CHAPTER - III

CONCEPTUAL DIMENSIONS OF PRIORITY SECTOR

3.1 Introduction

Priority Sector

Where does the term come from?

The term "priority sector" does not belong to economics where we find reference to primary, secondary and tertiary sectors of economy. It also does not belong to commerce where one come across terms like Private, Public and joint Sectors depending upon the ownership of the business entity in question. The term does not find its mention even in the old texts of banking encyclopedias. Then where does this term come from in the books of banking now available in the market?

The first occasion when the term "priority sector" was used appears to be on Dec. 14th 1967, when Shri. Morarji Desai the then dy. Prime minister and finance minister said in lok sabha that there shas been public concern that several priority sectors such as agriculture, small scale industries and exports were not receiving their due share of bank credit. The National Credit Council was set up to assess the demand of bank credit for various sectors of economy and to determine priorities for the grant of loans or for investment having regard to the availability of resources and the requirements of priority sectors.

During 1967-68 as a supportive measure, RBI considered the increase in bank’s advances to such priority sectors namely agriculture, SSI and export eligible for refinance from them at a concessive rate apart from considering increments in such advances as liquid assets of banks for the purpose of computation of bank’s liquidity ratio. To give an organized thrust to priority sector lending by
commercial banks 14 major banks of the country were Nationalized in July 1969.

What changes have since been witnessed?

Though concessionality in interest rates for export credit was available as early as in August 1967, dimension of concessionality for priority sector lending in general was introduced in March 1972, when loans under priority sector were exempted from the minimum lending rate of 10 percentage per year. The scheme of DRI loans was introduced under which loans for poorer sections within the priority sectors were given at the rate of 4 percentage p.a. i.e. 2 percentage below the bank rate prevailing in 1972. In due course, the concessionality in interest rate was linked with various aspects such as size of loans, activity, income of the borrower, the scheme under which loan granted etc. In November 1974, with a view to enlarging the flow of credit to the neglected sectors, the banks were advised by the government of India that their priority sector lending should reach a level of not less than one-third of their outstanding credit by March, 1979. It was at this stage that the dimension of allocationality of priority sector lending was added.

In March 1980, the Govt. of India, decided that the horizon of priority sector lending by commercial banks should be further enlarged from 33 percentage to 40 percentage by 1985 and banks should actively promote the implementation of 20 point programme for improving the lot of weaker section.

In March 1982, consequent upon the announcement of new 20 point economic programme the RBI incorporated certain modification in the profile of priority sector lending. The coverage of some of the elements namely retail trade, small business professionals and self employed persons was revised. It was also added that consumption loans and housing loans granted to the beneficiaries belonging to the weaker sections shall also be treated as priority sector credit. In respect of the allocationality of priority sector lending with in
broad allocation of 10 percentage of bank credit, the achievement of sub targets was also modified as under:

- 40 percentage of total bank credit to go to the priority sectors by March 1985.
- 15 percentage of total bank credit to be given as "Direct Agriculture Credit" within priority sector lending.
- The advances to "weaker section" with in priority sector lending to reach a level of 10 percentage of total bank credit by March 1985.

In 1987 for laying more emphasis on direct agricultural credit with in priority sector lending, it was advised by the Reserve Bank of India that commercial banks should give such advances to the extent of 17 percentage of total bank credit by March 1989 and raise them further to 18 percentage by March 1990. Recently in April 1993 with the announcement of credit policy, the Reserve Bank of India has advised the Foreign banks that those who have not met the priority sector lending target of 15 percentage would be required to deposit the short fall at the bank rate with Small Industrial Development Bank of India (SIDBI) for on lending. It has been further stipulated that target for priority sector lending by foreign banks has also been raised from 15 percentage to 32 percentage of total credit which is to be achieved by them by March 1994.

**Evolution of Priority Sector Lending:**

Chronological developments witnessed since the genesis of priority sector lending may be grouped in four phases which are tabulated here under:

**Grounding Phase:**

1967 - coining of the term "Priority sector"

1969 - Emphasis on priority sector lending on Nationalization of 14 major banks

1972 - Concessionality in interest rate for priority sector lending introduced through DRI scheme.
**Specification Phase:**

1974 - Priority sector lending to reach 1/3rd of the outstanding bank credit by March 1979 in banks.

1977 - Export credit excluded from priority sector credit (except to SSI)

1978 - Priority sector lending to reach 1/3rd of the outstanding credit by March 1980 in Indian private sector banks.

1979 - 6 more banks nationalized and stress on priority sector lending increased.

- Proportion of priority sector credit to be raised to 40 percentage of outstanding bank credit by March 1985.

- Concept of “weaker section” introduced with sub target of 10 percentage of net credit within priority sector lending.

**Streamlining Phase:**

1982 - Broadening of the concept of priority sector by including pure competition loan & housing loan also redefining retail trade, small business etc.

1983 – Direct agriculture credit to be raised to minimum of 16 percentage by March 1987 and to be further raised to minimum of 18 percentage by March 1990

**Re-inforcement Phase:**

1989 - Foreign banks also advised to undertake priority sector lending.

- 10 percentage of total credit by March 1989 to be raised to 12 percentage by March 1990 and further to 15 percentage by March 1992.

1990 - Interest rate linked with “size of loan” doing away with concessionality of other counts except DRI and export loans.
1993 – Foreign banks to undertake priority sector lending up to 32 percentage of their credit including their export credit.

Views of the Experts of Financial Sector Reform and Priority Sector Credit:

The provision of subsidized and easily accessible credit constituted the central theme of rural/agricultural development strategies adopted by India during the 1970s and 1980s. In fact, lending to the priority sector was regarded as a "people's sector" by the policy makers, regulators, and banks till 1990s. Donors like the World Bank were also very active during the pre-liberalized period as it had been associated with 750 agricultural credit projects spread over 102 countries in the world. The banks in general and rural banking institutions of particular have been under periodical examination during recent years in order to make them vibrant and dynamic.

In the case of commercial banks for example, it was reported that in the process of economic development through credit, their institutional viability was neglected, risk management measures were missing or inadequate, credit was provided at concessional interest rates mostly to big farmers, loans were wrongly and unprofitably allocated or misused, standard credit packages advocated were not suited to the heterogeneous needs of small borrowers etc. The social objectives of poverty alleviation programmes through subsidized credit have not been achieved as reported by many studies. The economic reform package launched in 1991 based on Narasimhan Committee report (1991) was to correct these weaknesses. The NC (1991) felt that "priority sector credit" should be redefined and to include only weaker sections. The credit target for this redefined priority sector should be fixed at just 10 percentage. Further the NC (1991) wanted to phase out the priority sector lending by banks to see if such a programme needed to be continued in future. The NC (1991) also recommended that "concessional interest rates to priority sector should be phased out"
The government of India did not take the direct, firing squad approach suggested by the NC (1991) fearing peasant apposition to “so sudden withdrawal of bank credit”. Subsequently, the attack on priority sector came from R.V. Gupta committee (1998). Which recommended:

1) Doing away with the target for agricultural lending (of 18 percentage of NBC)

2) Allowing commercial banks to freely fix rates of interest for loans of all amounts, even small ones. (i.e. doing away with subsidy on agricultural loans) and

3) Doing away with compulsory posting of bank staff to rural centres. This report was followed by a second Narasimham committee (1998), which acknowledges the political compulsion faced by Government of India, but persisted in recommending that priority sector be brought down to just 10 percentage the NC (1998) at least finally recognized that the small and marginal farmers and the tiny sector of industry and small business have problems with regard to obtaining credit and some earmarking may be necessary for this sector. It also recommended that the definition of “priority sector” be expanded yet further and the sectors like food processing and related service activates in agriculture, fisheries, poultry and dairy etc. should also be covered under the scope of priority sector, Narasimham committee (NC) (1998) repeats the directive of NC (1991) that “the interest subsidy element in credit for the priority sector should be totally eliminated”. In almost exactly the same words as the Gupta committee, NC (1998) says, “it is the timely and adequate availability of credit rather than its cost which is material for the intended beneficiaries”. The impact of NC (1991) and NC (1998) with regard to lending to priority sectors, particularly agriculture and weaker section has not been positive A large number of development oriented rural bankers now feel that “economic reform by and large has by – passed the agriculture and weaker sections”. Recently even RBI
also came out saying that the priority sector lending percentages of the commercial banks has came down substantially at least during the first phase of reform (1991-95).

With regard to priority sector credit, the important measures introduced by the RBI during 1991-2001 are given below.

a) In 1992, a target of 10 percentage for export credit was introduced for foreign banks. However, export does not form part of the priority sector for domestic banks.

b) In 1993, the overall priority sector lending target for foreign banks was increased from 15 to 32 percentage. While there is a sub-target for SSI for foreign banks, no target on advances to SSIs was imposed on domestic banks.

c) The RBI redefined SSIs with investments in plant and machinery worth up to Rs. 6 million. All advances granted to SSIs within this definition were treated as priority sector advances by the RBI.

d) In 1995-96, banks facing shortfall in achieving the priority sector sub targets of 18 percentage for agriculture were advised to contribute an amount equal to the shortfall to the Rural Infrastructure Development Fund (RIDF), set up at the NABARD. Further, banks facing a shortfall in achieving the priority sector targets were advised to provide Rs. 10 billion on a consortium basis to the khadi and village industries commission at an interest rate of 15 percentage below the average PLR five major banks on top of lending to the handloom co-operatives to finance viable khadi and village industrial units. This lending is now treated as priority sector leading by the RBI.

e) In 1996-97, banks were further notified that the credit extended to dealers in drip sprinkler irrigation systems and agriculture machinery would be regarded as indirect finance to agriculture and thus, priority sector lending. In the same year, banks were informed that all short
term advances to traditional plantations regardless of size of land holding would be regarded as direct agricultural advances and therefore, as priority sector lending.

f) In 1998-99, priority sector lending included incremental credit given to NBFIs for on lending to small road and water transport operators and to units in tiny sectors of industry and investment in venture capital. In the same year, activities such as food processing and related services in agriculture fisheries, poultry and dairy forming were included in the priority sector.

g) In 2000-01 micro finance extended by banks to individual borrowers directly or indirectly was recognized as part of priority sector lending.

Reflecting these changes as of March 2001, the priority sector credit by the banks comprises the following:

a. Agriculture (direct and indirect)

b. SSI.

c. Small business

d. Small road and water transport

e. Retail traders

f. Professionals and self-employed persons

g. Housing

h. Education loans

i. Micro credit etc.

j. Weaker sections

Consisting of small and marginal farmers with land holding up to 5 acres, landless laborers, tenant farmers and shave croppers, artisans and village and cottage industries enjoying credit limit up to Rs. 25,000, IRDP beneficiaries, beneficiaries belonging to the scheduled castes and tribes, beneficiaries under
the DRI and SUME schemes as also under the scheme for liberation and rehabilitation of scavengers (SLRS) and self help groups under NABARD’s pilot projects.

With respect to the overall target of priority sector lending the government has not until now expressed any intension to lower the requirements contrary to the recommendations of the Narasimham committee (1991). That advances to the priority sector should be reduced from 40 to 10 percentage. While the targets of 40 percentage imposed on domestic banks and 32 percentage on foreign banks have not changed during the reform period.

3.2. Classification Of The Priority Sector Advances:

Agriculture:

The agricultural sector is entitled for the following types of assistance under the priority sector lending by the banks.

Direct finance to farmers for agricultural purposes

1. Short term loans for raising crops i.e. for crop loans. In addition, advances up to Rs. 10 lakh to farmers against pledge hypothetication of agricultural produce for a period not exceeding 12 months, where the farmers were given crop loans for raising the produce, provided the borrowers draw credit from one bank.

2. Medium and long term loans provided directly to farmers from financing production and development needs.

Purchase of agricultural implements and machinery

1. Purchase of agricultural implements.

2. Purchase of farm machinery.

3. Purchase of transport equipment to facilitate agricultural activity.

4. Transport of agricultural inputs and farm products.

5. Purchase of plough animals.

Development of irrigation potential through
1. Construction of shallow and deep tube wells, tanks, etc. and purchase of drilling units.

2. Constructing, deepening clearing of surface wells, boring of wells, electrification of wells and purchase of oil engines and installation of electric motor pumps.

3. Purchase and installation of turbine pumps, construction of field channels etc.

4. Construction of lift irrigation project.

5. Installation of sprinkler irrigation system.

6. Purchase of generator sets for energisation of pump sets used for agricultural purposes.

**Reclamation of land and land development schemes:**

Bunding of farm lands, leveling of lands, terracing, conversion of dry paddy lands in to wet irrigable lands, wasteland development, development of drainage, reclamation of soil lands and prevention of Stalinization, reclamation of ravine lands, purchase of bulldozers etc.

Construction of farm building and structures etc. Bullock sheds, implements sheds, tractor and truk sheds, farm stores etc.

**Construction and running of storage facilities:**

Construction and running of warehouses, godowns, silos and loans granted to farmers for establishing cold storages used for storing own produce.

Production and processing of hybrid seeds for crops. Payment of irrigation charges etc. Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to customs services units, payment of development cess etc.

**Other types of direct finance to farmers:**

1. To traditional and non traditional plantations and horticulture.
2. For allied activities such as dairy, fishery, piggery, Poultry, bee keeping etc.

**Medium term & long Term loans :**

1. Development loans to all plantations, horticulture, forestry and wasteland.
2. Development loans for allied activities.
3. Development of dairying and animal husbandry in all its aspects.
4. Development of fisheries in all its aspects.
5. Development of poultry, piggery, bee keeping etc. in all its aspects.
6. Development and maintenance of stud farms, sericulture including grain ages etc. However, breeding of race horses cannot be classified here.
7. Bio gas plants
8. Financing of small and marginal farmers for purchase of land for agricultural purposes.
9. Financing setting up agri clinics and agri business centers by agricultural graduates.
10. Investment by banks in securitized assets, which represent direct advances to agriculture.

**Indirect Finance To Agriculture :**

1. Credit for financing the distribution of fertilizers, Pesticides, Seeds etc.
2. Loans up to 40 lacks granted for financing production of inputs for the allied activities such as cattle feed, etc.
3. Loans to electricity boards for reimbursing the expenditure already incurred by them for providing low tension connection from step down point to individual formers for energizing their wells.
4. Loans to SEB are for Systems Improvement Scheme under special Project agriculture (SI-SPA)
5. Loans to farmers through PACs and LAMPS.

6. Deposits held by the banks in Rural Infrastructure Development Fund maintained with NABARD.

7. Subscription to bonds issued by the Rural Electrification Corporation exclusively also for financing pump set energisation programme in rural and semi urban areas and also for financing system Improvement Programme. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by REC shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31st 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2005.

8. Subscription to bonds issued by NABARD with the objective of financing exclusively agricultural allied activities. However, the investments made by banks in such bonds issued by NABARD, shall not be eligible for classification under priority sector lending with effect from April 1, 2007.

Other Types of Indirect Assistance:

1. Finance for hire purchase schemes for distribution of agricultural machinery and implements.

2. Loans for construction and running of storage facilities including cold storage units designed to store agriculture produce / products, irrespective of their location. If the storage unit is registered as SSI unit, the loans granted to such units may be classified under advances to SSI, provided the investment in plant and machinery is within the stipulated ceiling.

3. Advances to Customs Service Units managed by individuals, institutions or organizations who maintain a fleet of tractors, bulldozers, well boring equipments, threshers, combines etc. and undertake work from farmers on contract basis.
4. Loans to individuals, institutions or organizations who undertake spraying operations.

5. Loans to co-operative marketing societies, co-operative banks for relending to co-operative marketing societies for disposing of the produce of members.

6. Loans to co-operative banks of producers.

7. Financing the farmers indirectly through the co-operative system provided a certificate from the State co-operative Bank in favour of such loans is produced.

8. Advances to State Sponsored Corporations for onward lending to weaker sections.

9. Finance extended to dealers in drip irrigation / sprinkler irrigation system / agricultural machinery, irrespective of their location, subject to the following conditions.
   1. The dealer should be dealing exclusively in such items or if dealing in other products, should be maintaining separate and district records in respect of such items.
   2. A ceiling of up to Rs. 30 lakhs per dealer should be observed.

10. Loans to National Co-operative Development Corporation for onward lending to the cooperative sector for purpose coming under priority sector.

11. Loans to farmers for purchase of shares in co-operative sugar mills and sugar mills set up as joint stock companies and other agro based processing units. (Rs. 6000 per eligible borrower irrespective of their land holdings.)

12. Loans to Arhatias for meeting their working capital requirements on account of credit extended to farmers for supply of inputs.

13. Lending to Non-Banking Financial Companies for onward lending to agriculture.

14. Investment by banks in securitized assets, which represent indirect advances to agriculture.
**Small Scale Industry Sector:**

The SSI sector industry sector comprising of the tiny, cottage and small scale industries are getting the following types of assistance from the banks under the provision of priority sector lending.

**Small Scale and Ancillary Industries:**

The Small Scale Sector covers the full range of small industrial enterprises. It includes industries using state of the art technology as well as tiny industrial units and activities of artisans, village and cottage industries. SSIs are included under priority sector lending and credit provided by the banks. “Small Scale” industrial units are those which are engaged in the manufacture, processing or Preservation of goods and in which investment in plant and machinery does not exceed 1 crore. These would, interalia, include units engaged in mining, quarrying, servicing and repairing of machinery. Small Scale ancillary units are those which are engaged in the manufacture or production of parts, components, sub assembles, tooling or intermediaries, or rendering of services and undertaking supplies or propose to supply or render not more than fifty percent of its production or services, as the case may be to one or more other industrial undertakings and whose investment in fixed assets in plant and machinery whether held on ownership terms or on lease or on hire purchase, does not exceed Rs. 1 Crores.

The investment limit of Rs. 1 crore for classification as SSI has been enhanced to Rs. 5 crores in respect of certain specified items under Hosiery, Hand tools, Stationery, Drugs, Pharmaceutical sectors, by Government of India.

**Tiny Enterprises**: Means an industrial unit whose original investment in plant and machinery does not exceed Rs. 25 lakhs irrespective of its location or population.

**Small Scale Service And Business Enterprises (SSSBFs)**

Industry related service and business enterprises having investment in fixed assets up to Rs. 10 lakhs (excluding land and building) and registered would be
given benefits of small scale sector. For computation of value of fixed assets, the original price paid by the original owner will be considered irrespective of the price paid by the subsequent owners. Investment made by banks in securitized assets representing direct lending to the SSI sector would be treated as their direct lending to SSI sector under priority sector, provided it satisfies the following conditions.

1. The pooled assets represent direct loans to SSI sector, which are reckoned under the priority sector.

2. Banks / Financial institutions originate the securitized loans.

**Indirect finance in the small scale industrial sector will include credit to:**

Agencies involved in assisting the decentralized sector in the supply of inputs and marketing of outputs of artisans, village and cottage industries.

- Government Sponsored Corporation / Organisations Providing funds to the weaker sections in the priority sector.
- Advances to handloom Co-operatives.
- Term finance / loans in the form of lines of credit made available to State Industrial Development Corporations / State Financial Corporations for financing SSIs.
- Credit provided by banks to KVIC under the Scheme for provision of credit to KVIC by consortiums of banks for lending to viable khadi and village industrial units.
- Subscription to bonds issued by NABARD with the objective of financing exclusively non-farm sector.
- Financing of NBFCs or their intermediaries for on lending to the tiny sector.
- Funds provided by commercial banks to SIDBI/ SFCs by way of rediscounting of bills of SSI. Which are originally discounted by a commercial bank and rediscounted by SIDBI / SFCs will be eligible for
classification under priority sector lending with effect from April 1, 2007.

- Deposits placed with SIDBI BY FOREIGN Banks in fulfillment of shortfall in attaining priority sector targets.

- Bank finance to HUDCO either as a line of credit or by way of investment in special bonds issued by HUDCO for on lending to artisans, handloom weavers, etc. Under tiny sector may be treated as indirect lending to SSI tiny sector.

- Loans for setting up of industrial estates.

**Khadi and Village Industrial Sector:**

All advances to KVI Sector, irrespective of their size of operations, location and investment in plant and machinery, will be covered under priority sector advances and will also be eligible for consideration under the sub target (60 percentage) of the SSI segment with in the priority sector.

Manufacture of common salt through any process including manual operation may be considered as an industrial activity and credit provided by banks to units engaged in the manufacture of common salt which satisfy the norms of SSI units may be classified under advances to SSI. Units engaged in ship breaking / dismantling of scrap thus obtained and hence the entire activity can be covered under processing. Therefore all small scale industrial units with original cost of plant and machinery not exceeding Rs.1 crore and engaged in ship breaking / dismantling activity may be considered as small scale industrial undertaking and banks advances to such units reckoned as priority sector advances.

Bank Loan bought leaf factories manufacturing tea are to be reckoned as priority sector leading to small scale industry provided the investment in plant and machinery does not exceed the prescribed limits.

Water mills have been recognized as an industrial activity and shall be eligible for registration as small scale industry.
Commercial banks are required to lend 40 percentage of their net bank credit to priority sector including SSI. Further in order to ensure that the banks will not neglect the credit needs of the small units among SSI it has been stipulated that banks should lend at least 40 percentage of their advances under SSI sector, to those units whose investment in plant and machinery is between 5 lakhs and 25 lakhs and the remaining to those units whose investment is over Rs. 25 lakhs.

Other Activities / Borrowers in the Priority Sector:

The other priority sector comprises of the various types of services. They are, small road and water transport operators, small business, retail trade, professional and self employed persons, housing education, micro credit, export finance etc.

Small road and water transport operators (SRWTOs)

Advances to small road and water transport operators owning a fleet of vehicles not exceeding ten vehicles, including the one proposed to be financed. Advances to NBFCs for on lending to truck operators and SRWTOs other than truck operators satisfying the eligibility criterion. Also, portfolio purchases from NBFCs made after 31st July, 1998 would also qualify for inclusion under the priority sector lending, provided the portfolio purchases relate to SRWTOs satisfying priority sector norms.

Retail Trade:

Advances granted to –

Retail traders dealing in essential commodities (fair price shops) and consumer co-operative stores and private retail traders with credit limit not exceeding Rs. 10 lakhs (Retail traders in fertilizers will form part of indirect finance for agriculture and those to retail traders of mineral oils under small business)

Small Business:

Small business would include individuals and firms managing a business enterprise established mainly for the purpose of providing any service other than professional service whose original cost price of the equipment used for
the purpose of business does not exceed Rs. 20 lakhs. Banks are free to fix individual limits for working capital depending upon the requirements of different activities. Advances for acquisition, construction, renovation of house boats and other tourist accommodation will be included here. Distribution of mineral oils shall be included under small business. Advances to judicial stamp vendors and lottery ticket agents may also be classified under the category.

Professional And Self Employed Persons –

1. Loans to professional and self employed persons include loans for the purpose of purchasing equipment, repairing or renovating existing equipment and or acquiring and repairing business premises or for purchasing tools and or for working capital requirements to medical practitioners including dentists, charted accountants, cost accountants, practicing company secretary, lawyers or solitors, engineers, architects, surveyors, construction contractors or management consultants or to a person trained in any other art or craft who holds either a degree or diploma, from any institution established, aided or recognized by government or to a person who is considered by the banks as technically qualified or skilled in the field in which he is employed.

2. Advances to accredited journalists and cameramen who are freelancers, not employed by a particular news paper / magazine for acquisitions of equipment by such borrowers for their professional use.

3. Credit for the purpose of purchasing equipment, acquisition of premises (strictly for business) and tools to practicing company secretaries who are not in the regular employment of any employer.

4. Financial assistance for running health centre by an individual who is not a doctor, but has received some formal training about the use of various instruments of physical exercises.
5. Advances for setting up beauty parlors where the borrower holds qualification in the particular profession and undertakes the activity as the sole means of living / earning his / her livelihood.

6. Preference may be given by banks to financing professionals like doctors, etc. Who are carrying on their professional in rural or semi urban areas. The term also includes firms and joint ventures of such professional and self employed persons. This category will include all advances granted by the bank under special schemes, if any introduced for the purpose.

7. Only such professional and self employed persons whose borrowings (limits) do not exceed Rs. 10 lakhs of which not more than Rs. 2 lakh Should be for working capital requirements, should be covered under this category. However, in the case of professionally qualified medical practitioners, setting up of practice in semi urban and rural areas the borrowing limits should not exceed Rs. 15 lakhs with a sub ceiling of Rs. 3 lakhs for working capital requirements. Advances granted for purchase of one motor vehicle to professional and self employed persons other than qualified medical practitioners will not be included under the priority sector.

8. Advances granted by banks to professional and self employed persons for acquiring personal computers for their professional use, may be classified in this category, provided the ceiling of total borrowings of Rs. 10 lakhs of which working capital should not be more than Rs. 2 lakh per borrower, is complied with in each case for the entire credit inclusive of credit provided for purchase of personal computer. However, home computers should not be treated on par with personal computers and excluded from priority sector lending.

Education:

Education loans should include only loans and advances granted to individuals for educational purposes up to Rs. 7.5 lakhs for studies in India and Rs. 15
lakhs for studies abroad, and not those granted to institutions and will include all advances granted by banks under the special schemes, if any introduced for the purpose.

**Housing :**

Commercial banks provide both direct and indirect finance to housing under the priority sector advances.

**Direct Finance –**

1. Loans up to Rs. 15 lakhs in rural / semi urban areas, urban and metropolitan areas for construction of houses by individuals, with the approval of the banks boards excluding loans granted by banks to their own employees.

2. Loans given for the requires to the damaged houses of individuals up to Rs. 1 lakh is rural and semi urban areas and Rs. 2 lakhs in urban areas.

3. Loans granted by banks up to Rs. 5 lakhs to individuals desirous of acquiring or constructing new dwelling units and up to Rs. 50,000/- for up gradation or major repairs to the existing units in rural area under the special Rural Housing Scheme of HGB.

4. Investment by banks in the mortgage backed securities, provided it satisfied the following conditions.
   
   a. The pooled assets are in respect of direct housing loans, which satisfy the definition for inclusion under the priority sector.
   
   b. The securitized loans are originated by the housing finance companies / banks ; and
   

**Indirect finance :**

a. Assistance given to any governmental agency for construction of houses or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of Rs. 5 lakh of loan amount per housing unit.
b. Assistance given to a non governmental agency approved by the NHB for the purpose of refinance for reconstruction of houses or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of loan component of Rs. 5 lakh per housing unit.

c. All the investment in bonds issued by NHB / HUDCO exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be reckoned for inclusion.

Consumption Loans:

Pure consumption loans granted to the weaker sections of the community under the consumption credit scheme should be included in this item.

Loans to NGOs / SHGs / Micro Credit:

a. Loans provided by banks to NGOs / SHGs for on lending to SHG / members of SHGs / discrete individuals or small groups, which are in the process of forming in to SHGs, will be reckoned as priority sector lending.

b. Lending to SHGs is to be included as a part of banks lending to weaker sections.

c. Micro credit provided by banks either directly or through any intermediaries should be included under the priority sector.

Food and Agro Based Processing Sector –

The following terms within the food and agro based processing sector would be eligible for classification as priority sector for lending. By banks.

a. Fruit and vegetable processing industry.

b. Food grain milling industry.

c. Dairy products.

d. Processing of poultry and eggs, meat products.

e. Fish processing.
f. Bread, oil seeds, meals, breakfast foods, biscuits, confectioneries (including coca processing and chocolate) malt extract, protein isolate, high protein food, weaning food and extruded / other ready to eat food products.

g. Aerated water / soft drinks and other processed foods.

h. Special packing for food processing industries.

i. Technical assistance and advice to food processing industry.

With regard to the size of the units within this sector, it is clarified that food and agro based processing units of small and medium size with investment in plant and machinery up to Rs. 5 crores would be included under priority sector lending. While loans to units satisfying SSI definition may be shown under advances to SSI, loans to other units should be shown separately in the half yearly statements on priority sector lending.

**Software Industry:**

Loans to software industry with credit limit up to Rs. 1 crore from the banking industry to be included under this items.

**Venture Capital:**

Investment in venture capital will be eligible for inclusion in priority sector, subject to the condition that the venture capital funds / companies are registered with SEBI. However, fresh investments that may be made by banks on or after July 1, 2005 shall not be eligible for classification under priority sector lending and the investments, which have already been made by banks up to June 30, 2005 shall not be eligible for classification under priority sector lending with effect from April 1, 2006.

**Leasing and Hire Purchase:**

Para-banking activities such as leasing and hire purchase financing undertaken departmentally by the banks will be classified as priority sector advances,
provided the ultimate beneficiary satisfies the criteria laid down by RBI for treating such advances as advances to priority sector

Loans to urban poor indebted to non-institutional lenders –

Loans to distressed urban poor to repay their debt to non-institutional lenders, against appropriate collateral or group security, subject to the guidelines to be approved by their Board of Directors, would be eligible for classification under the priority sector. Urban poor for this purpose may include those families in the urban areas who are below poverty line.

Such loans to urban poor may be classified under weaker sections within the priority sector and may be reported in the return being submitted by the banks, under a separate subhead, “Loans to urban poor indebted to non institutional lenders” under the broad head “Other Priority Sector”.
### 3.3 Performance of Commercial Banks in Priority Sector Lending in the Indian Context:

**Table 3.1**  
Performance of Commercial Banks in Priority sector credit (March Ending)  
(Rs. In Crores)

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<td>1) Net Bank Credit</td>
<td>105632</td>
<td>112190</td>
<td>132782</td>
<td>140914</td>
<td>169038</td>
<td>189664</td>
<td>218203</td>
<td>218219</td>
<td>2546203</td>
<td>292943</td>
<td>340888</td>
</tr>
<tr>
<td>2) Total Priority sector</td>
<td>42276</td>
<td>44581</td>
<td>48863</td>
<td>5319</td>
<td>61794</td>
<td>69609</td>
<td>79131</td>
<td>91319</td>
<td>127807</td>
<td>146546</td>
<td></td>
</tr>
<tr>
<td>3) percentage of Ps Credit to NBC</td>
<td>40.2</td>
<td>39.8</td>
<td>36.6</td>
<td>37.0</td>
<td>36.6</td>
<td>37.8</td>
<td>41.7</td>
<td>41.9</td>
<td>43.5</td>
<td>45.6</td>
<td>43.0</td>
</tr>
<tr>
<td>4) Total Agriculture Credit (Direct &amp; Indirect)</td>
<td>15857</td>
<td>18265</td>
<td>20010</td>
<td>21205</td>
<td>2513</td>
<td>26351</td>
<td>31012</td>
<td>34305</td>
<td>40078</td>
<td>46190</td>
<td>43685</td>
</tr>
<tr>
<td>5) percentage of Agriculture Lending to PS</td>
<td>26.7</td>
<td>24.4</td>
<td>24.3</td>
<td>25.1</td>
<td>26.3</td>
<td>26.4</td>
<td>25.5</td>
<td>26.6</td>
<td>26.7</td>
<td>27.7</td>
<td>27.3</td>
</tr>
<tr>
<td>6) percentage of Agriculture Lending to NBC</td>
<td>15.0</td>
<td>16.3</td>
<td>15.1</td>
<td>15.1</td>
<td>13.9</td>
<td>14.3</td>
<td>16.4</td>
<td>15.7</td>
<td>16.3</td>
<td>15.8</td>
<td>15.7</td>
</tr>
<tr>
<td>7) Total Lending to SSI</td>
<td>167873</td>
<td>17398</td>
<td>19388</td>
<td>21561</td>
<td>25643</td>
<td>29462</td>
<td>31542</td>
<td>30109</td>
<td>42674</td>
<td>45788</td>
<td>48445</td>
</tr>
<tr>
<td>8) percentage of SSI Lending to Total PSAD</td>
<td>39.3</td>
<td>39.0</td>
<td>39.8</td>
<td>40.5</td>
<td>41.8</td>
<td>42.4</td>
<td>39.9</td>
<td>41.7</td>
<td>39.8</td>
<td>36.8</td>
<td>33.1</td>
</tr>
<tr>
<td>9) percentage of SSI Lending to NBC</td>
<td>15.9</td>
<td>15.5</td>
<td>14.6</td>
<td>15.3</td>
<td>15.3</td>
<td>16.0</td>
<td>16.6</td>
<td>17.5</td>
<td>17.3</td>
<td>15.6</td>
<td>14.2</td>
</tr>
<tr>
<td>10) Total Lending to other priority sector</td>
<td>10290</td>
<td>10681</td>
<td>11865</td>
<td>12779</td>
<td>13918</td>
<td>15579</td>
<td>16478</td>
<td>18881</td>
<td>24448</td>
<td>32079</td>
<td>40395</td>
</tr>
<tr>
<td>11) percentage of Other Priority Sector Credit</td>
<td>24.3</td>
<td>24.4</td>
<td>24.4</td>
<td>24.0</td>
<td>22.5</td>
<td>22.4</td>
<td>20.8</td>
<td>20.7</td>
<td>22.8</td>
<td>25.1</td>
<td>27.6</td>
</tr>
<tr>
<td>12) percentage of Other Priority Sector to NBC</td>
<td>9.7</td>
<td>9.7</td>
<td>8.9</td>
<td>9.1</td>
<td>8.2</td>
<td>8.5</td>
<td>8.7</td>
<td>8.6</td>
<td>9.9</td>
<td>11.0</td>
<td>11.8</td>
</tr>
<tr>
<td>13) percentage of Weaker Section Lending to NBC</td>
<td>9.7</td>
<td>9.7</td>
<td>8.9</td>
<td>9.1</td>
<td>8.2</td>
<td>8.5</td>
<td>8.6</td>
<td>8.7</td>
<td>9.9</td>
<td>11.0</td>
<td>7.3</td>
</tr>
</tbody>
</table>

**Sources:** Reports on Trend and Progress of Banking in India, RBI – Different Years

The Priority sector lending of the commercial banks, which was Rs. 42,276 crores as on March 1991, has increased to Rs. 1,46,546 crores as on March 2001. However, this absolute increase in the amount of credit to priority sector has not reflected in terms of its percentage share to net bank credit. Particularly, between March 1992 to March 1996 period. During this period, this ratio has less than the RBIs stipulation of 40 percentage of NBC, Since 1997, the percentage share of priority sector credit to NBC of the PSBs has crossed the RBIs stipulation. As on March 2001, the priority sector lending ration to NBC was around 43 percentage for the public sector banks as a group.
Agriculture advances:

As on March 1991, agriculture advances of the commercial banks was Rs. 15,857 crores which increased to Rs. 53,683 crores as on March 2001. Even as on March 2001, the ratio of agriculture advances to NBC, was short of 2.35 percentage of the 18 percentage stipulation. The ratio of direct agriculture advances of the commercial banks to NBC has reduced from 13.66 percentage as on March 1994 to 11.10 percentage as on March 2001. In fact, the ratio of direct agriculture lending of commercial banks to their NBC as on March 2001, was the lowest among all the eight years (1994 to 2001) under study. The share of indirect agriculture advances of PSBs to NBC has, however, increased from 1.4 percentage as on March 1994 to 4.6 percentage as on March 2001.

Advances to SSI:

The outstanding advances of the commercial banks to the SSI as on March 1994 was Rs. 21,561 crore which increased to Rs. 48,445 crores as on March 2001. The share of SSI outstanding loans of the commercial banks to NBC has increased from 15.3 percentage as on March 1994 to 17.5 percentage in 1998, and again it got reduced in 1999 and in 2000. As on March 2001, this ration was only 14.2 percentage. The percentage share of tiny sector within the SSI has been continuously declining in all these years. For example, this ration was 30.2 percentage in 1997 and as on March 2001, it stood 12.6 percentage only.

Advance to Other Priority Sector:

This includes the credit to transport operators, small businesses, professional, self employed, consumption loans, housing finance etc. The share of this sub-sector to NBC of the commercial banks has been continuously increasing during the reference years. It stood at 11.8 percentage as on March 2001 as against 7.4 percentage in 1994.
Table 3.2
Target Achievements & Recovery Of Direct Agriculture Advances
By Commercial Banks During 2000-01 to 2005-06
(Rs. In Million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Target</th>
<th>Achievement</th>
<th>Annual Growth percentage</th>
<th>Demand</th>
<th>Recovery</th>
<th>Overdue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000-01</td>
<td>258.930</td>
<td>246.540</td>
<td>12.5</td>
<td>224.290</td>
<td>155.400</td>
<td>68.890</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(95.2 percentage)</td>
<td></td>
<td></td>
<td>(69.3 percentage)</td>
<td></td>
</tr>
<tr>
<td>2001-02</td>
<td>308.830</td>
<td>293.320</td>
<td>19.0</td>
<td>245.610</td>
<td>177.580</td>
<td>68.030</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(95 percentage)</td>
<td></td>
<td></td>
<td>(72.3 percentage)</td>
<td></td>
</tr>
<tr>
<td>2002-03</td>
<td>368.380</td>
<td>339.210</td>
<td>15.6</td>
<td>289.400</td>
<td>210.110</td>
<td>79.300</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(92.1 percentage)</td>
<td></td>
<td></td>
<td>(72.6 percentage)</td>
<td></td>
</tr>
<tr>
<td>2003-04</td>
<td>425.760</td>
<td>422.110</td>
<td>24.4</td>
<td>335.440</td>
<td>250.020</td>
<td>85.420</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(99.1 percentage)</td>
<td></td>
<td></td>
<td>(74.5 percentage)</td>
<td></td>
</tr>
<tr>
<td>2004-05</td>
<td>556.160</td>
<td>652.180</td>
<td>54.5</td>
<td>351.920</td>
<td>296.120</td>
<td>55.800</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(117.3 percentage)</td>
<td></td>
<td></td>
<td>(84.1 percentage)</td>
<td></td>
</tr>
<tr>
<td>2005-06</td>
<td>850.240</td>
<td>942.780</td>
<td>44.6</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(110.9 percentage)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Reports on Trend and Progress of Banking in India, RBI – Different Year-2007

Note: Figures in brackets under achievements indicate percentage achievements of targets.

Figures in brackets under recovery indicate percentage recovery to demand & under overdue indicate percentage overdue to demand.

NA – Not Available
Rural and semi-urban branches of each of the commercial banks have been allotted service area comprising specified number of villages, since April, 1989. This has facilitated all villages of the country easy and dependable access to banks to meet rural households financial services. Each branch is expected to formulate Service Area Credit Plan every year for the purpose of providing credit to the rural households. This micro level credit planning exercise should help the bank to progressively bring within its fold all eligible households for receiving credit and related services. In the ultimate process this exercise should prove to improve quality and productivity of lending. RBI has since the year 1994-95 has advised commercial banks to ensure 25 percentage annual growth rate in the matter of disbursement of credit in the above table showed that annual growth was between 12.5 percentage and 24 percentage during 2000-2001 to 2003-04. The growth was spectacularly high at 54.5 percentage during 2004-05 which, however, declined to 44.6 percentage in the following year. Disbursements of credit as against targets ranged from 92.1 percentage to 117.3 percentage during the six year period. Achievements were higher than 100 percentage only in the last two years.

Commercial banks recovery to demand under direct agricultural advances was 69.3 percentage during the year 2001 which gradually increased during following three years. It however, phenomenally rose to 84.1 percentage in the year 2005. During the five year period, the demand and percentage of recovery to demand have progressively increased in the successive years where as overdue amount has increased until the year 2004 and then it steeply declined by Rs. 29,620 million in the following year.

Priority Sector Lending:

Commercial banks have been providing credit for small scale industries, rural and cottage industries, tiny sector, khadi and village industries, handloom, handicrafts, coir and silk units under secondary sector as well as for a wide variety of purposes under service and business sector. Thus priority sector advances include agriculture, small scale industries and service and business
sector. The credit support to priority sector not only stimulates increased farm
and non-farm sector output, but also creates large scale self employment
opportunities following table exhibits commercial banks comparative
performance on outstanding credit to agriculture as well as to priority sector.
Table 3.3

Priority Sectors and Agriculture Outstanding Credit by Commercial Banks
(31st March, 2000 to 31st March 2006) (Rs. In Millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Priority Sectors</th>
<th>Agriculture</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>1,274,780 (43.3 percentage)</td>
<td>452,960 (14.3 percentage)</td>
</tr>
<tr>
<td>2001</td>
<td>1,491,160 (43.7 percentage)</td>
<td>523,710 (15.7 percentage)</td>
</tr>
<tr>
<td>2002</td>
<td>1,714,840 (43.5 percentage)</td>
<td>581,420 (14.8 percentage)</td>
</tr>
<tr>
<td>2003</td>
<td>1,997,860 (41.2 percentage)</td>
<td>705,010 (14.5 percentage)</td>
</tr>
<tr>
<td>2004</td>
<td>2,444,560 (43.6 percentage)</td>
<td>844,350 (15.1 percentage)</td>
</tr>
<tr>
<td>2005</td>
<td>3,070,460 (42.8 percentage)</td>
<td>1,099,170 (15.3 percentage)</td>
</tr>
<tr>
<td>2006</td>
<td>4,103,790 (40.3 percentage)</td>
<td>1,549,000 (15.2 percentage)</td>
</tr>
</tbody>
</table>

Sources: Reports on Trend and Progress of Banking in India, RBI – Different Year-2007

Figures in bracket indicates percentage to Net Bank Credit

During the seven year period from 2000-2006 commercial banks outstanding credit to priority sectors increased by 221.9 percentage from Rs. 1,274,780 million as on March 2000 to Rs. 4,103,790 million as on 31st March, 2006. Priority sector advances of commercial banks accounted for over 43 percentage of net bank credit in four years as against the target of 40 percentage which however, declined from 42.8 percentage to 40.3 percentage in three years.

Agriculture advances of commercial banks during the period rose by 242 percentage from Rs. 452,960 million to Rs. 1,549,000 million. Share of agriculture advances in the net bank credit by commercial banks ranged between 14.3 percentage and 15.7 percentage during 2005-06, all commercial banks were able to meet the priority sector target of 40 percentage of net bank credit.
Table 3.4
Financial Assistance to SSI Sector by Commercial Banks

<table>
<thead>
<tr>
<th>Year (As on end of March)</th>
<th>Net Bank Credit (Rs. In Crores)</th>
<th>Credit to SSI</th>
<th>Share of SSI Credit as percentage of NBC</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of Accounts in lakhs</td>
<td>Amount outstanding (Rs. In Crores)</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>1,20,374</td>
<td>31.72</td>
<td>17.513</td>
</tr>
<tr>
<td>1992</td>
<td>1,21,160</td>
<td>29.23</td>
<td>17.398</td>
</tr>
<tr>
<td>1993</td>
<td>1,32,782</td>
<td>30.40</td>
<td>19.388</td>
</tr>
<tr>
<td>1994</td>
<td>1,40,714</td>
<td>30.19</td>
<td>21.561</td>
</tr>
<tr>
<td>1995</td>
<td>1,69,038</td>
<td>32.25</td>
<td>25.843</td>
</tr>
<tr>
<td>1996</td>
<td>1,84,391</td>
<td>33.77</td>
<td>29.482</td>
</tr>
<tr>
<td>1997</td>
<td>1,89,684</td>
<td>29.44</td>
<td>32.542</td>
</tr>
<tr>
<td>1998</td>
<td>2,18,219</td>
<td>26.24</td>
<td>38.109</td>
</tr>
<tr>
<td>1999</td>
<td>2,46,203</td>
<td>22.00</td>
<td>42.074</td>
</tr>
<tr>
<td>2000</td>
<td>3,16,427</td>
<td>20.00</td>
<td>48.400</td>
</tr>
<tr>
<td>2001</td>
<td>3,41,291</td>
<td>19.00</td>
<td>54.268</td>
</tr>
<tr>
<td>2002</td>
<td>3,94,064</td>
<td>17.00</td>
<td>52.646</td>
</tr>
<tr>
<td>2003</td>
<td>4,85,271</td>
<td>17.00</td>
<td>58.311</td>
</tr>
<tr>
<td>2004</td>
<td>5,60,819</td>
<td>17.00</td>
<td>58.045</td>
</tr>
<tr>
<td>2005*</td>
<td>7,17,304</td>
<td>18.00</td>
<td>67.634</td>
</tr>
</tbody>
</table>

* Data are provisional


After economic reforms, commercial banks are sanctioning loans to SSI, keeping in mind the policy of improving profitability of banks and reducing volume of non-performance assets. This kind of attitude of commercial banks curtails the share of small scale sector in net bank credit.

Since the nationalization of fourteen major banks in 1969, the small scale industrial sector has been accorded priority status in the bank’s lending programme. The nationalized and other commercial banks are encouraged to give liberal credit assistance to the small units through the operating of the credit guarantee scheme and the targets laid before them under the priority programme.
3.4 INDIAN BANKING ISSUES

1. NPA Management:

For historical reasons the level of Non-Performing Assets (NPAs) has been very high in Indian Banks. There are both visible and invisible NPAs. Can strategies such as professional appraisal, timely delivery of credit, credit supervision, analysis of securities and identifying problem credit help to reduce the level of NPAs in the immediate future? The Union Minister for Finance announced that seven additional debt recovery tribunals will be established. What has been the experience of such tribunals so far? What changes are needed in the present legal system to facilitate NPA management to attain the desired goal?

2. Risk Management and Asset-Liability Management:

Credit Risk Analysis has assumed greater importance with the liberalization and autonomy given to banks and also to companies. Risk control has almost become a new incantation. Of late new types of risk have been identified: Currency risk, commodity risk, equity risk and Interest rate risk. This interest rate risk, in turn, consists of - level risk, shape risk and basis risk of the yield curve. The reserve Bank of India has issued guidelines for effective asset-liability management and risk management. Can the banks develop the much needed risk assessment models?

3. Relationship Banking and Universal Banking:

Relationship Banking and Universal Banking are presenting both challenges and opportunities. Are Indian Banks emerging as financial supermarkets providing with range of financial services through a single window as the Khan Committee recommended?
4. **Customer Service:**

Both Product and Marketing of Market Services have assumed new dimensions in recent years. A Veteran with two eyes... the first is the cultivation of diligence and the second is keen institution.” Can the Indian Banks meet the challenge of market driven banking business?

5. **Human Resource Development in Banks:**

The new task which the Indian Banks are called upon to face require men or bankers with new skills. Can the present set up lead to HRD in the public sector banks? Are the training needs fully met now?

6. **Privatisation Syndrome:**

The burning issue of privatization of public sector banks has met with a lot of resistance. Does the move towards privatization indicate the inadequacies or failures of banking sector reforms already initiated?
3.5 **STRUCTURAL, OPERATIONAL AND MANAGERIAL ISSUES**

**Structural Issues:**

The reports of the Narasimham Committees, have not provided a clear and unambiguous roadmap for the future shape of the Indian banking system. They have vaguely hinted at the need for developing the banking structure so as to evolve a few national level banks, 10 or so regional level banks and the merger of the regional rural banks either with the parent banks or amalgamating them into subsidiaries. This has created a scare among the weaker rural banks about losing their identity. There is lack of clarity in their recommendations as far as the future of the various segments of the banking sector. Recently, the Reserve Bank of India has announced the new norms for the entry of private sector banks. At least a couple of new banks may appear on the banking scene, under the new norms, though they are more stringent.

New banks, both Indian and foreign, were welcomed by the Committee. How many banks do we need, is not ascertained by them or by the regulators. Nine new banks came into being since 1993. While they made a sensational impact on the image of banks, they started scouting for mergers and take over of not only new banks but also much older and bigger banks. They have already initiated the process of mergers, the lead being taken by HDFC Bank, followed by ICICI Bank and UTI Bank. Two of the new banks have thus already lost their individual identity. Some of the smaller banks in the private sector are now shaken by the merger mania.

After thirty years of nationalized banking, the government of India has thought it expedient to allow the public sector banks to access the capital market to expand their capital base. It has wisely decided that the state exchequer cannot spare precious capital any more. Many of the state-owned banks have raised capital from the public during the last two years. Thus a joint sector in banking is emerging. There would be a major change in the composition of the bank
boards. The private share-holders would have a say in the appointment of the directors. This should pave the way for the radical changes contemplated in corporate governance as recommended by the Kumaramangalam Committee. The unions, however, are making some noise against the disinvestment by the Government, denouncing the measures as privatization. But what is really happening is the transition of the public sector banks into the joint sector where the banks are partially owned by the private investors.

**Operational Issues:**

The diversified growth of the banking sector, prompted more often by ad hoc goals and sometimes induced by populist policies, has resulted in many operational deficiencies and problems. They have weakened the financial viability of many banks.

The emergence of non-performing assets is one of the most vexatious developments in the Indian banking sector. A gross NPA of Rs. 60,841 crore is not a healthy sign. What is disheartening is that during FY 2000, it has increased to this level from the previous year's level of Rs. 58,722 crore. The net NPA has also increased during this period from Rs. 24,211 crore to Rs. 26,188 crore. The NPA ratio, however, shows a marginal decline, from 7.24 percent to 6.77 percent. Drastic reduction in the NPAs is very crucial for improving the health of the banks in India. The Debt Recovery Tribunals established in different centres have been able to achieve very little so far in reducing the number of suit-filed accounts accumulated in various courts. The Asset Reconstruction Commission, which the Narasimham Committee recommended has been a non-starter.

The profitability of the banks are under tremendous pressure as they operate with a very thin interest spread. One of the private sector banks has incurred loss during the previous year, as it had to make adequate provision for the bad and doubtful advances. The total profit of 293 reporting banks was Rs. 7763 crore during FY 2000. Compared to this the profit of a single multinational
company producing fast moving consumer goods was Rs. 1229 crore. The consortium of banks financing this company, perhaps, may not earn such a high volume of profit.

The rate of return on advances, adjusted for the cost of funds, works out to be 2.80 percent for FY 2000. It has declined during the year from previous year -2.97 percent. The rate of return on investments, adjusted for the cost of funds, also indicates a marginal fall, from 4.03 percent to 3.87 percent. The banks have to therefore plan to increase their income from the non-fund based business. In this segment, the foreign banks and the computer-savvy new banks are the formidable competitors.

The exodus of bank staff under the VRS appears to be beyond the expectation of many banks. Some of them, it is reported, have prevailed upon the optees to withdraw their resignations. It appears that they have not correctly assessed the financial implications of the volume of compensation to be paid. They have to earn higher profits to pay for those who desert them with a hefty cheque and bond.

**Managerial Issues**

There are many managerial issues, which require the immediate attention of the banks for consolidating their position in the context of the changes that are taking place. Some of them are intricate, while some may look cosmetic, yet inevitable.

A review of the unremunerative business handled and the loss incurring branches is an imperative need. For some reason in the past, banks have been carrying on non-profitable business in certain branches. They may not be recovering the cost of serving some of the customers for historic reasons. As free meals are not permissible under the new dispensation, it is time that they start charging them or terminating such services. Perpetually loss-incurring
branches may have to be closed or merged with the nearby branch. This should be considered as an operation needed for maintaining its health.

They have to avoid the dogmatic adherence to their traditional business based on the brick and mortar banking. Adoption of Information Technology is inevitable for their survival in the current banking scenario. Computerisation of banking operations cannot wait for the convenience of the bank staff. Efficient and quick service is what the customers expect from the banks. ATMs and front office computerization is emerging as very common ingredients of the new banks, which are attracting the existing customers of the older banks. Some of the foreign banks are reported to have built up customer base of millions of depositors through the installation of ATMs in convenient locations.

Efficient management of human resources is another area, which has not received the importance it deserves. Without a long-term perception, banks have been recruiting staff since their nationalization. In 1972, the total bank staff was only 3 lakh. With the massive branch expansion, the banks went on a recruitment spree. This process was supported by the government, which established the Banking Services Recruitment boards in almost all state capitals. These Boards were instrumental in inducting into the banking sector large number of staff. By March 2000, the staff strength increased to 10.17 lakhs; 2.90 lakh officers; 5.01 lakh clerks; and 2.09 lakh sub-staff. Their numerical strength increased their bargaining power to such an extent that the process of computerization was delayed by more than a decade because of their Opposition. The non-performing assets are not confined to the financial resources alone, the human resources also have its share of NPAs. It is not known as to whether the VRS has been able to make a dent on the NPA among the staff. There was a suggestion made earlier under which the bank staff would be permitted to go on sabbatical leave for a period up to 5 years. This suggestion was a good scheme, under which the bank staff could have asked to go on leave to work in software or computer-related companies and come back.
to the bank, after gaining proficiency in computer application in banking transactions. This would have helped the computer related companies also to gain an insight into the operational aspects of banking, which they want to computerize. Somehow, this scheme did not find favour with the bankers. The future staff recruitment has to be aimed at inducting into the banks the computer-literate personnel.

The success of the banks under the present situation depends upon their capacity to adapt themselves to the fast changes taking place. Globalization, liberalization and privatization would collectively drive the weaker banks to the brink of extinction or involuntary merger. The market forces cannot be expected to merciful towards the weak and small. Evidences are growing, both in India and abroad, indicating that the small may not be beautiful any longer.
3.6 CHALLENGES FACED BY PUBLIC SECTOR BANKS

Survival and growth is the first objective of all business organisations. Till recently, this was not true to the Public Sector Banks, which had a protecting shell from the Government. Deregulation of the Banking Industry and the entry of New Private Sector Banks, has taken out much might from their protective shell. Banks which have raised capital from the market are almost on line with market driven strategies. Once the government stake is brought down, the circle comes full and the unit would be exposed to all vagaries and adversities of nature. In future, these Public Sector Banks would face many or all of the following challenges:

a) Competition-Cut-Throat

The metro business of Current and SB particularly, high network individuals is being snatched away by New Private Sector Banks. For wholesale deposits, as the Private Banks have comparatively thinner operating expenses, they are in a position to offer competitive rates to pick up the cream of the wholesale deposits.

The PSBs would find it very difficult to raise resources in a cost effective manner – the very nerve of banking business. While the situation is already faced, the pinch would be felt, as the Private Banks, start aggressive on their expansion.

b) Technology:

Banking is basically a service industry. Service quality becomes the deciding factor or selling point. Non-absorption or less absorption of technology would definitely bring down the quality of the services rendered by PSBs. As the technology is advancing too fast, the absorption runs the risk of continuous upgradation due to the inbuilt of sole science. Online banking, Banking Hut, Internet Banking,
Telebanking etc. Have not taken off fully. By the delay in absorption, PSBs lose the competitive edge on the one hand and the process of absorption as delayed, becomes costly and complicated.

c) **Human Resources:**

Like maintaining the quality of other portfolios, the quality of the Human Resource Portfolio is also to be continuously improved and sustained. This is a very big challenge. While the cream will always have its own exit route, the other-than-cream stuff would remain as a burden. Improving the manpower skills in line with the developments in the industry is the crux.

d) **Capital Adequacy:**

Maintaining the minimum capital adequacy level has been a great challenge. Banking cannot expand their assets without providing for adequate capital. The capital cannot be raised by the market at frequent intervals, as the appetite and attraction of banking stocks is limited. Due to squeezed margins, the capital funds generated through the route of plough back of profits is limited.

In the years to come, the regulatory CAR is expected to be at higher levels as recommended by the RBI. The government is not in a position to infuse funds.

e) **Market Expectations:**

The Banks will constantly face the challenge of running upto the expectations of its shareholders. There comes the Corporate Governance code, continuous enhancement of the shareholder value, reasonable returns to them etc.
f) Management of the Bottom Line:

On the one hand, the Banks are forced to quote a competitive PLR. There comes the exposure to priority sectors at a concessional rate. This reduces their Yield on Advances. The yield curve on the government securities is constantly falling. This has made the PSB’s yield on funds highly vulnerable.

On the other hand, the PSBs are forced to quote most competitive rates on various maturity bands due to competition. The two way effect squeezes the Net Interest Margin.

In the non-interest front, the route for expansion of income are limited. Niche areas like cash management may go off once the RBI’s proposed real time clearing system takes off. The core sources of DD/TT/MT commission, guarantee commission have limited scope. The operating expenses, regardless of level of business, keep escalating at a given rate. As such, the burden management has become quite challenging.

Provision management scenario is distressing. Higher provisions are being laid out for standard assets. As the tax planning routes are very limited, there is no relief to the taxation provisions.

All this have made the management of the Bottom line challenging. The position is expected to worsen in the future.

g) Risk Management:

Gone are the days of adhocism, apart from RBI guidelines, the PSBs face the challenge of proper risk management in their own interest. The risks assumed are to be quantified. The risk appetite of the bank is to be fixed and through proper models, pricing of the products needs adjustment. The market risk management mechanism and credit risk management mechanism is to be integrated, in the interest of the bank.
This is an ongoing process leading to the management of grave challenges of huge mismatches in liquidity and interest rate sensitivity. Management of the funds of the bank on these lines, in the coming years demands extra resources and technical skills and the will of the Top Management.

h) NPA Management:

This is an ever increasing never ending story. This is a trap. In their very business, banks have to raise the resources and lend them. Lending implies increasing NPAs. Increasing NPAs means provisioning and follow-up. This involves unquantifiable time, and resources of the bank.

i) Global Standards:

Gearing up to the global standards in accounting, audit, presentation of the financial information, in the wake of globalization is another area calling for urgent action.
3.7 CHALLENGES AND PROSPECTS IN THE NEW MILLENNIUM

Standing on the threshold of the new millennium, we can foresee two things for the Indian Banking Industry; one in the form of opening up of eldorado of opportunities in the LPG environment of Liberalisation, Privatisation and Globalisation, and the other in the form of challenges and risks associated with cruising towards the unchartered horizons of free market. The banks have to prepare themselves to grapple with the challenges of competition and convert them into opportunities, which call for critical introspection and intelligent anticipation. The situation calls for toning up business acumen to scout for, identify and capture new business opportunities on one hand and on the other, equipping with appropriate skills and knowledge to identify, anticipate, manage and mitigate various market related risks, liquidity risk, interest rate risk, legal risk and operational risks.

1. Competition from Foreign Banks:

With the liberalization of branch licencing policy, many foreign banks have already opened their shops in India and there will be many more in days to come. In order to compete effectively with these ultra modern international banks, the Indian commercial banks need to possess matching financial muscle, as fair competition is possible only among the equals. In the wake of the integration with the global market, mergers and acquisitions will become a necessity in future as size is the main area where the banks in India have been left way behind in comparison with foreign banks. While the banks in India have record number of branches and employees, in the critical test of capital, they are tiny by international standards. Moreover, there has been a spate of mergers of banks in the West, making the big banks even bigger. A Bank’s size is really to be determined by the size of its balance sheet and Indian banks will have no other option than to acquire a competitive size. Mergers and acquisition route provides a quick step forward in this direction, offering
opportunities to share synergies and reduce the cost of product development as well as delivery. The proposal of both Khan and Narasimham Committees, of merging strong Indian banks/financial institutions together to withstand global competition makes a lot of sense in the light of the international trends. Though there are legal and social constraints to these moves at present, one can foresee that the market compulsion will soon force their removal. Given the trend towards gigantic banks with high capital base, our banks have to substantially enlarge their capital base.

2. **Competition from New Generation Private Banks**

Besides the fierce competitive pressures from the global majors, the competition is hotting up with the entry of a host of new generation private banks. These banks have a head start due to advantages of starting with a clean slate, thus scoring over the existing PSBs and private sector banks in areas like uneconomical branch network, NPAs etc. Lean and nimble, equipped with latest technology and technology driven product lines, these new entrants have raised the customer expectations very high. These new banks have set the tone, and to an extent, also the standard for technological improvements by harnessing the latest in information technology. Anywhere banking, extending business hours beyond normal hours, ATMs, etc. have been effectively used by them. The compulsions of fulfilling the new customer expectations as regards the quality as well as the requirements of MIS for managing risks has brought an acute awareness amongst the older banks of the role and importance of technology in their lives. As the market has become largely customer centric, the key to success in the changed environment will be one's ability to reach the client at his doorstep and meet the requirements of products and services in a customized manner. However, as the race for customers could sometimes lead to adverse selections, the situation calls for aggression laced with caution so as to ensure efficient management of both liabilities and assets.
3. **Competition from other Participants in the Financial System:**

No about, the public sector bank have played a major role in mobilising the saving of the community in the last three decades. However, in spite of reaching a near saturation point with respect to geographical reach, the penetration has not fully exploited the potential in transforming the saving pattern indicated that the blank could garner only a meagre share, less than 5 percentage of the total saving generated in the country. The rest goes to other financial instrument like deposits with NBFCs, companies, capital markets, gold real estate etc, mutual funds are now posing greater challenges to banks in resource mobilisation with their additional advantages in terms of income of tax benefits as a large share of saving still goes into other than bank deposit, the challenge before banks lies in not only combating within the banking industry, but also from other participant in the financial system.

4. **Asset Liability Management and Risk Management:**

In the globalised financial system, opportunities to maximise profits are accompanied by an explosion in the volumes and the banks are confronting increasing pressure in this high risk market environment. Banks are said to absorb credit risk and liquidity risk from the borrowers and pass on the risk free financial instruments to the investors. In the past, such risks were compensated under the huge interest margin available. In the deregulated scenario, the banks need to understand the risks associated with the liabilities and assets and plan, organise and have control over the maturities, size, flow, mix and interest rates. The freeing of interest rates has brought to the fore a compelling need to make urgent improvements in the management of liabilities as well as assets of the banks. The banks now need to pay attention to management of interest rate risks and proper pricing of their liabilities as well as assets depending upon the market realities and perception, instead of waiting for a signal or directive from the Reserve Bank of India. To adapt to this changed situation, the banks have to
set up an efficient and comprehensive MIS without which, neither asset-liability nor risk nor price management is possible.

The Reserve Bank of India has recently issued comprehensive guidelines to the banks for putting in place an effective asset-liability management system. The cornerstone of an effective asset-liability management system will be the ability to identify, anticipate, manage and mitigate risks that are well known today as also those that will appear in relation to the products of tomorrow. Banks are now focusing more on managing liquidity, interest rate risk, credit risk and other market risks. As the pricing of loans is now deregulated, the banks have to develop a risk assessment model for assets acquired and relate their pricing thereto. Focus will be shifted from process-based administration to risk-based management and different risks have to be suitably identified, categorised and priced instead of being offered common cost plus price. With the impending capital account convertibility, cross border movement of financial capital would become a reality. Such a scenario would lead to the alignment of domestic interest structures with the international levels. As the exchange risk management will be more relevant, the banks have to come out with appropriate risk management instruments to manage exchange risk besides offering risk management products to their clients. Further, given the growing integration of financial markets and the danger of contagious spreading from one country to another, there is an urgent need for identifying the best practices reflecting the country specific requirements vis-a-vis international norms. As the asset classification and income recognition norms will be further tightened to bring them closer to international standards and the banks will be oriented towards sophisticated tools of risk management and asset liability management, the focus will certainly shift from mere growth to profitable growth. The banks have to integrate their domestic and forex treasuries and develop new derivative products like forward-to-forward options, futures, etc.
5. Non-performing Assets:

Non-performing Asset is a double-edged sword which cuts into profits of the banks by not earning interest as well as resulting in provisions out of the profits. The level of net NPAs in Indian banks is far higher than in international level due to historical reasons. In fact, most of the banks have recovered substantial amount under NPAs and the major portion of the remaining NPAs in the banking system is hardcore one, which has to be tackled only through effective legal system. The present legal recourse takes a long term process to meet its logical conclusion. Legal processes and legal provisions need to be changed to suit the post-reform environment. If the measures suggested in the Narasimham Committee Report (1998) are properly implemented, the NPA levels in the banks will definitely come down to be on a par with international standards. The banks have to be equipped with adequate risk appraisal system to minimise the fresh delinquencies, that too, in the globalised and high-risk operative environment. Asset Reconstruction may take a firm shape in the days ahead.

6. Increasing Pressures on Margins:

As a result of growing disintermediation and intense competition amongst the banks for higher quality business, there will be increasing pressure on the spreads. The reduction in spreads will have to be compensated through higher turnover and other fee-based income. While rationalisation and computerisation are some of the answers for cost cutting, diversified earning stream combined with economics of scale will help the banks smoothen out the impact of shrinking spreads. The banks have to focus more on increasing their fee based and service generated income. Here too, the pricing will be under pressure in the customer-driven market. The banks will have to be on constant look out for new avenues of income. No doubt, a stiffer competitive environment will emerge in the new millennium, but this will enable the industry to reach high degree of market efficiency for the overall societal good.
The emerging scenario will present new opportunities to banks enabling them to explore the territories so far uncharted by them. To hedge these market risks, derivative instruments like interest rate swaps, futures, options etc. have to be introduced by the banks. Credit cards, mortgage finance, infrastructure lending, leasing and factoring will come into greater limelight in the banking industry. Diversification into capital market related activities like stock broking, underwriting, gilt trading, depository services, loan syndication, debenture trusteeship, fund based activities like bullion trading, insurance sector and service based activities like traveller cheques, travel related service, etc. will come in handy for the banks to sustain their profitability in the wake of narrowing interest margins. Given the insignificant level of population covered at present, the insurance sector offers immense potential for new entrants. As banking and insurance complement each other a great deal, many banks will be extending their horizons to the insurance sector.

The banks will be focusing on opening of specialised branches with state-of-the-art technology for various business segments. Strategic business unit approach will be adopted by targeting specific branches for enhancing the income stream in potential areas. Considering the large outlay of funds required for infrastructure projects, the participation of financial sector to supplement the budgetary allocations will be imperative and this market segment provides exciting investment opportunities for the banks.

Securitisation, which is a well-established product in foreign countries, can be used by banks in India as an alternate source of off-balance sheet funding to improve the liquidity. Amendments are needed in the Transfer of Property Act, Negotiable Instruments Act, Stamps Act etc. and once the regulatory framework is in place, securitisation will emerge as an important tool for asset liability management and for improving the leverage and capital adequacy ratio to pave the way for faster growth of the Indian financial sector.
7. Product Innovation and Marketing:

The growth in the disposable income of the population, the changing lifestyles and the global changes and their impact on the economy result in ever-changing and diversified needs of the customers. The speed of response in the changing business environment will be the crucial factor for the success and survival of banks. As the market is progressively changing from seller's market to buyer's market, now the time has come for the banks to put themselves in the customer's shoes. The banks have to anticipate and understand the needs of the customers through effective market survey and bring out structured products to suit the specific requirements of various types of customers. Value-added services tailored to demand and soaring performance standards are fast becoming the norm. The branded products, which, because of the branding, will bear assurance of their content and quality, will attract more clients and fetch higher margins. Through increased absorption of technology, and delegation of powers, the banks have to focus on adding speed to the service by cutting down the response time. Telebanking, customer terminals, anywhere connectivity of bank branches are some of the technology oriented innovations which enhance the convenience of the customers. Specific products need to be developed suitable to 'cost-conscious customer' as well as convenience-conscious customer. The banks have to focus on product specific innovations to carve out niche market. The new challenge is to get the right service to the right customer at the right price and right time, rather than trying to provide all services to all customers.

8. Relationship Banking:

Relationship banking, which has made its mark on the Indian banking scenario rather late, would become more and more widespread to emerge as the anchor for banks' survival in an otherwise shrinking industry. To tackle the problem of thinning interest margins, the banks will have to focus on relationship banking with high value clients to explore the full potential of income from various
products and services offered to the clients. Appointment of Relationship Managers, bringing high value accounts under one executive etc. are to be seen in this context. The banks have to acquire and offer new skills, a process which will enable them to establish with their clients, a long-term and mutually beneficial relationship, through innovative product lines and flexible pricing. The continued desirability of the relationship will be measured by the banks, based on present and future earning potential of the relationship. Relationship banking is also essential to retain and expand the clientele base through customisation of products and product innovation. As customer and customer service are replacing deposits as the fundamental raw material, the new earnings equation requires maximising profit potential of each customer relationship. It leads to better risk-sharing than under the transactional banking where customer is resolicited for every transaction.

9. Universal Banking:

An important trend emerging nowadays is the gradual blurring of distinction between the roles of commercial banks and financial institutions. Banks have started entering the area of project financing, which, was so far an exclusive domain of the financial institutions. On the other hand, financial institutions, which began as exclusive term lending agencies, have started entering the arena of short term lending and seek to offer other services which, have been the preserve of commercial banks. This development has brought us a step closer to the concept of Universal Banking, where, under one roof, multifarious services can be offered to the customer, thus making way for greater overlap in coverage of the products offered by different players. The Khan Committee recommendations on Universal Banking called for broad-basing the skill levels to enable banks to render a range of financial services through a single window. The banks will be emerging as the financial supermarkets, providing a complete range of financial services under one roof, such as banking, security trading, insurance and investment banking.
10. Challenges In-built into the Indian Banking Structure:

There is a unique challenge for the commercial banks in our country, as they have to manage the different segments of the entire expanse of the economy. They can not afford to neglect any one of these or prefer to serve only one of these at the expense of others. In a vast country like India and with wide disparity in standards and ways of living in its rural, semi-urban, urban and metropolitan centres, banking services have been designed and delivered in tune with the different levels of economic prosperity enjoyed by the populace in each of these areas and their relative needs. Location-wise, in rural and semi-urban areas, where a vast majority of the Indian population resides, what really matters is not innovativeness or sophistication of products but the simplicity and low cost of their delivery. Prosperity-wise, out of the country's population of around 100 crores, around 60 crores are still in the segment of below middle income group. While about 25 crores are still below the poverty line and the armoury of social banking has to be geared towards helping them come above the poverty line within the next 10 to 15 years, the remaining 35 crores people will be still requiring financial services closer to the traditional standard products. This simple and underdeveloped traditional segment is still very significant for the Indian banks in terms of reach and potential. The Indian banking industry can not afford to overlook or minimise the necessity of serving this segment of the economy. The new private sector banks and foreign banks will continue to operate at only one end of the spectrum, i.e., the most lucrative one comprising high networth individuals and corporates. The challenge before commercial banks in India, therefore, lies in managing the two ends of the spectrum of banking services with equal felicity and in apportioning their resources equitably over the spectrum.

11. Good Corporate Governance:

In the liberalised milieu, regulation and self-regulation will go hand in hand. An effective Self-Regulatory Organisation (SRO) for the banking industry to
monitor the activities of the members, lay down the ground rules and settle disputes among members amicably, will be a logical development. The Indian Banks' Association, which, was highterto doing the role of an SRO, has to be structurally changed and broadened and empowered to carry on this role effectively. As the banks are passing through a phase of stiff competition and the expectations of the stakeholders, i.e., shareholders, customers, employees and community in general, are raising, there ought to be a product system of corporate governance to be enforced by restructuring the hierarchy, redesigning the flow of work and undertaking process re-engineering with a view to cutting costs and enhancing margins. The banks will pay more attention to controlling operating costs for enhancing the productivity of manpower and capital. The basic issues in corporate governance are effectiveness and accountability. Transparent practices by way of additional disclosure on key information, enhanced quality of service and appointment of professionals in the Board and Audit Committee of the Banks are the steps initiated in the direction of good corporate governance of banks, which will further improve in the coming years.

12. Technology, the Banks' Forte for Survival:

Among the safest forecasts which can be made about the business outlook is that information technology will spread wider and deeper into everyday working life. Financial services in general and banking in particular, is the biggest area where technology is being applied to change the way business is being done. The future banking in India is going to be information technology driven. Information technology offers a chance for banks to build new systems that address a wide range of customer needs including many that may not be imaginable today. Computerisation of banks appears to be a panacea for many problems faced by the industry. It directly results in increasing the productivity of workforce, speedier operations, facilitates volume growth and better customer service. It delivers greater knowledge about customers, their buying behaviour and lifestyles, enabling the identification of better products and
services suitable to them. It also leads to effective management and expeditious
decision process. The Electronic Highway has widened the horizons of banking
services. The networking of banks, remote access and ATM facilities would
transform the face of banking in India. Telebanking and Anytime Anywhere
Banking would no longer remain the monopoly of foreign and private sector
banks. The need for customers entering the bank premises would become
increasingly less as the customer friendly products such as telebanking and
customer terminals would enable them to transact and bank from the comfort of
their home/office. As technology will have a powerful impact on the mode of
delivering financial products, branch network is likely to become less
important for delivering financial services and lose its competitive edge to
technology. The entry of internet banking and emergence of E-commerce
indicate the roadmap of the banking services in the next century. With the
increasing acceptance of internet/intranet, banks would transact business
through the internet and customers can have access to the data/ information
anytime from anywhere. Point of sale terminals would become common place
at shopping centres, airports and train terminals, eliminating the need for
carrying cash. The workforce have to be trained in the direction of optimum
utilisation of the information technology.
3.8 LIMITS OF CREDIT - NOT CREDIT LIMITS

The post-independence story of credit for rural development begins with the Report of the Committee of Direction to direct an all-India Rural Credit Survey (briefly RCS Committee) set up by the Reserve Bank of India (RBI) in 1954. Its Report lies at the bottom of the policy, progress and problems in this field over the past forty years. The survey showed that, in 1951-52, the private credit agencies taken together (excluding commercial banks) supplied 93 percent of the total amount borrowed by cultivators; that, of the total borrowing by cultivators, roughly 50 percent was for family expenditure, 28 percent for capital expenditure on farm, and 10 percent for current farm expenditure; that relatively larger proportions of the borrowings of big and large cultivators were from institutional agencies and that the dependence of the medium and small cultivators on private agencies was much the greater in that order. Regarding the long-term credit, the Planning Commission had pointed out that 'a major part of the advances made hitherto by the Land Mortgage Banks were for repayment of old debts' (Planning Commission, 1953, pp. 234-249).

Undaunted by these facts and without seeing the underlying reasons, the Committee expected that the situation could be corrected by what they called an integrated scheme of re-organisation of the system of rural credit founded on three fundamental principles, viz., (a) full co-ordination between credit and other economic activities, (b) State partnership at different levels, and covering co-operative credit, processing, storage, warehousing, and marketing, as also commercial banking as represented by the important sector of State associated banks, and (c) administration through fully trained and efficient personnel, responsive to the needs of the rural people. The main lines of reorganisation and development recommended were as follows:

(a) At the primary base, establishing larger-sized primary credit societies supplying not only agricultural credit but eventually also rural industrial credit and also meeting, to a limited extent, the consumption needs of agricultural
labourers, handicraftsmen, etc., besides those of the member cultivators. At the apex level, financial, administrative and technical strengthening of state co-operative banks, and at the district level by either establishing branches of state co-operative banks or expansion or consolidation of central banks; coordination with land mortgage banks; the organization of new central and primary land mortgage banks, (b) Progressive organization, on a co-operative basis, of marketing and processing with the needed financial administrative and technical assistance from the State, and the development of storage and warehousing through State partnered organizations, (c) Progressive organization, on a co-operative basis, of as large a sector of economic activity as possible, e.g., farming, irrigation, transport, milk supply, dairying, livestock-breeding, cottage industries, etc., with financial, administrative, and technical assistance from the State, (d) Establishing a State Bank of India, through the amalgamation of the Imperial Bank and certain State-associated Banks with major State participation in the new and enlarged institution, (e) Organization by a Central Committee for Co-operative Training all India, regional, and State-wise, training for personnel of both co-operative departments and co-operative institutions (Reserve Bank of India, 1954, Vol. II, pp. 533-534).

In the structure of co-operative credit prescribed by the Committee, there was to be a State Co-operative Bank, a Central Land-Mortgage Bank, and a State Co-operative Marketing Society at the apex in each State. At the district level, there was to be preferably a District Central Co-operative Bank or a branch of a State Co-operative Bank, a primary Land Mortgage Bank, and a District Marketing Society. At the primary level there were to be large-sized primary agricultural credit societies, primary land mortgage banks, grain banks, and primary marketing credit societies.

The proposed State Bank of India would help in financing of individual co-operative marketing and processing societies.
This sounds very much like Proudhon (1809-1865), the French socialist who, a hundred years ago, proposed a system, called 'mutualism', of equitable exchange between self-governing producers, organized individually or in association and financed by free credit granted by the 'people's bank'. The units of the radically decentralized pluralistic social order were to be linked at all levels by applying the 'the federal principle'. But there is an important difference: Proudhon was anti-statist even to the extent of being an anarchist while the Committee of Direction of the Rural Credit Survey were essentially statists. The visionary now was Prof. D. R. Gadgil who later, in his lectures titled 'Towards a Co-operative Commonwealth' (Prof. Brij Narain Memorial Lectures, University of Punjab, 1960), argued at length for Government sponsored Co-operation. In his statism, he was fully supported by the other two members of the Committee of Direction, A. D. Gorwala and B. Venkatappiah, both able members of the erstwhile Indian Civil Service.

Soon after the publication of the Report of the Committee of Direction, Sir Malcolm Darling (Darling, 1955), referring to the vast and rapid expansion of co-operative credit advocated by the Committee, said: "The Committee have certainly made out a strong case, on paper at least, for a large increase in the flow of credit, but I cannot forget Professor Carver's dictum that 'farmers who do not keep accurate accounts (and how many do this in India?) and who have not a keen sense of values should avoid use of credit like the plague'. But that was written before the age of planning, and the trouble is that one plan necessitates another. Hence, in large measure, this particular plan. "What guarantee," he asked, "is there that it (credit) will go only to the creditworthy or that the cultivator with more money to spend will be more punctual in repayment, more provident and less feckless? The camel driver, says an Arab proverb, has his plans, and the camel has his. So has it often been between Government and peasant in the past, and it may well be so again". (International Co-operative Alliance Review, June, 1955).
Sir Malcolm Darling was also a member of the Indian Civil Service who joined the service in 1904 and, as a senior civil servant, served mostly in Punjab. Relevant to our subject, we may note that he was the Registrar, Co-operative Societies, Punjab, 1927 and Chairman, Punjab Banking Enquiry Committee, 1930. He had also the academic distinction of being Vice-Chancellor, University of Punjab, 1931 and 1937-38, President, Indian Economic Association, 1928 and President, Indian Society of Agricultural Economics, 1940. He was the author of (i) Some Aspects of Co-operation in Germany and Italy, 1922; (ii) The Punjab Peasant in Prosperity and Debt, 1925; (iii) Rusticus Loquitor or the Old light and the New in the Punjab Village, 1930; and (iv) Wisdom and Waste in the Punjab Village, 1934.

Referring to the state participation, Sir Malcolm Darling raised the fundamental questions: "How will self-help and mutual help fare with so much done for the members by Government? Are they not likely to wilt, or even be crushed under the weight of the proposed state structure? It is intended that Government should gradually withdraw from partnership as societies become more competent to manage their own affairs; but, as India knows, it is never easy to persuade those in authority that the time has come for withdrawal, still less easy to get employees to train others to take their place." (Darling, 1955).

But, India had already accepted the centrally planned development strategy wherein, not just state participation but, the state playing a major role was a key element. Naturally, the RBI and the GOI accepted the recommendations of the RCS Committee. The State Bank of India was established by an Act of the Parliament in 1955. The Reserve Bank of India Act was amended in 1955 to provide for the establishment of two funds, namely, the National Agricultural (Long-term Operations) Fund and the National Agricultural Credit (Stabilization) Fund. In February 1956, the National Agricultural (Long-term Operations) Fund was created to provide loans to the States to enable them to subscribe the share capital of cooperative credit institutions. The RBI could also give long-term accommodation from this Fund to Central Land Mortgage...
Banks provided that such debentures were fully guaranteed by the state Governments as to the repayment of principal and payment of interest. Medium term loans could also be made by the GOI, from which States would be able to borrow for subscribing to the share capital of non-credit cooperative institutions.

In the Second Five-Year Plan, proposals regarding rural credit generally followed the recommendations of the RCS Committee. Sir Malcolm Darling was invited by GOI "to review recent developments in the field of Co-operation with reference to programmes in the Second Five-Year Plan..." We quote below the first three paragraphs of the Introduction to his Report submitted on June 17, 1957:

"The Second Five-Year Plan involves the most spectacular effort ever contemplated in the field of agricultural co-operation... In short, Co-operation is to be 'the vital principle of all rural development'.

I need hardly say that I am in entire sympathy with this principle. It has long been my belief that Co-operation is the only satisfactory means of securing the peasant's well-being in this complicated world. But if this faith is to be justified, nothing must be done to endanger the movement, particularly at the primary level, where it has its real being. Too much is at stake and too many millions affected. Accordingly, in considering the programme... and its relation to the movement as it is, it was necessary to consider whether so much could be done in so short a time without endangering it. The field I was specially concerned with was agricultural credit and... I came to the conclusion that the pace proposed was too fast for sound development even in the four States - Bombay, Andhra, Madras and the Punjab - where the movement is strongest, doubly so in the others I visited or was able to consider.

Against this it is urged that India must develop at the pace of totalitarian countries, however, with this difference that the stimulus must come from below, and on a co-operative basis; otherwise democracy will not survive. This
difference is all important, for all democratic processes involve a slower pace that authoritarian. In the draft Outline of the Plan it is rightly said that 'if strong primary units exist at the base, effective organisations can also be built. Yet it is proposed to add an imposing stray - for co-operative manufacturing, marketing and processing - to a structure ... nowhere very strong and in some States of its foundations. This is sooner or later to risk partial, perhaps even in some areas, total collapse. And if that happens, experience shows only too clearly that rebuilding is extremely difficult - also very costly. Bihar and Bengal are conspicuous examples of this; indeed in every State, the path of Co-operation is strewn with wreckage." [Planning Commission, 1957, pp. 1-2].

In 1962, the RBI undertook a resurvey called the All-India Rural Debt and Investment Survey, 1961-62, to assess changes since the RCS 1951-52. It showed that over the ten years, borrowings from the cooperative had increased from 3.1 to 15.5 per cent but that private money lenders still predominated. There was little change in the purpose of borrowing and household expenditure continued to be the major purpose accounting for almost half of the total. Moreover, much progress had not occurred in the cooperative sector in some parts of the country despite the efforts made during the first two Five-Year-Plan periods.

The Third Plan (1961-66) admitted that the RBI had played a major role in the building up of the cooperative movement during the first two Plans through its financial supervision, arrangements for training, loans to States for participation in the share capital of cooperative banks, and advances to cooperative banks, etc., and expected the RBI to play an even larger role in the Third Plan [Planning Commission, 1962, pp 201-206]. More specifically, it proposed to set up the Agricultural Refinance Corporation, later called the Agricultural Refinance and Development Corporation (ARDC). The ARDC was established in July 1963 with an authorised share capital of Rs. 25 crore and a paid-up share capital of Rs. 5 crore, a major portion of which (i.e. Rs. 2.97 crore) was taken up by the RBI. Scheduled Commercial Banks were also
made its share-holders. The Corporation was set up primarily as a refinancing agency providing medium-term and long-term finance to State Cooperative Banks, Central Land development Banks, and Scheduled Commercial banks for financing reclamation and preparation of land, soil conservation, mechanised farming and development of animal husbandry, dairy farming, pisciculture, poultry-farming, etc.

The All-India Rural Credit Review Committee appointed by the RBI in July 1966, in its Report, submitted in 1969, that is, fifteen years after the Report of RCS Committee in 1954, admitted that the Integrated scheme of rural credit envisaged by the R.C.S. Committee (1954) with State participation at every level of the cooperative structure, had not been pursued or implemented vigorously in all the States; that cooperatively backward States were still lagging behind; characteristically, the remedy suggested was to set up Agricultural Credit Corporations in these States. There were weaknesses in a number of banks and societies, in other parts of the country too, of low deposits, high overdues and, general lack of business-like management. Of course, the remedy was to take corrective actions namely to reorganize non-viable primary credit societies into economically viable ones; rehabilitate weak central cooperative banks; take administrative and policy measures to check overdues; streamline lending policies and procedures of cooperative institutions; and let central banks and apex banks finance directly cultivators and societies in areas where they were weak or dormant.

At the bottom of it all lay the notion that non-viable primary credit societies can be converted into economically viable ones by finance from central banks and apex banks by putting on them unbearable burden. It was easy and natural to extend the logic to small and marginal farmers who, as farm families, were essentially non-viable. Hence, in spite of the admission of failure of the policy enunciated by the RCS Committee (1954), the All-India Rural Credit Review Committee (1966) emphasised that credit must be made more easily accessible to the small farmers. Special pilot programmes called the Small Farmers
Development Agencies (SFDA) were recommended, one in each State to identify the problems of small but potentially viable farmers and help them with inputs, services and credit, the funds for which should be provided by the GOI. The illusion continued that small farmers were potentially viable if only credit was supplied on concessional terms and SFDA were established in 45 selected districts to assist small holders with holdings of two hectares or less and approved 40 projects (MFAL) for the provision of supplementary occupations and other employment opportunities for sub-marginal farmers, agricultural and landless labourers.

In the meanwhile, in December 1971, the National Commission on Agriculture (NCA) submitted an interim report on the credit needs and services for small and marginal farmers and agricultural labourers. It recommended the institution of an integrated agricultural credit service for the provision of credit along with inputs and services covering not only the complete range of farm produce up to the marketing stage, but also ancillary farm occupations, such as those of rural artisans and craftsmen which provide services to the farmers; a single agency providing short, medium and long-term credit as also inputs and services. It would have three constituents: (i) Farmers' service societies (FSS) - one for each tehsil/block or any other viable unit of convenient size, with as many branches as were required in the area; (ii) a Union of these societies at the district level, and functional district organisations for specific commodities; and (iii) Lead Bank in the district assuming leadership in the matter of organising integrated agricultural credit service [Ministry of Agriculture, 1971, pp. 1-2, 23-25]. It was essentially, the same old wine in a new bottle with the old empty bottle kept side by side.

To speed up the flow of institutional credit to the weaker sections of the rural community, Government felt that it was necessary to establish 'new institutions on the basis of attitudinal and operational ethos entirely different from those obtaining in the public sector banks' and set up a Working Group on Rural Banks (1975). Based on its recommendations, 48 Regional Rural Banks
(RRBs) were set up by 1977. They were to grant loans and advances particularly to small and marginal farmers and agricultural labourers and to rural artisans, small entrepreneurs and persons of small means engaged in trade and other productive activities in their areas of operation; the lending rate of the banks was not to be higher than the prevailing lending rates of cooperative societies; and the salary structure of the employees was to be determined by the Government, having regard to the salary structure of their employees of the State Government and local authorities of comparable level and status in the area of their operation.

In its final report submitted in January 1976, the NCA pointed out that the rise in the overdues from year to year had affected the credit-worthiness of the cooperative system and its ability to extend further credit to the farmers and that the same was true of the lending by the public sector banks. Nevertheless, it charged the commercial banks and the cooperatives that they did not make any serious attempt to understand the special credit needs of the small farmers, let alone the marginal farmers or agricultural labourers, and develop the ability to attend to their needs. The NCA felt that, for this purpose, a comprehensive ground-level organisation was needed which would facilitate the conversion of credit into inputs and services as well as the realisation of fair price for the produce, and would operate fully on commercial basis covering all the needs of the farmers [Ministry of Agriculture and Irrigation, 1976 pp. 568-57]. The Farmers' Service Societies provided the desired organization but, while regional adaptations were made, it was necessary to ensure that distortion of objectives did not take place and that the individual banks were not loaded with the heavy strain of organisational work for new FSS. One wonders how the NCA expected the FSS to meet the credit needs of the small and marginal farmers and agricultural labourers and still operate fully on commercial basis. Clearly, the policy makers were afflicted by populism and an irrepressible desire to create new institutions.
With the advent of the new technology in agriculture, the All-India Rural Credit Review Committee (1966) expected that the demand for credit would increase, and seeing that the cooperative credit structure would not be able to meet the entire demand, recommended an active and positive role for commercial banks in the field of agricultural credit. In July 1969, the largest fourteen commercial banks were nationalised and their lending policies and procedures were oriented to meet the requirements of the priority sectors of the economy. Agriculture, particularly the small farmer, was one of the priority sectors. Each district was allotted to one bank called the 'lead' bank which would survey the resources and potential for banking development in that district, offer advice to small borrowers, particularly cultivators, assist other primary lending agencies, and maintain liaison with Government and quasi-government agencies [Planning Commission, 1970, pp. 139-142 and 217-221].

Thus, the predominant role played by the cooperative movement in the supply of institutional credit lasted from 1951-52 to 1968-69 and there was a shift in emphasis from cooperatives only to a multi-agency approach. This was both because of limitations of cooperative resources, which in fact were largely RBI resources, and the failure of the cooperative sector to perform. Weaknesses in the movement continued despite all the efforts to reorganize and strengthen the cooperative credit institutions.

In 1970, the RBI formulated a scheme under which, in areas where the central cooperative banks were weak, the commercial banks were to finance primary agricultural credit societies as a transitional measure. They would advance short and medium-term credit only through the primary credit societies while they could provide long-term credit directly. In November, 1972, the Steering Committee of the All-India Debt and the commercial banks did provide the necessary finance, they did not pay much attention to the revitalisation of the societies and professionalisation of their management.
In December 1972, an RBI Study Team on Overdues found that defaults were by and large wilful and there was hardly any distinction between small and big farmers in this respect. Defective lending policies of the cooperatives, especially inadequate and untimely credit or overfinancing or lack of supervision over the end-use of credit, fixation of unrealistic due dates and financing of defaulters combined with apathy of the managements in taking quick action against recalcitrant members, and lack of support from state governments had encouraged defaults and led to the piling up of overdues [Reserve Bank of India, 1974, pp. 224-225]. A programme of rehabilitation by way of relief in respect of defaults under short and medium term agricultural loans by non-wilful defaulters, especially those who belonged to the low income category, was also recommended. The Team suggested several measures including automatic disqualification of managing committees/boards of directors, denial of fresh credit and voting rights to defaulters as well as their sureties, amendment of Cooperative Societies Acts of various states, the Registrar to issue orders on his own motion for the recovery of loans as arrears of land revenue and the setting up of State Farming Corporations for the purchase of lands of defaulters at the time of auction. Needless to say, these were all politically impossible propositions.

With the multiple institutional agencies operating in the field of rural credit cooperatives, RRBs and Commercial Banks, a number of problems arose, such as, uncoordinated credit disbursal, diversion to unproductive purposes, inability of the credit agencies to formulate agricultural programmes on the basis of an area approach, overlapping and duplication of banking facilities, lagging recovery, and numerous problems arising out of different systems, procedures, security norms, service charges, interest rates etc.

In March 1979, the RBI appointed a Committee to suggest improvements in the existing arrangements for institutional credit for agriculture and rural development (CRAFICARD). The Committee noted that problems of agricultural credit had not only grown in complexity and size but had also
merged with the larger tasks of rural development and recommended the setting up of a new apex bank - the National Bank for Agriculture and Rural Development (NABARD) - providing undivided attention, forceful direction, and pointed focus to the credit problems arising out of the integrated approach to rural development. The NABARD was to take over from the RBI the overseeing of the entire rural credit system including credit for rural artisans and village industries and the statutory inspection of cooperative banks and RRBs on an agency basis though the RBI could continue to retain its essential control. The Sixth Five-Year Plan (1980-85) endorsed the setting up of the NABARD and NABARD was established by an Act of Parliament in July 1982 'for providing credit for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas.'

The Sixth Five-Year Plan (1980-85) noted that mounting overdues had clogged the system of cooperative credit. At the end of June 1985, the percentage of overdues to demand at the PACS level was around 40 per cent while at the level of LDBs it was around 42 per cent. It was worse in the case of RRBs and commercial banks at around 50 per cent. The health of agricultural credit institutions, both cooperatives and commercial banks, was in a very sad state in many parts of the country. Wilful default and overdues were mounting even in cooperatively progressive States like Gujarat and Maharashtra.

Committee after committee had mentioned this ad nauseam but they ended up recommending bypasses to let the credit flow round the overdues acting on the dictum: 'Credit should be given not only where it is due but also where it is overdue.' But now, a new factor had entered the system. By writing off agricultural loans and providing subsidies out of the State exchequer, some States had set a bad precedent. According to the Seventh Plan, if this trend was not reversed and if banks were reduced to institutions providing grants rather
than recycling credit, the banking system would not be able to meet the credit needs of agriculture in future [Planning Commission, 1985, Vol. II, p. 17]

These several problems were anticipated and articulated in the RCS Committee's Report (1954). But there appeared no other solution. Hence, the conclusion, in the famous phrase, was: "Cooperation has failed, but Cooperation must succeed" [Reserve Bank of India, 1954, Vol. II, p.372]. The remedy was to create "new conditions in which it can operate effectively and for the benefit of the weaker." The essence of the new conditions was state-partnership at all levels. The need for a strong base was recognised. There were repeated exhortations to strengthen, to reorganize, to restructure, to revitalise the primary cooperatives. But, there was little appreciation that this could not be done by initiative from above. Instead, a weak base was vastly expanded as per plan targets and an immense governmental and semi-governmental superstructure was created. The driving principle seemed to have been; 'If people cannot or will not do it, the state can and will do it.'

There has been an admirable concern for the weak and the poor and, understandably, credit was the panacea because little else could be done within the framework of policy which prevailed over forty years. That sometimes it can do more harm than good was recognised but was forgotten or overlooked. The RCS Committee (1954) had quoted a French proverb which says - 'Credit supports the farmer as the hangman's rope supports the hanged' and made a perceptive observation: "But if credit is sometimes 'fatal', it is often indispensable to the cultivator.... Agricultural credit is a problem when it cannot be obtained; it is also a problem when it can be had but in such a form that on the whole it does more harm than good," [Reserve Bank of India, 1954, VI. II, p. 151]. Unfortunately, this perception was not pursued and liberal credit was advocated not only where it was needed but where it would be taken. In justification, the Committee said that 'a large part of the working funds which the subsistence farmer needs has the appearance of being related to his consumption rather than to his production' and then with a certain prescience
noted: "Such a farmer in effect requires what is familiar to Governments in India as 'ways and means advances'". Precisely so. The ways and means advances are supposed to be very short term borrowing by the Government. But the Government systematically converted them into long term debt which now amounts to over two-thirds of the national income of the country and the interest payments on which amount almost to a quarter of the annual revenues of the Government. In similar manner, overdues are mounting in agricultural credit with this difference that they are called by their proper name, namely, overdues.

Evidently, the forebodings of Sir Malcolm Darling have come true. The situation demands, not more of the same thing but, a new and fresh thinking. There are some signs of this in the reports of the latest two committees, one appointed by the RBI (1986) and the other by the Ministry of Finance (1991).

In August 1986, the Reserve Bank of India appointed yet another Agricultural Credit Review Committee (Chairman: A.M. Khusro) which submitted its Report in August 1989 [RBI, 1989]. While the refrain of all previous committees and working groups had been that the co-operatives have not done as well as they should have, the Khusro Committee (1989) points out that the experience of commercial banks and RRBs has shown that the weaknesses which were earlier considered as those peculiar to the co-operative system in fact arise from such deficiencies as relate to the structure of agricultural production itself [RBI, 1989, p. 166, para 5.10]. But then, it missed the point and said nothing about how to restructure agricultural production. Instead, like all previous committees and working groups, it proceeded to consider how to reorganise the structure of rural credit as though this was a substitute to reorganise the structure of agricultural production. The three main elements in the structure of rural credit are the commercial banks, the regional rural banks, and the co-operatives. The committee considered them in that order.
As the Committee points out, the place of the commercial banks in the rural credit system rests on the fact that, if lendings to rural and weaker sections are to be at concessional rates, there has to be some cross-subsidisation and, in the Indian context, only commercial banks have the capacity to do it [RBI, 1989, p. 118, Para 3.59]. But too much burden has been placed on the commercial banks. They are mandated to achieve certain targets and sub-targets under priority sector lendings. Forty per cent of the total credit is required to be channelled to identified priority sectors such as agriculture, small-scale industry, small business, etc. Direct finance to agriculture and allied activities is to reach a level of 17 per cent of net bank credit and credit for weaker section 10 per cent. All these targets were achieved by the banks by March 1988. [RBI, 1989, Pp. 81-82, Paras 3.07 and 3.09]. The share of commercial banks in IRDP (Integrated Rural Development Programme) loans has gone up to 69 per cent, compared to 23 per cent that of RRBs and 8 per cent that of cooperatives [RBI, 1989, Pp. 87-91, Paras 3.13 to 3.18].

The commercial banks have found sanctioning and monitoring of a large number of small advances in their rural branches time consuming and manpower intensive and consequently a high cost proposition. Also, the staff in rural branches of commercial banks lack sufficient motivation to work in the rural areas for various reasons, both monetary and non-monetary. Therefore, supervision of rural advances has come to be neglected. As a consequence, the overall recovery by commercial banks in respect of their direct advances to agriculture as at the end of June 1987 was 57.4 per cent. Their recovery under IRDP was even smaller, at 45.3 per cent [RBI, 1989, pp. 100-102, paras 3.34 to 3.37].

The overall profitability of the commercial banks has been under strain for some time due to rise in the cost of deposits, declining yield on advances, rise in establishment expenses, etc. Losses on account of rural business of commercial banks have been contributing to their overall losses. Low interest rates on agricultural advances, lendings under IRDP, relatively poor deposit
mobilisation in rural branches, lower staff productivity, etc., have contributed to the poor profitability of rural business. As rural lending has been found contributing to losses cross subsidisation has become necessary raising the cost of credit to the non-priority sectors [RBI, 1989, pp. 112-118, paras 3.52 to 3.59].

The Committee concludes that if commercial banks are to emerge as a strong system to be able to purvey credit effectively and efficiently in the rural areas, the targets for financing weaker sections and the rural poor should be reasonable, such as the system can bear. [RBI, 1989, pp. 127-130, paras 3.81 to 3.83].

Coming to RRBs, the Committee points out that, in setting up the RRBs in 1975, the intention was to create an institution which combined the local feel and familiarity with the rural problems which the co-operatives possessed and the degree of business organisation and modernised outlook which the commercial banks had. Partnered by GOI, State Government and Sponsor Bank in the equity ratio 50:1 5:35, these new banks were conceived as low cost district banks exclusively to meet the credit needs of the target group, i.e., small and marginal farmers, agricultural labourers, artisans and other rural residents of small means [RBI, 1989, pp. 131-134, paras 4.01 to 4.09]. But, the RRBs have belied the basic assumptions of the Working Group on Rural Banks (1975). There has been near-parity in pay scales between commercial banks and RRBs. The local feel thought to be brought in by RRBs through their staff was not found to be the same as in co-operatives. As on June 1986, the recovery of RRBs was 49 per cent of demand. Wilful defaults, misuse of loans, lack of follow-up, wrong identification of borrowers, extension of benami loans, staff agitations, etc., contributed to the poor recovery in the RRBs [RBI, 1989, pp. 142-143, paras 4.21 to 4.22]. Add to this the fact that their lendings were exclusively to weaker sections, at low interest rate margins and high operating cost involved in handling small loans with no scope for cross-subsidisation [RBI, 1989, pp. 139-141, paras 4.18 to 4.20]. In consequence,
there has been a steep decline in their profitability, poor recoveries and problems relating to management and staff. Out of the total of 194 RRBs in 1986, the number of 157 RRBs at the end of December 1986 amounted to Rs.100 crore and these had wiped out the entire share capital of 117 RRBs as on that date [RBI, 1989 pp. 137-139, paras 4.15 to 4.17]. It will be only fair to say that weaknesses of RRBs are endemic to the system and non-viability is built into it. In the circumstances, the RRBs would not be able to serve the interests of the target group in the manner expected of them.

The Committee concludes that there can be no place for the RRBs in the country's rural credit system for the future and that they should be merged with the sponsor banks [RBI, 1989, pp. 148-149, paras 4.34 to 4.37]. The Committee does not see that this will only add to already unbearable burden on the commercial banks. The Committee is of course right that, if lendings to rural and weaker sections are to be at concessional rates, there has to be some cross-subsidisation. But the cross-subsidisation does not have to be within each institution or even within each component of the total system. As the Committee elsewhere says, all that is needed is that the system consists of two segments, a larger segment responding to the market forces and operating side by side with a smaller, poorer, and hence protected segment and that the latter is within the absorbable capacity of the total system. In fact, if two segments are kept separate, it may help avoid leakages and give greater transparency to concessions and subsidies so that one knows who is paying for whom and how much.

The Committee confirms the major weaknesses of the co-operative system which umpteen previous committees, working groups, etc., have pointed out; namely, neglect of the base level institutions, with the lower tiers looking up to the higher tiers for refinance at all levels while higher level institutions look after their own interests often at the cost of the primaries (RBI, 1989, p. 173, para 5.22). The Committee emphasises that the essence of basic features of co-operative banking system must be a larger reliance on resources mobilised
locally and a lesser and lesser dependence on higher credit institutions. Heavy
dependence on outside funds has, on the one hand, made the members less
vigilant, not treating these funds as their own, and on the other led to greater
outside interference and control. Overall, this has made the co-operatives a
mediocre, inefficient and static system (RBI, 1989, pp. 175-177, paras 5.27 tp
5.29). This is of course true, but while reiterating it, the Committee forgets its
own revelation, namely, that the vitality of the rural financial institutions
depends on the vitality of the economy and the activities pursued by the
borrowers. The fact is that agricultural credit co-operatives are essentially co-
operatives of the borrowers and there is hardly any scope for raising resources
except by coercive procedures.

Co-operation in India has been both state patronised. That was one of the basic
tenets of the RCS Committee (1954). As already noted, fifteen years after, the
Rural Credit Review Committee in its Report (1969), admitted that the
Integrated Scheme of Rural Credit envisaged by the RCS Committee (1954),
with State participation at every level of the co-operative structure, had not
been pursued or implemented vigorously in all the States; this was only a polite
way of saying that it had failed. The Khusro Committee (1989), has elaborated
on this failure. It points out that the powers which vest in the government under
the co-operative law and rules are all-pervasive and the state has come to gain
almost total financial and administrative control over the co-operatives, in the
process, stifling their growth. Some of the unhealthy results of politicisation are
interference in the recovery of co-operative dues-or promise to write off the
dues if elected to power, and determination of interest rates on considerations
other than financial returns, i.e., with an eye on populist appeal. Such actions
generate a general psychology of non-repayment, vitiating the recovery climate
and jeopardising the financial interest of credit agencies. Besides, mass
supersessions are resorted to on political consideration. Paradoxically, state
partnership, which was conceived as an effective measure for strengthening the
cooporative credit institution, has paved the way for ever-increasing state
control over co-operatives, culminating in virtually depriving the co-operatives of their democratic and autonomous character. Effective non-official leadership along with democratic management has disappeared altogether. The time has come to reverse this process.

But, evidently, the Committee did not think that the time had come to reverse the process of creating new institutions. It argued that the state apexes in the credit sector and the other larger co-operative banking systems with all-India jurisdiction have yet no national level bank of their own to function either as a national balancing centre of the surpluses of the state systems or the national level non-credit co-operative systems or the larger co-operative enterprises; these functions are today done in some areas perfunctorily and in others (such as deposit holders), effectively by the commercial banks. Only a national apex co-operative bank could fill the systemic gap and hopefully help build the systemic strength and cohesiveness which stems from a union of the state apexes. Hence, the Committee recommended the establishment of a National Co-operative Bank of India (NCBI) (RBI, 1989, pp. 323-326, paras 8.01 to 8.09).

In June 1991, the new Government of India announced a New Economic Policy effecting major changes designed to correct the macro-economic imbalance and effect structural adjustment so as to bring about a more competitive system and promote efficiency in the real sectors of the economy. Financial sector reform is a necessary concomitant of trade and industrial policy liberalisation and in fact is critically important. Hence, the Ministry of Finance appointed a Committee in August 1991 (Chairman: M. Narasimham) to examine all aspects relating to the structure, organisation, functions and procedures of the financial system. The Committee submitted its Report in November 1991.

The Committee's criticism of the statism which has entered into the financial system will bear some repetition. The most important aspect of statism has
been policy-induced rigidities such as an excessive degree of central direction in terms of investments, credit allocations, branch expansion, and even internal management aspects of the business. There has also been an element of political reference to which the system has been subjected and which has come in the way of the institutions operating on the basis of their commercial judgement and in the framework of internal autonomy. Indian banks operating as they do within the confines of a rigidly controlled system have virtually ceased being competitive or innovative.

The claims of the Government and public sector on the banking system's resources have been steadily rising through the mechanism of the Statutory Liquidity Ratio (SLR) which today accounts for 38.5 percent of the net demand and time liabilities of the system. The figure for priority sector lending has now reached the current target of 40 percent of aggregate bank credit. A significant part of the expansion in the priority sector credit has been in respect of agriculture as needed to meet the sub-target for this sector of 18 percent of aggregate credit. Small scale industry comprising both industry, transport and the self-employed, represents the other important priority sector and the attention which the banks have been paying to meeting the needs of this sector is reflected in the growth of credit to it to a level of almost Rs. 16,000 crore in 1990, representing 16.5 percent of total bank credit. Given the overall resources constraint, an increase of credit to the priority sector has meant a certain pruning of credit to the non-priority sectors.

The relative insulation of priority sector advances from overall credit restriction during periods of tight monetary policy has meant both a reduction in relation to requirements of such credit to the non-priority sectors and an increase in the cost of such credit as an aspect of cross-subsidisation to recompense the lower rates earned on priority sector credit.

Most of the expansion in volume and in the number of borrowal accounts has been in respect of the agricultural sector. Agricultural credit deployment has
risen to a level of over Rs. 14,000 crore and now exceeds the same by the co-operatives. The system of directed credit programmes has contributed to an expansion of credit in the directions that were considered necessary. In purely quantitative terms this expansion must be regarded as a successful fulfilment of the objectives of such redirection. However, this achievement has been brought about at the cost of a deterioration of the quality of the loan portfolio, the growth-of overdues and consequent erosion of profitability. Fixation of targets for specific sector lending was essentially the means to achieve the broader goals of credit allocation, but over the years the means appear to have become ends in themselves. The desire to attain credit targets has meant inadequate attention to qualitative aspects of lending and consequent rise in loan delinquencies.

The objective of developmental credit policy was to forge a link between technological upgradation in agriculture and small industry and the availability of finance to enable such technological upgradation. This was the basis for the emphasis of purpose-oriented credit as distinct from the earlier security orientation. But, this has led to blurring of the distinction between the concepts of credit need and creditworthiness. The distributing growth in overdues is a consequence of the measure of laxity and departure from the principles of sound banking. But by far the most serious damage to the system and one which has contributed to the decline in portfolio quality has been the evidence of political and administrative interference in credit decision making. Populism and political and administrative influence bordering on interference should have no place in the lexicon of banking and finance but unfortunately, over the years, competitive populism has affected banking and credit operations.

The experience with regard to IRDP is instructive in this regard. In many cases of IRDP lending, banks have virtually abdicated their responsibilities in undertaking need based credit assessment and appraisal of potential viability and instead have tended to rely on lists of identified borrowers prepared by Government authorities. The phenomenon of loan meals was quite contrary to
the principles of a professional appraisal of bank credit needs. There was hardly any serious appraisal of credit need, potential productive activity or provision for effective post-credit supervision. The intended socially-oriented credit, in the process, degenerated into irresponsible lending. Loan waivers have added an additional element of politicisation of banking apart from the grave damage to the concept of credit discipline by encouraging defaults. The political element which condones overdues should also have paid regard to the social obligation which banks own to their depositors to invest their funds with due prudence.

Directed credit programmes have had adverse implications for the profitability of banks also because of the stipulation of concessional lending rates on priority sector credit and the element of subsidy on such lending which now accounts for a not insignificant portion of banks' spread. Subsidisation of this type of lending arises from the misconception that socially oriented credit should also be low cost credit. Subsidisation of credit is clearly a case of misplaced emphasis; timely and adequate access to credit is more important than its cost.

If the logic of extension of credit to the priority sector is to make these sectors economically viable by enhancing production and productivity, two decades of such preferred credit is a long enough period to attempt an evaluation of its continuing need, particularly to those who are able to stand on their own feet and to whom the directed credit programmes with the element of interest concessionality that has accompanied it, has become a source of economic rent. Hence, the Committee suggests that the system of directed credit programmes should be gradually phased out making it economically worthwhile for banks to expand their lending to these sectors without detriment to loan quality or banks' income.

Regarding the RRBs, the Committee agreed with the assessment of the RBI Committee (1989), but suggested a different solution, namely, that the sponsor
banks should segregate the operations of their rural branches through the formation of one or more subsidiaries which should be treated on par with the RRBs in regard to cash reserve and statutory liquidity requirements and refinance facilities from NABARD with a view to improving the viability of rural operations.

We may now put together certain comments and recommendations of the last two committees which show some signs of fresh thinking on this question which, for almost four decades, had bogged down in the principles enunciated and recommendations made by the RCS Committee (1954). As the Khusro Committee (1989) points out 'The vitality of the rural financial institutions depends on the vitality of the economy and the activities pursued by the borrowers' (paras 1.50 to 1.52) and further 'The weaknesses which were earlier considered as those peculiar to the co-operative system in fact arise from such deficiencies as relate to the structure of agricultural production itself (para 5.10). Therein lies the non-viability of the primary credit societies at the village level. No wonder that all efforts to revitalise them have failed. There was little realisation, at least open admission, that the primary societies will remain non-viable so long as the structure of agricultural production remained what it was. Instead, on this weak base, was raised an imposing superstructure which subsequent committees kept reshuffling and creating some new institutions adding confusion to the confounded thinking. The Khusro Committee (1989) also pronounces the cardinal truth, namely, 'In a poverty ridden economy, financial institutions do have a responsibility towards weaker sections, but it is essential to recognise the limitations of credit as the principal instrument of poverty alleviation'. The Narasimham committee opined that 'the pursuit of distributive justice should use the instrumentality of the fiscal rather than the credit system'.

These are good starting points for a new thinking in this field out neither of the two committees did go further and consider how to re-organise the structure of agriculture production rather than the structure of rural credit; probably, they
thought that this would mean going beyond their terms of reference. Surprisingly and notably, the very first Five Year Plan (1951-56), in its Draft Outline, had put its finger on the essence of the problem. It said: "Many of the weaknesses of Indian agriculture are inherent in the structure of the rural economy. The bulk of the agricultural producers live on the margin and are unable to invest in the improvement of the land. There is widespread underemployment - and the economy cannot provide and sustain continuous employment for the available labour - The conditions are typical of a static backward economy, which is unable to expand and keep pace with the growing population" (Planning Commission, 1951, p. 94). The remedy was sought in a radical re-organisation of its structure of production which was called Co-operative Village Management. The Commission was aware that "under co-operative management fewer hands would be needed for cultivation than at present" (Planning Commission, 1951, p. 101) and, that, therefore, "the pace at which co-operative village management should be developed, would depend upon the pace at which, simultaneously, it was possible to absorb workers released from the-village" (Planning Commission, 1951, p. 102). The Commission knew that this would be a long process.

Hence, it proposed a more modest programme for immediate action, namely, to organise agriculture into two sectors: one of private registered farms being holdings above a prescribed level and the other of co-operative farming societies comprising holdings below the prescribed level (Planning Commission, 1951, 103). The chief merit of this proposal lies in its explicit recognition of two sectors in Indian agriculture: one viable and the other non-viable. From the point of view of rural credit, this is an important distinction and it is advisable, as both the RBI (1989) and the Narasimham (1991) committees have suggested, to make and maintain that distinction.

We may first consider the viable sector. Its definition in terms of holdings above a certain prescribed limit is not quite relevant for purposes of viable banking whether commercial or co-operative. From a banker's point of view, a
farm is viable if its proposal for a loan, whether short-term, medium-term or long-term, is bankable at market rate of interest. Whether such a farm should be registered is a matter of detail. There is an obvious advantage in registering it provided it does not create a web of bureaucracy which can entangle and destroy any reasonable proposition. If registered, it may be brought under tax and labour laws in due course. But this can wait. For immediate purposes, we recognise that it has a proven ability and competence to use credit productively and it is essential that it has opportunity to expand as a farm.

From this point of view, it will be necessary to reconsider the present laws concerning tenancy and ceiling on holdings. There was a time when tendency legislation giving security of tenure and regulating rent and, in some cases, making the tenant the owner of the land, was necessary and justifiable. The purpose was to promote owner of the land, was necessary and justifiable. The purpose was to promote owner cultivation. Owner cultivation had to be promoted by legislation because, with the traditional agricultural technology, cultivation was not profitable and land owners preferred to lease out their land, rack-renting and otherwise exploiting the tenant through trading and money-lending as allied activities. For the same reason, a non-agriculturist was prohibited to purchase agricultural land. In the conditions of agricultural technology then prevailing, the nexus of absentee ownership, trading, and money-lending had to be broken. There is no denying that the success has been only partial. One reason is that millions of owners and tenants are involved and the arm of the law does not reach them all. More importantly, with the new agricultural technology coming in, things have changed radically. Owner cultivation of a minimum size of land has become viable and it no longer needs legislative support. We have not taken note of this fact and continue with the same old tenancy legislation.

The second element is ceiling on landholdings. One must admit that this has almost totally failed; that it has been circumvented by various means such as subdivision and benami transactions. One need not be surprised. The surprising
part is that it was at all accepted showing how politically weak was the lobby of even owner-cultivators in those early days. They were called kulaks, the enemies of socialism, and they admitted the sin silently. Ceiling on land holdings is a ceiling on income that one may make from owner-cultivated agriculture and hence constitutes a ceiling on ability and intelligence that will enter and say in agriculture. It further weakens agriculture politically.

Of course, that was not the explicit intention of ceiling legislation. Its purpose was to acquire ceiling surplus land and to distribute it to the landless in the false belief that ownership of land, however small, itself is a value. Whatever the success of these measures, they tended to freeze the situation in agriculture and inhibit movement in and out of agriculture. The case for ceiling was argued and supported by elaborate academic exercises, by academics whose own salaries were way above the citizen's income in agriculture. They demonstrated, by questionable statistical methods, the productivity of resources was greater on a small farm than on a large one and, more importantly, there was greater 'labour absorption' in a small farm than in a large one. 'Labour absorption' is an obnoxious and hateful concept made fashionable by academics working in or for international organizations drawing salaries and pensions that would make even the old zamindars green with envy. These academics have not bothered to divide the net value added in a small farm by the labour 'absorbed' in it, and to ask whether the labour so 'absorbed' gets a minimum subsistence or is only absorbed by the soil. Underlying all these sophisticated exercises and the prose developed around it, is the fact that our land reforms, other than abolition of feudalism in land relations, is aimed at keeping all the surplus population in agriculture and giving it some succour without withdrawing it from agriculture.

The unspoken intention is to protect the organized labour in the non-agricultural sector, the vanguard of socialism, from the invasion of the reserve army held in agriculture. As a result, the differential between the per worker GDP in agriculture and non-agriculture has been steadily growing; the ratio of per worker GDP in non-agriculture to per worker GDP in agriculture was 2.19
in 1950-51; it increased to 2.69 in 1960-61, to 3.46 in 1970-71, to 3.73 in 1980-81 and to 4.35 in 1989-90. The non-agricultural sector does not take in any more people than it can remunerate at the relatively high level. All the rest must stay behind in agriculture and share whatever may grow there. Agriculture has been treated as a parking lot for the poor.

By 1965, the new agricultural technology was on the horizon and it was possible to visualise that owner cultivation would soon become viable. Hence, a New Strategy for agricultural development was devised with greater emphasis, quite rightly, on the application of the latest advances in agricultural technology. But there was hardly any new thinking on land reforms. Earlier positions on tenancy reform and ceiling on landholdings had hardened. Time has come to reconsider these positions. A viable farm, one which can use credit at market rate, must have opportunities to grow as a farm. An essential condition for an industry to grow is that a firm engaged in it must have capacity and an opportunity to grow; a salaried radical or a policy maker would not recognize this because he is accustomed to annual increments and promotion by sheer passage of time. Like an industry, for agriculture to grow, a farm or a farmer must have capacity to create a surplus and plough it back in to agriculture and thus grow as a farmer. The new technology has made this possible, but the ceiling laws have made it impossible. Hence, the first thing to do is to remove the ceiling. A farmer should be allowed to buy or even lease-in land and expand his holding. It is these technologically oriented and commercially minded farmers who will now form the nuclei of future agricultural development; not the T & V system which has served its purpose. Rural banking, whether commercial or co-operative, should support such viable farmers or their associations, whether co-operative or corporate, on purely commercial considerations.

It is important to recognise that, in the present circumstances, there are limits to the amount of surplus that agriculture, even its viable sector, can generate for its own development and that therefore, like a developing country needs
outside capital. So does agriculture. The loan capital must come from the banking sector, whether commercial or co-operative. But that is not enough. Like a developing country, agriculture needs outside capital in the form of investment and conditions need to be created so that outside, that is, non-agricultural capital may flow into agriculture as a purely business proposition. There are several small and large agricultural development projects such as watershed development or wasteland development or afforestation which require large scale acquisition and development of land. This needs to be not only permitted but actively encouraged whether it comes in the form of investment by persons or associations of persons organised whether as co-operatives or as partnerships, private or public limited companies. For almost four decades, we have tried to view co-operation in agriculture as one component of a larger concept of a co-operative commonwealth. This has proved to be a utopia. Time has come to wake up and turn attention to letting agriculture prosper, at least in its viable sector, by attracting loan and equity capital from outside agriculture. This requires that a non-agriculturist, whether a person or an association of persons, whether co-operative or corporate, should be able to buy or lease in land, enter agriculture as a commercial proposition. Rural banking, whether commercial or co-operative, should support such enterprise on purely commercial considerations.

Let us now consider the non-viable sector consisting of holdings below the prescribed limit; in other words, of small and marginal farmers and sub-marginal farmers and agricultural labour. This is a sector which cannot afford credit at market rates of interest. Indeed, their problem is not one of credit but of income which means gainful employment. Nevertheless, credit continues to be looked at as a panacea for all problems and ills of agriculture and weaker sections. Even the Narasimham Committee suggests (1991) that the directed credit programmes should cover a redefined priority sector, consisting of the small and marginal farmer, to which are also added tiny sector of industry, village and cottage industries, rural artisans, small business and other weaker
sections and that the credit target for this redefined priority sector should be fixed at 10 percent of the aggregate bank credit though later it does suggest that the system of directed credit programmes should be gradually phased out making it economically worthwhile for banks to expand their lending to these sectors without detriment to loan quality or banks' income. What one needs is a more detailed indication of how directed credit programmes should be gradually phased out.

The Khusro Committee (1989) has a more stylised formulation. It envisages, what it calls, a socially tempered market system for rural credit where a larger segment responding to the market forces should operate side by side with a smaller social segment, and cautions that the social component has to be within the absorbable capacity of the total system as otherwise it would be counterproductive for the social component itself (RBI, 1989, pp. 4-6, paras 1.08 to 1.12). What the Committee calls the social component is evidently the non-viable sector. What both the committees have argued conclusively is that any concessional credit to the non-viable sector has proved not only counterproductive to that sector but also detrimental to the otherwise viable sector turning it almost non-viable. One must therefore consider how concessional credit to the non-viable sector may be gradually phased out as the Narasimham Committee (1991) has suggested.

As earlier mentioned, committee after committee has pointed that the entire co-operative credit structure has been built on a weak base, namely, the primary credit societies at the village level without realising, or at least openly admitting, that the primary societies are weak because their lending business is essentially non-viable. Hence, little was done except to exhort that the primary societies should be revitalised. Now, if we wish to take seriously the Narasimham Committee's (1991) suggestion that the concessional credit to the non-viable sector should be gradually phased out, it will amount to gradually winding up co-operative credit institutions at all levels as privileged institutions and bring such of them as will survive on par with the commercial banks. This
is what was suggested, without saying it in so many words, by the Informal Group on Institutional Arrangements for Agricultural Credit which the RBI had set up in 1964, which is more than 25 years ago. The corrective measures suggested by the Group included, besides the usual exhortation to revitalise the co-operative credit structure from the primary level upwards, (i) liquidation of all dormant societies which were beyond redemption; (ii) provision of credit to non-defaulting cultivators of such dormant societies through the central or the apex banks or their branches; (iii) amalgamation of non-viable banks; (iv) statutory provisions for creating a charge on the land of the defaulting cultivators; and (v) coercive processes for recoveries of outstanding loans. Later, the Study Team on Overdues of Co-operative Credit Institutions constituted by the RBI in 1972 had suggested several measures such as (i) automatic disqualification of managing committees/boards of directors, (ii) denial of fresh credit and voting rights to defaulters as well as their sureties, (iii) amendment of Co-operative Societies Acts of various states enabling the Registrar to issue orders on his own motion for the recovery of loans as arrears and (iv) the setting up of State Farming Corporations for the purchase of lands of defaulters at the time of auction.

Among these several recommendations, (iv) and (v) of the Study Team (1972) concern the recovery of overdues and the steps suggested are politically impossible propositions. We shall presently return to them. However, recommendations (i), (ii), and (iii) of the Informal Group (1964) are perfectly legitimate and feasible propositions and if followed through consistently give a phased programme of gradually rolling the entire network co-operative credit institutions in each state into two apex institutions, namely. State Co-operative Bank providing short term credit and State Land Development Bank providing long term credit. These two co-operative banks should work on par, with, and in competition with the commercial banks and development finance institutions without any special privileges except that they may allowed to pay a slightly higher rate of interest on their deposits so long as they stay viable.
Coming to the recommendations of the Informal Group (1964) and the Study Team (1972) concerning the recovery of overdues, it seems that a more positive and helpful approach than coercion is possible. We suggest that in such cases, the banks, both State Co-operative and the State Land Development, should provide service to sell the land of the defaulters so that they may get better than the distress prices. The service may be extended to the non-borrowers who are prudent enough not to borrow. Such sales should be exempt from the Stamp Duty provided the seller will agree to deposit the sales proceeds with the bank, net of bank recoveries if any, for a minimum period of say five or ten year. As an incentive, a slightly higher interest may be paid on such deposits. The purpose is not to allow the seller to spend away the sales proceeds and become a destitute. It is likely that if a small, marginal, and sub-marginal farmer sells his land and keeps the sales proceeds in a fixed deposit, he will be better off than if he continues to cultivate the land, most often on borrowed money. It is thus that in due course a large number of persons may get out of the non-viable sector of agriculture.

In most cases, the lands on sale will be purchased by available fairer or other agricultural enterprises which we have suggested should be allowed to buy or lease in land. This is better than the recommendation of the RBI Study Team on Overdues (1972) to set up State Farming Corporations for the purchase of lands of defaulters at the time of auction. It is better for two reasons: first, a private sale, not necessarily to the lender, will be less humiliating than a public auction, second, the land in question will be better cultivated if it is purchased by a private farmer with a stake than by a State Farming Corporation with no stakes whatever.

All this sounds harsh but, unfortunately, this is the crux of restructuring agricultural production so that it may become viable as an industry. The principal problem of Indian agriculture is that it is overburdened with a disproportionate share of our population. Further, as suggested above, if agriculture is divided into two sectors, viable and non-viable, it will be seen
that it is the non-viable sector which bears the burden of the surplus population. In fact, the non-viable sector is non-viable not because it lacks technology or credit, but because it has to bear the burden of all the surplus population which the rest of the economy refuses to support. Hence, the solution lies in withdrawing permanently or semi-permanently a sizeable population out of the non-viable sector of agriculture and reduce its burden. It is precisely this process which the banks, as suggested above, should initiate and expedite.

The population which thus comes out of agriculture will have to be given gainful employment, either self-employment or wage employment. There is a certain philosophical position which prefers self-employment to wage employment. In the past, attempts have been made by promoting highly subsidised labour intensive technology. More recently, this is sought to be done through the Intensive Rural Development Programme (IRDP) partly supported by bank credit. In both cases, the person is left to his devices to fend for himself in the market place. This is the cruelest thing that may be inflicted on a poor man. A poor man needs a secure job at reasonable wages which is what the policy makers enjoy while they extol the virtues and dignity of self-employment. There is no greater hypocrisy than this.

Some wage employment will be available in the viable sector and also in the agricultural enterprises set up by erstwhile non-agriculturist. But this may not be enough and some additional employment will have to be provided in the Plan in the projects pertaining to construction of roads, soil and water conservation, afforestation, etc. Whether these are executed departmentally or by private contractors including labour co-operatives is a matter of detail somewhat outside the present subject. But, employment on regular plan projects is to be preferred to special employment programmes such as the Jawahar Rojgar Yojana. Hence, enough funds must be provided in the plan for such projects.
Besides the plan projects, an employment programme will be useful as a standby. There has been much talk of the support prices for agricultural produce. There is an equal need for a support price for labour which, at present, one might place at Rs. 1,000 per month. This is not much more than the poverty line income for a family of five. Let the government offer a wage of Rs. 1,000 per month to whosoever is willing to work on whatever and wherever work is available; transport and temporary hutments taken care of. Let the marginal and sub-marginal farmers, and the landless take it or leave it. The employment must be permanent but on condition that one is willing to work wherever work is available. The present notion of giving employment near everybody's home is romantic; there are no useful or productive works near everybody's home. This is not an occasion to expand on this theme. But I shall say that the financial resources presently being spent on several poverty alleviation and employment programmes, and the credit being sunk in non-viable propositions are adequate to undertake such a programme.

This will require a mobile labour force mobilised in appropriate labour organisations. Two types of labour organisations are possible and both may be tried. One is the labour co-operatives with a minimum number of 50 workers as the present law provides. Government should guarantee continued employment from one work to another on a contractual basis to all labour co-operatives provided they are willing to move from work to work. Possibly, all small and medium works can be executed through such labour co-operatives. The other form of labour organisation is what, in the Draft first Five-Year Plan, was called the Land Army. We need not go into details of its regional organisation. The state governments should prepare massive projects of irrigation, afforestation, soil and water conservation, major road construction, and the like, with estimates of mandays required. The Land Army should execute these works by employing labour as far as possible in the local area but moving it when necessary wherever work is available. The country has the necessary
organisational ability which has never been tried and financial resources which are being frittered away elsewhere.

It may be said that such an offer of a salaried and assured employment may induce many marginal and submarginal farmers to lease out or sell their lands and leave agriculture. But, precisely this should be the objective of restructuring agricultural production; namely, to enable the non-viable farmer to come out of agriculture; at least, to give him the option. Forty years ago, the Draft Outline of the First Five-Year Plan in a chapter titled 'Reorganization of Agriculture' had categorically stated that agriculture cannot be developed as an efficient industry unless "the number of workers engaged in the ordinary operations of farming is reduced." This cardinal truth can no longer be neglected.

Finally, a few suggestions regarding the manner in which the present banking system, both commercial and co-operative, should be reorganised. First, let the various co-operative credit institutions function so long as they are commercially viable. Otherwise, they should be gradually phased out. We have already referred to the recommendations of the Informal Group on Institutional Arrangements for Agricultural Credit (1964). Regarding the commercial banks, particularly the nationalised ones, as already mentioned, the Narasimham Committee (1991) suggested a reorganisation of the banking structure which should consist of (a) 3 or 4 large banks (including the State Bank of India) which could become international in character; (b) 8 to 10 national banks with a network of branches throughout the country engaged in general or universal banking; (c) Local banks whose operations would be generally confined to a specific region; and (d) Rural banks (including RRBs) whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities. This is being too mechanical. The whole economy, comprising agriculture, industry, and services, is becoming every day more and more complex, and for intelligent banking, the banking system must remain alive to the latest developments in
each sector. No single bank can do this. Hence, each bank, at least the nationalised banks, should be asked to progressively specialise in one or more areas and withdraw from the rest. The State Bank of India with over 60,000 branches spread all over the country is best equipped to fulfil the banking needs of agriculture, agricultural processing industries, and agricultural exports. Let it devote itself to this single task and leave the other fields to the other banks.
Conclusion:

The concept of priority sector advances was formulated in 1968 with the introduction of social control over the banks. The National Credit Council was of the opinion that those neglected sectors of the economy which did not have adequate access to bank finance but which, deserved due recognition from the banking system due to their economic importance should be treated as "Priority Sector".

The description of the priority sectors was formalized in 1972. Initially no specific targets were laid down for these banks to lend to the priority sector. In the 1980's targets and sub target were laid down for the bank and they were asked to provide 40 percentage of the net bank credit to the activities coming under this sector. Since then, there have been several changes in the scope of priority sector lending and the targets and sub targets applicable to various bank groups.

At present the priority sector broadly comprises the following activities – Agriculture, small and medium scale industries, other priority sectors which comprise of small business, retail trade, small transport operators, professional and self employed persons, housing, education loans, micro credit, export Credit and weaker sections etc. The lending under the priority sector by the targets is subject to the guidelines issued by the Reserve Bank of India from time to time.