IJBARR
E- ISSN -2347-856X
ISSN -2348-0653

PRIORITY SECTOR LENDING IN AGRICULTURE IN INDIA

Dr. Mohammad Azam Khan*   Imran Ahmad**
**Associate Professor,Department of Economics,AMU Aligarh UP .*
***PhD Scholar,Department of Economics,AMU Aligarh UP .*

Abstract
Priority sector lending is a financial device to uplift the disadvantage sector of the economy especially agriculture and some other hitherto neglected sectors. Over the period of time the meaning of priority sector lending has been changed due to some important factors. These factors are political as well as economic. The current position of priority sector is being diluted by increasing the scope of lending activities under this policy. It has been found that the policy is functioning in illusion. Why because? It keeps target same as it first advised (40% of total net credit) while the area under its protection has been increased over the period. The present study tries to seek the attention of people to give a fresh look on it in the context of relooking the agriculture sector with hope and aspiration.

Key Words: Priority Sector Lending, Agriculture Credit, Financial Liberalization .

INTRODUCTION

Priority Sector Lending which implies certain amount of loan to be directed towards agriculture and allied activities, were considered importance by the state in the beginning of nationalization of banking sectors. Priority Sector Lending came in 1969 as a major policy instrument of RBI when the study group of the National Credit Council headed by D R Gadgil identified the credit biasness with respect to key sector of the economy ie Agriculture. By the early definition *Priority Sector Lending means the coverage of institutional finance mainly by public sector banks in three core areas of economy agriculture, small scale industries, and Self-employed and each major bank was given target and the performance of banks in this regard was to be monitored continuously by the RBI*. The New Definition by RBI*Priority sector refers to those sectors of the economy which may not get timely and adequate credit in the absence of this special dispensation. Typically, these are small value loans to farmers for agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.* These sectors has been hitherto severely neglected by banks because of two main reasons the risk factor and urban bias.

It was found in various reports and study like All India Rural Credit Survey 1954 and credit council committee headed by DR Gadgil. The majority farmers were out of the ambit of formal credit institution. They were persistently under the rural indebtedness because of high interest charge by informal sectors (local Money Lenders, Goldsmith, Banias, etc.). Therefore, RBI to bring them under the wall of protection has realized it. Under a special framework, a certain percentage of credit has been allocated to hitherto neglected sector. Under this special arrangement, the sector comprises agriculture, small-scale industries and exports and it termed as priority sector lending target. This was the first policy recommendation by reserve bank of India in this direction. In the later development, the above-defined target area has been expanded by including other identified weak sector of the economy. The sector expansion under priority lending policy is carrying heavy critics, which will be discussed later in this paper.

Priority sector lending target came simultaneously with the nationalization of several banks, which came meaningfully in 1969 when 14 banks were nationalized by the government of India. The nationalization of banks was considered as one of the bold steps of government, which was done with the help of RBI after independence in the financial system of the economy. The earlier period was characterized as the skewed nature of lending activities of the then exiting banks. The period of immediate independence banking sector was dominated by mainly private banks and therefore the saving mobilization was in a few private hands. However, during this period there was the concept of Cooperative Credit Society a neat institutional arrangement by government to support the agriculture and rural sectors of the economy. The main institutions were the State Bank of India and its associates for financing cooperative marketing and processing societies, and related activities. This arrangement was found inadequate in later time when the agriculture sector has been diversified and the pressure of demand for credit created with the advent of green revolution and adoption of new technology in the agriculture sectors. At this point of time came the concept of social control of the financial institutions which means the purposeful and equitable distribution of resources mobilized by banks from general public keeping in view relative priorities of developmental needs. This led to the nationalization of banks in 1969. During this period the agriculture sector could not attract more than 2 percent of total bank credit therefore the RBI laid down the policy which is commonly known as Priority Sector Lending Target. The target was set as 40 percent of total net credit allocated to the agriculture, small-scale industries and self-employed in 1985 .

LITERATURE REVIEW

Lending to priority sector was the social obligation rather than profit maximization. The basic purpose behind this was to bring the small farmers, traders, and peasants and other deserving people at a sustained level in their activities and protect them from rural indebtedness created by indigenous banking system where they charged an arbitrary higher interest rate.

There are several studies revealed the changing nature of the lending to priority sector with the expansion and inclusion of some new areas without formal accepting the guidelines given by Banking Reforms Committee headed by M Narashimham in 1991. The recommendation was made considering the distortion factors of banks efficiency and profitability. Committee as nonviable amount felt the target of 40 percent net bank credit to the Priority Sector Lending. By accepting, some points of recommendation of the committee the Integrated Rural Development Program (IRDP) has been withdrawn. Saying that it has been distorted the pattern of lending. Some of the scholars argued that what does distortion means. Does distortion has it means that large section of the population should not come in the formal organized sector. Does not it have any relevance to boost the confidence of marginal section of the society in their productive activities? Should it not be reflected that the initiation of the government which could help to the large section of the population in their productive activities being encouraged? The committee has also shown some of the banks, which met the social obligation along with profitability. This justifies that the viability and profitability are not solely factor of unviable social obligation before banks rather the order of provisions and wiliness to work in remote and rural areas of the economy.

It is common that banks are forced by centre and state government to take the decision, which might results against their interest. "*If delinquency in the directed credit programme is what is worrying to the committee. And has prompted it, to suggest 'consolidation' then, equally, the large level of delinquent loans which have infected the traditional sector should have prompted the committee to suggest a curtailment of lending to these sectors".(D. N. Ghosh 1992) "Bank Profitability and Priority Sector Lending: From Populism to Impressionism 1992"*.

The committee estimated the infected proportion of bank portfolio in agriculture and small industries is 20 percent, which is argued by Ghosh, is relatively low in comparison to large and medium industries. It is because of the general phenomenon of credit provision to sick industries. He further advocates for providing formal and neat credit rather than providing especial subsidies to agriculture and allied sectors.

A study by KM Shajahan (1998) says that the lending target is total bank credit rather bank deposit. It affects the priority sector lending by way of taking the CD ratio as denominator of the policy norms. Paper further speaks about the impact of such policy device on poor income states like Uttar Pradesh and Bihar. The author says that if banks give loans as a percentage of total lending, it may come down if CD ratio slips down. While in the case of total deposit, the CD ratio does not affect the target amount. Thus, it also in a way is constraining the priority-lending target.

RBI report (1998-99) on *Trends and Progress of Banking* reports number of factors works as obstacle in a way of success in priority sector lending. These are inadequate budget and flow of fund to the implementing departments. Delay in completion and formulation of preliminary work relating to drawl of funds with respect to irrigation project. Complete of land acquisition formalities, obtaining forest and environment clearances from government etc.

The nonperforming asset (NPA) was another area of concern of banks for their profitability. Another study by K.M. Shajahan(1999) says that NPAs are more in non-priority sector than in priority sector form 1995-99. The study shows data in its paper and says that NPAs has increased 6.9 percent in the non-priority sector and decreased 6.3 percent in priority sector. It further says that overall NPAs declined was in fact due to better recovery and performance in priority sector.

A study by Rajaram Dasgupta (2002) says that the priority sector credit lacks focus as well rationality. It was in the pre reform period when the emphasis was on the poor and weaker sectors. *"The finance extended by the banks to more affluent sections was included in priority sector, which was not justified"*. He further claims that the RBI to pleas politicians, bankers and other vocal segments of community. RBI has taken the suggestion for enlargement of the coverage of the priority sector very seriously. But, has ignored other advice relating to concentration of small and marginal farmers, rural artisans, weaker sections etc.

Rajaram Dasgupta (2002). There was a nexus among different players for the misuse of the credit and a group of people use it as vote bank politics. A study by C.H. Hanumatha Rao (2005) reveals the political culture in credit delivery. He further says that this affects to both banks as well as users of credits.

IJBARR
E- ISSN -2347-856X
ISSN -2348-0653

A joint study by Dinesh, Furkan and Shahid (2006) shows that the target of 40% under priority sector by PSBs after 1997 has not been made on the account of efforts made by banks to extend such neglected sector of the economy. Such achievement was due to enlargement of PSL definition.

A study by C.P. Chandrasekhar (2005) says that there is a huge credit supply, which is in the form of Personal loan, and it is about 45% of indirect finance.

NEEDS FOR PRIORITY SECTOR LENDING

The following paragraph listed in nutshell the need and requirement of priority sector lending. 1) To bring the hitherto neglected sectors of the economy into main stream economy.2) To provide cheap credit to the neglected sector of the economy. 3) To reduce the influence of local moneylenders on the rural economy.4)To protect the small sectors and sections from the arbitrary high interest rate charged by local money lenders.5) To encourage small farmers and traders in their activities in the economy.6) To enhance the overall developmental goal of the country.

THE BROAD PERIOD OF PRIORITY LENDING POLICY

The first Period begins since independent until 1969. This period is the most fragile period in terms of all aspect of economy. It is the period of establishment and protection from many challenging issues of socioeconomic development. It has been defined by the following factors. 1) Dominance of private banks, 2) Branches were concentrated in urban areas, 3) Banks were lending to big industries, 4) Resources in few hands 5) Working of cooperative societies.

The second period starts from1969 to 1991. It can be characterised in the following points 1) Focus was on the priority sector. 2) Till mid 1970 the target was not fixed clearly 3) In 1974 the target was fixed as 33% of total credit 4) In1985 10% fixed for weaker sector and 33 % increased to 40% of total Credit 5) And sub-target 18% to direct agriculture in 1990 6) Indirect (not>4.5) finance to agriculture.

The third period starts from 1991 to till today. The Narshimham Committee has recommended cutting down target from 40% to 10%. However, it has not been accepted by RBI and remains continue with old target of 40%. In this period, the area of priority sector has expanded and many new sector has been brought up into this protection provision. These new sectors include software industries, agro based and food processing industries, some MNCs like Pepsi, Hindustan UniLiver, Kelloggs, ConAgra etc. The limit of finance to various sector has also be raised over time. The period is characterized as period of dilution of Priority Sector Lending.The main agenda behind priority sector lending policy of RBI was considered as the social obligation of the banks rather profit maximization. Therefore, my paper tries to analyse the trend in priority sector lending in the context of social objective of the banks in post reform period.

Scope of Priority Sector Lending in Pre-reform and post-reform period

The scope of priority sector lending in post-reform period enormously increased as compared to pre-reform period. This could be seen clearly in the following table1.

Table1: Scope of Priority Sector lending in Pre-reform and Post-reform period

Pre-Reform	Post-Reform
1)Agriculture which included loan to the Farmers for raising crops, purchase of bullocks, farm equipment, Irrigation, traditional and non-traditional plantations. (Sub target 18%) 2) Small Scale Industries 3)Small Business Enterprises 4) Professional And Self-Employed (up to Rs 2 lakh) 6) Small road and water transport Operation. 7) Housing upto Rs 5000 8) Education 9) Weaker Section including DRI Schemes 10) Consumption	1) Agriculture (sub target 18%) 2) SSI including Industrial Estate 3) Small Business (Working capital up to Rs 50,000) 4) Small Road and Water Transport operations (10 vehicles) 5) Retail traders (up to Rs 10 lakh) 6) Professional and Self-Employed(up to Rs 10 lakhs) 7) State Sponsored Organisation for SC & ST 8) Education Loans 9) Hosing loan (up to Rs 5 Lakh, direct loan up to Rs 10 lakh to Urban/ Metro) 10) Consumption Loans to Weaker sections. Loan to weaker sections which includes small and marginal farmers, landless labourers, tenant farmers, sharecroppers, Artisans, village and Cottage industries, Beneficiaries of SGSY, DRI, SJSRY, SLRS, SHG, and Schedule Cast and Schedule Tribes. 1 1) Refinance by Banks to RRBs.

IJBARR
E- ISSN -2347-856X
ISSN -2348-0653

	12) Microcredit 13) Software Industries(up to Rs one Crore) 14) Agro and Food Processing(Investment limit Rs 5 Crore) 15) Venture Capital

Source: Reserve Bank of India (RBI website)

From the above table1, it clearly resembles that the scope of priority lending sector from pre to post reform period ostensible increased. The continuous rise of many components like agro-based food processing production sector, venture capital, software industries, microcredit, refinancing to rural regional banks, retail traders etc. Not only number of sector has increased but also the loan limits for different projects also revised. The revise limit for loan also helps in increasing the number sectors under priority sector target. The revise limit for loan are housing loan, education, small scale industries, professionals and self-employed, rural infrastructure development funds etc. By looking into above table we can understand the tendency of monitoring authority as well as banks in their predefined objective and responsibility that how the track has changed. The point of social objective of the banks which has been initially targeted to achieve. That has looked diverted with the change that had been taking place in the post-reform period.

The identified neglected sectors of the report of DR Gadgil have almost disappeared or amalgamated. It is because the inclusion of new sectors (housing, retail sector, education, professionals, software industries, venture capital, refinancing to Regional Rural Banks, refinancing to Nonbanking Finance Corporation etc.) undermined the true meaning and its significance for lending activities. This is what at the policy level brought up the changes in the priority sector lending.

Performance of Public Sector Banks under Priority Sector Lending Target

Table 2 :(Percent of ANBC/OBE for the year 1969 and from 1991-2013)**

Years	Overall Priority Sector	Agriculture	Years	Overall Priority Sector	Agriculture
1969	14.6	5.36	2003	42.5	15.3
1991	40.2	15	2004	43.6	15.05
1992	39.8	16.3	2005	42.8	15.32
1993	36.6	15.1	2006	40.2	15.25
1994	37.8	15.1	2007	39.7	15.42
1995	36.6	13.9	2008	44.6	18.23
1996	37.8	14.3	2009	42.7	17.5
1997	41.7	16.4	2010	41.6	17.83
1998	41.9	15.7	2011	42.1	16.5
1999	43.5	14.3	2012	37.2	15.8
2000	43.6	15.8	2013	36.3	15.0
2001	43.0	15.7	2014*	34.1	12.6
2002	43.1	15.9	2015	-	-

Source: Reports on Trend and Progress of Banking in India, RBI Various Years.

Note[1]:

From the above table it shows that the overall target of 40% of net credit of the banks has been achieved in almost every year in post- reform period. From 1997 to 2011 is the best period of completion of target in overall priority sector lending. Then after the bank are not fulfilling the lending target as it is depicting in the table in a declining trend. In the year of 1969, the priority sector was receiving only 14.6 % and agriculture 5.36% however then the target and sub-target was not institutionalised. It was in mid1970 when target and sub-target was incorporated in this institutional arrangement. In 1974 the overall target was set as 33% percent of total bank credit while the sub-target of 16% for agriculture was in 1986 and 17% in 1989 and 18% in 1990. Thus the target was set for agriculture successively in increasing order as per the utility of credit need for this sector overt the time. However, the agriculture sector is found neglected continuously in time. The amount of credit that has been directed to this sector is found decreasing in order. Except in the year of 2008 nowhere else, the target has been achieved. This indicates the policy failure in this direction. It has been argued by many studies that the target which has

[1] **Figure for the year 2014 is the percentage share in Total Advances*
***Adjusted Net Bank Credit/Off Balance Sheet Exposure*

been achieved by banks was not the account of effort made by banks rather including new areas and sectors under priority sector. This interpretation is quite logical and correct because the overall priority sector is performing better but agriculture sector is jeopardizing from this target. Which however is the most important and strategic sector for Indian economy where large population are dependent. .

Changing Nature of Priority Sector Lending:

With new definition of Priority sector lending the area of operation has been widen while target remain same as 40 percent of net bank credit. Currently the areas, which are under priority sector lending are as follows (i) Agriculture (ii) Micro and Small Enterprises (iii) Education (iv) Housing (v) Export Credit (vi) Others.

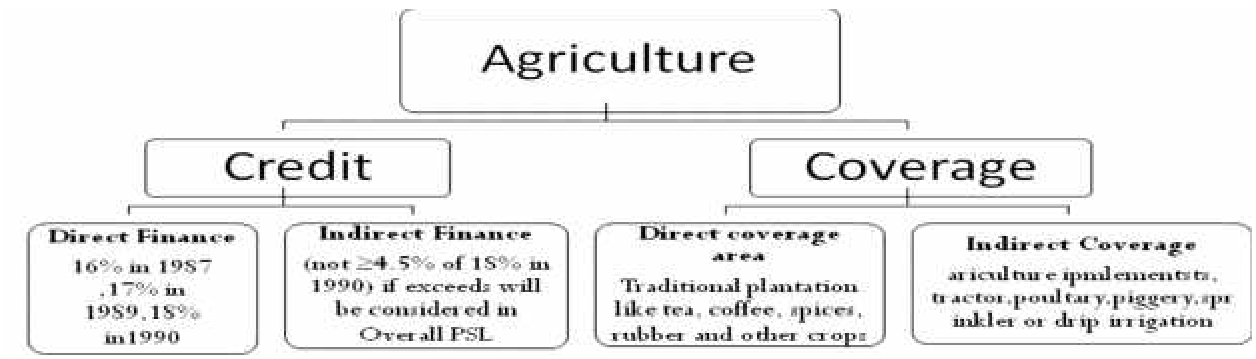
In the pre reform period the agriculture credit was earmarked directly for farmers, some of whom were big farmers but majority were small and marginal farmers. Agriculture credit was mainly for agriculture and allied activities purposes like production, storage and transportation of agricultural and allied products. Within agriculture, food crops were emphasized with a clear classification of traditional and non-traditional plantation and area of cultivation. The amount of Rs 5000 was fixed for marginal and small farmers confined to traditional plantation and this amount was genuinely required as input cost for agriculture produces even in 1996-97 average input cost as per CSO data was Rs 5200. This has been changed in post reform period and lending activities went in irrespective of size holding of land and requisite amount for economic activities of the farmers. The emphasis diverted from marginal and small farmers to big and medium farmers by ignoring the real need of the farmers while looking into the profitability of lending institutions. The amount for short-term loan was raised from Rs50000 to Rs100000. While this order of demand for short term loan among small and marginal farmers were not matched. Thus there is access supply in relation to capacity of the farmers which led to inefficiency in both; lending institution because of lack of effective demand for credit and in agriculture because of lack of credit resources due to incapability of small farmers to aces formal loans. It can also be said that the demand for credit, which need to be created among the reluctant small and marginal farmers, had been curtailed by increasing the ceiling loans for specific groups, which was earlier at a desired level. Another important point need to raise here is that the loan, which was earlier for direct agriculture and allied products now, had been diverted to purchase some vehicles like Jeeps, Pick-up, and mini buses, which clearly indicates big farmers the group of beneficiary's rather small and marginal farmers. This kind of initiation and policy changes favours to big farmers in their profitability, monopoly of production, transportation, diversification of nonfarm activities, etc. For example a big farmer who is accessing credit can utilize in the form of tractor or pump-set with this acquisition he can also use the same engine of pump set or tractor battery for home electric appliances like fan, tube light, water supply etc. by a little modification of same engine. This is real existing scenario in rural areas where electricity is scarce and no electricity. Thus it raises the status of that family in relation to others and which indirectly hurting the government policies to the poor people. This shows and people say that government is not for poor rather with affluent and vocal people of the society.
The following points has been drawn from different literature of earlier contributors and RBI reports to show the changing face of priority sector lending that has been institutionalised as a social obligatory regime for banks.

- The process of widening the priority sector progressed by including loans to software industries, investment in venture capital, food and agro-based processing etc.
- The owning limit of road and water transporters was increased from 6 vehicles to 10 vehicles.
- The ceiling on housing loan in rural and semi urban areas under priority sector lending extended from Rs3 lakh to Rs5 lakh.
- The Definition of SSI has changed with respect to investment of Rs3 crores (from 35lakh, 45lakh, 60lakh and 75lakh).
- The limit of finance to tiny enterprises has also increased from Rs5 lakh to Rs25 lakh.
- In 1997-98, indirect finance to agriculture under priority sector was widened by classifying finance extended to State Electricity Board (SEB) for system improvement scheme in rural areas under Special Project Agriculture of Rural Electrification Corporation (REC). (Shajahan,1999).
- Large borrowers interested in real estate speculation and receive large proportionate of credit.
- The Rural Infrastructure Development Fund was included under priority sector and banks were allowed to contribute to the fund to the extent of the shortfall in meeting lending target (Shajahan,1999).
- The corpus of RIDF also increased in revision such as Rs 2,500 crores to 3000 crores from RIDF-III to RIDF-IV. (Ghosh, 2005).
- There is implicit limit for small borrowers because of increased credit band in order to keep them away from the credit facilities being provided by banks. This statement confirms with CSO input cost estimation. The input cost for food crop as per CSO estimation was Rs5200 in 1997 while short-term credit supply was fixed by Rs 1 lakh (Dasgupta, 2002). The issue is that the demand for credit from the weaker section and weak sector of the economy

IJBARR
E- ISSN -2347-856X
ISSN -2348-0653

decreases continuously. This issue should have to address seriously if the social objective of the economy would have to achieve. There must be some confidence booster initiation among the needy people of the society.

Agriculture Sector
(Way of Deployment of Credit and Coverage area)

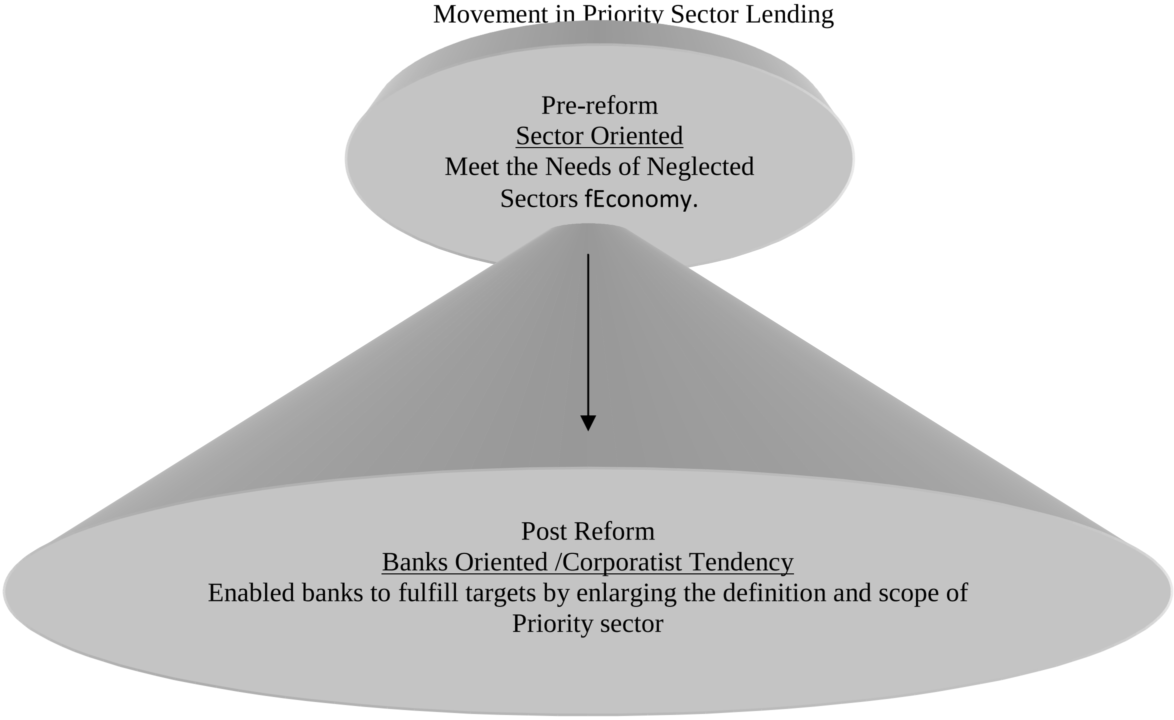


Sources: authors' own construction (data from RBI website)

Note[2]

In agriculture with sub-target, 18% has been finally fixed in 1990. This target was to be achieved by banks as direct lending to this sector. However, later the concept of indirect finance to agriculture has been introduced which affected it negatively. The indirect finance to agriculture though it was fixed as 4.5% but it left the scope to divert the fund other than agriculture which facilitated to the banks to fulfil the overall target of priority sector lending.

Movement in Priority Sector Lending



[2] # In 1993 the indirect finance was included with 18% target.
And 4.5% of 18% was set for indirect finance and said if exceeds will be considered in overall PSL.

IJBARR
E- ISSN -2347-856X
ISSN -2348-0653

CONCLUSION AND SUGGESTIONS

There are two process continued since post reform period in the direction of Priority sector lending policy. On one hand the limit of financial resources increased and on the other hand the new sectors included which increased the base of Priority sector Lending Target while keeping unchanged limit 40 percent of total bank credit which was fixed in 1985. In this policy regime what has been found that the competition increased in terms of accessibility of finance within the limited stipulated credit delivery by banks. And the relevance of Priority sector Lending has been lost over a period of time. The following point should be focused if we are looking back to agriculture sector in the current scenario. Agriculture plays a pivotal role in Indian economy not now and then but always because it is feeding largest population of the country directly. Even international trade it is showing as a comparative advantage sector of the economy since very long time. Therefore, to fight with poverty and many other socioeconomic evils with which India is struggling since long time need to focus on agriculture in a very neat and clean framework on the actual ground, which means with proper implementation. The farmer suicide is not only one policy failure rather it is total failure of the democratic setup of the country.

- The indirect way of reaching target should be abolished.
- Bank should not seek for easy route of financing in such a diverse developing country.
- Intermediaries should be abolished like refinancing to NBFC and MFI so that the true agriculture and marginal farmers can get the benefit.
- Because of diversification in agriculture, the sub-target for most deserving categories should be amended immediately.
- Banks should have to show positive attitude towards small borrowers
- The saving of the large masses should have to reach judiciously to the needy people.

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