CHAPTER – II

PRIORITY SECTOR LENDING POLICY
DIRECTIONS AND OVERVIEW

A) BACKGROUND

B) POLICY DIRECTIONS AND OVERVIEW
BACKGROUND

Socio-economic growth implies balanced regional development, optimum utilization of local resources, wide employment opportunities & reduction of inequality in income & wealth. The Directive principles of the state policy, as laid down in the constitution provide that the state shall strive to promote welfare of the people by securing & protecting, as effectively as it may, a social order in which justice; social economical & political, shall inform all the institutions of national life. Banking system constitutes an important link among the various economic activities & can play a direct role not only in creating the machinery needed for financing developmental activities but also in ensuring that the finance made available goes into the desired direction.

Banking industry, therefore, has been called upon to play a critical development role in the new dimensions of social & economic changes. It has been diverted from class banking to mass banking, from security oriented lending to purpose oriented lending & from profit oriented financing to social banking. The creation of State Bank of India in 1955 is considered to be the beginning of social banking. However, the social control over banks in 1968 & nationalization of commercial banks in 1969 are important landmarks which added a new dimension to the banking industry. These symbolized further concrete steps in taking banking
away from the elite to the egalitarian society (5) & providing financial assistance to the needy & the poor. (6)

Amelioration of the lot of the poorer section of the society is the philosophy of social banking. Social banking stands for the orientation & direction of the various activities of commercial banks towards the upliftment of the poor & downtrodden with the aim of achieving Socialistic pattern of society. (7)

The term Social banking refers to the policy induced bank assistance to designated priority sectors & weaker section of the community, such as agriculture, small scale industries, professionals & self-employed, road & water transport operators, retail trade & small business, & education. These sectors had hardly any access to the banking system prior to nationalization of banks in 1969. (8)

The concept of “Priority Sector Lending” is mainly intended to ensure that assistance from the banking system flows in an increasing measure to these sectors of the economy which, though accounting for a significant proportion of the national product had not received adequate support of institutional finance in the past. (10)

The genesis of the concept of priority sectors may be traced back to the setting up of lending targets for commercial banks by the national credit council. This council determined targets in respect of two important priority
sectors viz., agriculture. Rs. 300-400 crores & small scale industries Rs. 240-250 crores. The targets were to be achieved during the year ended June 1969. (11) The meaning & significance of Priority sector was elaborated at the conference of custodian on nationalized banks held in New Delhi in July, 1970, by the then finance Minister in the following words.

“When we talk of priority sector, the emphasis is on the needs of the common man, the man who is engaged or is willing to be engaged in a productive endeavor which is socially useful & economically viable but is handicapped for lack of finance on reasonable terms. It is also necessary for the development backward regions, which are stagnating for lack of enterprises and finance. (12)

The priority sectors came to be defined more elaborately in 1972 on the basis of the report of informal study group on statistics relating to advances to priority sectors, constituted by the RBI in May, 1971. Besides agriculture & SSI, the road & water transport, retail trade, small business, professionals & self-employed persons & education were included in the list of priority sector for advances. (13) In the light of this report, certain guidelines were issued, indicating the scope of the items to be included under the various categories of the priority sectors.

**WEAKER SECTION WITHIN PRIORITY SECTOR**

When the idea of priority sector was conceived, RBI did not spell out any ceilings on the credit extended by the banks to the more affluent sectors within the priority sectors. The Krisnaswami working group on priority
sector lending observed in 1972 that there is a need to ensure that bank advances within priority sectors are given increasingly to the comparatively weaker sections. The weakness sections within priority sector would mean the under-privileged sections of the society. Their weakness may either be financial or social. The socially weaker sections of society such as schedule caste/tribes persons are as a class, financially weak, & suffer from a lack of bargaining power & articulation in getting their grievances met. (14)

The working group introduced the concept of weaker sections within two main priority sectors viz. agriculture, comprising small & marginal farmers & landless laborers & borrowers for allied activities with credit limit up to Rs. 10,000 & SSI, comprising the units/borrowers with credit limits upto Rs. 25,000. It was recommended that advances to the small & marginal farmers and the agricultural laborers should be raised from 37% of the total direct lending in the agricultural sector to 50% by March, 1983. (15)

The concept of weaker sections within the priority sectors has been widened by the Ghosh working Group on the Role of banks in implementation of 20 point programme, appointed in March, 1982. Weaker section comprising the following:

1) Small & marginal farmers with landholding upto 5 acres, landless laborers, tenant farmers, & share croppers;
2) Artisans & persons in village & cottage industries enjoying credit limit up to Rs. 25,000.
3) IRDP, DRI & SEPUP beneficiaries &
4) Beneficiaries belonging to scheduled caste/scheduled tribes.
Since the different sectors of the economy like agriculture, industry, trade, transport, services, education etc. are inter-related, a simultaneous development of all these sectors is necessary to bring about the rapid economic development of the economy in long run. Considering the strategic role of agriculture, cottage and small scale industry, retail trade and small business, road and water transport undertaking, education and self – employment projects in increasing the supply of food and other consumer goods so as to meet the increasing domestic demand for them, in containing inflationary pressures and in generating employment opportunities, apart from their role in accelerating the rapid long-run development of the Indian economy, these sectors are designed as the priority sectors of the economy. (17)

Participation of banks in priority sector lending in the country will accelerate the commercialization of Indian agriculture, a trend that has recently set into the Indian agriculture system, so as to increase the marketable surplus of food grains in the country required to feed its non-agricultural population and possibly, even for export. It will help in promoting the banking habit among the rural people and in mobilizing rural saving for purpose of capital formation and economic development. It will also help in diffusing the fruits of economic development over a larger section of the Indian society and will thereby enable the Indian commercial banking system to fulfill its socio-economic obligations in the context of the rapid economic progress of the country. (18)
POLICY DIRECTIONS AND OVERVIEW

Credit is an important instrument required for national development and it should be utilized according to the national priorities. Till late sixties, commercial banks in India were mainly financing trade, commerce and Industry. The flow of credit towards agriculture and weaker sections of the community was quite low. In order to ensure equitable distribution of credit, keeping in view the relative priorities of development needs, the scheme of social control over banks was initiated in December, 1967. The national credit council was set up in February 1968, mainly to periodically assess the demand for bank credit from various sectors of the economy and to determine the priorities for grant of loans and advances having regard to the availability of resources. Social control was followed by nationalization of 14 major Indian scheduled commercial banks on 19th July, 1969. The main objectivities of nationalization were “to control the heights of the economy and to meet progressively, and serve better, the needs of development of the economy in conformity with national policy and objectives.” The nationalized banks were advised to open branches in rural and semi-urban areas and provide funds for all productive activities irrespective of the size and social status of the borrowers, particularly to those in the weaker sectors of the economy, six more private sector banks were nationalized on 15th April, 1980 extending further the area of public control over the country’s banking system. (19)

The acceptance of social control and subsequent nationalization of the major commercial banks initiated an important phase in the history of banking in India. It essentially tried to bring together certain sectors and sections of Indian economy and the commercial banks which were usually
stranger to each other. Whatever banking network was developed in the country, was by and large, confined to the urban areas in geographic sense and only to certain well to do and advanced sectors such as trade, commerce and industry in economic sense. The spread and frequency of the banking sector was not only limited, but it was lopsided as well and hence it kept a large section of population beyond its scope. (20)

The agriculture sector which not only generated basis food items for human beings and raw materials for industry and exports for the country, but also was the main source of employment remained outside the purview of the banking sector. The self-employed person of modest means was also not considered as a prospective client of the banking sector. The policy and efforts aimed at correcting such an imbalance gave rise to the concept of priority sector. (21)

Certain sectors of the economy were declared as priority sectors for the purpose of providing bank credit to them. The concept of priority sector lending has been evolved to ensure that bank credit flows in an increasing measures to certain vital sectors of the economy which are included in the priority sector for the purpose of lending by banks. This concept has been reviewed from time to time to make necessary changes according to national planning priorities. In November, 1974, public sector banks were advised that their priority sector lending should reach a level of not less than one third of their outstanding credit by March, 1979. Private sector banks were also advised in November, 1978 to undertake similar responsibilities and lend at least one-third of their total advances to the priority sector by the end of March, 1980. It was further decided in March, 1980 that banks should
raise the proportion of their advances to priority sector to 40 percent by March, 1985 and within the overall target, a significant proportion should be allocated to the beneficiaries under the 20 point programme. (22)

Reserve Bank constituted a working group on 13th March, 1980 under the chairmanship of Dr. K. S. Krishnaswamy, its then Deputy Governor, to give suggestions for implementation of the above decisions. The working Group submitted its report on 22nd April, 1980. It had suggested introduction of the concept of weaker sections in the main component (agriculture and small scale industries) of the priority sector with separate sub-targets for lending to such weaker sections. On the basis of its recommendations, the Reserve Bank introduced certain sub-targets for weaker sections within the overall target of priority sector. (23)

The Prime Minister announced the New 20 point programme on 14th January, 1982. At the instance of the Government of India, the Reserve Bank constituted on 11th March, 1982, a working committee under the Chairmanship of its then Deputy Governor, Shri A. Ghosh, to give recommendations for active participation of banks in implementation of the New 20 point programme. The working group submitted its report on 17th June, 1982. It did not suggested any change in the overall target of 40 percent of net bank credit set for priority advances to be achieved by banks by the end of March, 1985. However, recommendations were made by it for modifications in certain sub-targets of different segments of priority sector and weaker sections. It also suggested a few changes in the definitions of some of the segments of the priority sector. On the basis of its recommendations, Reserve Bank revised certain sub-targets of priority sector and the definitions of weaker sections. (24)
The need for Urban Co-operative bank for providing credit to priority sectors had been examined by the standing advisory committee for Urban Co-operative banks constituted by Reserve Bank of India in May 1983. The recommendations of the committee were accepted by Reserve Bank of India and accordingly the targets for lending to priority sector and weaker section by the Urban Co-operative banks were stipulated. (25)

Lending Targets Under Priority Sector Lending

The targets fixed for the priority sector lending and prevalent at present are as follows:

Forty percent of the domestic Indian commercial banks-public as well as private should go to priority sector.

Ten percent of net bank credit of the domestic Indian commercial banks – public as well as private will be for the weaker sections.

Foreign banks operating in India should lend a minimum of 32 % of their net bank credit to priority sector.

Foreign banks should reach 12% sub-targets each in export credit and credit to SSI sector.

Any shortfall in priority sector targets by the foreign banks should be placed in the form of deposits with SIDBI for one year at the rate of 10% p.a.
Total lending to agriculture (both direct and indirect) should not be less than 18% of the net bank credit of the domestic Indian commercial banks, however, agricultural lending under the indirect category should not exceed one-fourth of the sub-target of 18% i.e. 4.5% of the net bank credit. However, such advances under indirect category in excess of 4.5% of net bank credit, if any, will be taken into consideration in computing the performance under the overall priority sector targets of 40% of the net bank credit.

Any shortfall in achieving the sub-targets of 18% for agricultural targets as on 31.12.94, subject to the maximum of 1.5% of the net bank credit should be deposited with NABARD. This deposit would earn a floating rate of 0.5% over the ruling maximum term deposit rate payable at quarterly internal.

With the enhancement of the investment limit of SSI from Rs. 60 lakhs to Rs. 3 crores and for the tiny sector from Rs. 5 lakhs to Rs. 25 lakhs, the banks should ensure that out of the total funds earmarked for SSI, 40% is made available for the units with investment upto Rs. 5 lakhs, 20% for the units between Rs. 5-25 lakhs and the remaining for other SSI.

Those banks which fail to fulfill their overall priority sector target of 40% even after their contribution to the Rural Infrastructure Development fund (RIDF) of NABARD will constitute a consortium of banks to lend money to national level KVIC and state level KVIBs. This will be treated as indirect lending to SSI under priority sector lending. This loan will be provided at 1.5% below the average Prime
Lending Rate (PLR) of five major banks in consortium and will carry Government guarantees.

At least one percent of the previous year’s net bank credit outstanding should go to Differential Rate of interest (DRI) and 40% of it should go to SC/ST.

Banks minimum allocation of housing finance should be at 1.5% of the previous year’s incremental deposit of this, 20% should be provided by way of direct lending. Of this 20%, at least half should be given as direct lending in rural and semi-urban areas. Another 30% of the total allocation is to be provided as indirect lending by way of term loan to housing finance companies, housing boards, slum clearance boards and other public agencies primarily for augmenting supply of serviced land and constructed units, Remaining 50% of the total allocation shall be by way of investment in secured bonds and debentures of HUDCO and NHB.

RRBs are also brought under priority sector lending and the targets are similar to commercial banks. (26)

Based on the recommendations made by the Standing Advisory Committee for UCBs, the targets for lending to priority sector and weaker section have been prescribed for the UCBs as given below:

(i) 60% of total loans and advances to priority sector and
(ii) Of the stipulated target for priority sector advances, at least 25%
     (or 15% of the total loans and advances) to weaker sections.
(iii) In order to ensure that credit is available to all segments of SSI sector, (Classified on the basis of investment in plant and machinery), the following sub-targets should be achieved. (27)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Category</th>
<th>Investment in plant and Machinery</th>
<th>% of total SSI advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Cottage Industries, Khadi and Village industries, artisans and tiny industries</td>
<td>Upto Rs. 5 lakhs</td>
<td>40</td>
</tr>
<tr>
<td>02</td>
<td>Cottage Industries, Khadi and Village industries</td>
<td>Between Rs. 5 lakh and Rs. 25 lakhs</td>
<td>20</td>
</tr>
<tr>
<td>03</td>
<td>Other SSI units.</td>
<td>Between Rs. 25 lakhs &amp; Rs. 100 lakhs.*</td>
<td>40</td>
</tr>
</tbody>
</table>

*In some cases limit is extended to Rs. 300 lakhs to in some other cases it is increased to Rs. 500 lakhs.

AGRICULTURE AND ALLIED ACTIVITIES

Agriculture occupies a very important place in the Indian economy. It provides food grains to the growing population, supplies raw material to industries, generate purchasing power and demand for consumer goods in rural areas and also plays a significant role in exports. Demand for credit to meet requirements of agriculture has increased considerably owing to use of modern technology, increase in use of fertilizers, insecticides and pesticides, increase in irrigation facilities and increase in coverage under high yielding varieties programme. Besides, it is also necessary for increasing the income of poor farmers and providing full employment to them. In view of high importance of agriculture in Indian economy, efforts are being made by RBI, NABARD, banks and Govt. agencies to increase the flow of bank credit to agriculture. (28)

Urban co-operative banks may provide direct as well as indirect finance to agriculture. Lending by schedules urban co-operative banks to
Non-Banking financial companies (NBFC) for on lending to agriculture is also considered as indirect finance as a part of priority sector lending to agriculture. Advances granted by urban co-operative banks upto Rs. 20 lakhs per dealer for dealing is drip irrigation/sprinkler irrigation systems and agricultural machinery is also classified under indirect finance to agriculture as part of the priority sector lending.

Advances granted by Urban Co-operative banks to the members for undertaking activities like, development of dairy and animal husbandry fisheries, poultry, piggery development and maintenance of stud farms, beekeeping, sericulture etc., purchase of bullock carts, camel carts, pack animals etc. distribution of inputs for allied activities such as poultry feed etc. is considered as advanced to activities allied to agriculture. (29)

SMALL SCALE INDUSTRY

The small scale industrial sector occupies an important place in our economy on account of its certain inherent advantages like low capital requirement, high employment generation and decentralization of industrial activity and widening of entrepreneurial base. The small scale sector in India turns out a wide range of products, from simple consumer goods to highly sophisticated products like micro-processors, mini-computers, electronic components, electrometrical devices, etc. In additions to satisfying domestic demand for several items, small scale sector contributes about 28 % of the total export from the country. (30)
Small scale industrial units are those engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery (original Cost) does not exceeds Rs. 1 crore. There would inter alia, includes units engaged in mini quarrying, servicing and repairing of machinery, in case of ancillary, the investment in plant and machinery (original Cost) should also not exceed Rs. 1 crore to be classified under small scale industry.

The investment limit of Rs. 1 crore for classification as SSI has been enhanced to Rs. 5 crores in respect of certain specified item under hosiery and hand tools by the Government of India.

**TINY ENTERPRISES**

The status of “Tiny Enterprises” may be given to all small scale units whose investment in plant and machinery is upto Rs. 25 lakhs irrespective of the location of the units.

**SMALL SCALE SERVICE & BUSINESS ENTERPRISES**

Industry related service and business enterprises with investment upto Rs. 10 lakhs in fixed assets, excluding land and building will be given benefits of small scale sector.
COTTAGE INDUSTRIES & KHADI VILLAGE INDUSTRY

The maximum investment limit in plant and machinery in respect of small scale industries engaged in the manufacture of certain hosiery, Hand tools, Stationery and drugs and pharmaceuticals items has been enhanced from Rs. 100 lakhs to Rs. 500 lakhs by the Government.

The SSI units set up prior to 24.12.1999 or got provisional registration prior to 24.12.1999, the limit of investment in plant and machinery has been enhanced to Rs. 300 lakhs by the Government. (31)

Refinance facility is available from RBI to urban co-operative banks for financing the units under the 22 broad groups of cottage and small scale industries. The activities of small scale industrial units engaged in manufacture and use of equipments/systems for development of new and renewable sources of energy are also classified under this head.

LOANS TO SMALL ROAD AND WATER TRANSPORT OPERATORS

Advances to small road and water transport operators owning a fleet of vehicles not exceeding 6/10 vehicles (including the one proposed to be financed) are considered as advances to priority sector. Recovery performances of banks regarding loans given to small road and water transport operators have been poor.

Loans to small road and water transport operators owning not more than six vehicles (including the one proposed to be financed) in respect of
primary (urban) co-operative banks having Demand and time liabilities (DTL) upto and inclusive of Rs. 25 crores be reckoned as priority sector advances.

Loans to small road and water transport operators owning not more than ten vehicles (including the one proposed to be financed) in respect of primary (urban) co-operative banks having Demand and time liabilities (DTL) of more than Rs. 25 crores be reckoned as priority sector advances.

The bank credit by scheduled primary (Urban) co-operative banks to NBFC’s for financing of trucks for the purpose of on lending to small road and water transport operators will be treated as priority sector lending, provided the ultimate borrowers satisfy the eligibility requirements for being classified under the priority sector.

PRIVATE RETAIL TRADERS

Advances to private retail traders dealing in essential commodities (fair price shops) reckoned as priority sector advances.

Other private traders with credit limits not exceeding Rs. 10 lakh may also be reckoned as priority sector advances.
SMALL BUSINESS ENTERPRISES

Small business enterprises include individuals and firms managing business enterprises established mainly for the purposes of priority services other than professional services, whose original cost price of equipment does not exceed Rs. 20 Lakh without any ceiling on working capital. The banks are required to fix individual limit for working capital depending upon the requirements of different activities undertaken. This segment does not include SSSBEs. An illustrative list of small business enterprises are indicated below:

a) Agents selling goods on commission basis.
b) Booking, clearing and forwarding agents.
c) Estate agents.
d) Press cum publishing houses, etc.
e) Hair dressing saloons,
f) Restaurants, hotels, canteens, etc.
g) Servicing and repairing of various types of machinery such as automobiles air-conditioning and refrigeration equipment etc.

EDUCATIONAL LOANS

Educational loans granted to individuals only for educational purpose and not those granted to institutions are included in priority sector. This would also include all advances granted by banks under special schemes, if any, formulated for the purpose.
HOUSING LOANS

Loans granted for construction, additions, alterations, repairs etc. granted as under would be categorized as housing loans:

Direct housing loans to individual by banks upto Rs. 10 lakhs for construction of houses in Urban and metropolitan areas will be eligible for inclusion under priority sector. Further, banks with the approval of their Boards may also extend direct housing loans upto Rs. 10 lakhs in the rural and semi-urban areas & cost be considered as part of priority sector advances.

- Loans granted by banks upto Rs. 1 lakhs in rural and semi-urban areas and Rs. 2 lakhs in urban areas for repairs additional alterations etc. to individual borrower would be reckoned as priority sector advances.
- Assistance granted to any government agency for the purpose of construction of houses exclusively for the benefit of SC/STs, where the loan component does not exceed Rs. 5.00 lakh per units and all advances for slum clearances and rehabilitation of slum dwellers would be classified as priority sector advances as well as weaker section advances.
- Besides, the government agencies, assistance given to non-governmental agencies approved by National Housing Bank (NHB) for the purpose of refinance, will also be eligible for all the categories of borrowers as applicable to government agencies as priority sector advances.
- All investments in bonds issued by NHB/HUDCO exclusively for financing of housing irrespective of loan size, per dwelling unit, will be reckoned for inclusion under priority sector advances.

**CONSUMPTION LOANS**

Consumption Loans include loans for general consumption, Medical expenses, Marriage ceremonies, funerals, births, religions, ceremonies, etc. not exceeding Rs. 1,000/- per individual.

**WEAKER SECTION ADVANCES**

The definition of weaker section in priority sectors broadly corresponds to the beneficiaries under the 20 points Economic programmes aimed at improving the standard of living of the weaker sections of the society.

Weaker section advances include (i) All advances upto the limits specified under the priority sector, granted to scheduled castes (SC), Scheduled Tribes (ST), and women, (ii) advances not exceeding Rs. 50,000/- under agriculture and allied agricultural activities, small industrial units, equipments/system for development of new and renewable source of energy, etc. advances to small Road and water Transport operators, Retail traders, small business enterprises, Professionals and self-employed persons other than SC/STs and women. (iii) Advances to road and water transport operators upto Rs. 50,000/- for purchaser of cycle rickshaws auto rickshaws small boats etc. as also for repairs and replacement of space parts.
(iv) in respect of education loans, advances granted to persons having monthly income not exceeding Rs. 2,000/- (v) Assistance granted to any governmental agency for the purpose of construction of houses exclusively for the benefit of SC/STs, where the loan component does not exceed Rs. 5.00 lakh per unit and all advances for slum clearance and rehabilitation of slum dwellers would continue to be classified as weaker section advances (vi) Besides the government agencies assistance given to non-governmental agencies, approved by NHB for the purpose of refinance (Housing loan) to weaker section, will also be eligible for all the categories of borrowers as applicable to government agencies as priority sector advances as well as weaker section advances.
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30. H. C. Dua, op. cit. P.-
31. Master Circular op. cit. P-