Chapter - 2
Commercial Banks
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The Commercial Banks form an important link in the rural banking system of India in present. Traditionally, however, the commercial banks in the country were largely urban based, as was shown earlier, and were financing mainly large-scale industries. Wholesale trade and commerce in the urban area and industrial centres in the country and were concentrating on the provision of short term secured loans to such occupations and were motivated by the objective of maximizing profit for their shares holders. The profit motive and the adherence to the real bills doctrine and to the commercial loan theory by the Indian commercial banks, like their British predecessors, had resulted in, as was shown earlier, certain serious imbalances- regional, local and sectoral- in the Indian Banking system with their adverse implications to the rapid and balanced development of the Indian Economy. Since the nationalization of the fourteen major commercial banks in the country in July 1969, there has been a considerable change and improvement in the geographical and sectoral coverage by the commercial banks in the country with a view to bring about a balanced regional, local and sectoral distribution of banking facilities in the country and with a view to develop the financial infrastructure of its economy, the two basic economic justifications for the nationalization of commercial banks in the country. Modern banks in India are Joint Stock banks. They are registered under the Indian Companies Act. They are classified by the
Reserve Bank of India into two categories: Scheduled Bank & Non-Scheduled Bank. Scheduled Banks are those banks which are included in the Second Schedule of Reserve Bank of India Act, 1934 and have a paid up capital and reserve not less than Rs 5 lakh. The operations of these banks are controlled and regulated by the Reserve Bank and they are eligible for its rediscounting facilities. Non-Scheduled Banks are those banks which have their paid up capital and reserves of less than Rs 5 lakh are not included in the Second Schedule of the Reserve Bank of India Act, 1934. Almost all (with a few exceptions) the private sector banks are scheduled banks. Some scheduled private sector banks are Indian Banks others are Foreign Banks. The scheduled commercial banks at present accounts for virtually the entire banking business in the country. At the end of March 1997, there were 100 scheduled commercial banks (excluding 196 Regional Rural Banks) comprising 27 public sector banks (PBS), 34 Indian private sector banks (old & new) and 39 foreign banks. Among the public sector banks, State Bank of India (SBI) is the biggest bank. Apart from the SBI, there are seven associate banks of SBI. Other 19 banks (New Bank of India was merged with Punjab National Bank in September 1993) in the public sector banks are nationalized banks; 14 of them were nationalized in 1969 and five others (excluding the New Bank of India) in 1980.¹

This chapter will now be devoted to an analysis under different sections of the recent trends in the geographical and functional coverage by commercial banks in the country and of their implications to rural banking.
Aspects and focus of rural savings and their implications will also be discussed.

A. Geographical and Functional Coverage by Commercial Banks

The Indian commercial banking system as at the end of June 1969 was marked by, as was seen in the preceding discussion, serious regional, local and sectoral imbalances. Since 1969, the banking expansion policy in the country has been aiming at overcoming these imbalances and at bringing about a more balanced distribution of banking facilities in the country and the trend in the geographical and functional coverage by commercial banks in the country. Since 1969 will now be discussed in the coming pages.

Geographical Distribution of Banking Facilities

The regional imbalances in the distribution of banking facilities in the country as at the end of June 1969, manifested itself as was pointed in the earlier discussion in the form of the availability of relatively developed banking facilities in the comparatively developed regions or states like Punjab, Haryana, Maharashtra, Gujrat, Tamil Nadu, Kerla and Karnataka, when viewed from the average availability of banking facilities in the country as a whole, as indicated by the average number of people served by a bank office, and non-availability of sufficient banking facilities in the relatively under developed regions or states like Bihar, Orissa, Madhya Pradesh, and
It was also pointed out in the previous discussion that the main reason for such regional imbalances in the distribution of banking facilities in the country was the profit motive and the adherence by the Indian Commercial Banks, in their quest for profit, to the real bill doctrine and to the traditional banking practices developed by their British predecessors and their consequent tendency to follow industrial and business activity and folk to these industrial and business centres and regions which offered them opportunities for profitable business, rather than initiate and lead industrial and business activity in those regions which had the potential for rapid industrial and business development.

Since the nationalisation of commercial banks in the country in 1969, there is a fundamental conceptual change with respect to the nature of banking and its role in the economy. It is now held that the banking system of the country constitutes, essentially and fundamentally, the financial infrastructure of the economy rather, than a mere agglomeration of profit seeking private business institutions. As such, the primary aim of banks in the country at present should be to initiate and encourage economic activity in regions and centres which are relatively under developed at present but which possess the potentialities for rapid development in the future terms of their resource endowment position, and not just to maximize their own private profit. Consequently the banking expansion and branch licensing policy in the country since 1969 has been such as to bring about a more balanced regional distribution of banking facilities in the country by directing
the commercial banks to open more and more branches in the backward regions and in the hitherto unbanked centres. Data pertaining to the trends in the regional distribution of banking facilities in the country are presented in Table 2.1. From this data it can be observed that the marked imbalance in the regional distribution of banking facilities in the country as at the end of June 1969 has been considerably removed the inter-regional distribution of banking facilities in the country as at the end of June 1997, as revealed by the average number of people served by a bank office, is much more balanced that what it was at the end of 1969. It was of course, better in the year 1991, 1992, 1993. This was achieved through a branch licensing policy that favored largely the opening of bank branches in the hitherto unbanked centres. It can be seen from the data contained in the Table that out of the total of 592 new branches of commercial banks opened in the country during the 1992-93 as many as 149 branches constituting 25 percent of the total were in unbanked centres. This percentage is much more than the percentage in the year 1994, 1995, 1996, & 1997. The emphasis given to the opening of branches in 1993 to the states of Andhra Pradesh is 46 and as many as 18 branches in unbanked centres, in the state of Uttar Pradesh is 65 and as many as 17 in the unbanked centres, 60 in Maharashtra but only 9 in unbanked centres. In 1994, 417 branches were opened in the year out of which 29 branches were opened in unbanked centres. 444 new branches were opened during 1995 out of which 8 branches were opened in unbanked centres, 728 branches were opened in 1996, out of which only 16
branches were opened in unbanked centres, and in 1997, 4523 new branches were opened out of which 6 branches were opened in unbanked centres as depicted in Table 2.1.

**Local Distribution of Banking Facilities**

The presence of local imbalance in the distribution of banking facilities was another features of Indian commercial banking system as at the end of June 1969. These local imbalances manifested themselves in the form of an unbalanced distribution of banking facilities as between the urban and rural area within a region or state. While the urban areas and industrial and business centres in a region had developed banking facilities, the rural area in a region was unbanked (see data in Table 2.2). Banking facilities tended to be concentrated in the bigger cities, industrial centres and port towns to the neglect of the banking needs of the rural area in the country. Another important aspect of the banking expansion policy in the country is to set these local imbalances in the distribution of banking facilities by directing the banks to open branches in the rural areas and unbanked centres in a region as was pointed out earlier . Consequently , the rural urban disparity in the availability of banking facilities in the country has narrowed down considerably in subsequent years as is evident from the data contained in Table 2.2. These data show that while the rural branches formed only 22.4 percent of the total number of 8,262 commercial branch office functioning in the country as at the end of June 1969, at the end of June 1997, rural branches found as much as 51.9 percent of the total numbers of 63513
branches of commercial banks functioning in the country. This was made possible because of the fact that the number of rural branches of commercial banks increased during the period at a much faster rate than the rate of increase in the number of branches functioning in the urban area. While the number of branches of commercial banks functioning in metropolitan and port towns increased by 354.84 percent, those functioning in urban centres increased by 541.53 percent and those functioning in semi urban centres increased by 312.22 percent during the period June 1969-June 1997 as against 668.61 percent increase in the total numbers of branches of commercial bank functioning in the country as a whole, the number of branches functioning in the rural centres increased by as much as 1700.27 percent. This is a clear point to the fact that the main thrust of the banking expansion policy adopted in the country since 1969 has been on the expansion of banking facilities in the rural areas and in the hither to unbanked centres with a view to provide the country's economy with a well developed financial infrastructure, one of the basic economic justifications for the nationalisation of commercial banks in the country in 1969.

Credit Deposit Ratios

It should be noted that the mere presence of a bank office in a locality or centre by itself cannot be taken as availability of banking facility in that region or locality. Banking facilities in a locality or centre can be to exist only when the level of economic activity in the locality or centres get encouraged because of the presence of the bank office and through its deposit and credit
transactions. While from the point of view of mobilizing saving, it is the amount of deposits mobilized by a bank that is important, from the point of view of influencing the level and direction of economic activity in a locality or centres it is the nature and volume of credit extended by the bank in the locality that is more important. Since the credit deposit ratio indicated that the extent to which the deposit mobilized by a bank office in a locality is used for a credit expansion in that locality and there by to influence the level of economic activity in the locality, the credit deposit ratio of bank office functioning in the rural and urban centres indicates the disparities or otherwise is the actual availability of banking facilities as between the rural and urban areas in the country.

Data pertaining to the credit deposit ratio of scheduled commercial bank in India as between the rural and urban centres are presented in Table 2.3. The data shows that the credit deposit ratio of the office of commercial banks functioning in the rural centres formed only 37.6 percent at the end of June 1969, in the case of offices functioning in the metropolitan centres the credit deposit ratio was as high as 98.2 percent as against the credit deposit ratio of 71.9 percent for the country as whole. This is a clear indicator of the fact that the commercial Bank were using their rural branches mainly for collecting deposits and were shifting the funds so collected for granting loans to industrialists and businessmen in the urban and metropolitan centres, evidently at higher rates of interest, and there by to maximize their profit. There was the phenomenon of large-scale rural urban shifts of bank deposit
in the country in 1969. The consequence of such a practice on the part of the commercial banks was that the credit needs of agriculture and other rural economic activities were not met by them and such activities in the rural area were thus denied of the benefit of banking facilities and bank credit. Such a wide disparity in the credit deposit ratio as between the rural and the metropolitan centres in the country as at the end of June 1969, is, therefore, an additional indicator of the local or rural-urban imbalance in the availability of banking facilities in the country in 1969. In contrast to this wide rural urban variations in the credit deposit ratio of commercial banks in the country as at the end of June 1969, the rural urban variations in the credit deposit ratio as the end of June 1997 were satisfactory, the ratio being 45.1 percent in rural centres, 41.2 percent in semi urban centres, 52.1 percent in urban centres, remarkable 85.3 percent in metropolitan centres as against the All India credit deposit ratio of 58.3 percent. This indicate the increasing tendency on the part of the commercial banks to utilize the deposits mobilized in the rural areas for deployment as credit in the rural areas themselves there by making bank finance increasingly available to the rural areas in the country for productive undertakings. This is also an indicator of the increasing trend towards a more balanced rural urban distribution of banking facilities in the country in recent years there by minimizing the extent of the local imbalances that existed in the banking system of the country in 1969. This is also indicative from the Table 2.3 that in recent years there were decline in the All India credit deposit ratio.
As was pointed out in the previous chapter, a sectoral imbalance in the availability of banking facilities in the country was another characteristic of the banking system of the country in 1969. These sectoral imbalances took the form of imbalances in the distribution of bank credit among the different sectors of the economy. Since the nationalization of commercial banks in India in 1969, however, there is a considerable improvement in the sectoral or purpose-wise distribution of bank credit in the country. Data pertaining to the sectoral distribution of bank credit since 1969 are presented in Table 2.4. While 79.5 percent of the total credit extended by the schedule commercial banks in India as at the end of June 1969 went to large and medium industry, wholesale trade and commerce, the share of agriculture, small scale industries and other priority sector including retail trade, being only 5.2 percent, 7.9 percent and 0.9 percent respectively of the total credit extended by the commercial banks. Credit extended by scheduled commercial banks in India as at the end of June 1969 went to large and medium industry was 79.5 percent of total credit extended is comparatively the larger amount spend in compare to subsequent years in this industry, the percent went to agriculture and small scale industries was highest in 1990 as compare to other years, among given to other priority sectors including retail trade were on increasing trend till 1985, highest 8.5 percent of the total credit distribution in 1985. After 1985 there was a declining trend in granting to other priority sectors including retail trade after 1985. In recent years, there
is comparatively balanced sectoral distribution of the scheduled commercial
bank credit in the country but the period from 1980 to 1990 was the period of
more balanced distribution of bank credit by giving the special attention to
food procurement operations, agriculture, small scale industries and other
priority sectors including retail trade. There was a more balanced sectoral
distribution of scheduled commercial bank credit in the country as at the end
of June 1985, with large and medium industry and whole sale trade getting
only 48.5 percent of the total credit extended by the scheduled commercial
banks in the country. The shares of agriculture, small-scale industries and
other priority sectors including retail trade increased proportionately as at the
end of June 1985 when compared with their shares as at the end of June
1985 being 15.8 percent, 13.8 percent and 8.5 percent respectively. The
relatively more balanced distribution of bank credit among the different
sectors or purposes in the country in one and half decade when compared
with that in 1969 has implication of rural banking in the country. Since
agriculture is basically a rural economic activity, and since small scale
industries and retail trades can develop extensively in the rural areas of the
country, extension of larger credit to these sectors implies an increasing
extension of banking facilities to the rural areas in the country and hence
implies a rapid expansion of rural banking in the country in recent years in
contact with the traditional urban based nature of commercial banking in the
country. The foregoing analysis of the trends in the expansion of commercial
banking facilities in the country since 1969 clearly shows that the regional,
local and sectoral imbalances that prevailed in the banking system of the country in 1969 have been set right considerably since then in conformity with the objective of developing the financial infrastructure of the economy. Instead of the people going to the banks, it is more appropriate to say that in recent years the banks in India have gone to the people in a big way, especially in the rural areas there by extending the much needed financial intermediation to those regions and localities which hitherto were lacking such facilities.

B. Financing Agriculture by Commercial Banks

Since agriculture is one of the main productive activities of man in the early stages of the economic development of a country, the development of agriculture is essential for the rapid economic development of the country as a whole for the following reasons:

1. Development of agriculture is necessary in order to supply food to the agricultural as well as the non-agricultural population of the country. Further, as the economic development of an under-developed country takes place, the population of the country has a tendency to growth at a higher rate than hither to and hence there is bound to be an increasing internal demand for food in the country and rapid agricultural development is necessary in order to meet such increasing demand for food in the country.
2. Agricultural development is necessary in order to have a regular source of supply of the different materials required as inputs by the various industries in the country.

3. Rapid development of agriculture and the consequent increase in the incomes of the agriculturists generates the savings required for capital formation in the industrial sectors of the economy and therefore, agricultural development is a source of domestic savings required for capital formation in the country.

4. Development of agriculture and the consequent increase in the incomes and purchasing power in the hands of the people generate the much-needed domestic market for the various industrial products of the country and thereby encourage further industrialization in the country.

5. Export of agricultural products earn valuable foreign exchange resources required for the import of machinery, raw materials and skills needed for the rapid industrial development of the country.

6. Developing of agriculture and the resulting economic porgies of the rural sector of the economy induce the required changes in the social and attitudinal factors among the rural people and generate such propensities, among them, which are favorable to further economic development. It should, however be noted that the development of agriculture in its turn depends upon the development of the industrial and others non agricultural sector is necessary in the order to supply the different types of agricultural inputs like machinery and fertilizers and to
provide the agricultural sector with an extensive market for its products. The rapid development of the industrial and other non-agricultural sectors of the economy called the secondary and the tertiary sectors, are necessary for another important regions. Many of the under-developed and developing countries like India are characterized by an excessive dependence of populations on agriculture giving rise to unemployment and underemployment, through of a disguised type, in the agricultural sector of the economy. Agriculture is the source of livelihood over 70 percent population of the country. Rapid development of agriculture on scientific lives and an improvement in the levels of income and living standards of the people in the agricultural sector of the economy are possible only if a large part of the agricultural population of the country is diverted to the non-agriculture sectors of the economy and this is possible only through a rapid development of the industrial sector of the country's economy.

Data pertaining to the relative shares of the agricultural and non-agricultural sectors of the Indian economy in the country's. Net Domestic Product and in the country's total work force are presented in Table 2.5. From the data it is clear that while 69.51 percent of the country's total work force was engaged in agriculture in 1961, agriculture contributed 49.34 percent of the Net Domestic Product of the country. In contrast with this, the non-agricultural sector of the country's economy engaged only 30.44 percent of the country's total work force in 1961, but contributed 50.66
percent of the country's Net Domestic Product. While 66.70 percent of the country's total work force was engaged in agriculture in 1991, agriculture contributed only 31.73 percent of the Net Domestic Products of the country. In the contrary to this the non-agricultural sector of the country's economy engaged only 33.30 percent of the country's total work force in 1991 but contributed as much as 68.27 percent of the country's Net Domestic Products, which reveals that having a huge amount of work force, the agriculture sector contributed only 31.73 percent in the Net Domestic Products. These data clearly show that the average productively of agriculture labor in India is much lower than the average productivity of non-agricultural labor and that the distribution of the Net Domestic Products of the country is highly skewed in favour of the non-agricultural sector of the economy. One reason for this is, evidently, the disproportionately large dependence of the country's population on agriculture. Over 70 percent population of the country is depend upon agriculture for their livelihood. Increase in the productivity of agriculture labour and improvement in the intersectoral, agriculture and non-agriculture distribution of national income, therefore, require a rapid development of the industrial and other non-agricultural sectors of the economy and a shift of a large part of the country's population from the agricultural to non-agriculture sectors. It is clear from the above discussion that the agricultural and industrial sectors of the economy of a country, as was pointed out earlier, are interdependent and that an
insufficient development of the one will retard the rate of development of the other sector of the country's economy.

**Agriculture's Need for Credit**

The rapid development of Indian agriculture requires large amount of credit for three definite reasons:

First, an increase in agricultural productivity and output requires intensive cultivation of land on modern scientific lines making use of scientific fertilizers, better seeds, better farm techniques like better irrigation, systematic protection of crops from pests and plant disease, etc. This type of scientific farming is capital intensive in character and has made necessary adequate and timely financial support to agriculture. While primitive agriculture can be carried on without much capital and credit, modern market-oriented agriculture can be carried on scientific lines only if it is ensured of an adequate and timely credit. In fact, the green revolution that has taken place in the country in recent years and the subsequent increase in the agricultural output of the country are made possible because of the increasing participation of the commercial banks and other credit institutions in providing agricultural credit in the country. Secondly, as the economic development of the country takes place through industrialisation and more people from the rural areas migrate to the urban and industrial centres in search of better employment and living standards, a phenomenon that characterizes the economic development of an under developed country,
and, as was seen above, one which is also necessary in order to facilitate agricultural development and improvement in agricultural productively, the exit of a large number of labourers from the agricultural sectors has to be compensated through the substitution of labour by capital. This increase the agriculturists's need for capital and their dependence on banks and other credit institutions for there credit requirements. Thirdly, the need for consumption credit of the agriculturists, such as the finance required to celebrate marriages and others social and religious functions, which and costly in the tradition bound Indian society, and for the purchase of durable consumer goods cannot be over-looked in any scheme of agricultural credit since in the absence of such consumption credit agriculturist are bounds to divert productive credit for consumption purposes. It may also be pointed out that such consumption credit also has a favourable effects on the economy in that it encourages general demand in the economy and there by includes higher levels of productive activity and employment.

**Financing Agriculture by commercial Banks in India**

The role of commercial banks in financing agriculture was almost negligible in the country since independence to nationalization of banks. An analysis of the data pertaining to the relative significance of the traditional sources of credit for agriculture in India presented in Table 2.6 shows that commercial banks supplied only 0.9 percent of the total agriculture borrowing in India in 1951-52 and 0.3 percent in 1961-62.
Agricultural moneylenders and professional moneylenders supplied the major share of credit to agriculturists in the country. But the situation has been changed over the years. Commercial banks in lending a major share in the institutional lending. As per the data available, during 1996-97 commercial banks contributed as many as 46.8 percent to the total credit supplied by the institutional sectors. This is an indicator that commercial banks have been in reach of rural inhabitants. Since before the nationalization of commercial banks agricultural money lenders remained the largest single source of credit to the rural house-holds for cultivation purposes as well as the non-cultivation purposes as is shown in Table 2.7. Even in the terms of total credit extended by the commercial banks, the share of agriculture in the total commercial banks credit in the country, since before the nationalization of commercial banks, was negligible. Table 2.8 presents data pertaining to the share of agriculture in the total credit extended by scheduled commercial banks in the country during the period 1951-68. These data reveal that agriculture received only 1.3 percent of the total scheduled commercial banks credit in the country in 1968 as against 2.7 percent in 1951 and 4.2 percent in 1953. There had, thus, been a traditional apathy on the part of the commercial banks in India to the financing of agriculture.

This apathy of commercial bank to financing agriculture in India was the consequence of the orthodox commercial banking principles and practices developed in England. Commercial Banks were developed in
England as profit seeking business institutions that were guided, while undertaking their business, by the objective of maximizing their own profit. Since the banks were guided by the profit motive and since the working funds of the banks came largely from the short-term deposits of public repayable on demand or at short notice, banks made it a principle to lend only short term loans against sound securities. Since large scale industry and trade could often adequate return on their investment in the form of interest, the lending principles and practices of banks in England were developed to suit the requirements of financing trade and industry and granting long terms and risky loans to agriculture was considered to be unsafe for the banks.

The commercial banks in India developed along these British traditions were concentrating on the provision of credit to trade and commercial and were traditionally averse to financing agriculture in the country. Commercial banks in India were traditionally considered to be institutions, which can not meet the financial needs of agriculture. This view was reiterated by the Rural Credit Survey Committee (1954) when it observed that "interest in rural areas there certainly is on the part of commercial banks, but this is for the purpose of getting deposits from those areas through branches, mobile, banks, etc., and not for financing either agriculture or cottage industry, This is entirely under-standable because the commercial banks not only in India but in most other countries, is not designed for agriculture finance, whether medium or long, on the one hand
and short terms on the other. This is the experience of several countries in which agriculture predominates." 5

Apart from these banking traditions, the agriculture in India was not in a position to furnish the commercial banks with the types of securities acceptable to them. An analysis of the securities wise distribution of scheduled commercial bank credit in India as on June 27, 1969, data pertaining to which are presented in Table 2.9. It shows that commercial banks in India were granting largely secured loans which formed 85.7 percent of their total advances as on June 27, 1969, incorfinitely with the real bills doctrine and were avoiding risky unsecured advances, which formed only 14.3 percent of their total advance as on that data. The observation made by George Racllat "If every advance on your books were covered by adequate security, it is clear that in respect of such advances you would stand absolutely exempt from the risk of loss, but the moment you begin to make exceptions to the rule, by granting advances to this client or to that without security, you leave the solid ground of safety for the treacherous swamps of banking risk" 6, summed up the attitude of commercial banks in India towards the granting of unsecured advances. An added advantage of secured loans is that enables the bank to have refinance facilities against these securities in times of need, so as to safeguard its own liquidity position.

Even while granting secured loan, the type of security preferred by the banks against the loans advanced by them is an important factor in
determining whether a particular sector of the economy or a particular occupation can have credit facilities from the banks, since all the sectors of the economy or occupations may not have the types of security that are traditionally considered to be bankable and are preferred by the banks. Viewed from this perspective the inability of the agriculturist in India to furnish the banks with the types of securities acceptable to them against their loans was an additional factor that tended to inhibit the commercial banks in India from lending to agriculture on a significant scale. Among the different securities, the one that was preferred by most by commercial banks in India 1969 was merchandise, advance against which formed 59.2 percent of total advances of banks. Advances against real estate a security which the agricultural borrowers can be expiated to have, formed only 2 percent of total advances, (The practice in America was however different. In the early period of banking development in America the security that was most acceptable to the banks was real estate since the economy was primarily agriculture and land was the most plentiful asset held by borrowers). In marked contrast with the practice of the Indian commercial banks of granting, by and lye, only secured loans, the agriculturists in the country preferred to have mostly loans against personal security and which are unsecured loans as per the traditional principles of commercial banking.

Data contained in Table 2.10 shows that as high as 78.1 percent of the total amount of cash loans borrowed by rural households in India during 1961-62 was against personal security without any tangible security such
loans. Loans against the security of agricultural commodities formed only 0.2 percent of the total amount of cash loans borrowed by the rural households in the country, a situation that stands in contrast with the marked preference of merchandise by commercial banks as security against the loans advanced by them. The explanation for this paradoxical situation lies perhaps, in the fact that through the agriculturists are the producers of agricultural goods in the country, they produced these goods mostly for family consumption or in such a small quality that they were not in apposition to raise bank loans against their security. The immobility of the agriculturists to offer the banks the types of securities acceptable to them against there loans was therefore, an additional factor that explains the traditional apathy of commercial banks in India to lending to agriculture on a significant scale.

**Recent Trends**

There has been a perceptible change in the attitude of commercial banks towards lending to the agricultural sector in the country from the last two decades. This change began during the fourth five-year plan of India (1969-74) where the role of commercial banks in financing agriculture, especially in those states where the co-operative credit structure was weak, was officially recognized in the country. The 4th Five-year plan stated that, in those states where the co-operative credit structure is at present unequal to the task, the need arises for the extension of banking and credit facilities from such agencies as commercial banks and agricultural credit corporations, commercial banks are expected to embark on a marked
expansion of their operations in the agriculture sphere. The All India Rural Credit Review Committee also pointed out the need for the direct financing of agriculture by Commercial banks. It suggested that "The direct financing by the commercial banks may be concentrated in the first instance among cultivators of the certain categories such as those engaged in raising high yielding varieties of food grains or other remunerative crops, hybrid seed products and those covered by special development projects. Gradually, however, such financing would extend to cultivators of every category (by size or crop grown) provided their farming is being carried on as a viable business, while certain types of accommodation for agricultural purposes should be available all offices, each commercial bank should determine in the light of its experience and appropriate investigations, and where necessary, in consultation with the agriculture departments of the state governments, the areas in which it may concentrate its efforts by way of direct credit to the cultivators."

With the nationalisation of the 14 major commercial banks in the country in 1969. The commercial banks in the country were asked by the government to play an important role in the meeting the credit need of the agriculturists. The banks were asked to lend an increasing portion of their resources to the priority sectors of the economy, consisting of agriculture, small-scale industries, retail trade, professional and self-employment persons. Nationalization of banks brought about a major shift in emphasis of
these banks from the credit worthiness of the borrower to the credit worthiness of the project to be financed.9

In accordance with this shift in emphasis from the credit worthiness of the borrower to the social productivity of the purpose of loan, the nationalized as well as the other scheduled commercial banks in the country have been increasingly participating in financing agriculture in the country, since 1969. Table 2.11 present data pertaining to the trends since 1969 (the year of nationalization) in the financing of agriculture by commercial banks in the country. From the data it can be seen that the amount of credit extended by the commercial banks in the country to the agricultural sector increased from Rs 188 crore as at the end of the June 1969 to Rs 30,874 crores as at end of March 1992. Relatively, the share of the agriculture in the total bank credit increased from 5.2 percent as at the end of June 1969 to 17.4 percent as at the end of March 1990. The share of agriculture in total bank credit steadily raised by March 1990, the highest percent share of agriculture in total bank credit. After March 1990, as shown by table percent share of agriculture in percentage the total bank credit is decreasing, but it is significant.

The above facts indicate that after the nationalization of banks in 1969, the nationalized banks as well as the private sector scheduled commercial banks have been attempting to change their lending policies and have been trying to mobilize large credit from traditional to non-traditional priority sector of the economy, including agriculture. Such a progress in the
field of agricultural credit by scheduled commercial banks in the country is made possible by an extensive branch expansion programme by the banks in the rural areas in the country.

**Certain Problems**

However the financing of agriculture by commercial banks in the country on a large scale is beset with certain problems and practical difficulties which may now be briefly discussed.

First, there is a difficulty arising out of the inability of agricultural borrowers to offer the type of securities acceptable to the commercial banks against the loans granted by them, and in the absence of sound securities, the commercial banks will not be able to finance agriculture to the extent necessary and permitted by their resources. It may be noted in this context that the inability of the agriculturists to offer sound securities against the loans borrowed by them and the consequent possibility of bad debts explains partly the exorbitant rates of interest charged by the village money lenders on their loans to the agriculturists in the country.

Secondly, there is serious problem arising out of the difficulty of the end use supervision of an agricultural loan by the lending bank due to the distance involve between the bank office situated in a town or village centre and its agricultural borrowers spread all over the village and this makes it difficult for the lending banks to ensure the productive use of loans. Through the gravity of this problem has been considerably reduced in recent years by
opening of a large number of banks offices, in the rural areas, the difficulty has not been completely over-come and continues to persist, through to a lesser degree, since even a village bank has to deal with clients spread over a large area which cannot be efficiently handled by the bank. As the Planning Commission has observed, "whatever may be the agency for rural credits, whether it is the village credit society, the branch of a commercial banks or of corporation or the revenue machinery, unless there are effective arrangements at all levels, especially at the local village level, for supervising the use of these loans and the pomp recovery of such loans, pumping in additional funds for agricultural credit will not be productive.

Thirdly, since agricultural production is subject to seasonal, climatic and monsoon conditions, crop failures and loss of agricultural incomes, due to the vagaries of monsoon and climatic conditions, will adversely affect the recovery position of agricultural loans and will impair the profitability of the leading bank, a factor that can not completely ignored even under the charged context of social productivity rather that private profitability. Commenting on the influence of these factors on the recovery position of agricultural loans, the Reserve Bank of India observe in its Annual Report for 1973-74 that in contrast to the rising pace of advances the recovery position is not wholly satisfactory. While the total demand in respect of direct agricultural advances of the public sector banks increased by Rs 24 crore between June 1972 and June 1973, the amount of recovery increased only by Rs 6 crore. In the result, the proportion of recovery to total demand stood
lower at 46.6 percent at the end of June 1973 as per against 50.7 percent as the end of June 1972. The rate of recovery has raised to 54.2 percent in 1985, 57.6 percent in 1994 and to 59.6 percent in the year ending 1995. The recovery position of the direct agricultural advance of banks has been improving since then, the situation is not satisfactory. Unless the satisfactory position in respect of agricultural loans is attained, the recycling of funds of banks will be adversely affected and this will have an adverse impact on the pace of economic development in the country.

Fourthly, lack of adequate expertise and knowledge of agricultural operations and inability to handle a large number of small loans for which direct field level supervision would be necessary, is another factor that tends to impede progress in the field of agricultural lending by commercial banks.

Lastly, the hitherto subsistence nature of Indian agriculture and the predominance of small holdings, often divided into a number of fragments, and the absence of the practice of commercial farming among the farmers make the recovery of agricultural loans to the smaller farmers difficult when compared with the recovery position of the loans to the bigger farmers. Hence a large share of the benefit arising out of the increasing participation of commercial banks in providing agricultural credit went naturally to the bigger farmers in the country.

From the above discussion of the problems and practical difficulties to be faced by commercial banks in providing direct financial assistance to the
agricultural sector it must not be concluded that commercial banks are not suitable for providing direct financial assistance to the agriculture sector. In fact from the point of view of inter sectoral and inter regional inability of funds, of linking the agricultural sector with the non-agricultural and industrial sectors of the country, of developing an integrated money market in the country and from the point of view of enabling agricultural to have an elastic source of credit, the commercial banks are suitable for the provision of direct financial assistance to the agriculture in the country on a large scale. The discussion only points out that rapid progress in the field of direct commercial bank credit to agriculture require the adoption of various measures to equip the banks with sufficient expertise in judging the productivity of agricultural loans, in understanding agricultural problems and in the end use supervision of the loans granted. Measures should also be adapted to device new types of bankable securities, which can easily be offered by the agriculturists against the loans borrowed by them from the commercial banks.

In the context of the priority accorded to agriculture, and also to give an impetus to the flow of credit, the Reserve Bank of India set up a one man High Level Committee of Sh R.V.Gupta in December 1997 to suggest measures for improving the delivery systems as well as simplification of procedures for agricultural credit. The Committee’s mandate was to identify the constraints faced by commercial banks in increasing the flow of credit, introducing new products and services and simplifying procedures and
methods of working with a view to enabling rural borrowers to access adequate and timely credit from the commercial banking system. The committee was asked to visit select branches and regional offices of the commercial banks, get a feedback from agriculturists farmer, borrowers, agricultural scientists, extension workers as well as field level staff and make proposals for further initiatives that could be taken by commercial banks for streamlining the delivery of farm credit. The Committee submitted its report on April 1998. The committee has set forth its views on the simplification of documentation and suggested indicative guidelines on the basis of which banks could devise fresh loans product for the farm sector, made recommendation in relation to measures, which are supportive for formulating the credit delivery system. Among others, committee believes that the basis of lending should be the confidence in the borrowers and that the focus of such appraisal needs to shift from purely project based consideration to a holistic assessment of the income stream of the borrowers. The committee is aware that the approach suggested requires a psychological reorientation towards the farmers and involves intensive interaction at the local level. Such interactions has been to be interwoven into the duty list of branch managers together with supportive measures including residence at the duty station, upgradation of expertise for providing basic counselling and information support to farmers, better computer/vehicular support and extensive training intervention. The committee observed that there are certain issues which over time have
become a part of policy but on which there is clearly need for a fresh examination as to whether such systems and policies have led to overall efficiency of the system. The committee believed that these issues need to be addressed and have therefore suggested certain policy changes, which will facilitate the increased flow of agricultural credit. Among other recommendations regarding policy changes, the committee feels that viability of lending for agriculture depends upon a number of factors such as appropriate volumes, acceptable levels of recovery and a margin to cover cost of funds as well as expenses in sanctioning, supervising the recovery of loans. Staff costs per unit for small loans and higher as compared to large loans and would need to be appropriately priced. Commercial banks are doing so presently through cross subsidisation of rates of interest, which implies that an extra loading of extra cost is being given to loans above Rs 2 lakh. Typically, rates of interest in banks vary from 12 percent for the lowest segment to over 19 percent at the upper end. It is our view that such cross subsidisation is not efficient form for fixing interest rates. Commercial banks should, therefore, be free to fix their rates for loans of all amounts as has already been done in case of the co-operative banks and RRBs.  

It is well accepted that over the years the Indian banking system has significantly achieved the goals of extending geographical reach and functional spread of banking services. However, as pointed out by the Committee on the Financial system, “this progress has exacted a heavy toll in the form of a decline in productivity and efficiency of the system and, in
consequence, a serious erosion of its profitability—even to the point of raising doubts about the viability of some important constituents of the system”.

During its field visits, it was repeatedly submitted by banks that they were increasingly uncomfortable with sanctioning loans under the subsidy-linked programme. It was pointed out that such programs have constricted operational flexibility, depressed income potential, blurred the distinction between credit need and credit worthiness, given a go-by to recoveries and had a psychologically negative impact on the self-image of field level bankers.

It was pointed out that the agricultural credit portfolios of commercial banks comprise two sets of borrowers— one linked of Government Subsidy Schemes where cases are sponsored by Government agencies and sanctioned by banks and the other identified by banks directly. Recoveries in respect of the former are around 30 percent while those in respect of the latter are 80 percent plus. The loans sanctioned under the subsidy linked schemes tend to contaminate the overall asset portfolio, restrict fresh lending and impede the flow of fresh credit in areas having large arrears. The Committee is of the view that the scope to further extend credit in sectors, such as agriculture, small industry and the self-employed is substantial provided this is done on the basis of the commercial decision of banks. District level Government officials expressed similar views regrading the implementation of credit-linked subsidy schemes. It was submitted that the emphasis of such schemes was on the achievement of physical targets and
that, in implementing the disaggregated district-wise targets handed down to them, they were conforming to systemic requirements. They added that since the impact of such schemes in bringing families above the poverty line or providing gainful employment was weak, there was a need for an overall review of the whole system. The issues raised by commercial banks in context of credit linked Government sponsored schemes raises the question as to whether the system of subsidy driven credit, which has been the principal instrument for reaching the poor, can be replaced by one where subsidies and credit exist side by side flow through separate channels and target different segments of the rural poor, if so, the condition necessary for such an arrangement.\textsuperscript{12}

The Committee believes that such an arrangement is possible. In its view, rural borrowers who have experience in dealing with assets- financial or physical can be targeted directly by commercial banks. Even those at the lowest rung of the poverty pyramid requiring assets and start-up support can be financed by banks through NGO\SHG intermediation coupled with expanded micro credit working capital facilities to the non-farm sector. The role of the government should be to utilise the subsidy accessed through the budgetary mechanism for improving infrastructural facilities, providing linkages, upgrading the quality of extension services and providing training to those identified for the purpose. The Committee is clear that the poor are bankable and that there is adequate experience in India as well as internationally to suggest that lending even to the poorest can be done
profitably and on a large scale given certain preconditions such as customer sensitive loan products, appraisal of projects consistent with assessment of borrowers, full discretion in selection thereof, reinstatement of collateral requirements, improved methods of working, better follow up and diligent tracking of overdues accounts. If this is done, there is no reason for banks not being able to lead development and increase access of credit to the poor consistent with productivity. During its discussions with State Governments as well as others, the Committee frequently came across a criticism that despite initiatives taken to accelerate the flow of credit to the agricultural sector, commercial banks continue to fall short of meeting the target for agricultural lending fixed at 18 percent of net bank credit. The Committee notes that net bank credit of public sector banks grew at an annual compound rate of 11.8 percent between March 1991 and March 1996. Agricultural credit grew at a compound rate of 10.7 percent, while credit to medium and large industry grew by 15.9 percent in the same period. In the real sector, GDP grew on an average by 4.8 percent, industrial production by 6.1 percent and agricultural production by 2.1 percent. The target of 18 percent lending to agriculture was fixed at a time when the reserve requirements were as high as 63 percent. These have progressively been reduced over the years and are now at 39 percent. Total lendable resources of banks have thus increased from 37 percent to 61 percent over the last five years. In absolute terms, lendable resources based on effective reserve requirements increased from Rs 113080 crore in 1992 to Rs 270536 crore in
1996 and net bank credit increased from Rs 117443 crore to Rs 228583 crore in the same period. In other words, since the base on which the target of 18 percent is calculated ‘doubled’ requiring banks to concomitantly double there lendings to agriculture to even maintain the same share, i.e. 16 percent in conditions where agricultural production itself was growing at 2.1 percent per annum. Although agricultural lending of public sector banks increased from Rs 15857 crore in 1991 to Rs 26351 crore in 1996, the share of such advances to net bank credit actually declined from 15.0 percent in 1991 to 14.3 percent in 1996. The targets for priority sector as well as for agricultural credit are fixed on the basis of ‘outstandings’ and drawing conclusions on the flow of credit to agriculture on this basis can be somewhat misleading since outstanding decrease as a result of improved recoveries as was the case between 1990 and 1995 during which period recoveries improved from 48.8 percent to 59.5 percent. Outstanding credit also decreases when write-offs take place. Thus, under the ARDRS 1990-91, public sector banks provided Rs. 2832 crore as debt relief of which around Rs. 1900 crore was for agriculture. The combined effect of improved recovery and write-offs was to reduce the share of lending to agriculture without any deceleration in the pace of lending to the sector.

It was represented to the Committee that tenant farmers were not being considered for sanction of credit as most such tenancies were oral and unregistered. The reasons for the prevalence of such practices are many, and include inability of landowners to cultivate either on account of infirmity
or service outside the village, or on account of landlordism in some areas. However, the prevalence of such practices is widespread throughout the country, and assessment is that about 20 percent of the lands cultivated are by oral tenants. It was represented that the prevailing system is not conducive to efficiency as tenants tend to cultivate on a non-optimal basis, as their sources of finance are limited to their own resources and borrowings, from moneylenders at higher rates of interest. It is the view of the Committee that if such tenants were brought within the purview of the banking system, there would be overall gains in terms of incomes for such tenants as well as agricultural productivity. Going further into the issue, it is clear that such tenancies continue to be oral as the land revenue acts of the various States ordinarily provide for tenants acquiring ownership status. The objective of such a stipulation was that land must be owned by the tiller. It was brought to the attention of the Committee that many of the leasing systems do not have an exploitative element and are business transactions in which the returns are shared on a fairly equitable basis. It was also represented by tenants as well as land owners that, whereas in urban areas property could be rented without the owner of the property being dispossessed, such an alternative was not available in rural areas on account of the land tenancy acts. It was argued that, in the interest of overall production and bringing into the mainstream the substantial portion of the lands under tenant cultivation, such renting be legally allowed. The
Committee therefore, suggests a review of the land tenancy acts so as to permit renting of land, without the owner losing property rights.  

C. Commercial Banks finance to the Priority Sectors

The policy of designating certain sectors of the economy as priority sectors and stipulating a certain percentage of the total resources of the commercial banks to be used for lending to such sectors of the economy is an attempt at bringing about a more balanced sectoral distribution of banking facilities in the country. To the extent to which the economics activities falling within the priority sectors belong to the rural sectors of the economy, the policy of priority sectors financing by commercial banks can be regarded as an attempt at expanding rural banking facilities in the country and hence commercial banks financing of productive activities in the priority sectors of the economy is an aspect of rural banking in the country.

The concept and need: -

The different sectors of an economy like agriculture industry, trade, transport, services, education etc. are interrelated and a simultaneous development of all these sectors is necessary in order to bring about the rapid development of the country in the long run. However, at any time, a particular sector or one or two of these sectors of the economy may be more important than the others either as the leading sectors in realising certain immediate and short run objectives or as the limiting sectors which obstruct...
the realisation of such objectives like increasing production, containing inflationary pressures or generating employment opportunities. Such sectors of the economy are then designated as the priority sectors of the economy. Considering the strategic roles of agriculture, cottage and small scale industry, retail trade and small business, road and water transport undertakings education and self employment projects in increasing the supply of food and other consumer goods so as to meet the increasing domestic demand for them, in containing inflationary pressures and in generating employment opportunities during the early years of the 1970s and even at present apart from their role in accelerating the rapid long run development of the Indian economy, these sectors are designated as the priority sectors of the economy. The concept, therefore, stress the significance of such priority sectors in the country's economy and highlights the need for according special treatment to such sectors in respect of extension of credit facilities and in the implementation of other economics policy measures.

A Dynamics Concept:

It should be noted that the concept of priority sector is not a static and rigid concept. A sector which is a priority sector of the economy at present may become less significant after a certain stage of economic development of the country is attained and some other sector will become more strategic and will be designated as the priority sector of economy. For example, considering the present factor endowment position of India, its
capital poor and labour rich character, the present level of economic
development of the country and the need to bring about an immediate
increase in output for containing inflation and the need for creating
immediate employment opportunities for labour, cottage and small scale
industries constitute a priority sector of the Indian economy at present. But
after a certain stage of development is attained and when the factor
endowment position of the country change, cottage and small scale
industries need not necessarily continue to be priority sector of the economy;
medium and large scale industries may take their place. The concept of
priority sectors is, therefore, a dynamic concept and not a static and rigid
concept.

Recent Trends in Priority Sector Financing by Commercial Banks

Since the availability of sufficient credit at low rates of interest is one
of the prerequisites of the rapid growth of any economic undertaking, the
commercial banks in the country, particularly by nationalised banks, are
asked, since 1969, to mobilise a large and increasing share of their
resources for meeting the credit needs of the priority sectors of the economy.
Incidentally, these were also the sectors which were denied of their genuine
need for bank credit till than and this neglect of the financial needs of these
sectors by commercial banks is definitely one of the reasons for the
insufficient development of these sectors and for the sluggish growth of the
Indian economy as a while. Table 2.12 contains data relating to the trends in
the financing of the priority sectors by the scheduled commercial banks in
the country between 1969 and 1997. The data reveals that the share of the priority sectors in the total credit advanced by the scheduled commercial banks has been steadily increasing from 14.0 percent at the end of June 1969 to 39.4 percent at the end of June 1985 which is highest share of credit to priority sectors in the scheduled commercial banks credit. Of the total amount of credit extended to the priority sectors as at the end of June 1985, agriculture received 40.8 percent, small-scale industries received 36.7 percent and other priority sectors together received 2.5 percent. Agriculture and small scale industries together, thus received 77.5 percent of the total amount of credit extended by scheduled commercial banks to the priority sectors in the country. While in the year 1997 priority sectors were extended 32.9 percent of the total credit extended by the scheduled commercial banks. Out of the total amount of credit extended to the priority sectors as at the end of march 1997, agriculture received 37.6 percent and small scale industries received 41.6 percent and other priority sectors together received 20.7 percent. Small scale industries and agriculture together received 79.2 percent of the total amount of credit extended by the scheduled banks to the priority sectors in the country, small scale industries are getting more credit in compare to agriculture in recent years. This is as it ought to be since it is the development of agricultural and small scale industries which one of strategic important in increasing the supply of food and industrial raw materials and consumer goods in the short period in order to meet the growing need of the economy for such goods and thereby to contain
inflationary pressures. An expert committee was set up in 1995 (Chairman: Shri Abid Hussain) to recommend policy reforms and new policies for the development of small and medium enterprises to make them viable and efficient units in the light of the technological changes and international competitiveness. The Committee in its report submitted to the Government of India in January 1997 has recommended several measures/changes encompassing various facts of the small-scale industries sector. Based on the recommendations of the committee, the limits on investment in plants and machinery in the small scale industries sector have been enhanced from the earlier level of Rs 60 lakh (Rs 75 lakh in the case of export oriented and ancillary units) to Rs 3 crore and for the tiny sector from Rs 5 lakh to Rs 25 lakh. In this context, it is also been decided that out of the funds available to all segments of the SSI sectors, banks should ensure that 40.0 percent will be made available for units with investments in plant and machinery upto Rs 5 lakh, 20 percent for units with investment between Rs 5 lakh and Rs 25 lakh and the remaining 40.0 percent for the SSI units.  

Rapid development of small-scale industries will have the additional advantage of creating employment opportunities for the unemployed labourers in the country. The increasing flow of bank credit to agricultural sector and SSI sector in the country had the desired effect since the easy availability of credit is one of the major contributors to the rapid progress in agricultural production as well as in the development of SSI in the country in recent years.
**Profitability of Banks:**

While there has been a considerable expansion of commercial banking in the country, both geographically as well as functionally, critics might observe that all is not well with such expansion. They would point out, in particular, to the deterioration in the profitability, the traditional criterion of judging the efficiency and soundness of the commercial banking industry, of the banks and in the quality of the service rendered by them recent years. Table 2.13 contains data pertaining to the recent trends in the profitability of scheduled commercial banks in the country. The data shows that during the period 1970-1984, there has been a generally decline trend in the profitability of the scheduled commercial banks, afterwards there is an increasing trend in the profitability of the scheduled commercial banks. Here it is necessary to mention that the profitability of the commercial banks is measured by expressing the aggregate profits of the banks as a percentage ratio of their aggregate deposits. If the profits of the banks are taken in the aggregate sense or are expected as a ratio of some other variable, such as aggregate credit, owned funds of banks or the aggregate number of bank employees some other trend, then what is exhibited in the table in the profitability of the banks may emerge. However, since the working capital of the banks consist of the aggregate deposits at their disposal, the percentage profit deposit ratio is a more appropriate measure of the profitability of the operations of the banks than any other ratio or any other aggregate measure.
It should be noted in this connection that in view of the need to mobilise a larger share of their resources to the priority sectors of the economy and to the weaker sections of the society, often at confessional rates of interest, the difficulties and higher operational expenditure involved in the end use supervision of such loans, difficulties in the timely servicing of such loans by borrowers, difficulties in timely recovery of such loans, etc., the profitability of the operations of the commercial banks in the country is bound to decline further when profitability is viewed from the traditional perspective.

**Need for Conceptual and Policy Changes**

Financing of the priority sectors on an increasing scale required to meet the need of rapid economic development, price stability and social justice, therefore, raises certain fundamental issues in commercial banking theory and practice and calls for certain conceptual and policy changes if the criticism, that the rapid expansion geographical and functional of the Indian Commercial Banking Industry since Bank Nationalisation is at the cost of profitability and efficiency, is to be avoided and to make public realise the social gains, as distinct from private profit, that emerge out of such an expansion of commercial banking activity in the country. Under the traditional self liquidity loans theory or the commercial loans theory of bank lending,\textsuperscript{15} the commercial banks in the country were granting loans only against negotiable and tangible security, the reputation and business standing of the borrower being the security in those exceptional cases where loans are
granted without any tangible securities against them. As a result, genuine productive purposes of strategic economic importance, but without adequate formal and negotiable securities against them, had to go without bank finance, while unproductive speculative purposes covered by bankable securities got the required financial assistance from the banks resulting in the unproductive use of bank credit from the social point of view. This explains why agriculture, small scale and cottage industries, retail trade etc. which are non-designated as the priority sectors of the economy, where denied, till recently, of their genuine share in bank credit in the country with all its retarding effects on the rate of its economic development. This implies that the diversion of larger bank credit into these sectors of the economy require the commercial banks giving up their traditional lending theory and practice and sacrificing profit as their primary objective to a certain extent and making the purpose of the loans and its social importance, rather than the formal security against if, the deciding factor while assessing a loan application. The orthodox commercial loan theory or the real bills doctrine which had the primary objective of ensuring the liquidity and profitability of the lending bank cannot, therefore be the relevant criteria of commercial bank lending at present. The real test of the economic usefulness of the performance of banks, as part of the financial infrastructure, lies at present in promoting social productive and encouraging economic activity on sound and desirable lines in consonance with the overall economic policy and objectives of the country. The lending activities of commercial banks should
henceforth be guided by criterion of social productivity and social usefulness and significance rather than private productivity, of the purpose of loan. The factors which the banker should take into consideration in deciding on a loan application are not whether the borrower can offer sufficient security against the loan or can repay the loan in time out of his further income, but whether the purpose of the loan is socially and economically desirable and that whether the use of the proceeds of the loan will encourage further economic activity in the region or elsewhere in the country so as to be beneficial to the economy as a whole. The purpose of the loan and its social productivity, rather than the security offered, though security may still serve a limited purpose, should be the basic criteria in deciding on a loan application. The objective of such a change in emphasis, from security purpose, is to ensure that genuine productive purpose do not go without bank credit on account of inadequate formal security behind them. Such a change in the theory and policy of commercial bank lending will also have the advantage of maximising the productive use of bank credit by diverting it, as much as possible, from speculative to productive lines.

The concept of profitability of banks also needs to be reinterpreted, as seen above, in order to include in it the socio-economic importance and productivity of the loan. The profitability of a bank should be interpreted in the sense of social productivity and not in terms of the amount of private profit that the bank makes annually as was the practice in the past. Unless the above conceptual changes are incorporated into the theory and policy of
commercial banking in India, the functioning of the banking system in the country will be held to be inefficient, since the diversion of larger credit to the priority sectors is bound to erode to profitability of the commercial banks in the traditional sense.

**Certain problems:**

Financing the priority sectors by the commercial banks on a large scale, however, involves certain problems, which may briefly be discussed now:

First; the conceptual difficulty in diverting larger bank credit to the priority sectors revolves around the need for theoretical and policy changes discussed above. While it is rather easy to alter a policy, it is difficult to change certain conceptual benefits like security and profitability, which have been traditionally held to be sacred principles of commercial bank lending. Changing them in favour of certain other unorthodox and economically and socially more relevant concept requires concerted effort on the part of economists and policy makers at educating both the bankers and the public on the irrelevance of the older concepts and the need for the adoption of new ones in the context of the rapid economic development of the country and the socio-economic changes that such development gives rise to.

Secondly, the traditional concept of security can be easily adopted and implemented, since it is easy to assess the market value of tangible assets. But it is practically difficult to assess the productivity and social importance of a loan application. Similarly, it is easy to assess the operational efficiency of
a bank in terms of the traditional concept of profitability and with reference to
the amount of profit that the bank earns annually. On the other hand, it is
practically difficult to quantify the operational efficiency of a bank in terms of
the social productivity of its operations, through the conflicts between private
profitability and social productivity in specific case of bank lending can easily
be visualised and pointed out. For instance, from the point of view of private
profitability, it is preferable for a bank to lend a whole-seller, on the security
of goods for speculative purpose at a high rate of interest through especially
such a lending activity is unproductive and undesirable. On contrast, lending
to agriculture or small scale industries at a lower rate of interest is a socially
productive and important transaction though such lending at low rates of
interest and with risks of default attached to it, will not be favour to the bank
from the point of private profitability.

Thirdly, there is also the difficulty involved in the effective end - use
supervision of agricultural loans borrowed by cultivators dispersed all over
the village often at considerable distance from the lending bank office and
without effective end - use supervision of the proceeds of the loan are liable
to be put to unproductive use by the borrower and will result in bad debts
with their harmful effects on the borrowers, on the lending bank and on the
economy as a whole. Similar is the case with loans advanced to small-scale
industrialists and for self-employment purposes, which have a greater
chance of being misused than the loans, granted by the banks in
accordance with the traditional real bill doctrine.

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Lastly, diversion of larger credit to the priority sectors may put the traditional sectors of bank financing into undue hardship of denying them the finance, which they genuinely need. It is also necessary to assess properly the credit absorption capacity of the priority sectors so that the credit extended to them does not remain idle, but is fully used for productive purposes. These calls for a proper credit plan carefully dovetailed with the national and regional development plans.

The foregoing discussion of the conceptual and practical difficulties involved in the priority sector financing by the commercial bank in the country only highlights the needs for conceptual changes and for taking precautionary any measures while financing the priority sectors, which are new lines of activity for Indian commercial banks are not suited to the undertaking of such credit activities. In fact such conceptual and policy changes are slowly being brought about in the country since Bank Nationalisation in 1969. The diversion of an increasing share of commercial bank credit to priority sectors of the economy, as is clear from the foregoing review, the differential rate of interest scheme, etc. highlight such theoretical and policy changes brought about slowly in the country by the Reserve Bank of India and the Indian Commercial banking system. There is still scope, however, for the increasing participation of commercial bank in priority sector financing in the country.
Welfare implication of priority sector financing --

Increasing participation of commercial banks in priority sector financing has two important effects, which may conveniently be called the developmental effect and the distributive effect.

First, since by definition the priority sectors of the economy are those sectors which play a strategic role in the economic development of the country, diverting an increasing portion of the resources of the commercial banks for financing the credit needs of the priority sectors of the economy will have the effect of bringing about a higher rate of economic development in the country through an expansion of productive economic activity in the priority sectors of the economy, consequently, the rate of economic development of the country will tend to increase.

Secondly, since the economic activities in the priority sectors are generally labour intensive in character, the rapid expansion of economic activity in the priority sectors made possible by an increasing availability of bank credit will create larger employment opportunities for the labourer than the volume of employment generated through the expansion of those sector of the economy into which bank credit tended to flow in the past. Such an increase in the employment opportunities for the labourers will have the effect of a redistribution of income from the riches to poorer classes of people in society. Combining the above two effects of priority sector financing, it can be said that the use of an increasing portion of the resources of the commercial banks for meeting the credit needs of the
priority sectors of the economy will help in attaining the objective of rapid economic development with special justice in the country.

Since promotion of social economic welfare is one of the basic objectives of economic policy in the country, it is desirable, in this context, to discuss the welfare implications also of priority sector financing by commercial banks in the country. This can be done on the basis of certain assumptions as follows:

1) The economy consists of two sectors, namely, the large and medium industry, whole sale trade and business on one hand and agriculture, small scale industry, retail trade, self employment occupations, etc. Which came under the priority sectors of the economy, on the other.

2) Economic units belonging to the first sector are assumed to be economically richer than those belonging to the second sector are.

3) The marginal utility of money is higher for the poor people than for the rich.

4) The loanable resources at the disposal of the banking system are limited.

5) Lastly, and from the above, lending more to the second sector implies a transfer of bank funds from the richer sector of the economy, the traditional sectors into which bank credit tended to flow in the country, to the poorer sector.

Lending an increasing portion of the resources of the banking system of the priority sectors of the economy implies a diversion of bank of bank...
funds from the traditional to the priority sectors of the economy. Since the traditional sectors of the country's economy into which commercial bank resources tended to flow in the past are assumed to be richer than the priority sectors, a diversion of bank funds from the traditional to the priority sectors will imply a diversion of resources from the richer sectors to the poorer sectors of the economy. Such a diversion of bank funds from the traditional sector will imply, on the other hand, a loss of resources for those sectors and will result in a fall in the level of production and income and an apparent fall in the level of economic welfare of the individuals belonging to those sectors of the economy.

In the case of priority sectors, on the other hand, the increased availability of bank credit will result in higher levels of production employment and income. The level of consumption and economic welfare of the individuals belonging to the priority sector will thereby increase.

In order to comment on the effects of these changes on the level of economic welfare of the society as a whole, it is necessary to see whether the individuals belonging to the priority sectors can compensate for the loss of economic welfare suffered by the individuals belonging to the traditional sectors. It is possible that when the level of economic activity and income in the priority sectors goes up, due to the productive use of bank credit, their demand for the products of the traditional sectors will increase and this increasing demand for their products will induce higher levels of productive activity employment and income in those sectors. This implies that the
traditional sectors will be sufficiently compensated for the apparent loss of income and welfare consequent to the transfer of bank funds to the priority sectors. The net effect of using a large portion of the resources of commercial banks in the country for meeting the credit requirements of the priority sectors of the economy is an increase in the level of economic welfare of the society as a whole in the country. Priority sector financing by commercial bank is, therefore, conductive to a higher level of economic welfare in the country.

**Need for Credit Planning: -**

Sectoral imbalances in the distribution of bank credit characterised the Indian banking system as it existed as at the end of June 1969. Since 1969, however a more balanced sectoral distribution of bank credit has come about in the country and diversion of an increasing portion of the resources of the banking system into the priority sectors of the economy is one aspect of such sectoral balance in the distribution of bank credit in the country. Care should, however be adopted to see that while diverting a larger portion of the resources of the banks to the priority sectors; the genuine needs of the traditional sectors of the economy for bank credit are not ignored. What is required is a balanced distribution of bank credit among the different sectors of the economy, taking into consideration the total availability of resources with the banking system, the credit needs of the different sectors of the economy and their relative absorptive capacities. It is in the context that credit planning assumes significance in the country.
Meaning: -

Credit planning can be defined as the allocation of the overall volume of bank-resources available in the country among the different sectors of the economy, considering their needs, absorptive capacities, and their active importance in the context of the economy's overall development and in promoting price stability and distributive justice.\textsuperscript{16}

The object of credit planning is to bring about the maximum productive use of the available resources at the disposal of the banking system in accordance with the priorities laid down in the national economic plan. This implies that credit planning is the part of overall economic planning in the country.

ASPECTS:

Credit planning has two aspects -- the macro aspect and the micro aspect.

In its macro aspect credit planning takes the form of allocating the overall volume of bank credit or resources available in the country with its banking system among the different sectors of the economy like large, medium, and small scale industry, agriculture, wholesale and retail trade and commerce, services, etc. On the basis of their relative importance in the national economy, their potential for development and their absorptive capacities. Targets should then be assigned to the different banks for the development of credit to the different sectors. On the basis of the relative volume of business undertaken by the different banks, the locality and region of their operation, the relative significance of the different banks in the
country's banking system, etc. Distribution of the overall volume of credit that can be deployed by the banking system among the different sectors of the economy and the allocation of sector-wise credit deployment targets among the different banks, therefore, constitute the Marco aspect of credit planing.

The micro aspect of credit planning deals with the allocation of these bankwise targets among the different branches of the individual banks, depending upon the size and operation of the branch, the area served by it, the credit absorptive capacity of the area, the potential for development in the area, etc. It should, however, be remembered that the credit needs of the relatively under developed states or regions of the country, which are unbanked hitherto and were denied of their genuine banking and credit needs, should be taken special care of while dealing with the micro-aspect of credit planing in accordance with the objective of bringing about a balanced regional and sectoral distribution of banking facilities in the country.

Since the volume of credit that a bank can create depends on the volume of deposits mobilised by it, targets for credit deployment should logically be preceded by bankwise and bank-branch wise targets for deposit mobilisation from new depositors by spreading the banking habit among a larger number of people. Importance should be attached to the volume of deposits mobilised by a bank from new depositors and not merely to the volume of deposits mobilised, since it is always possible that the new deposits mobilised by one bank are drawn from another through a process of
shifting of deposits to that bank from another. What is significant, therefore, is the volume of deposits mobilised from individuals who did not have the banking habits so far. Hence, a comprehensive deposit-planing or a plan for deposit mobilisation should form an integral part of credit planing and credit planing will be successful the only when it is linked with such a deposit planning.

From the above it can be pointed out that credit planing involves the lying down of different types of targets for credit deployment at different levels. Four types of such targets can be thought of and they are.

(i) **Sector wise targets**
(ii) **Bank wise and bank-branch wise targets**,  
(iii) **Region wise targets** and  
(iv) **Location wise targets**.

(ii) Sectorwise targets are those which specify the macro-ratios according to which the aggregate resources at the disposal of the banking system are to be disbursed among the different sectors of the economy such as industry, agriculture, trade and commerce services etc., depending upon their relative needs for credit and their relative credit absorptive capacities and the aggregate resources available at the disposal of the banking system. As was pointed out earlier, there were marked imbalances in the sectoral distribution of bank credit in the country as at the end of June 1969 and one of the objectives of the banking expansion policy in the country since then has been to
set right such imbalances. Credit planning should aim at attaining this objective by laying down sector-wise targets for credit deployment at the macro-level. It should, however, be remembered that the basic objective of credit planning is not just to lay down targets for credit development but to ensure the optimum productive use of bank credit in the country. Hence, while laying down sector-wise targets for credit deployment, with a view to bring about a balanced distribution of credit among the different sectors of the economy, the relative credit absorptive capacities of the different sectors and their relative needs for credit should be carefully considered so that the credit allotted to certain sectors does not remain unused while the other sectors of the economy are denied of their genuine needs for credit and hence and optimum use of credit, from the social point of view, is not attained in the economy.

(iii) Allocating the sectoral targets among the different banks or fulfilment depending upon the relative sizes, volume of operations and regional coverage of the different banks constituting the country’s banking system can arrive at bank-wise targets. These bank-wise targets for credit deployment can further be divided among the different branches of each bank.

(iv) Distributing the macro level sectoral targets among the different region of the country arrives at region-wise targets. For instance, once the total amount of credit to be granted to the agricultural sector
or to the small scale industries sector in the country as a whole is determined, it is necessary to decide the distribution of this amount among the different region or states of the country depending upon the relative levels of development or backwardness of the different regions, their potential for further development, their credit requirements, the need for bringing about a balanced regional economic development in the country, etc.

(v) Since the objective of economic policy is to bring about a balanced regional economic development of the country, the mobility of bank funds from the relatively prosperous region to the relatively backward regions is essential in the process of the economic development of the country and the need for such inter-regional mobility of bank funds should be taken care of while formulating the region wise targets for credit deployment under credit planning.

(vi) Lastly, the location wise targets under credit planning refer to determining the rural urban flow of bank resources within a region. The credit needs of the rural areas were neglected till recently by the commercial banks in India and they shifted the deposits collected in the rural areas to the urban areas for profitable deployment. In order to avoid the resulting rural urban imbalance in the distribution of bank credit within a locality in the country, it is necessary to decide the extent to which rural deposits are to be used for lending in the rural areas themselves and the extent to which rural urban mobility of bank
funs should be allowed in the interest of optimum productive use of bank resources in the country and these consideration have to be incorporated into the location wise targets under credit planning. It was pointed out earlier that the success of credit planning requires its integration with deposit planning and similar targets can be laid down in the case of deposit planning as well.

**Need:**

The need for credit planning in the country arises on account of the following two factors

1. **Scarcity of credit:** The overall volume of bank resources or bank credit available in the country is much short of the needs of the different sectors of the economy. These scarce resources at the disposal of the country's banking system should, therefore, be rationed out among the competing alternative use of credit. Under the capitalist, unplanned and traditional system of banking, this rationing of scarce credit is being undertaken by the pricing (the rate of interest in the case of credit) process.

   An excess demand of credit in relation to its availability will push up the market rate of interest which, in its turn will discourage the marginal borrowers and will thereby reduce the demand for credit to the level of its supply. A large supply of credit in relation to the demand for it will, on the other hand, have a depressing effect on the rate of interest which in its turn, will encourage the marginal borrowers and push up the demand for credit to the level of its supply. The pricing process will, therefore, if left free to
operate, have the effect of eliminating excess supply or demand and will always bring about equilibrium in the credit market.

(2) Conflicting interests: However, such a distribution of scarce credit among the competing and alternative use of varying importance, may not be optimum distribution from the point of view of the society as whole, since such a system has the effect of mobilising credit to those richer sectors of the economy, often the large scale industry and wholesale business sectors in India, which can pay the high rate of interest and will deprive the other poorer sectors of the economy, like agriculture, small scale industry, retail trade etc., of their genuine need for credit irrespective of the productivity and importance of the use of credit in such sectors from the point of view of society. This, consequently result in a wholly unplanned and unbalanced distribution of credit among the different sectors of the economy.

In order to induce the maximum productive use of bank credit from the point of view of the society as a whole and to induce the possible and optimum rate of development of the economy, credit should be distributed among the different sectors of the economy not on the basis to their ability to pay higher rates of interest, but on the basis of their relative importance in the economic system, their ability to contribute to increasing production, to create employment opportunities, to maintain price stability and to distribute fruits of economic development equitably among the different sectors of the people in society. These are objectives of a social character, which often tend to conflict with the traditional objective of profit maximisation followed by
commercial banks in India and in other capitalist countries. Thus, the alternative use which are socially important need not always be profitable from the point of view of the lending bank so that there arise a conflict between the interests of the society and the lending bank. Prior to the nationalisation of banks in India in 1969, when the banks were answerable to their shareholders, profit maximisation was the primary objective of banks and they could not incorporate these social objectives, which level to conflict with considerations of private profitability in their working. Under the present system on the other hand, where the nationalised banks, wholly owned by the society, are answerable to the society as a whole and not to private shareholders, they should not only adopt these social objectives but should also make them the guiding principles of their credit activities. The system is, however, devoid of pricing process a distributor of scarce credit among competing uses. Credit planning is the alternative to the pricing process and is the mechanism, which is now used to distribute the limited sources at the disposal of the banking system among the various competing uses.

The foregoing discussion highlights the need for credit planning in the country at present in order to attain the various social objectives of banking and the goals of economic policy. Credit planning, it may be repeated, will be successful in attaining such objectives only when it is integrated with deposit planning.
Saving Habits & Forms:

The amount of credit that the banking system can lend is obviously conditioned by the volume of savings mobilised by it from the people in the form of deposits and, therefore, deposit mobilisation by the banks is as important as credit deployment.

Since the deposits kept with the banks by public come from their savings, the motives for savings, the magnitude of saving their and the forms in which savings are held by the people have a significant bearing on the value of deposits mobilised by the banking system. This section will now be devoted to a discussion of the motives for saving and the forms of saving in the country and if their implications to rural banking.

Motives for savings:

At least for motives four savings and the forms of saving by people can be pointed out and these motives are.

1. The security motives
2. The income motives
3. The liquidity motives
4. The convenience motive

(1) The Security Motive: Security in future life is the first and perhaps the earliest of all the motives for savings by individuals -- saving for the rainy days, as it is proverbially said. Since the future is uncertain and the future flow of income of individuals is also uncertain, they tend to hold a part of their present income for future use through savings. In this context
commodities functioned as store of value in a barter economy and money acts as the store of value in the present day money economy. Even in the present day money economy, the barter form of saving is still in vogue, particularly in the rural areas of an undeveloped country as in the case of India. It is observed, for instance, that many of the rich agriculturists in India, who have income to save, hold their income for the future in the form of the agricultural crops grown by them. They sell such crops only when they need liquid cash. Through such a practice can be viewed as a method which enables the agriculturist to get a higher price for their products, by selling them at a time when their prices tend to be high, majority of agriculturists holding such goods do so as a form of saving income for the future as is evident from the fact that most of the agriculturists, who have such stocks of goods, invariably sell them when the need for liquid cash arises irrespective of the level of prices prevailing in the market. It may incidentally noted that during a period of severe inflationary pressures, as has been the situation in India since 1956, with minor exceptions, saving in the form of goods is preferable to savings in the form of money since, while hoarded money loses its valued during inflation, goods gains value due to rising prices.

(2) The income motive: - The presence of banks and other financial institutions which act as repositories of the savings of the people and offer to pay interest on the savings entrusted to their custody adds a new dimension to individual savings in that they are now capable of earning an income, in the form of interest, for the further apart from offering future security.
Consequently, earning income for the future is an additional motive for saving by individuals. However, what are important from the point of view of earning income are not saving as such, but the form in which savings held since all forms of saving do not yield income. While the savings held in the form of money do not bring any additional income in future, and may even read to a loss of income in the form of falling value of money due to evaluation, saving held in the form of bank deposits bring an income in the form of interest. The net income that the saver gets depends, however, on the rate of interest vis-à-vis the rate of inflation. Unless the normal rate of interest is higher than the rate of inflation, the saver will not be able to get a net income from his savings. However, the presence of a rate of interest on bank deposits, however, low the rate may be, acts, at least partly, as a hedge against inflation and thereby makes saving in the form of bank deposits preferable to savings in the form of money.

(3) The liquidity motive: - While savings are essentially meant for the future, the possibility of marking use of such savings for meeting unexpected monetary contingencies at any time is an additional factor that encourages people to save. For this purpose, the forms in which savings are held must possess a high degree of liquidity so that such savings can be liquidated in times of need. Commercial bank deposits in India, for example, are relatively more liquid than post office savings or savings kept in other financial institutions which generally impose certain restrictions on the withdrawal of deposits before maturity. Bank deposits, on the other hand, are relatively
liquid since it is possible for the depositor to make use of even his term deposits in times of urgent need by raising a loan against them. This aspect of bank deposits makes them more attractive as a form of savings than deposit in other financial institutions.

(4) The convenience motive: - The process of saving and getting back the income saved in times of need should be convenient to the savers. Travelling long distances for putting their savings in a bank or in other financial institutions and cumbersome procedures to be followed while depositing their savings or while withdrawing them will only discourage the savers. Incomes on savings can be earned, for instance by lending savings locally to individual borrowers who are often prepared to pay higher rates of interest than the financial institutions. But such lending are risky and are very inconvenient in times of need. The convenience motive for saving makes savers prefer a local branch of a bank for depositing their savings rather than travel long distance to put their savings in a bank of their choice.

**Rate of savings in India:** - The above are the various motive for savings by individuals in a country. The aggregate volume of savings undertaken individually by the people in a country provides it with the resources required for investment and capital formation. Obviously, the individual savings by millions of individuals in the country have to be gathered and made collectively available for investment by the industrialists and business- men through the intermediation by banks and other financial intermediaries functioning in the country. A developing economy requires a
high rate of domestic saving for two important reasons. First domestic savings constitute the real and ultimate source of capital formation; a high rate of capital formation and economic development in the country requires a high rate of domestic saving.

Secondly, a developing economy will not be able to increase the supply of consumer goods at the required rate during the initial stages of its economic development because of the necessity to divert resources from the production of consumer goods to the fields of investment and capital formation. Therefore, unless consumption is restricted, scarcities of consumer goods, inflationary pressures and the associated problems are bound to arise in the initial stages of economic development and these problems, related the pace of development of the economy. A high rate of domestic saving avoids the emergence of such problems by restricting consumption expenditure in the country.

As analysis of the rate of domestic saving in India reveals (data in table 2.14) that the rate of gross domestic saving in India has increased steadily from 16.8 percent of the gross domestic product in 1970-71 to 24.7 percent in 1978-79 and has decreased thereafter to 22.1 percent in 1983-84 and thereafter increased to 29.0 percent in 1996-97 which is the highest percentage so far. The rate of domestic saving in India is equal or even higher than the rates of domestic saving in some of the developed countries in the world.
**Sectoral shares: -**

It is enlightening to analyse the sectoral shares in gross domestic saving in India and their implications to banking in the country. For this purpose the economy is divided into three sectors namely, the household sector, the private sector and the public sector, the private corporate sector and the public sector, in accordance with the classification undertaken by the central statistical organisation in the country. The data pertaining to the sectoral shares in the gross domestic saving in the country are presented in Table 2.15. From these data it can be found that the share of the household sector in the gross domestic saving in the country in 1990-91 formed 84.3 percent in 1990-91 and 77.08 percent in 1996-97 where as 71.8 percent in 1970-71. Since 1970-71 it varies between 70 to 85 percent. The share of the private corporate sector was 16.8 percent in 1995-96 and 14.8 percent in 1996-97 and of the public sector was merely 2.5 percent in 1993-94 and 7.4 percent in 1996-97 as against 18.5 percent in 1970-71.

These data reveal that the major share of the gross domestic saving in India comes from the household sector. This predominance of household savings in the gross domestic savings in India is an indicator of the underdeveloped nature of the Indian economy since it is generally found that it is the industrial or business community that does most of the savings in the form of business profits in a developed economy, while the major share of the gross domestic saving in an underdeveloped economy comes from the household sector.
Forms of saving:-

While the rate of domestic saving in a country is important in itself, the funds in which savings are held are equally important in determining whether the savings undertaken by the individuals are available to the economy for investment by industrialist and businessmen for all forms of saving do not make the savings equally available for the economy for investment. While savings held in the form of bank deposits or in other financial forms are easily available for the industrialists, savings held in other forms like money or goods do not make them available for investment.

Therefore, the form in which individuals hold their savings are as important as the rate of saving in determining the availability of resources for capital formation in the economy.

Table 2.16 presents data relating to the form of household savings, which formed 77.8 percent of the gross domestic saving in the country in 1996-97 and 74.4 percent in 1995-96. These data reveal that saving in the form of commodities or physical assets formed 54.7 percent of the total gross household saving in India in 1983-84 as against 60.6 percent in 1980-81. Financial savings, on the other hand, formed 45.3 percent in 1995-96 as against 39.4 percent in 1980-81. Among the different forms of financial savings, the share of currency decreased from 18.8 percent of the total gross household financial saving in India is 1980-81 to 10 percent in 1992-93 thereafter increased to 16.9 percent in 1995-96 while the share of net deposits decreased from 34.7 percent of the total gross household financial
savings in India in 1980-81 to 15.3 percent in 1989-90 thereafter increased to 35.1 percent in 1993-94 and further decreased to 27.7 percent in the year 1995-96.

**Implications to Rural Banking:**

Having analysed the rate, sectoral shares and forms of saving in India, their implication to rural banking how be discussed.

(i) It was pointed out earlier that mobilisation of deposits is an important aspect of the functioning of commercial banks in a developing economy and that the process of credit planning in the economy will be successful only when it is linked with deposit planning. The fact that the rate of saving in the country has been increasing in recent years and has reached a fairly high rate, 29.0 percent of the gross domestic product at current prices in 1996-97, has a favourable implication of banking in that such a high rate of domestic saving is favourable to increasing deposit mobilisation by the banks in the country.

(ii) An analysis of the sectoral shares is the gross domestic saving in the country shows that it is the household sector that the major portion, 77.8 percent in 1996-97, of the gross domestic saving in India originates. From this follows that in order to mobilise larger deposits, the commercial banks should concentrate on attracting the savings generated in the household sector of the economy. It can be
observed that since a more than half part of the household savings in the country is held in physical assets, 54.7 percent of the total gross household savings in 1995-96, the deposit mobilisation effort by the commercial banks will be successful only if the banks introduce different types of savings schemes that are attractive to the households, as substitutes for physical assets, as medium of saving. This is all the more so in the rural areas of the country where the agriculturists who have income to save, save their income in the form of agricultural crops grown by them. Conversion of such household savings in the form of goods or other physical assets into bank deposits, so as to make such saving available for productive investment elsewhere in the economy through the intermediation by the banks, requires entrepreneurial skills on the part of the banks in introducing different types of saving schemes that are attractive to the households and which meet their differing levels of income, saving habits and financial needs.

(iii) Since the security motive and the incomes motive are important factors that induce the people to save ensuring a stable future value of the savings in the banks and an adequate yield on such savings are necessary in order to encourage the households to put their savings in the banks. This may require the adoption of a system of inflation indexed interest rates on bank deposits in the country.
The bank should also adopt measures by which the liquidity of bank deposits kept by the savers is increased since liquidity is an additional motive for saving. Banking should also be convenient to the people in terms of distance, formalities and banking procedures. Availability of a bank office at a convenient distance is necessary to attract the rural people towards the banks and this requires further expansion in the availability of banking facilities in the rural areas of the country.

The foregoing discussion of the geographical and functional coverage by commercial banks in the country since 1969 shows that since the nationalisation of the fourteen major commercial banks in the country in July 1969, the commercial banks in India have brought about considerable improvement in the field of rural banking in the country and in making banking facilities available in its rural areas. However, there is still scope for improvement in the field and such improvement calls for entrepreneurial skill on the part of the commercial banks in the country in spreading the banking habit among the people in the rural areas by adopting measures to make bank deposits attractive to the people as medium of saving.
References


8. Reserve Bank of India; *Report of the all India Rural Credit Review Committee*, 1969, P. 994.


12. Ibid P. 40-41.

13. Ibid P. 42, 45.


