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## Priority sector lending in India: Revisiting the issue under new guidelines of RBI

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### Abstract

The banking sector plays a vital role in the development of the economy and the role of bank credit in economic development cannot be neglected. For removal of poverty and equitable distribution of income, various credit arrangements have been arranged by RBI off and on and one of them is Priority Sector Lending. In Priority Sector Lending, credit is given to those sectors which are creditworthy and contribute to the national product of an economy but not able to perform well due to lack of finance. Priority sector includes agriculture, MSMEs, educational loans, housing loans, export credit, social infrastructure, small business, and weaker sections of the society, etc. RBI issues various guidelines from time to time to do the financial inclusion in these sectors, in the same line, new guidelines have been issued by RBI on September 4, 2020. In the present study, we have discussed various changes that have been done in priority Sector lending as per the new guidelines. Major problems faced by the priority sector have also been discussed.

**Keywords:** Priority sector, public sector banks, commercial banks, guidelines of RBI, priority sector credit

### 1. Introduction

The banking sector plays a crucial role in the development of a nation's economy. "The key players in the development of the economy are commercial banks in general and public sector banks in particular." (Mahesha NM, 2018) <sup>[5]</sup> Bank credit has an enormous role in the development of the economy. Besides economic growth, it should also lead to the removal of poverty and equitable distribution of income for that several committees have looked into the aspect of rural credit and priority sector credit in India. (K. C. Chakrabarty, 2012) <sup>[1]</sup> In the same line, new guidelines have been issued by RBI for Priority Sector Lending on September 4, 2020, under the chairmanship of Shri U.K. Sinha & Shri M.K. Jain.

Priority sector refers to those sectors of the economy which are creditworthy and viable in contributing to the national product of the economy but are handicapped due to lack of finance on reasonable terms. In other words, those activities which have national importance and have been assigned priority for development are included in Priority sector. (R.K. Uppal, 2009) <sup>[9]</sup> Hence, the adoption of the priority sector concept for the purpose of bank lending reflects the effort to synchronize the lending activities of each bank with the national priorities.

### 2. Historical Background of Priority Sector Lending

Agriculture has always been playing a very big role in Indian economy as a major proportion of the population has always been engaged in agriculture but unfortunately in pre nationalization period, it was not given that much importance in providing credit and more importance was given to big business houses therefore National Credit Council was established in 1968 to monitor the priorities of the bank's credit (Dhanyesh Prabhakaran Pillai, 2017) <sup>[6]</sup> and to further improve the scenario, the nationalization of banks was done in 1969. In 1974, it was decided that 33.33 % of total credit advances would be lent to priority sectors by the commercial banks. In 1980, this target was further revised to 40% by March 1985. For the purpose of priority sector lending, prime importance was given to agriculture, small scale industries, education loans, housing loans, infrastructure, small businesses, sole

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proprietors and weaker sections of the society, etc. (A. Udhaya Sweetline, 2017) [8] Various changes have been done from time to time according to the financial status of the economy in priority sector lending. In the same line, Reserve Bank of India has issued the revised guidelines for Priority Sector Lending as on September 4, 2020, with the aim to encourage and support environment-friendly lending policies to achieve sustainable development goals. It was also recommended by 'Expert committee on micro, small and medium enterprises' under the chairmanship of Shri U.K. Sinha and the 'Internal working group to review agriculture credit' under the chairmanship of Shri M.K. Jain. The provisions of these guidelines shall apply to every commercial bank including Regional Rural Bank (RRB), Small Finance Bank (SFB), Local Area Bank (LAB), and

Urban Cooperative Bank (UCB) (Master circular of RBI, September 4, 2020)

### 3. Aims and Objectives

- To examine the revised guidelines issued by RBI for Priority Sector Lending
- To analyze the various problems, facing by Priority Sectors.

### 4. Current Priority Sector Targets

The targets and sub-targets set under Priority Sector Lending for different commercial banks in India are as follows:

**Table 1:** The Targets and sub-targets set under Priority Sector Lending for commercial banks as per new guidelines

Categories	Domestic commercial banks (excluding RRBs and SFBs) and foreign banks with 20 branches and above	Foreign banks with less than 20 branches	Regional Rural Banks	Small Finance Banks
Total Priority Sector	40 % of Adjusted net bank credit (ANBC) or Credit Exposure of off Balance sheet Exposure (CEOBE) whichever is higher	40% of ANBC or CEOBE whichever is higher out of which up to 32% can be in the form of lending to exports not less than 8% can be to any other priority sector	75% of ANBC or CEOBE whichever is higher; However, lending to Medium Enterprises, Social Infrastructure and Renewable Energy shall be Reckoned for priority sector achievement only up to 15% of ANBC	75% of ANBC as computed or CEOBE whichever is higher.
Agriculture	18% of ANBC or CEOBE whichever is higher out of which a target of 10% is prescribed for Small and Marginal Farmers	Not applicable	18% of ANBC or CEOBE, whichever is higher out of which a target of 10% is prescribed for Small and Marginal Farmers	18% of ANBC or CEOBE whichever out of which a target of 10% is prescribed for Small and Marginal Farmers
Micro Enterprises	7.5% of ANBC or CEOBE whichever is higher	Not Applicable	7.5% of ANBC or CEOBE whichever is higher	7.5% of ANBC or CEOBE whichever is higher
Weaker sections	12% of ANBC or CEOBE whichever is higher	Not applicable	15% of ANBC and CEOBE whichever is higher	12% of ANBC or CEOBE whichever is higher

**Source:** RBI Master circular-priority sector lending-targets and classification, September 4, 2020

In addition to this, these targets will be implemented in a phased manner. In Primary Urban Cooperative Bank, the overall target of Priority Sector lending will be increased from 40% to 75% gradually and by March 2024, it will reach 75%. In the same manner, the Priority sector target for marginal farmers and weaker sections will be reached from 8 % and 10 % to 10 % and 12% respectively by march 2024.

## 5. Categories of Priority Sector Advances as per new guidelines of 2020

As per the guidelines of RBI, categories and sub categories under Priority sector are furnished below:

### 5.1 Agriculture

Since independence, Agriculture has been the main source of livelihood in India, more than half of the population is still engaged in agriculture and it plays a vital role in generating employment. It also proves crucial in providing raw material to Agro-based industries. Because of its due importance, it has been categorized under priority sector lending, further sub categories are also included there, that are as follows:

#### 5.1.1 Farm Credit- Individual Farmers

In this category, loans to individual farmers, self-help groups, joint liability groups, proprietorship firms of farmers and agricultural in allied activities are included.

As per the revised guidelines, loans for installation of standalone solar agricultural pumps and for solarization of grid connected agricultural pumps and loans to farmers for installation of solar power plants on barren /fallow land or in stilt fashion on agriculture land owner farmer has been included in farm credit.

#### 5.1.2 Farm Credit - Corporate Farmers

In this category, farm credit to corporate farmers, farmer producer organizations, companies of individual farmers, partnership firms and cooperatives of farmers engaged in agriculture and allied activities are included.

As per the revised guidelines, Loans up to ₹5 crore per borrowing entity to Farm produce organizations /Farm produce companies are included in this category.

#### 5.1.3 Agriculture Infrastructure

As per the revised guidelines, Loans for construction of oil extraction/ processing units for production of bio-fuels, their storage and distribution infrastructure along with loans to entrepreneurs for setting up of Compressed Bio Gas (CBG) plants have been included in this category

#### 5.1.4 Ancillary Services

Loans given to co-operative societies, startups, food, and Agro-processing units are included in this category.

As per the revised guidelines, Loans up to ₹50 crores to startups, that are engaged in agriculture and allied services

have been added to this category. Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Large-sized Adivasi Multi-Purpose Societies (LAMPS) for on-lending to agriculture. Loans sanctioned by banks to MFIs for on-lending to the agriculture sector. Loans sanctioned by banks to registered NBFCs (other than MFIs) have also been added to this category

### 5.1.5 Small and Marginal Farmers

Marginal farmers are the farmers who hold lands up to 1 hectare and the farmers with a landholding of 1 hectare to 2 hectares are covered under the category of small farmers. It also includes landless agricultural laborer, tenant farmers, oral lessees, and sharecroppers

As per the revised guidelines, Loans up to ₹2 lakh to individuals solely engaged in Allied activities without any accompanying land holding criteria have been added.

### 5.1.6 Lending by Banks to NBFCs and MFIs for on Lending in Agriculture

As per the revised guidelines, this Point is newly added in Priority Sector Lending i.e., Bank credit extended to registered NBFC-MFIs and other MFIs (Societies, Trusts, etc.) which are members of RBI recognized SRO for the sector, for on-lending to individuals and also to members of SHGs / JLGs. (not applicable to RRBs, UCBs, SFBs, and LABs). Bank credit to registered NBFCs (other than MFIs) towards on-lending for 'Term lending' component under agriculture will be allowed up to ₹ 10 lakh per borrower

### 5.2 Micro, Small and Medium Enterprises (MSMEs)

Micro Small and Medium Enterprises (MSMEs) are the growth engines of the Indian economy, (<https://www.livemint.com/news/india/msmes-the-growth-engines-of-the-indian-economy-11597923225239.html>) as its contribution is prominent in employment generation, after agriculture, most of the population of the country is generating their livelihood from this sector only. Further it contributes about 40% of overall exports and 30% of the country's Gross Domestic Product, due to these characteristics, it is covered under priority sector.

Micro enterprises are those enterprises in which the investment limit is less than ₹1 crore and turnover is less than ₹5 crore, Small enterprises are those enterprises in which the investment limit is less than ₹10 crore and turnover is less than ₹50 Crore and Medium enterprises are those enterprises in which the investment limit is less than ₹50 crore and turnover limit is ₹250 crore.

As per the revised guidelines, in other finances to MSMEs, Credit outstanding under General Credit Cards (including Artisan Credit Card, Laghu Udyami Card, Swarojgar Credit Card and Weaver's Card etc. in existence and catering to the non-farm entrepreneurial credit needs of individuals) Loans up to ₹50 crore to Start-ups. MSMEs have also been included.

### 5.3 Education

As per new guidelines, Loans to individuals for educational purposes including vocational courses not exceeding 20 Lakhs will be considered as eligible for priority sector classification, earlier it was 10 Lakh.

### 5.4 Export Credit

Export credit under agriculture and MSMEs will be classified under their respective categories for Priority sector lending, other than agriculture and MSMEs, export credit will be allowed to be classified under this head. It will be 2% of ANBC or CEOBE whichever is higher in case of domestic banks and foreign banks (with 20 branches and above) and 32% of ANBC and CEOBE whichever is higher in case of foreign banks with less than 20 branches.

As per the new guidelines, Export credit up to 32 percent of ANBC or CEOBE whichever is higher is allowed as Priority sector Lending (in case of Foreign banks with less than 20 branches)

### 5.7 Housing

As per the new guidelines, bank loans for affordable housing projects using at least 50% of Floor area ratio/Floor Space Index for dwelling units with carpet area of not more than 60 sq. and bank loans to HFCs (approved by NHB for their refinance) for on-lending, up to ₹20 lakh for individual borrowers, for purchase/construction/ reconstruction of individual dwelling units or for slum clearance and rehabilitation of slum dwellers have been added for Priority Sector Lending in this category.

### 5.8 Social Infrastructure

For priority sector lending, setting up of schools, drinking water facilities, sanitation facilities including construction/ refurbishment of household toilets and water improvement at the household level are included under the category of social infrastructure.

As per the revised guidelines, loans up to a limit of ₹10 crores per borrower for building health care facilities including under 'Ayushman Bharat' in Tier II to Tier VI centers are also added to this category.

### 5.9 Renewable Energy

As per the new guidelines, Bank loans up to a limit of ₹30 crores to borrowers for purposes like solar based power generators, biomass-based power generators, wind mills, micro-hydel plants and for non-conventional energy based public utilities, viz., street lighting systems and remote village electrification etc. will be eligible for priority Sector classification. For individual households, the loan limit will be ₹10 lakh per borrower.

### 5.10 Others

As per the new guidelines, Loans not exceeding ₹1.00 lakh per borrower provided directly by banks to individuals and individual members of SHG/JLG provided the individual borrower's household annual income in rural areas do not exceed ₹1.00 lakh and for non-rural areas it does not exceed ₹1.60 lakh, and loans not exceeding ₹2.00 lakh provided directly by banks to SHG/JLG for activities other than agriculture or MSME, viz., loans for meeting social needs, construction or repair of house, construction of toilets or any viable common activity started by the SHGs. And Loans up to ₹50 crore to Start-ups, that are engaged in activities other than Agriculture or MSME have been added in this category.

**6. Analysis**

- There is no change in the overall Priority Sector Lending target, it is the same as 40%. Foreign banks with 20 branches and above are the same that of domestic banks in terms of priority sector targets.
- As far as RRBs and SFBs are concerned the overall target of PSL is the same here also. But in Urban Cooperative Banks’ overall target for PSL will be increased to 75% by the year 2024.
- In the sub-target categories, the target for small and marginal farmers will increase from 8% to 10% by the year 2024 and the target for weaker sections will also increase from 10% to 12% by the year 2024 in all commercial banks in a phased manner except UCBs and RRBs.
- In the category of agriculture, some new loans have been introduced for the purpose of priority sector i.e., loans for the installation of solar agricultural pumps, loans for the production of biofuels and for setting up of compressed biogas plants, loans to startups that are engaged in ancillary activities have been introduced. New loans have been introduced for small and marginal farmers and for the members of self-help groups and joint liability groups.
- In the category of MSMEs, loans up to 50 crores for startups have been introduced.
- To improve health infrastructure, the loan limit for ‘Ayushman Bharat’ has been increased.

**7. Problems and Prospects**

Many arrangements have been done by the government under priority sector credit to help weaker and the creditworthy sector of the country but due to various reasons, the purpose of Priority Sector Lending is not getting fulfilled properly. Some lacunas that are coming in between are discussed below:

**7.1 Problems in Agriculture finance**

Agriculture sector, the most important sector of the economy where a major proportion of the population is getting its livelihood is suffering from many problems. Under priority sector lending, the loan sanctioned to the farmers by various banks is not that much adequate to fulfill the different aspects of agricultural operations and often farmers divert such loans for unproductive purposes. Many small and marginal farmers do not get the benefit due to less attention, on the contrary, more attention is given to big farmers.

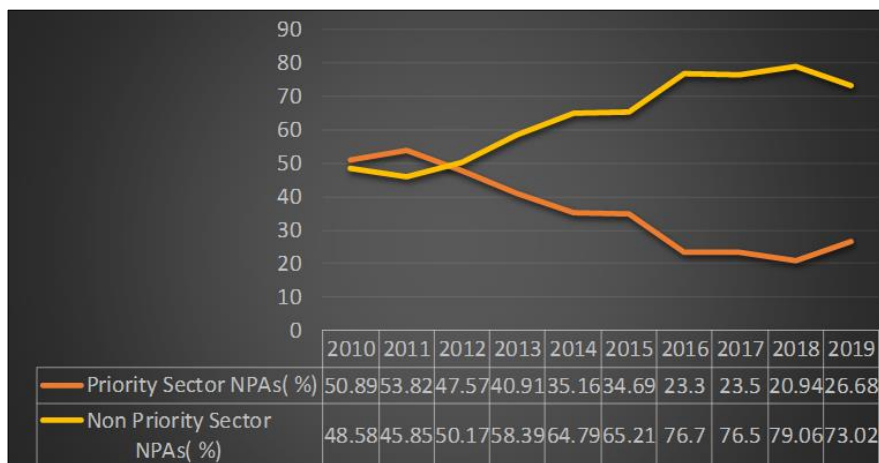
**7.2 Processing time and Cost**

The purpose of the Priority Sector Lending is to provide ease to needy sectors of the economy but the procedure to avail these loans is very tedious and involves plenty of documentation and other formalities, due to long processing time in sanctioning of the loan and high transaction cost involved in the loan, industries are facing trouble in getting loans. Although the processing time and cost remains low in the case of startups but it gets higher for the industries which are in growth stages.

**7.3 Problems of NPAs**

Non-performing assets are the assets that are not expected to generate further income. Those assets which are overdue for more than 90 days are considered non-performing assets. When borrowers do not pay their loans timely, it creates NPAs. Many researchers believe that Priority Sector Lending is also one of the causes of rising NPAs in banks, therefore, it became a problem for priority sector, many banks do not want to give loans to priority sectors due to the fear of NPAs.

The status of NPAs in the last 10 years has been presented with the help of the graph given below:



Source: Compiled from statistical table published by RBI (rbi.org.in)

**Graph 1:** NPAs in Priority and Non- Priority Sector Lending

The above graph shows the percentage of total NPAs of the Priority sector and the Non-Priority Sector in public sector banks. NPAs in priority sector was 50.89% of total NPAs of public sector banks and it further increased in 2011 to 53.82 after that, it declined continuously till 2018 and in 2019 again it starts rising.

NPAs of banks (Priority and Non-Priority sector) increase due to various reasons like ineffective debt recovery system, Government intervention, poor legal framework, etc. Due to

increasing NPAs, banks avoid giving loans to priority sectors and this is also one of the problems of priority sector lending.

**8. Conclusion**

Priority Sector lending is the crucial service that is being performed by commercial banks for the sake of the development of the overall economy. For the development of these important sectors, RBI issues dynamic guidelines



off and on, in the same series, revised guidelines of RBI have been issued on September 4, 2020. The purpose behind the revised PSL guidelines was to do better credit penetration in credit deficient areas. After analyzing these guidelines, it has been concluded that more emphasis has been given to the weaker section of the society in a phased manner. Renewable energy Plants have been promoted and they will prove beneficial in reducing environmental degradation and it will further improve the electricity generation capacity. The goal is development in a sustainable way. Due attention has been given to small and marginal farmers. To protect the interests of marginal and small farmers, bank credit to NBFCs has been extended. To generate employment opportunities, funding up to 50 crores to start-up MSMEs have been introduced, it will improve the employment condition in rural India as most of the MSMEs are operated in rural areas. In the education sector, target funding has been further increased to 20 Lakh. No significant importance has been given to export however it plays a vital role in improving the national product of the economy. Self-help groups and Joint Liability Groups have been promoted, it will improve the participation of women in economic activities and it may prove an effective tool towards reducing poverty. By promotion of joint liability groups, small and marginal farmers will be benefitted, as most of the time, they refrain from enjoying their due benefits. By doing common activities and pooling of their resources, small and marginal farmers will be encouraged to work together and will be able to use modern technologies and it will improve their revenues and will improve the contribution of agricultural activities in the national product as well. Revised priority sector guidelines focus more on the development of agricultural and MSMEs, some limitations have also been discussed above. Due to rising NPAs and huge transaction costs, Banks avoid lending to the Priority sector, due to this they are not able to fulfill their targets and it is a major area of concern. There is a need to work in this area. If these problems have been solved then the purpose of Priority Sector Lending will be solved and it will prove a game-changer in the overall performance of the Indian economy.

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