Union Territory of Pondicherry after its merger with Indian Union has tasted the planned growth under various Five Year / Annual plans. From a mere Rs.3.39 crores of plan expenditure in 1961 (at the time of de-jure merger), the plan expenditure rose to Rs.698.71 crores by the end of Eighth Five Year Plan. This shows the growth potentials available in the Union Territory of Pondicherry.

The Gazetteer of India says that the first serious attempt to compute the Union Territory’s income was made by National Council for Applied Economic Research (NCAER). The economy of the Union Territory of Pondicherry is well diversified and does not depend on agriculture like many other states in the country. One-third of the Territory’s total income is accounted for by agriculture including animal husbandry and fisheries. A little less than four per cent is derived from fishery activities.

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76 Indian Bank (Lead Bank), Agenda Notes for State Level Bankers’ Committee Meetings, Various Years, Pondicherry.


78 Francis Cyril Antony (Editor), op. cit., pp.840-842.
One-fourth of the state's income originates under the industries sector, mostly of the modern manufacturing type. The trade, transport and other services under tertiary sector account for merely 30 per cent of the Territory's income.

The Sectoral share of Net State Domestic Product\(^7\) of the Union Territory of Pondicherry for 1996-97 indicates that the contribution of primary sector has declined from 18.50 per cent in 1980-81 to 14.39 per cent in 1996-97. Secondary sector share has declined from 55.55 per cent to 25.37 per cent for the same period. The contribution of tertiary sector has gone up to 60.24 per cent in 1996-97 from a mere 25.95 per cent in 1980-81. One of the major factors for declining contribution from primary sector is the reduction of land available for cultivation due to its diversification towards residential, industrial and commercial purposes. The inadequate flow of credit towards primary sector, particularly to fisheries sector has caused reduction in its contribution to the state income. Despite increasing contribution of services sector towards state income, adequate credit deployment has not been ensured by commercial banks towards this sector.

According to Ramadass\(^8\) the Union Territory of Pondicherry is one of the economically advanced States, if we go by the All India Per capita norm. In 1997-98, the people below poverty line was 53.9 per cent which increased to 64.7 per cent in 1984-85. Thus, the poverty has grown during 1977-78 to 1984-85. This is an alarming trend and in fact constitutes one of the paradoxes of this Territory as high incidence of poverty coexists with very high per capita income in this Territory. This has serious policy implications for the future.


\(^8\)M. Ramadass, op. cit., pp.509-522.