

The Draft Technical Paper on Review of Priority Sector Lending, prepared by the Internal Working Group set up in Reserve Bank under the chairmanship of Shri C. S. Murthy, Chief General Manager-in-Charge, Rural Planning and Credit Department, was placed on the RBI website on September 30, 2005 for public opinion. Subsequently, on November 8, 2005 one sub-paragraph has been added under paragraph 6.10 of the Technical Paper.

DRAFT TECHNICAL PAPER
BY THE
INTERNAL WORKING GROUP
ON
PRIORITY SECTOR LENDING



**This Draft Technical paper does not necessarily reflect the views
of Reserve Bank of India**

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RESERVE BANK OF INDIA
RURAL PLANNING AND CREDIT DEPARTMENT
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SECTION 1

INTRODUCTORY

1.1 The origin of priority sector prescriptions for banks in India can be traced to the Credit Policy for the year 1967-68, wherein it was emphasised that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture, exports and small-scale industries, as a matter of urgency. However, the description of the priority sector was formalised in 1972 on the basis of the report submitted by the Informal Study Group on Statistics relating to advances to the Priority Sectors constituted by Reserve Bank in May 1971. On the basis of this report, Reserve Bank prescribed a modified return for reporting priority sector advances and certain guidelines were issued in this connection in February 1972, indicating the scope of the items to be included under various categories of priority sector. In most of these cases, the guidelines indicated only the general description of the advances to be included and no ceilings were fixed, except in the case of small-scale industry and road and water transport operators where ceilings on the value of original investments were indicated.

1.2. The scope and extent of priority sector has undergone several changes since then with several new areas and sectors being brought within the purview of this sector. While there has been continuous demand to include new areas such as infrastructure within the ambit of priority sector, there have also been suggestions that the focus on the needy sectors of economy and weaker sections of the society is getting lost because of such inclusions. A need has therefore, been felt to review the concept and the segments of priority sector. Consequently, in paragraph 89 of the Annual Policy Statement of Reserve Bank of India for the year 2005-06, it was stated that prescriptions relating to priority sector lending have been modified from time to time, and generally the eligibility criteria have been enlarged to include several new areas. In December 2004, it was decided that direct advances to priority sector will be encouraged, thus beginning a phased withdrawal of eligibility in special bonds of specified institutions.

1.3 In paragraph 90 of the Annual Policy, *ibid*, it was stated that “one view is that lending to any infrastructure project should be made eligible for priority sector lending while making sub-targets fungible within the overall target. There is another view that enlargement of areas has resulted in loss of focus. It is also held that credit growth in housing, venture capital and infrastructure has been strong while it has been sluggish in agriculture and small industries. Further, it is argued that only sectors that impact large population, weaker sections and are employment-intensive such as agriculture, tiny and small industry should be eligible for priority sector. Since there are several issues that need to be considered in this regard, it is appropriate that these are debated and examined in depth”.

1.4 In order to examine the issues raised in the Annual Policy, it was decided that an Internal Working Group be set-up for the purpose.

- a) to examine the need for continuance of priority sector lending prescriptions;
- b) to review the existing policy on priority sector lending including the segments constituting the priority sector, targets and sub-targets, etc.;
- c) to examine the suggestions received regarding eligibility criteria of various items under priority sector and related aspects; and
- d) to recommend changes, if any, required in this regard.

The composition of the Working group was as follows:

Shri C.S.Murthy, Chief General Manager in-Charge - Chairman

Members

Shri A.P.Gaur, Director, DESACS;

Smt Jaya Mohanty, Director, DEAP;

Dr. Mohua Roy, Director, MPD;

Dr. Sathyan David, GM, UBD;

Shri T.B.Satyanarayan, GM, DBOD; and

Shri N.K.Bhatia, DGM, RPCD, Member-Secretary.

1.5 The Working Group prepared six separate papers on the following subjects:

- a) Directed Lending: International experience;
- b) Objectives of directed lending in India and concepts of priority sector lending;
- c) An analysis of priority sector lending;
- d) Recommendations of earlier committees and suggestions received from different sources and action taken thereon;
- e) Priority sector lending – Penalty provisions; and
- f) Priority sector lending and Inter Bank Participation Certificates.

1.6 The Working Group examined the comments made by earlier Committees/ Groups regarding priority sector lending and the action taken thereon in the past. It also examined the various suggestions given by banks, IBA and others with regard to priority sector lending. The Working Group identified several issues pertaining to the priority sector lending and discussed them in detail during the course of its meetings.

1.7 Based on the discussions and the working papers prepared as above, the Working Group has prepared this Technical Paper to facilitate wider discussions. The Technical Paper is presented under the following Sections:

- a) Section 2: Directed Lending: International experience;
- b) Section 3: Origin and background of priority sector in India;
- c) Section 4: An analysis of trends in priority sector lending by banks in India;
- d) Section 5: Priority Sector Lending and Inter Bank Participation Certificates;
- e) Section 6: Review of priority sector lending policy; and
- f) Section 7: Summary of options.

SECTION 2

DIRECTED LENDING: INTERNATIONAL EXPERIENCE

Introduction

2.1 Directed credit programme involving loans on preferential terms and conditions to priority sectors was a major tool of development policy in both developed and developing countries in the 1960s, 1970s and mid-1980s. Even though Japan and other East Asian countries supported well managed and focused directed credit programmes, the experience of most countries around the world showed that directed credit programmes suffered from abuse and misuse of preferential funds for non-priority purposes, increased the cost of funds to non-preferential borrowers, involved a decline in financial discipline that resulted in low repayment rates, and contributed to the government being burdened by unpaid loans and huge arrears. Moreover, once introduced, directed credit programmes proved to be difficult to discontinue.

2.2 The rationale behind directed credit is to bridge the discrepancy between private and social benefits, when high investment risk of the projects and problems of information asymmetry discourage lending to small and medium sized firms. Use of policy-based lending, in addition to other forms of industrial assistance (e.g. lower taxes, grants, etc.), is premised on the argument that the main constraint facing new or expanding enterprises is their limited access to external finance at reasonable terms and conditions. Directed credit programmes involving small subsidies overcome this constraint; but to avoid the misuse of funds and abuse of credit programmes, a strong emphasis must be placed on the maintenance of macroeconomic stability to minimize distortions in incentives and on effective monitoring to ensure timely repayment of loans.

2.3 During the late 1980s and 1990s, several countries adopted the stance of financial liberalisation and deregulation of interest rates. Market oriented financial and credit policies started to replace directed credit policies of the earlier decades. It was not until recent years that the governments with weaker economic and institutional infrastructure have adopted a more nontraditional and liberal approach, i.e. microfinance. The recent experience of developing countries like Bolivia, Bangladesh, Indonesia and the Philippines, to name a few, in microfinance has shown its significant function in creating access to financial services by the poor.

Country experience in comparative perspective

2.4 A few countries like India, Nepal, Pakistan, and Philippines continue to prescribe directed credit requirements. A few economies in transition like Peoples Republic of China (PRC), Kyrgyz Republic, and Viet Nam do not have directed credit requirements as such, but have similar programmes. Select country experiences are presented in the Appendix.

2.5 A comparative analysis based on key aspects of credit policies such as the scope and size of the programmes, the level of subsidies, the sources of funding, the types of implementing institutions, the quality of monitoring and supervision, the rate of loan recovery and loan losses, and the underlying strategy and focus of credit policies in Japan, Korea and China vis-à-vis the Indian experience is presented in the following paragraphs.

Scope and Size

2.6 The scope of credit policies was more narrowly focused in Japan, even though it was targeted towards exports, large industry, declining sectors, and for socio-economic purposes. Normally, the size of directed credit programmes did not exceed 15 per cent of the total funds mobilized by the financial system. Even if the funds mobilized through the Bank of Japan's rediscounting policies and the 'overloan' position of large commercial banks are included, the total 'directed' credit funds did not exceed 20 per cent of total lendable resources. In Korea, directed credit programmes were also heavily focused toward exports and large industrial units, although in the 1980s there was a shift in favour of lending to smaller firms. In Korea, directed credit programmes were more extensive than in Japan and amounted to over 50 per cent of total lendable resources in the 1970s, though they fell to around 30 per cent of the total lendable resources of the financial system in the 1980s following the rise in the relative share of finance companies and other non-bank financial intermediaries.

2.7 In China, policy-based lending amounted to about a third of total bank credit. Credit allocation continued to be reminiscent of budget allocation in a socialist economy, while directed credit programmes were mainly targeted toward large state-owned enterprises. In India, directed credit programmes covers lending to agriculture, SSI, small business and weaker sections. About 70 per cent of the lendable resources of Indian commercial banks were subject to statutory reserve and priority credit requirements.

Level of Subsidy

2.8 Generally, the level of subsidy was small in all the countries, mainly because of their ability to maintain relative macroeconomic and price stability. The level of subsidy was perhaps largest in Korea as well as in China, which was plagued by phases of high inflation. It was also very large in Japan in the high inflation years of the late 1940s. In Japan, where policy-based loans were not subject to compensating balances, the level of subsidy on borrowing from policy-based financial institutions was greater than the reported nominal spread between interest rates on policy-based loans and interest rates on other loans because of the impact of compensating balances on commercial bank loans, especially for lending to smaller firms. In Korea and China, real interest rates paid by the borrower on policy-based loans were often negative, though they

did not reach the very low levels seen in many other developing countries that suffered from persistently very high inflation.

Sources of Funding

2.9 The sources of funding in Japan after the implementation of balanced budgets and tight monetary control in the late 1940s were fiscal funds based on the mobilization of postal savings. In Japan, as in India, central bank credit played a relatively minor part, although in Japan the central bank rediscount window was occasionally a major source of funds, especially in the 1950s and early 1960s, to accommodate the 'overloan' position of the large commercial banks. In Korea and China, central bank credit was far more important in funding policy-based loans and this contributed to the higher rate of inflation experienced by these two countries. Foreign debt capital was an important source of policy-based funds only in Korea, where the government encouraged recourse to foreign borrowing but subjected it to strict controls and direction. In China, inflows of foreign capital, mainly from the Chinese diaspora, supported the operations of new firms in the economic zones. In Japan and India, foreign capital has been a less important source of funding.

Implementing Institutions

2.10 In Japan, the institutions involved in extending policy-based finance were mainly the government financial institutions, though the private long-term credit banks also played an important part. Commercial banks provided support for export finance, especially through the central bank's rediscount window, and were subject to administrative guidance that favoured lending to industry. In contrast, in Korea, not only special banks such as the Korea Development Bank and the Export and Import Bank of Korea, but also the commercial banks, which were state-owned and controlled, were heavily involved in policy-based finance. The same was also true in China. In India priority sector norms are applicable to the entire commercial banking sector, with different prescriptions being applicable for the domestic and foreign banks.

Monitoring and Supervision

2.11 A distinguishing feature of policy-based finance in Japan and Korea was the close degree of monitoring and supervision of the allocation and utilization of preferential funds. Both countries promoted close consultation, coordination and information exchange between the government and the private sector. Loan approval was preceded by careful design and independent appraisal. Monitoring of fund utilization was very strict. Fund disbursement was based on adequate documentation, while continuation of access to policy-based loans depended on attainment of objective targets. In China, monitoring and supervision were much less effective, reflecting in part the considerable decentralization of decision-making power away from the central government to local governments and local financial institutions. This resulted in considerable diversion of funds to non-priority uses. In India, the definition of the priority sector has been widened over the years

to encompass a wide spectrum of activities giving rise to differing perceptions relating to the end-use of resources.

Loan Recovery and Loan Losses

2.12 Partly because of stricter monitoring and partly because of the achievement of very high growth rates over a persistent period, loan losses in Japan were unusually low. However, the reported very low loan loss rates may also be attributed to the absorption by the general budget of the losses from lending to the declining industries, such as coal mining. In Korea, loan losses were much higher, especially in connection with the over ambitious expansion in heavy and chemical industries. The costs of credit intervention were borne by banking institutions, while many of these losses have yet to fully recognized. Similar problems also existed in China. In the Indian case, however, the asset quality of priority sector loans has witnessed improvement in the recent years.

Strategy and Focus

2.13 Japan and Korea had clearly formulated strategies for supporting industrialisation and export promotion. They both encouraged strong domestic competition and production at internationally competitive levels. Effective mechanisms were created in both countries for communication between government and industry, for establishing common goals, and for sharing risks. In contrast, in China, state enterprises faced little domestic competition and domestic enterprises were shielded from international competition through high trade barriers. In India, the focus of priority sector lending has been on agriculture, small-scale industries, and other segments impinging on the welfare of small borrowers and other weaker sections of the society.

Summary Findings

2.14 The country experiences on directed credit programmes display mixed results. The major observations are listed below:

- Due to the low repayment rates, there are higher risks of default, resulting in a deterioration in the asset quality. A few governments had to use the option of recapitalisation for reviving banks as a one-step measure for cleaning up, entailing a huge fiscal cost.
- As reflected by the experience of Japan and Korea, effective credit appraisal and monitoring of programmes seem to be highly important for the success of any directed lending programme.
- There are problems in targeting, as it may result in diversion of funds for non-priority purposes.

- The pricing of the loans for priority purposes is another intricate issue. Though in most of the countries cross-subsidisation in interest rates has not been substantial, it has the tendency to increase the cost for non-preferred borrowers. In cases where the loan discounts are significant, they work to distort the incentive structure and ultimately reduce the effectiveness of the monetary policy.
- Although it is desirable to have priority sectors defined for a limited period with clear sunset provisions, the experience has been that once introduced, these are difficult to dispense with them.
- Directed lending or funding, and complex and distorting subsidy regimes result in a system wherein banks do not function as autonomous profit-maximising entities, but to some extent as quasi-fiscal bodies, providing virtual subsidies to selected segments of the economy which do not appear on the general government balance sheets.
- Directed credit programme is more effective when channellised through specialised financial institutions other than banks, viz., Reconstruction Finance Bank (RFB) and Development Bank of Japan (DBJ) in Japan and Land Bank of the Philippines, Development Bank of the Philippines.

Appendix

Country Experience: A Comparative Table

	Schemes	Experience	Current Status
Brazil	Sectorally directed credit (quantity controls) combined with lower than market interest rates (price controls), or budgetary or off-budget support, often funneled through publicly owned banks.	Directed credit failed to meet intended targets, with better-off farmers capturing much of the subsidies. Portfolio quality problems necessitated recapitalisation of banks. In agriculture the largest 2 per cent of the borrowers receive 57 per cent of the loans, while the smallest 75 per cent of borrowers receive only 6 per cent of credit in 2002.	
China	Lending quotas for State-owned Banks, and price control schemes.	Large NPLs, political biases, and difficulties in monitoring.	Experimenting with switchover to microfinancing actively since 2000 (Grameen Bank model started in 1993).
India (July 1, 2005)	A target of 40 per cent of net bank credit has been stipulated for lending to the priority sector by domestic commercial banks. Within this, sub-targets of 18 per cent and 10 per cent of net bank credit respectively, have been stipulated for lending to agriculture and weaker sections. A target of 32 per cent of net bank credit has been stipulated for lending to the priority sector by foreign banks. Of this, the aggregate credit to small-scale industries sector should not be less than 10 per cent of the net bank credit and that to the export sector should not be less than 12 per cent of the net bank credit. The domestic scheduled commercial banks, having shortfall in priority sector contribute to Rural Infrastructure Development Fund (RIDF) and in the event of failure to attain the stipulated targets and sub-targets, foreign banks are required to contribute to the Small Industries Development Bank of India (SIDBI).	The definition of priority sector has been widened over the years. The priority sector lending is fraught with targeting problem, though asset quality has not been a major issue.	Though priority sector lending for banks continues, microfinance is being recognized as an alternative and an effective tool of rural finance.
Indonesia	Special credit scheme (KUK)- Pakjan 90 and Pakmei 93.	Characterised by high defaults and large continuing losses. Risk	The emphasis has gradually shifted to

	Schemes	Experience	Current Status
		concentration and connected lending contributed to the banking crisis in late 1997.	microbanking.
Nepal	'Intensive Banking Programme (IBP)' based on the 'Area Development Approach' and provides credit to all the beneficiaries within a specific geographical area on the merit of project viability and relies on the regular supervision of the credit projects. It also provides credit on group guarantee basis to the poor who cannot offer collateral. Since 1991/92, the commercial banks have been directed to extend 12 per cent of deposit liabilities to priority sector and a certain percentage of their total loans to the deprived sector.		Priority Sector Credit Programme extended by the commercial banks will be phased out within the next five years but deprived sector lending is proposed to be continued.
Pakistan	Mandatory credit targets for agriculture since 1972.	Although agricultural credit in volume terms has increased, the contribution to rural finance has not improved.	Legal and regulatory systems have been put in place to provide an enabling environment for MFIs since 2002.
Philippines	Banks are required to allocate an amount equivalent to at least 25 per cent of their loanable funds for agricultural credit, of which an amount equivalent to at least 10 per cent of the loanable funds shall be made available for agrarian reform credit. In the absence of qualified borrowers, the amount set aside for agrarian reform credit, but not actually loaned out, may be invested temporarily in other bonds/securities declared eligible for the purpose by the BSP. Similarly, there are mandatory credit requirements for small enterprises.		Policy now directs government agencies not to directly provide financial services and instead transfer this function to government financial institutions (i.e. Land Bank of the Philippines, Development Bank of the Philippines, etc).

SECTION 3

GENESIS AND EVOLUTION OF PRIORITY SECTOR IN INDIA

Introduction

3.1 An enunciation of the need to channelise the flow of credit to certain sectors of the economy, known as the priority sectors, in the larger interests of the country, can be traced to the Reserve Bank's credit policy for the year 1967-68. In view of the severe imbalances which had developed in the economy in the preceding two years as a result of shortfalls in agricultural output and slowing down of industrial production, credit policy for the slack season 1967 was liberalized on a selective basis with a view, among other purposes, to enlarging the flow of credit to the priority sectors such as agriculture, exports and small-scale industries (SSI).

Social control over banks

3.2 At around the same period, the Government of India initiated steps to institute social control over banks to remove certain deficiencies observed in the functioning of the banking system and to promote a purposive distribution of credit, consistent with the basic economic and social objectives. One of the deficiencies observed was that traditionally, the bulk of bank advances was directed to large and medium-scale industries, and big and established business houses, while agriculture, SSI and exports – the hitherto neglected sectors – did not receive adequate attention. The measures for social control over banks, were therefore, initiated by the Government of India in 1967-68 with a view to securing a better adaptation of the banking system to the needs of economic planning and its playing a more active and positive role in aiding sectors like agriculture and SSI. The scheme of social control envisaged a purposive distribution of available lendable resources as well as a more effective mobilization of savings.

3.3 At the second meeting of the National Credit Council held on July 24, 1968, it was emphasised that commercial banks should increase their involvement in financing of the priority sectors, viz., agriculture and SSI as a matter of urgency. In that context, a list containing various types of agricultural advances, which would qualify for the purpose, was prepared and forwarded to banks in March 1969. As regards SSI, no separate guidelines were issued, but it was indicated that direct loans given to road-transport operators, including operators of taxis and auto-rickshaws (original book value of whose investment is less than Rs 7 lakh) and loans for setting up industrial estates would also qualify. The social control measures became formally effective in February 1969.

Nationalisation of banks and after

3.4 The nationalisation of the 14 major commercial banks in July 1969 led to a considerable reorientation of bank lending, especially to the priority sectors of the economy, which had not previously received sufficient attention from the commercial banks. It gave an impetus to the process of reallocation of banking resources to suit the socio-economic needs of the country. There was a greater involvement of banks in these and other socially desirable sectors. Moreover, institutional credit facilities at reasonable rates of interest were extended to a large number of borrowers of small means such as small farmers, small-scale manufacturers, retail traders, road transport operators, small businessmen, professionals and self-employed persons, and also for education. One of the objectives of nationalisation of 14 major commercial banks was to ensure that no viable productive endeavor should falter for lack of credit support, irrespective of the fact whether the borrower was big or small. Thus, the concept of priority sector lending was evolved further to ensure that assistance from the banking system flowed in an increasing measure to the vital sectors of the economy and according to national priorities.

Classification of Priority Sectors and Stipulations on Targets for Lending

3.5 The description of the priority sectors was formalised in 1972 on the basis of the report submitted by the Informal Study Group on Statistics Relating to Advances to the Priority Sectors constituted by the Reserve Bank in May 1971. On the basis of this report, the Reserve Bank prescribed a modified return for reporting priority sector advances and certain guidelines were issued in this connection in February 1972, indicating the scope of the items to be included under the various categories of priority sector.

3.6 In November 1974, public sector banks were advised that their priority sector lending should reach a level of not less than one-third of the outstanding credit by March 1979. In November 1978, the private sector banks were advised to lend a minimum of 33 1/3 per cent of their total advances to the priority sectors by the end of March 1980. In March 1980, all domestic scheduled commercial banks were advised to raise the proportion of the priority sector advances from 33 1/3 per cent to 40 percent of aggregate advances by March 1985. In achieving this overall target, the banks were asked to ensure that their direct advances to agriculture should be at least 15 per cent of net bank credit (NBC) by March 1985 and 16 per cent by March 1987. Further, it was stipulated that banks' advances to the weaker sections of the society should reach 25 per cent of their total priority sector advances or 10 per cent of NBC by March 1985.

3.7 In 1980, Reserve Bank set up a Working Group on Priority Sector Lending and 20-Point Economic Programme (under the Chairmanship of Dr. K. S. Krishnaswamy, the then DG, RBI) to

work out the modalities for implementation of two decisions taken in March 1980 by the Government of

India, viz., that banks should aim at raising the proportion of their advances to the priority sector from 33 1/3 per cent to 40 per cent by 1985, and that the banks should actively promote the implementation of the 20-Point Programme which aimed at improving the lot of the weaker sections of the population. The Group identified the categories of beneficiaries requiring assistance from the banking system in pursuance of the 20-Point Programme and spelt out the manner in which assistance could be rendered. As most of the beneficiaries under the Programme fell in the relatively under-privileged group within the priority sector, the Group suggested certain changes in the approach to priority sector lending. In particular, it introduced the concept of 'weaker sections' within the priority sector and recommended separate sub-targets for lending to the weaker sections in the two main categories of the priority sector, namely, agriculture and SSI, within the overall enhanced target of 40 per cent for lending to the priority sector. Housing loans upto Rs 5,000 for construction of houses for SC/ST and weaker sections, assistance to any governmental agency for construction of houses for SC/ST and low-income groups (where loan component does not exceed Rs 5000 per unit) and pure consumption loans granted to the weaker sections under the Consumption Credit Scheme were recommended for inclusion in priority sector.

3.8 On acceptance of the recommendations of the Working Group, the Bank issued instructions on October 29, 1980 for implementing them. The important instructions were as follows:

- (i) Priority sector advances should constitute 40 per cent of aggregate bank advances by 1985. For achieving the target, banks should ensure that a minimum of 40 per cent of the incremental credit plus such additional amounts flow to the priority sector every year, so that they progressively reach the target of 40 per cent by 1985,
- (ii) Forty per cent of the priority sector advances should be earmarked for agriculture and allied activities. In other words, advances to the agricultural sector should be at least 16 per cent of total advances by 1985,
- (iii) Direct advances to the weaker sections in agriculture and allied activities (i.e. small and marginal farmers and landless labourers) should reach a level of at least 50 per cent of the total direct lending to agriculture (including allied activities) by 1983, and
- (iv) Advances to rural artisans, village craftsmen and cottage industries should constitute 12.5 per cent of the total advances to SSI by 1985.

3.9 It was also stressed on the banks that the emphasis should be not only on the priority sector but also on the weaker and under-privileged groups within each sector.

3.10 The classification of the various segments that comprise the priority sector was further restructured based on the report of the 'Working Group on the Role of Banks in Implementation of New 20-Point Programme' (Chairman: Shri A Ghosh, 1982). The recommendations made by the working group were accepted by the Government of India and Reserve Bank of India (with modifications) and instructions were issued to banks in February 1983. The various segments which were classified by the above Group's report under priority sector were Agriculture (both direct and indirect finance), SSI, Small Road and Water Transport Operators, Retail Trade, Small Business, Professional and Self Employed Persons, State sponsored schemes for Scheduled Castes/Scheduled Tribes, Education, Housing and Consumption.

3.11 Targets and sub-targets under the different priority sectors for different categories of banks have been reviewed and revised periodically. The sub-target for agriculture and allied activities (which was set at 15 per cent of NBC to be achieved by March 1985) was subsequently raised to 16 per cent by March 1987, 17 per cent by March 1989 and 18 per cent by March 1990. This sub-target was further bifurcated in October 1993 to a minimum of 13.5 per cent for direct loans and a maximum of 4.5 per cent for indirect loans.

3.12 Foreign banks operating in India were advised to progressively increase their advances to the priority sector categories of borrowers and such advances were to reach a level of 15 per cent of their NBC by the end of March 1992. In April 1993, this ratio was further raised to 32 per cent of NBC to be achieved by March 1994. Within the enhanced target of 32 per cent, two sub-targets of 10 per cent in respect of SSI and 12 per cent for exports were fixed.

3.13 New private sector banks were advised to observe priority sector lending targets as applicable to other domestic commercial banks at 40 per cent. The Local Area Banks (LABs) in the private sector were also advised in August 1996 to observe priority sector lending targets as applicable to other domestic banks. Within this target, LABs are to adhere to the requirement of lending at least 25 per cent of their priority sector deployment (10 per cent of NBC) to weaker sections. Primary co-operative (urban) banks are also required to attain a priority sector lending of 60 per cent of their total advances, of which at least 25 per cent should be to weaker sections.

Observations of the Narasimham Committees- I and II

3.14 In 1991, the Committee on the Financial System (Narasimham Committee) had observed that the directed credit programmes had played a useful purpose for extending the reach of the banking system to cover sectors, which were neglected hitherto. However, the Committee observed that the pursuit of such objectives should use the instruments of the fiscal rather than the credit system. The Committee recommended that directed credit programmes should be phased out. It proposed that priority sector should be redefined to comprise the small and

marginal farmer, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections. The target for this redefined priority sector should be 10 per cent of aggregate credit. The recommendation was, however, not accepted.

3.15 The Committee on Banking Sector Reforms (Narasimham Committee-II) (1998) again gave careful consideration to the issue of directed credit and noted the reasons why the Government could not accept the earlier recommendation. It observed that directed credit had led to an increase in non-performing loans and had adversely affected the efficiency and viability of banks. It was observed that 47 per cent of all NPAs emanated from the priority sector. At the same time, the Committee also accepted that a sudden reduction of priority sector targets could have the danger of a disruption in the flow of credit to these sectors. In its report, the Committee recognized that the small and marginal farmers and the tiny sector of industry and small businesses have problems with regard to obtaining credit and some earmarking may be necessary for this sector. Under the present dispensation, within the priority sector, 10 per cent of NBC is earmarked for lending to weaker sections. The Committee recommended that given the special needs of this sector, the current practice may continue. The Committee also proposed that given the importance and needs of employment oriented sectors (like food processing and related service activities in agriculture, fisheries, poultry and dairying), these sectors should also be covered under the scope of priority sector lending. It, however, recommended for the removal of concessional rates of interest on loans up to Rs 2 lakh and a phased moving away from overall priority sector targets and sub-sector targets. The Committee also recognized that enhancement of credit to these sectors is critically dependent on the availability of adequate infrastructure in these areas.

3.16 A brief review of the different committees that have studied the concept of priority sector, the main recommendations made and action taken thereon is given in **Annexure 1**.

Targets prescribed

3.17 As per extant instructions, the targets and sub-targets set under priority sector lending for domestic and foreign banks operating in India are given below:

	Domestic banks	Foreign banks
Total Priority Sector advances	40 per cent of NBC (60 per cent for RRBs)	32 per cent of NBC
Total agricultural advances	18 per cent of NBC However, advances under indirect lending to agriculture in excess of 4.5 per cent of NBC would not be reckoned in computing performance under the sub-target of 18 per cent.	No target
SSI advances	No target	10 per cent of NBC
Tiny sector within SSI	40% of SSI advances to units having investment in plant and machinery up to Rs 5 lakh, 20% to units with investment between Rs 5 lakh and Rs 25 lakh (Thus, 60% of SSI advances should go to the tiny sector)	Same as for domestic banks
Export credit	Export credit does not form part of priority sector	12 per cent of NBC
Advances to weaker sections	10 per cent of NBC (15 per cent for RRBs)	No target
DRI advances	1 per cent of previous year's total advances.	No target

Composition

3.18 There have been several changes in the composition of priority sector over the years. At present, the priority sector broadly comprises agriculture, SSI and other segments such as small business, retail trade, small road and water transport operators, professional and self-employed persons, housing, education loans, micro credit, software, etc. Detailed classification containing the list of items in different segments of priority sector advances is given in Annexure 2.

3.19 The definition of weaker sections in priority sector has also been revised and accordingly, the weaker sections in priority sector are now defined as:

- a) Small and marginal farmers with land holdings of 5 acres and less, landless labourers, tenant farmers, and share croppers;
- b) Artisans, village and cottage industries with individual credit requirements not exceeding Rs.50,000/-;
- c) Beneficiaries of the Swarnajayanti Gram Swarojgar Yojana (SGSY);
- d) Scheduled Castes and Scheduled Tribes;

- e) Beneficiaries of the Differential Rate of Interest (DRI) Scheme;
- f) Beneficiaries under Swarna Jayanti Shahari Rojgar Yojana (SJSRY);
- g) Beneficiaries under the Scheme for Liberation and Rehabilitation of Scavengers;
- h) Advances to Self Help Groups; and
- i) Loans to distressed urban poor to pre-pay their debt to non-institutional lenders, against appropriate collateral or group security, subject to the guidelines to be approved by their Board of Directors.

Penalty provisions

3.20 In the initial years of priority sector prescriptions, although specific targets had been fixed for lending to the sector and also for sub-sectors within the priority sector, no penalties were prescribed for non-achievement of the targets. Penalties for non-achievement of priority sector targets were first imposed on foreign banks in 1993 in the form of maintaining deposits, equivalent to the amount of shortfall in priority sector lending, with SIDBI. Consequent upon setting up of the Rural Infrastructure Development Fund (RIDF) with NABARD in 1995, public and private sector banks were required to deposit amounts in the RIDF linked to their shortage under achievement of priority sector lending prescriptions. There are no penalty provisions for Regional Rural Banks.

Foreign banks – Deposits with SIDBI

3.21 In August 1988, foreign banks operating in India were advised that their priority sector advances should be progressively increased to the level of 15 per cent of their net outstanding advances by the end of March 1992. However, as at the end of March 1992, the priority sector advances of these banks constituted only 7.86 per cent of their NBC. The non-compliance by foreign banks with the instructions was viewed seriously by Reserve Bank and the banks were advised in April 1993 that the shortfall should be rectified by the end of June 1993. In the event of failure to attain the target, foreign banks were required to deposit, for a period of one year, an amount equivalent to the shortfall, with SIDBI at a rate of interest of 10 per cent per annum.

3.22 In April 1993, it was also decided that the requirement for lending to priority sector in respect of foreign banks should be raised from 15 per cent to 32 per cent of their NBC from March 1994. Further, with effect from July 1993, the composition of priority sector advances in case of foreign banks was widened to include export credit. It was prescribed that within the overall target of 32 per cent, the advances to SSI sector and export sector each should not be less than 10 per cent of the NBC. The stipulation of depositing the amount of shortfall with SIDBI against the enhanced target of 32 per cent was continued on the same terms. In November 1996,

the sub-target for export sector was raised to 12 per cent, which was required to be reached before March 1997.

3.23 The rate of interest on deposits with SIDBI was brought down to 8 per cent for deposits made on the shortfall at the end of March 1995. The rate of interest was further reduced to 6.75 per cent and Bank Rate in March 2003 and November 2003 respectively. With effect from the year 2005-06, the tenure of deposits with SIDBI has been increased from one to three years. Further, the rate of interest payable to banks has been linked inversely proportional to the extent of shortage in achieving the target/ sub-targets. It now varies between the Bank Rate and Bank Rate minus 3 per cent.

3.24 Since the inception of the scheme, a sum of Rs 5,150 crore has been placed with SIDBI. The amount received under this category is not kept separately by SIDBI but merged in the general pool and utilised for the operations of SIDBI towards promotion, financing and development of the small-scale sector in the country.

Public and private sector banks – Deposits under RIDF

3.25 Although targets for public sector and private sector banks were prescribed in 1974 and 1978 respectively, no penalties were initially imposed on these banks for not achieving the targets. In the Union Budget of 1995-1996, the Government announced a scheme for setting up of a Rural Infrastructure Development Fund (RIDF) for assisting the State Governments and State owned corporations in quick completion of on-going projects relating to minor and medium irrigation, soil conservation, watershed management and other forms of rural infrastructure, such as rural roads and bridges, market yards, etc. Consequently, the RIDF was established with NABARD with a corpus of Rs 2000 crore and contributions to the RIDF were required to be made by the commercial banks to the extent of their shortfall in their agricultural lending, subject to a maximum of 1.5 per cent of their Net Bank Credit (NBC). The deposits to be made by the banks were to be for five years at an interest rate of 12.5 per cent. The rate of interest chargeable on loans granted to State Governments was fixed at 13 per cent.

3.26 Since then, the RIDF has been extended on a year-to-year basis through announcements in the Union Budget. The amount of corpus has also been increased over time. Over the years, there have been changes in the list of activities, which can be financed through RIDF, the basis for determination of contribution of banks to the Fund, the interest rates payable to banks and also the rates of interest payable by State Governments to NABARD for the loans taken from the Fund.

Loans from RIDF

3.27 During the initial year, irrigation projects were given a major thrust, while rural roads and bridges received priority from RIDF II onwards. Since then many other activities such as rural drinking water schemes, soil conservation, rural market yards, rural health centres and primary schools, mini hydel plants, Shishu Shiksha Kendras, Anganwadis and system improvement under power sector, etc. were added to the list of eligible activities under RIDF. From RIDF V onwards, RIDF ambit was also extended to projects undertaken by Panchayat Raj institutions and projects in social sector covering primary education, health and drinking water. Since RIDF X, many other activities such as minor irrigation projects/micro irrigation, flood protection, watershed development/ reclamation of waterlogged areas, drainage, forest development, market yard/ godown, Apna Mandi, rural haats and other marketing infrastructure, cold storage, seed/ agriculture/ horticulture farms, plantation and horticulture, grading and certifying mechanisms such as testing and certifying laboratories, etc., community irrigation wells for irrigation purposes for the village as a whole, fishing harbour/ jetties, riverine fisheries, animal husbandry and modern abattoir have been added to the list of eligible activities.

Rates of interest on deposits and loans out of RIDF

3.28 The Government of India decides the rates of interest on loans out of RIDF given to State Governments. While deposits under RIDF I to RIDF IV were for a period of five years, the period of deposits in respect of subsequent tranches was increased to seven years. The rates of interest in respect of deposits under RIDF as well as on loans provided to State Government were fixed rates up to RIDF VI. In 2001, at the time of RIDF VII, with a view to disincentivise banks, it was decided to inversely link the interest rate on banks' contributions to RIDF to the extent of shortfall in the agricultural lending vis-à-vis the stipulated target of 18 per cent. In September 2003, the lending and deposit rates in respect of undisbursed amounts of RIDF IV to VII were restructured to be at 9 per cent and 8 per cent respectively. Again, in November 2003, the lending and deposit rates for undisbursed amounts under RIDF IV to IX were revised downwards.

Sanctions and Disbursements out of RIDF

3.29 The corpus of RIDF I to RIDF X taken together amounts to Rs. 42,000 crore. As per figures furnished by NABARD for the period ended March 2005, cumulative sanctions and disbursements stood at Rs 42,948.51 crore and Rs 25,379.68 crore, respectively. The disbursements under RIDF I to III (which have since been closed) have been 90 per cent and above. Under RIDF IV to VI, the disbursements have been 80 per cent or above. The disbursements under the subsequent tranches have been lower as projects under RIDF continue for several years and disbursements continue over a period of time. The major portion of RIDF funds have been utilised in projects relating to irrigation, rural roads, rural bridges and rural water supply.

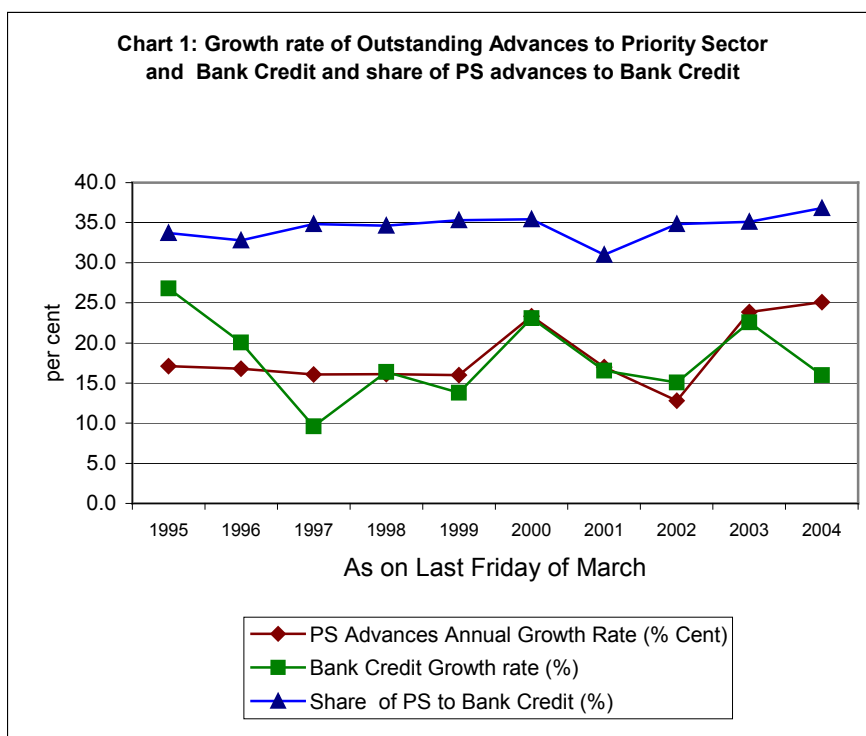
SECTION 4

AN ANALYSIS OF TRENDS IN PRIORITY SECTOR LENDING BY BANKS IN INDIA

4.1 In this Section, an analysis of trends in advances to priority sector and its various segments (agriculture, SSI, other segments of priority sector), bank-group wise (public sector banks, private sector banks and foreign banks) achievements in priority sectors, activity-wise credit to various segments and its sub-segments, credit to weaker sections and credit extended under Differential Rate of Interest Scheme has been presented. Further, the performance of banks in lending to priority sector vis-à-vis the targets set for them as also the incidence of non-performing assets in priority sector have been discussed.

Growth in Priority Sector Advances of Scheduled Commercial Banks excluding RRBs

4.2 The credit advanced to the priority sector by scheduled commercial banks recorded an average annual growth rate of 18.4 per cent during the period from 1995 to 2004, which was marginally higher than the average annual growth of 18.0 per cent observed in aggregate bank credit. However, the share of priority sector advances as a percentage of NBC had shown undulating trends during the period. During 1995-1996, it fell from 33.7 per cent to 32.8 per cent, but remained steady at around 35 per cent during the years 1997 to 2000. Thereafter, it dipped sharply to 31.0 per cent in 2001 recovered to 35.1 per cent in 2003 and further to 36.8 per cent in 2004. The details relating to growth rates of priority sector advances and bank credit are given in Annexure 3 and also presented in Chart 1.



A segment-wise analysis of credit extended by scheduled commercial banks to various segments of priority sector is presented hereunder.

A. Credit to Agriculture

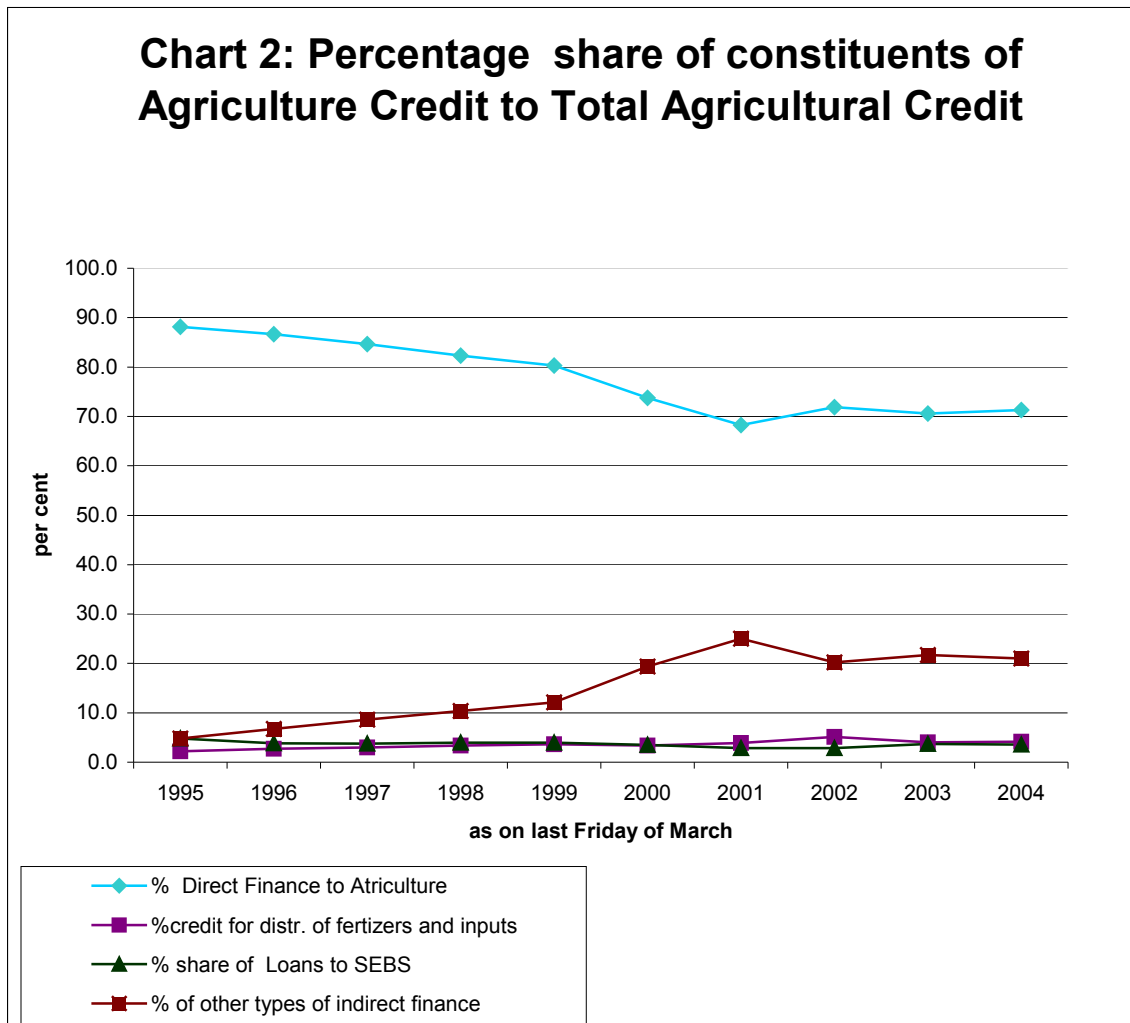
4.3 The number of accounts covered under agriculture in priority sector declined from 2.03 crore in 1995 to 1.99 crore in 2004. However, outstanding advances to agriculture had increased substantially during the period from Rs. 24,200 crore to Rs.99,302 crore, registering an average annual growth rate of 16.6 per cent. Outstanding advances to agriculture as a percentage of Net Bank Credit had recorded a negligible increase from 11.4 per cent as at the end of 1995 to 11.5 as at the end of 2004.

4.4 During the period 2001-04, the total outstanding credit to agriculture sector extended by public sector banks was within the range of 15-16 per cent of NBC as against the target of 18.0 per whereas in respect of private sector banks, the share of agricultural credit in NBC increased from 7.1 per cent to 11.8 per cent during the same period.

4.5 The average annual growth of direct finance to agriculture was lower at 13.9 per cent during 1995-2004. The share of direct finance to agriculture in total agricultural credit declined from 88.2 per cent in 1995 to 71.3 percent in 2004. Direct finance to agriculture as a percentage of NBC had also declined from 10.1 per cent to 8.2 per cent during the above period.

4.6 The share of credit for distribution of fertilizers and other inputs which was at 2.2 per cent in 1995 increased to 4.2 per cent in 2004. The shares of other types of indirect finance to agriculture to total agriculture credit increased significantly from 4.8 per cent to 21.0 per cent during the said period. As a percentage of NBC, other types of indirect finance to agriculture increased from 0.6 per cent to 2.4 per cent.

4.7 Indirect credit to agriculture provided by banks, comprising of finance for distribution of fertilizers and other inputs and other types of indirect finance, grew at a rate of 30.8 per cent during the corresponding period (Annexure 4).



4.8 It would be observed that the share of indirect credit to agriculture in total agriculture credit increased from 11.8 per cent in March 1995 to 28.7 per cent in March 2004 despite the fact that indirect agriculture advances are reckoned only to the extent of 4.5 per cent while measuring the performance of banks in achieving the target of 18.0 per cent of NBC in agriculture. As a percentage of NBC, indirect credit to agriculture increased from 1.4 per cent to 3.3 per cent during the above period.

B. Credit to Small-Scale Industries, Setting up of Industrial Estates and Small Road and Water Transport Operators

4.9 Scheduled commercial banks' credit to SSI increased at an average annual rate of 11.7 per cent during the period 1995 to 2004, as compared to the average annual growth rate of 18.4 per cent in bank credit to priority sector during the same period. However, the credit to SSI as a percentage of NBC declined from 13.8 per cent to 8.2 per cent. The number of accounts of SSI units availing of banking finance declined from 29.6 lakh to 18.1 lakh during the same period (Annexure 5). However, outstanding credit per account increased from Rs.0.98 lakh in 1995 to Rs.3.94 lakh in 2004. Though loans for setting up of industrial estates grew at an average annual rate of 36.6 per cent, the growth rate showed fluctuations during the period, with very high growth rates in 1998, 2001 and 2004 and negative growth rates in 1995, 1996, 1999, 2000, 2002 and 2003. Such loans as a percentage of NBC were at a negligible level.

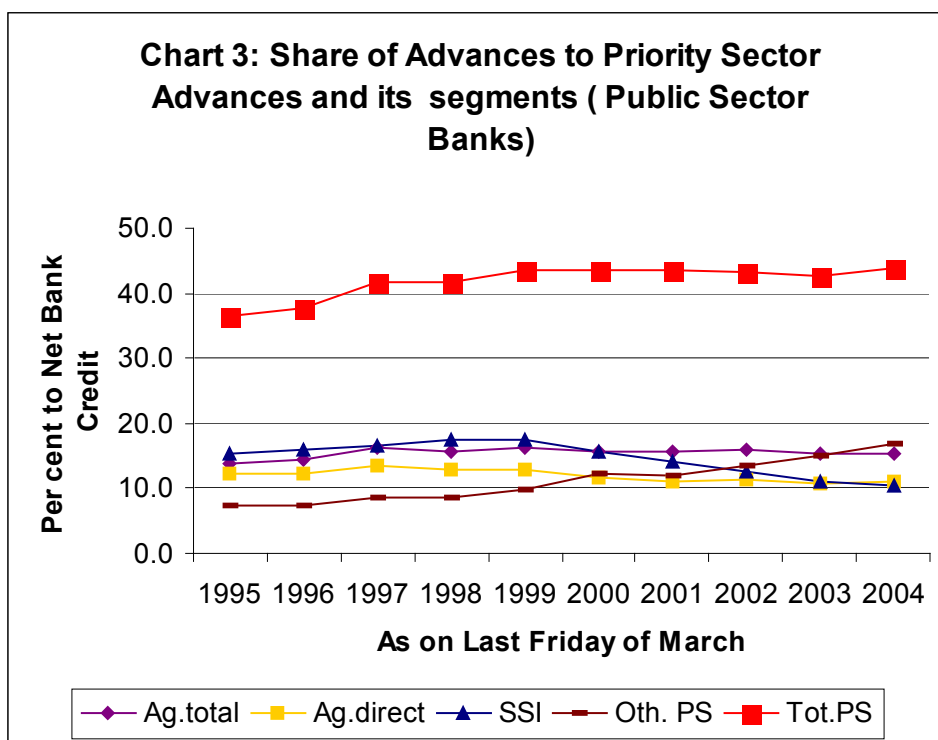
4.10 The average annual growth rate of advances to Road and Water Transport Operators was at 12.7 per cent during 1995-2004 with per account outstanding amount at Rs.0.41 lakh in 1995 vis-a-vis Rs.1.40 lakh in 2004. Loans to Road and Water Transport Operators as a percentage of NBC declined marginally from 1.4 per cent to 1.0 per cent. The significant feature observed in this regard is the decline in the number of accounts in SSI and other sub-sectors over the period, while the amount outstanding increased. This shows that enhanced credit limits were granted to such units to meet their requirements.

Bank Group-wise Credit to Priority Sector

A. Public Sector Banks (PSBs)

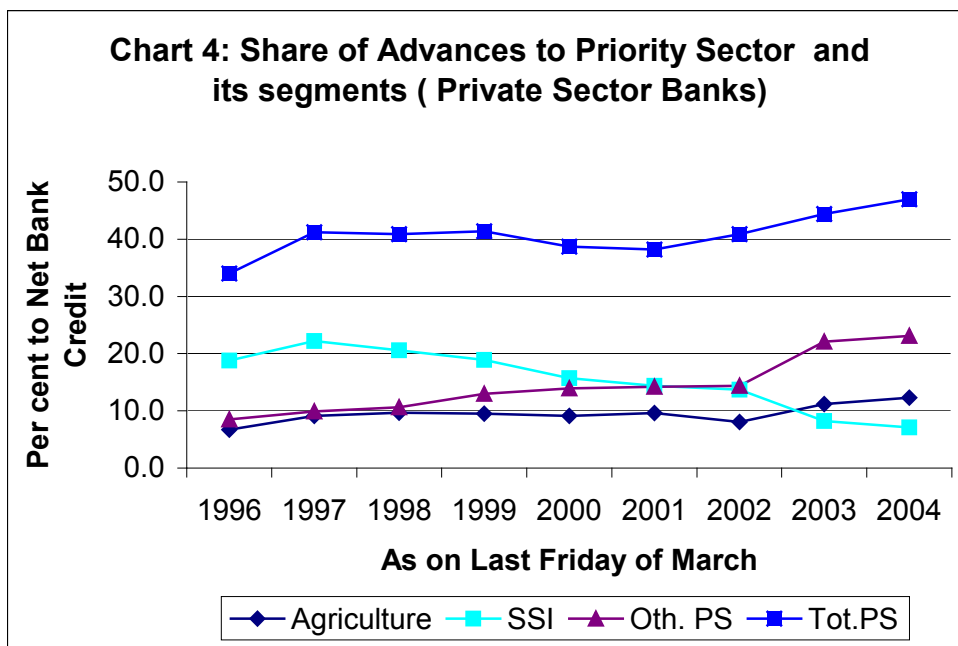
4.11 The outstanding priority sector advances of PSBs increased by 21 per cent in 2003-04 as against an increase of 18.6 per cent during 2002-03. During the period 1995-2004, the average annual growth rate of advances to priority sector by public sector banks was 17.6 per cent as compared to average growth rate of NBC at 16.7 per cent in the same period. The higher growth in priority sector advances of PSBs during the above period was primarily due to 28.8 per cent average growth rate recorded by other priority sectors which compensated for the low average growth rate in credit to SSI (9.3 per cent) and direct agriculture credit (15.7 per cent). The share of priority sector advances in NBC of PSBs increased to 44 per cent in 2003-04 from 42.5 per cent in 2002-03. The growth in priority sector advances of PSBs was fuelled by the surge in the

loans and advances to various other priority sectors and robust growth of credit to the agriculture sector (Chart 3). Advances to agriculture constituted 15.4 per cent of NBC of PSBs as on the last reporting Friday of March 2003 (Annexure 6). The share of advances to other priority sectors in NBC of PSBs increased to 17.0 per cent in 2003-04 from 15.0 per cent in 2002-03. The number of accounts covered under various major segments (agriculture, SSI and other priority sectors) of priority sector declined over the period.



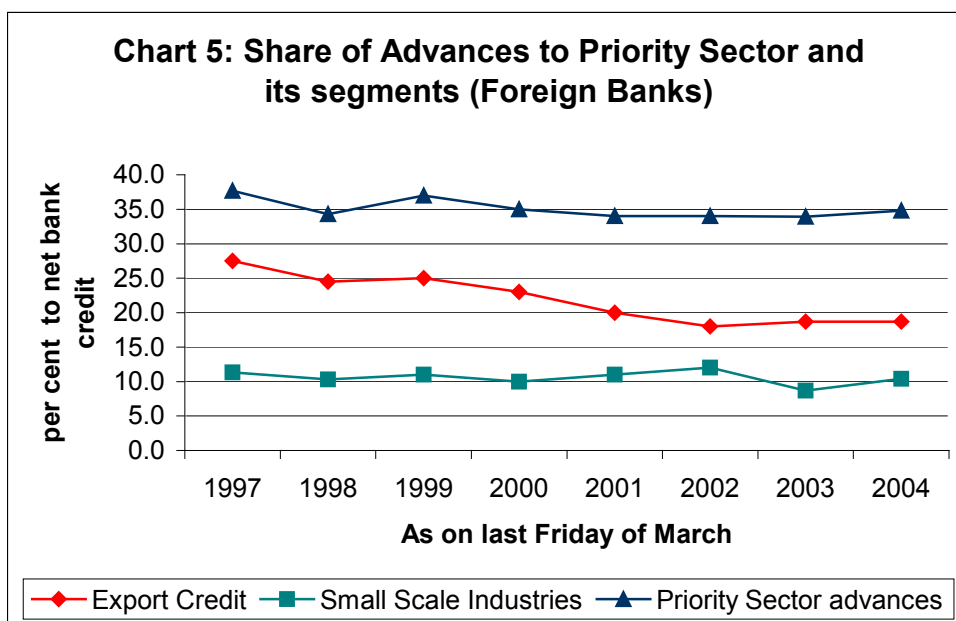
B. Private Sector Banks

4.12 Private sector banks' lending to priority sector as a percentage of their NBC has been showing an increasing trend. The share of their advances to priority sector in NBC had increased from 44.4 per cent in 2002-2003 to 47.4 per cent in 2003-04. During the period from 1997 to 2004, average annual growth rate of priority sector advances of private sector banks was 29.5 per cent which was mainly contributed by the growth in lending to other priority sectors (44.7 per cent) and agriculture (37.4 per cent). In comparison, the average annual growth rate for advances to SSI was at 8.4 per cent. In absolute terms, credit to agriculture, SSI and other priority sectors had increased. The share of credit to other priority sector category was the highest at 23.1 per cent of NBC, followed by advances to agriculture and SSI. The lending of private sector banks to agriculture sector had increased to 12.3 per cent of their net bank credit in 2003-04, higher by 1.1 per cent over that in 2002-03 (Annexure 7). The respective shares of credit to agriculture, SSI and other priority sectors in total priority sector advances of private sector banks over the period from 1996 to 2004 are presented in Chart 4.



C. Foreign Banks

4.13 Foreign banks operating in India are required to achieve the target of 32.0 per cent of NBC for priority sector advances with sub-targets of 10.0 per cent for SSI and 12.0 per cent for exports. Lending to the priority sector by foreign banks constituted 34.8 per cent of their NBC as on the last reporting Friday of March 2004, of which the shares of export credit and SSI as a percentage of NBC were 18.7 per cent and 10.4 per cent, respectively (Annexure 8). During the period 1998-2004, the average annual growth rate of priority sector advances of foreign banks was 16.9 per cent. The average annual growth rate during the same period for SSI was at 18.1 per cent compared to 12.0 per cent growth in export credit. There had been a slow down in the share of export credit of foreign banks compared to the share of SSI, which hovered around 10 per cent as depicted in Chart 5.



Sub-segment-wise credit to Priority Sector- Scheduled Commercial Banks

4.14 Credit extended by scheduled commercial banks according to major segments – agriculture, SSI and other priority sectors has been discussed in paragraphs 4.2 to 4.9 above. The trends in outstanding credit under various sub-segments of priority sectors during the years 2002 and 2003 (Annexure 9) are discussed in the following paragraphs.

4.15 Out of the advances to SSI, term loans increased by Rs.2114 crore (18.9 per cent) to Rs.13,300 crore during the year 2003. However, composite loans to artisans, village and tiny industries showed a marginal growth of Rs.139 crore (7.5 per cent). The advances to cottage, village and tiny industries accounted for 23.2 per cent of the total SSI advances in 2003.

4.16 Under other priority sector advances, housing loans accounted for the highest share of priority sector advances at 20.5 per cent in 2003 (increased from 14.3 per cent in 2002), followed by retail trade (5.8 per cent), small business (3.3 per cent), small road and water transport operators (2.6 per cent) and advances to food and agro processing industries not satisfying SSI norms (1.9 per cent).

4.17 The shares of other constituents except education loans (consumption loans, funds provided to Regional Rural Banks, advances to self-help groups, advances to software industries having limit up to Rs.1 crore, and investments in venture capital) constituted individually less than 1 per cent in total advances to priority sector.

4.18 As regards growth in the other constituents of priority sector advances, the highest growth was in advances to self-help groups (284.3 per cent), export credit to SSI sector by

foreign banks (166.8 per cent), advances to cottage, village and tiny industries (160.0 per cent), housing loans – direct (101.5 per cent) and education loans (90.6 per cent).

4.19 The decline, in percentage terms, was significant in respect of advances to RRBs (96.5 per cent) and advances to State sponsored organizations for SCs/STs for purchase of inputs (74.0 per cent) in 2003 over 2002.

Advances to Weaker Sections

4.20 As against the target of 10 per cent of NBC, achievement in purveying credit to weaker sections by PSBs was to the extent of around 7 per cent during 2001 to 2004. In the case of private sector banks, the achievement, which varied between 1.70 per cent in the year 2001 and 1.34 per cent in 2004, had fallen short of the target considerably.

Table 1: Advances to Weaker Sections

As on last Friday of March	Public Sector Banks			Private Sector Banks		
	Amount (Rs. Crore)	% of NBC	%NPA*	Amount (Rs. Crore)	% of NBC	%NPA*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2001	24,805.33	7.28	22.51	958.94	1.70	19.72
2002	28,974.90	7.30	21.71	1,142.06	1.82	10.30
2003	32,303.75	6.76	19.39	1,223.40	1.48	16.78
2004	41,588.64	7.44	18.90	1,495.49	1.34	12.15

- Data pertain to end-March
- Source: Report on Trend and Progress of Banking in India

Advances Under Differential Rate of Interest (DRI) Scheme

4.21 The scheduled commercial banks are required to extend advances under DRI Scheme to the weakest of the weaker sections at a rate of interest of 4.0 per cent. A target of 1.00 per cent of outstanding amount of bank credit as at the end of March of previous year has been fixed under the DRI Scheme. As against this, the public sector banks had attained a level of only 0.07 per cent as at the end the year 2004. The achievement, in percentage terms, had been declining persistently over the period. The number of beneficiaries and outstanding amount of loans have also declined over the years. However, the amount outstanding increased marginally in 2004.

Table 2: Advances of Public Sector Banks under Differential Rates of Interest (DRI) Scheme

As on Last Friday of March	No. of Accounts (in lakhs)	Amount Outstanding (Rs. in crore)	Total Bank Credit (as at the end of March preceding year) (Rs. in crore)	DRI Advances as a Percentage of Total Bank Credit as at the end of March of the previous year
(1)	(2)	(3)	(4)	(5)
1995	19.47	683	1,38,648	0.49
1996	15.52	678	1,65,377	0.41
1997	14.30	655	1,93,963	0.34
1998	9.05	544	1,97,186	0.28
1999	7.29	485	2,33,852	0.21
2000	5.90	422	2,65,554	0.16
2001	5.14	358	3,16,446	0.11
2002	NA	NA	3,41,292	NA
2003	3.70	299	3,96,953	0.08
2004	3.68	315	4,77,899	0.07

Source: Statistical Tables Relating to Banks in India

4.22 The meagre amount of loans to an individual borrower (while no minimum amount has been stipulated for loans under DRI scheme, the maximum amount of loan permitted under the scheme is Rs.6,500/-) and the low rate of interest (4%) under the Differential Rate of Interest Scheme seem to be acting as dampeners to the borrowers and bankers respectively.

Bank-wise Frequency Distribution of Targets vis-à-vis Achievements

4.23 The frequency distribution in various ranges of achieving the target for priority sector advances as a percentage to NBC as on the last reporting Friday of March 2004 is given in Table 3. Out of 27 public sector banks, only nine banks achieved the target of 18 per cent relating to credit to agriculture. Among private sector banks, only 11 out of 30 banks had attained the target. As regards the achievement of target in respect of credit to weaker sections (10 per cent), seven public sector banks achieved the target as compared to 4 banks in the private sector.

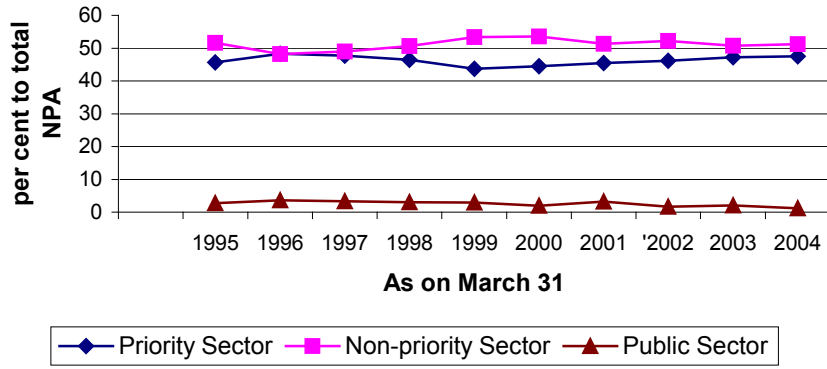
Table 3: Frequency distribution of lending of Indian Scheduled Commercial Banks to Agriculture, Weaker Sections and Priority Sector Advances as a percentage to NBC

Agriculture as % NBC- 2004						
	<12%	12-15%	15-18%	>18 %	Total banks	%NBC
Public Sector Banks	3	6	9	9	27	
% Share of agriculture credit	4.2	36.4	26.2	33.3	100	15.41
Private Sector Banks	15	3	1	11	30	
% Share of agriculture credit	16.2	5.2	1.3	77.1	100	15.81
Weaker Sections as % NBC						
	<5%	5-7%	7-10%	>10%	Total banks	%NBC
Public Sector Banks	8	7	5	7	27	
% Share of weaker sections	9.6	16.9	41.4	30.1	100	7.44
Private Sector Banks	25	0	1	4	30	
% Share of weaker sections	50.3	0	14.1	35.6	100	1.34
Priority Sector Advances						
	<40%	40-44%	44-48%	>48%	Total banks	%NBC
Public Sector Banks	2	9	10	6	27	
% Share of priority sector	22.3	24.5	29.2	24	100	43.94
Private Sector Banks	12	2	2	14	30	
% Share of priority sector	10.7	8.8	8.3	72.1	100	47.35

Non-Performing Assets (NPAs) in Priority Sector

4.24 The aggregate NPAs of public sector banks under priority sector was maximum at Rs.25,150 crore in 2002, accounting for 46.2 per cent of total NPAs. However, in 2004, it declined to Rs.23,841 crore, though as a percentage to total NPAs, it increased to 47.5 per cent. The share of NPAs under priority sector remained in the range between 44.2 per cent (2001) and 52.5 per cent (1995) of the total NPAs for State Bank of India and its Associates (Annexure 10). The details of NPAs of public sector banks (including SBI and its associate banks) in priority and non-priority sector are presented in Chart 6.

Chart 6 :Sector wise Non-Performing Assets of Public Sector Banks



SECTION 5

PRIORITY SECTOR LENDING AND INTER-BANK

PARTICIPATION CERTIFICATES

5.1 Some banks purchase Inter-Bank Participation Certificates (IBPCs), where the underlying asset qualifies as priority sector lending, for meeting their priority sector obligations. Since data on market-size and functioning of the IBPCs market, were not available, a survey of some prominent public sector and private sector banks and foreign banks was conducted thereon. The results of the survey are presented below along with the implications of usage of IBPCs in connection with priority sector lending.

Size, Functioning and General Characteristics of the Market for IBPCs

A. Usage of IBPCs

5.2 The IBPC scheme was introduced in 1988 with a view to providing an additional instrument for evening out short-term liquidity within the banking system. However, banks in India have a preference for building up their own assets portfolio and hold the assets in their books. Due to this reason, as also due to some features of the extant IBPC scheme, such as non-transferability of IBPCs and the issue of IBPCs being allowed to the extent of only 40 per cent of underlying advances, IBPCs have not been widely used by banks. Thus, the market is not too deep with very few participants. (Modifications in the extant scheme, which would make it more useful to the users of the instrument, as suggested by some banks and other organisations, have been examined in MPD in a separate Inter-departmental Group Report on IBPCs, submitted in April 2005).

B. Types of IBPCs

5.3 Some banks, especially public sector banks, have stated that in view of the surplus liquidity in the system in the last four years, they have not felt the need to issue IBPCs to augment the liquidity of their loan portfolio. Usage might increase in a situation of tighter liquidity. Foreign and private sector banks have used IBPCs as an alternative source of lending. They have also used IBPCs to obtain their balance of priority sector lending (PSL) shortfalls, including agriculture, from PSL-surplus banks.

5.4 There are two types of participations: (i) Inter-Bank participations with risk sharing; and (ii) Inter-Bank participations without risk sharing. Generally, banks have issued IBPCs on a risk-sharing basis so as to reduce the size of their credit portfolio since this reduces their capital requirement as well. Also, since there is no reserve requirement on such IBPCs, banks have preferred to use this instead of the IBPCs without risk sharing.

C. Tenor and Size of the Market

5.5 No data on the overall size of the market is available, though the IBPC guidelines have laid down data reporting requirements regarding this instrument in the fortnightly returns under Section 42(2) of the Reserve Bank of India Act, 1934. However, surveyed banks confirm, on the basis of bank-level data for the past three years, that IBPCs have accounted for a small amount of business as compared to their overall advances, and often none at all, especially for the public sector banks. They have also requested for certain modifications in the extant scheme to revive the market.

5.6 The number of banks using the instrument has grown from five, in the year 2000 to about 15, at present. The market players consist of generally private and foreign banks and a few nationalised banks.

5.7 The total size of the market is difficult to ascertain. However, the consensus estimate of the banks surveyed is that the total size of the deals entered into in a year is around Rs. 2,000 – 3,000 crore. Almost all the deals were in the risk-sharing variety of IBPCs. Indeed, IBPC market has grown over the past 3-4 years. The growth rate would be in synchronisation with growth in advances of the participants and has been driven to meet the requirements of priority sector credit. The average size of IBPC deals in priority sector, including agriculture, is Rs. 80-100 crore.

5.8 The market for IBPCs, under the extant scheme, lacks depth and is seasonal in nature. Most of the deals happen in February and March. One bank said that 80 per cent of the IBPC transactions take place during the December-March period, every year, and predominantly pertain to priority sector /agriculture. Almost all the deals are at the tenor of 91 days, but a few have been done at the tenor of 180 days as well.

D. Interest Rates on IBPCs

5.9 The rates on IBPCs are market-dependent and also depend upon the purpose – such as whether it goes towards meeting the regulatory obligations. The rate of interest is bilaterally agreed between the participating banks. Rates are quoted in tune with prevailing short-term money market rates. One bank said that cost of funds raised through IBPC (based on PSL) has

come down from 5.0 per cent during 2003 to 3.75 percent in 2005. This is borne out by another bank which stated that, when banks sell IBPCs based on PSL, the IBPC deal rates range between 2.0 per cent to 4.0 per cent whereas deal rates for non-PSL IBPC are higher - around 3-month inter-bank rate plus 25 bps. About four years ago, this spread was nearer to one per cent but the growing inter-bank term lending and borrowing market has reduced the spreads. The spread over the benchmark rate is on account of the illiquidity of the participation certificates, which, as per extant regulations, are not transferable.

E. Documentation and Other Procedures

5.10 IBPC transactions are handled at the banks' treasuries. Some banks have stated that investment in IBPCs is a part of banks' investment policy and investments are made as per regulatory guidelines after obtaining approvals from the appropriate authority. An earlier survey had revealed that some banks have product programmes to regulate the purchase of assets through IBPCs. These programmes define the processes to be followed and also stipulate that besides marking credit limits on the assets, credit limits on the banks, which sell the risk, should also be marked. Another bank had stated that though it does not have specific guidelines for sale of IBPCs, as part of the operational procedure, the lines freed up from the sale of IBPCs continue to be earmarked, like in the case of commercial paper, so that when the bank has to repurchase the certificates, there is no problem on credit limits. One public sector bank had stated that its Board-approved policy includes internal control measures such as a maximum per bank exposure limit of Rs.300 crore and centralising the activity only at the bank's treasury branch.

Investments in IBPCs for Complying with the Priority Sector Lending Norms

5.11 Although, the IBPC scheme has been used by banks for evening out short-term liquidity within the banking system, some banks have been using this instrument for evening out/complying with their priority sector obligations, *albeit* on a limited scale. It may be noted that the Master Circular on Lending to Priority Sector does not include IBPCs as an eligible category of investment.

Views of Other Working Groups on IBPCs and Priority Sector Lending

5.12 The Discussion Paper of Working Group on Directed Lending set up by Reserve Bank in 2001 had discussed the issue of usage of IBPCs for meeting priority sector obligations in detail and had suggested that *"...the banks, which are not in a position to accomplish priority sector targets may be allowed to buy the obligation in the form of participation certificate or other products with or without risk for a fee from other banks, which have attained more than prescribed*

target. There are some banks, which have comparative advantage over others in financing the priority sector and have a higher propensity to exceed the target.Thus, participation certificates can be converted as a tool to reward banks with proven track record and a consistent good performance in priority sector credit portfolio. Select banks which have surpassed the prescribed bench-marks under priority sector credit and the sub-sectors can be allowed to issue Participation Certificates (carving out of their Priority Sector Credit Portfolio) which can be bought by banks which are short of fulfilling the priority sector credit targets or sub-targets like agriculture and weaker sections and thereby achieve the prescribed bench-mark levels. As the ceiling on interest rates on Participation certificates has been removed, banks are free to determine the interest rates, which would be market-driven."

5.13 The Report of the Inter-departmental Group on IBPCs, submitted in April 2005, had dealt with the issue of usage of IBPCs to fulfill priority sector requirements. It was stated therein that *"The Group deliberated on the regulatory issue of whether IBPCs could be used to meet the priority sector lending (PSL) obligations. It was observed that the Master Circular on Lending to Priority Sector does not include IBPCs as an eligible category for classification under priority sector. Hence, its usage by banks to cover their shortfall by resorting to IBPCs was not in accordance with the priority sector guidelines and was not being allowed. It was stated that the intention in the Master Circular was that banks should be involved in lending to priority sector. It was also observed that the extant guidelines on IBPCs do not deal with their classification under priority sector. It was stated that IBPCs - especially the risk sharing variant, which was mostly used by banks - had to be held for a minimum period of 91 days. It was felt that since only PSL surplus banks would sell off PSL loans, such participations might promote a secondary market in PSL loans and increase origination of PSL loans by banks advantageously placed to do so. Since participating banks would buy participation in standard assets, it was observed that an explicit permission to sell such loans through participation would induce the originator banks to conduct stricter due diligence so that they can sell such loans in future. In the circumstances, the Group recommended that the issue of classification of IBPCs under priority sector, together with the recommended tenor thereof, could be examined further."*

5.14 Permitting the banks to treat their investments in IBPCs on risk-sharing basis as part of their priority sector lending has the following advantages:

- i. IBPCs - especially the risk-sharing variant, which is mostly used by banks - have to be held for a minimum period of 91 days. Therefore, in case of such IBPCs, there is a transfer of credit risk to the purchasing bank for the period of participation.
- ii. It is likely that only PSL-surplus banks would sell off PSL loans and such participations might promote a secondary market in PSL loans and increase origination of PSL loans by banks advantageously placed to do so. The liquidity provided by banks purchasing

IBPCs might enable the issuing bank to grant further loans to the priority sector. Since this liquidity emanating out of PSL-based IBPC is available to the originating bank at a lesser rate, it will reduce its cost of funds.

- iii. Apart from transferring credit risk and increasing liquidity by selling IBPCs, PSL-surplus banks can also reduce their capital requirement for maintaining the stipulated capital adequacy ratio, as selling IBPCs (with risk) out of a part of their advances will enable the banks to reduce the quantum of advances (in this case, the excess priority sector advances) in their credit book.
- iv. Since the size of IBPCs based on priority sector lending, including agriculture, is fairly sizeable at Rs.80-100 crore, permission to invest in PSL-based IBPCs for meeting priority sector obligations might increase the flow of credit to this vital sector of our economy.
- v. Since purchasing banks can buy participation only in standard assets, it would induce the originating banks to conduct stricter due diligence while sanctioning loans so that they can sell such loans in future.
- vi. Permission to use IBPCs to meet priority sector obligations would enable the banks, which do not have rural/wide branch networks to achieve their PSL targets.
- vii. As a further incentive, over a period of time, such specialised IBPCs (comprising of priority sector advances) can be allowed to be traded/transferred among the banks, which will provide a short-term funding instrument at market-determined interest rates.
- viii. Usage of IBPCs might increase in a situation of tighter liquidity, though only 15 banks are using IBPCs at the present situation of surplus liquidity. Indeed, IBPC market has grown somewhat over the past 3-4 years. Growth rate in the IBPC segment would be in synchronisation with growth in advances of the banks, which has been showing an upward trend in the recent months.

5.15 There are certain arguments against permitting the banks to treat their investments in IBPCs on risk-sharing basis as part of their priority sector lending, which are as follows:

- i. The objectives of IBPCs are to facilitate adjustment of liquidity in the market and not provision of bank credit to priority sector.
- ii. There are few banks using the instrument and the amount involved is only Rs.2,000-Rs.3,000 crore, that too for a limited period of 3 to 6 months. As such, permitting IBPCs may not result in a substantial flow of bank credit to priority sector.
- iii. Investment in specified bonds, which were earlier eligible for meeting priority sector obligations, is being phased out to ensure more direct lending to priority sectors.
- iv. Recently, investments made by banks in securitised assets representing direct lending to the SSI sector or lending to agriculture have been permitted to be treated as their direct lending to SSI sector/lending to agriculture under priority sector. But banks'

investment in IBPCs may not be treated in the same way since they do not represent a 'true sale' as in the case of securitisation as these would revert back to the originating bank after the completion of tenor of the IBPC. Permitting investment in IBPCs for the purpose of Priority Sector norms would, therefore, be tantamount to book adjustments without any outflow of credit to priority sector.

- v. The maturity period of the IBPCs has no bearing with the repayment schedules of the underlying assets. As such, they cannot be equated with the underlying assets.

Options available

5.16 In view of the foregoing discussion,

(i) All banks, which are required to lend to priority sector, could be permitted to invest in PSL-based IBPCs, on a risk-sharing basis, and these would form a part of their priority sector lending. However, banks would have to separately report the quantum of such PSL-based IBPCs in their priority sector returns so as to enhance transparency. Such specialised IBPCs (whose underlying assets comprise priority sector advances) can be allowed to be traded/ transferred among the banks, which will provide a short-term funding instrument at market-determined interest rates. Their maturity period should also be dependent upon the repayment schedule of the underlying assets.

SECTION 6

REVIEW OF PRIORITY SECTOR LENDING POLICY

6.1 The Working Group identified the following issues relating to priority sector lending which had a bearing on the TOR:

- A) Whether priority sector lending prescriptions are still necessary;
- B) Reviewing the existing list of priority sector segments;
- C) The definition of Net Bank Credit (NBC) and the method for computation of priority sector targets; and
- D) Review of the overall targets and sub-targets for priority sector for both domestic as well as foreign banks.

These are discussed in the following paragraphs.

A. Need for continuance of priority sector prescriptions

6.2 Even after 36 years of priority sector lending prescriptions, it is observed that certain important sectors in the economy continue to suffer from inadequate credit flow. Even though the current share of agriculture and allied activities in India's GDP at 22 per cent is less than half of what it was three decades ago, the agriculture sector continues to be the single largest occupation as it still provides livelihood to about two-thirds of the population. Moreover, the production base continues to comprise predominantly small and marginal farmers. It also contributes about 14.7 per cent of the export earnings and provides raw material to a large number of industries. Similarly, the SSI sector occupies a unique position in the Indian economy. In terms of employment generated, this sector is next only to agriculture sector. It has a share of over 40 per cent of the gross industrial value added in the economy. About 50 per cent of the total manufactured exports of the country are directly accounted for by this sector. The policy thrust to this sector has been consistent with multiple objectives of employment generation, regional dispersal of industries and a seedbed for entrepreneurship. A few other segments also impact a large number of small borrowers. However, credit deployment to these sectors of the economy has not been to the desired extent. **As such, the need for having priority sector prescriptions continues to exist.**

B. Review of Segments of Priority sector

(1) Criteria for classification as priority sector advances

6.3 Although there is a need to continue with priority sector prescriptions, the composition of the priority sector needs a re-look and review. Initially, sectors of the economy, which were not getting adequate bank credit, were included. Subsequently, a few other segments covering the small borrowers as also a few emerging sectors like development of computer software were added. However, considering that credit flow to some of these sectors has been satisfactory, the segments, which satisfy the following criteria, may be considered for inclusion in the priority sector:

- a) affect large sections of society;
- b) are of considerable importance to the national economy;
- c) benefit small borrowers and involve small loans;
- d) relate to those sectors which face difficulty in getting bank credit; and
- e) lead to substantial employment generation.

(2) Segments under Priority Sector

6.4 As per the above criteria **the broad categories of priority sector for all domestic banks as also for foreign banks may comprise agriculture, small-scale industries, small business and educational loans.**

(3) Additions/ Deletions of different segments/ sub-segments

(i) Agriculture

6.4.1 The importance of agriculture in the Indian economy has already been emphasised in paragraph 6.2 above. Agriculture may, therefore, continue as an important segment of priority sector. However, some of the extant provisions may need to be revised.

6.4.2 At present, advances up to Rs 10 lakh to farmers against pledge/ hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, are treated as direct agricultural advances, provided the borrowers draw crop loans from the same bank. **As farmers who have not availed of bank finance for production of crops may still seek produce loans for marketing their crops, the loans granted to them against pledge/ hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months can be considered for classification under direct agricultural advances to farmers. However, where a farmer avails crop loans from the banking system, the restriction regarding availing finance from one bank may continue, in the interest of financial discipline and prudent monitoring of the loans.**

6.4.3 At present, finance for setting up of agriclincs and agribusiness centres by agricultural graduates is classified as direct finance to agriculture. **As such clinics and centres could be**

set up by other persons also, the criterion 'by agriculture graduates' under this category may be deleted. Further, as the finance in such cases does not go directly to the farmers, loans for financing agriclinics and agribusiness centres may be classified under indirect finance to agriculture.

6.4.4 The focus of agricultural lending by banks should be on direct lending. With this end in view, Reserve Bank has been gradually phasing out the modes of indirect financing by banks under agriculture, particularly where no on-lending to farmers is involved. In this context, **the following items could be considered for being ineligible for priority sector status:**

- i) Loans to Electricity Boards for reimbursing the expenditure already incurred by them for providing low tension connection from step-down point to individual farmers for energizing their wells;**
- ii) Loans to SEBs for Systems Improvement Scheme under Special Project Agriculture (SI-SPA); and**
- iii) Finance for hire purchase schemes for distribution of agricultural machinery and implements.**
- iv) Advances to State-sponsored Corporations for onward lending to weaker sections.**
- v) Loans to National Co-operative Development Corporation (NCDC) for on-lending to the co-operative sector.**

Further, all indirect finance to agriculture may be considered for a weightage of 25 per cent only for the purposes of reckoning under agriculture segment of priority sector. The present ceiling of 4.5 per cent (i.e. 25 per cent of 18 per cent) for lending under indirect finance to agriculture would consequently stand withdrawn.

(ii) Small-Scale Industries

6.5 The importance of SSI sector in the Indian economy has been given in paragraph 6.2 above. This sector may, therefore, continue to be included under the priority sector. However, some of the issues/ suggestions received in this regard are considered hereunder:

6.5.1 Under the extant instructions, certain categories of advances where the credit is given to intermediaries for on-lending to the SSIs and subscription to bonds issued by NABARD for non-farm activities are classified under indirect finance to SSI sector. **As no distinction is made between direct and indirect finance to SSI in terms of fixing targets or computation of**

achievement or reporting mechanism, doing away with the separate classification of finance to SSI into direct and indirect may be considered.

6.5.2 Suggestions were received for having a separate sub-target for SSI sector as in the case of agriculture. The suggestion was earlier examined by the Internal Group to Review Guidelines on Credit Flow to SME Sector. The Internal Group recommended that the existing system of fixing self-set targets as well as the sub-targets to the tiny industries may continue. **Considering that credit to SSI sector by public sector banks has increased from Rs 25, 843 crore in March 1995 to Rs 58,278 crore in March 2004, showing a decennial growth of 125.51 per cent, there does not seem to be any need for a change in this regard.**

6.5.3 In view of the need to provide more direct finance to SSI, the following types of lending, which are currently treated as indirect finance to SSI, may be considered for being ineligible for priority sector status:

- i) Credit provided to Government sponsored Corporations/organizations for onward lending to weaker sections;
- ii) Term finance / loans in the form of lines of credit made available to State Industrial Development Corporation/ State Financial Corporations for financing SSIs;
- iii) Funds provided by commercial banks to SIDBI/SFCs by way of rediscounting of bills of SSIs which are originally discounted by a commercial bank and rediscounted by SIDBI/SFCs;
- iv) Loans for setting up of industrial estates;

(iii) Small Business

6.6 At present, Small Road and Water Transport Operators, Retail Traders, Small Business, Professional and Self-Employed Persons, State Sponsored Organisations for SCs/STs, Education, Housing, Consumption Loans, Loans to SHGs/NGOs, Food and Agro-based Processing Sector and Software Industry form the different categories under the segment 'Other Priority Sector'. It is suggested that advances to Small Road and Water Transport Operators owning a fleet of not more than five vehicles (instead of ten as at present) including the ones proposed to be financed, Retail Trade, and Small Business Enterprises could be included as a separate category under 'Small Business' and all other advances classified at present under 'Other Priority Sector' could be excluded from the purview of priority sector lending.

(iv) Education

6.7 Educational loans should include only loans and advances granted to individuals for educational purposes up to Rs. 7.5 lakh for studies in India and Rs. 15 lakh for studies abroad, and not those granted to institutions. All advances granted by banks under special schemes, if any, introduced for the purpose may also be included under this category.

6.8 As mentioned in paragraph 5.16, all banks, which are required to lend to priority sector, could be permitted to invest in PSL-based IBPCs, on a risk-sharing basis, and these could form a part of their priority sector lending. A weightage of 25 per cent could be assigned for such investments for the purpose of reckoning them under priority sector. The classification of these IBPCs as agriculture (direct/ indirect), SSI, small business or as educational advances would be as per the underlying assets.

C. Definition of NBC and method of computation

6.9 As per the extant instructions, the figure of bank credit reported by banks in their fortnightly returns submitted under Section 42 (2) of the Reserve Bank of India Act, 1934 formed the basis for computation of NBC. According to it, bank credit in India (excluding inter-bank advances) comprises the following:

- a) Loans, cash-credit and overdrafts
- b) Inland bills purchased and discounted
 - (i) Bills purchased
 - (ii) Bills discounted
- c) Foreign bills purchased and discounted
 - (i) Bills purchased
 - (ii) Bills discounted

For the purpose of computation of priority sector norms, banks are required to exclude from the above, the figure of deposits under FCNR (B) and NRNR Schemes. As the NRNR Scheme has since been discontinued, the existing accounts under the scheme may be continued only up to the date of maturity.

6.10 The present system of computation of priority sector obligations in relation to NBC is based on the outstanding advances of banks as on a particular day. Linking the priority sector obligations to outstanding advances has its shortcomings as outstandings tend to decline as a result of better recovery, write-offs, etc. Moreover, a portion of outstandings comprises non-performing assets (NPAs), which continue to get reflected in the achievement of banks in lending to priority sector. Disbursement during a given period is, therefore, a better indicator of banks' lending. **In order to improve the flow of credit to the priority sector and to ensure that a certain proportion of funds out of the total bank credit flows to**

this sector, the computation of priority sector lending obligations of banks could be linked to the total disbursements made by banks during the previous year. The targets for banks under this system would have to be determined separately after obtaining from banks the figures of segment-wise actual disbursements during the last five years. However, since the system of linking priority sector lending to NBC has been in vogue since the beginning, sufficient time needs to be given to banks to changeover to the new system. As such, this option could be made effective from 2007-08, by which time, necessary mechanism for this purpose should be put in place by the banks.

"However, the above option leaves out some of the foreign banks having offices in India, which either have no NBC or negative NBC, due to which these banks would not be obliged to lend any amount to the priority sector or SSI/export sector. A few such banks have mobilized substantial deposits and have large off-balance sheet exposures. These banks would also not be obliged to deposit the amount of shortfall in achievement of the target/sub-targets, with SIDBI as they do not have any NBC. The internal group of CGMs constituted in the Reserve Bank to examine the matter and suggest a suitable framework had, therefore, recommended that **the target for all the foreign banks may be set at 32% of Net Bank Credit (NBC) or 32% of the credit equivalent amount of the off-balance sheet exposures whichever, is higher. In order to increase the priority sector lending by foreign banks and to have a level playing field, the recommendation of the Internal Group of CGMs could be implemented from the year 2006-07. Further, the sub-targets in lending to SSI and Exports sector may also be linked to NBC or credit equivalent amount of the off-balance sheet exposures, whichever is higher.**"

6.11 **In order to ensure a smooth switch-over to the new regime the banks should, in the meanwhile, develop suitable Management Information Systems to maintain and compile segment-wise data relating to disbursements, recoveries, NPAs, rates of interest, etc.** This will facilitate a meaningful review and analysis by the banks' boards of directors as also submission of periodic returns to the Reserve Bank. Such a review and analysis will also enable the banks to charge realistic weighted interest rates based on factors such as cost of funds, operational costs, risk-weightage, etc.

D. Targets for priority sector lending

6.12 As mentioned in paragraph 6.10 above, the targets for priority sector lending under the proposed system would have to be determined separately. Till that time the existing targets and sub-targets may continue.

6.13 The proposed list of Priority Sector Advances, based on options suggested in this Section is given in Annexure 11.

SECTION 7

SUMMARY OF OPTIONS

Need for continuance of priority sector prescriptions

7.1 The need for having priority sector prescriptions continues to exist. (Paragraph 6.2)

Segments under priority sector

7.2 The broad categories of priority sector for all domestic banks as also for foreign banks may comprise agriculture, small-scale industries, small business and educational loans. (Paragraph 6.4)

Agriculture

7.3 The loans granted to farmers, who have not availed of bank finance for production of crops, against pledge/ hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months can be considered for classification under direct agricultural advances to farmers. However, where a farmer avails crop loans from the banking system, the restriction regarding availing finance from one bank may continue, in the interest of financial discipline and prudent monitoring of the loans. (Paragraph 6.4.2)

7.4 As agriclincs and agribusiness centres could be set up by persons other than agricultural graduates also, the criterion 'by agriculture graduates' under this category may be deleted. Further, in such cases, as the finance does not go directly to the farmers, loans for financing agriclincs and agribusiness centres may be classified under indirect finance to agriculture. (Paragraph 6.4.3)

7.5 The following items could be considered for being made ineligible for priority sector status:

- vi) Loans to Electricity Boards for reimbursing the expenditure already incurred by them for providing low tension connection from step-down point to individual farmers for energizing their wells;
- vii) Loans to SEBs for Systems Improvement Scheme under Special Project Agriculture (SI-SPA); and
- viii) Finance for hire purchase schemes for distribution of agricultural machinery and implements.
- ix) The advances to State Sponsored Corporations for onward lending to weaker sections.

- x) The loans granted to National Co-operative Development Corporation for on-lending to the co-operative sector for agricultural purposes.

Further, all indirect finance to agriculture may be considered for a weightage of 25 per cent only for the purposes of reckoning under agriculture segment of priority sector. The present ceiling of 4.5 per cent (i.e. 25 per cent of 18 per cent) for lending under indirect finance to agriculture would consequently stand withdrawn. (Paragraph 6.4.4)

Small-scale industries

7.6 As no distinction is made between direct and indirect finance to SSI in terms of fixing targets or computation of achievement or reporting mechanism, doing away with the separate classification of finance to SSI into indirect and direct may be considered. (Paragraph 6.5.1)

7.7 Considering that credit to SSI sector by public sector banks has increased from Rs 25, 843 crore in March 1995 to Rs 58,278 crore in March 2004, showing a decennial growth of 125.51 per cent, there does not seem to be any need for having a sub-target for SSI sector. (Paragraph 6.5.2)

7.8 The following types of lending may be considered for being ineligible for priority sector status:

- i) Credit provided to Government sponsored Corporations/organizations for onward lending to weaker sections;
- ii) Term finance / loans in the form of lines of credit made available to State Industrial Development Corporation/ State Financial Corporations for financing SSIs;
- iii) Funds provided by commercial banks to SIDBI/SFCs by way of rediscounting of bills of SSIs which are originally discounted by a commercial bank and rediscounted by SIDBI/SFCs; and
- iv) Loans for setting up of industrial estates.

Small Business

7.9 Advances to Small Road and Water Transport Operators owning a fleet of not more than five vehicles including the one proposed to be financed, Retail Trade and Small Business Enterprises could be included as a separate category under 'Small Business' (Paragraph 6.6).

Education

7.10 Educational loans should include only loans and advances granted to individuals for educational purposes up to Rs. 7.5 lakh for studies in India and Rs. 15 lakh for studies abroad,

and not those granted to institutions. All advances granted by banks under special schemes, if any, introduced for the purpose may also be included under this category.(Paragraph 6.7)

Inter Bank Participation Certificates (IBPCs)

7.11 All banks, which are required to lend to priority sector, could be permitted to invest in PSL-based IBPCs, on a risk-sharing basis, and these would form a part of their priority sector lending. A weightage of 25 per cent could be assigned for such investments for the purpose of reckoning them under priority sector. The banks would have to separately report the quantum of such PSL-based IBPCs in their priority sector returns so as to enhance transparency. Such specialised IBPCs (whose underlying assets comprise priority sector advances) can be allowed to be traded/ transferred among the banks, which will provide a short-term funding instrument at market-determined interest rates. Their maturity period should also be dependent upon the repayment schedule of the underlying assets. (Paragraph 5.16)

Method of computation

7.12 The computation of priority sector lending obligations of banks could be linked to the total disbursements made by banks during the previous year. The targets for banks under this system would have to be determined separately after obtaining from banks the figures of segment-wise actual disbursements during the last five years. However, since the system of linking priority sector lending to NBC has been in vogue since the beginning, sufficient time needs to be given to banks to changeover to the new system. As such, this option could be made effective from 2007-08, by which time, necessary mechanism for this purpose should be put in place by the banks. (Paragraph 6.10)

7.13 In order to ensure a smooth switch-over to the new regime the banks should, in the meanwhile, develop suitable Management Information Systems to maintain and compile segment-wise data relating to disbursements, recoveries, NPAs, rates of interest, etc. (Paragraph 6.11)

Recommendations of Earlier Committees and Action Taken

Sr. No.	Name of the Committee, year of report and recommendations	Action taken
1.	<p>Working Group on the Modalities of Implementation of the Priority Sector Lending and 20-Point Economic Programme by Banks (Chairman: Dr K.S. Krishnaswamy), 1980</p> <p>The Group recommended that consistent with the decision taken to increase the share of priority sector targets for public sector banks, the same obligation should be put on private sector banks. It further recommended that out of the advances to priority sector, at least 40 per cent should be extended to agriculture sector by each bank.</p> <p>It also specified that out of total direct lendings under agriculture, at least 50 per cent should be to the weaker sections (small and marginal farmers and landless labourers and persons engaged in allied activities with borrowal limits not exceeding Rs 10,000).</p> <p>Housing loans upto Rs 5000 for construction of houses for SC/ST and weaker sections, assistance to any governmental agency for construction of houses for SC/ST and low-income groups (where loan component does not exceed Rs 5000 per unit) and pure consumption loans granted under the Consumption Credit Scheme were recommended for inclusion in priority sector.</p>	<p>All commercial banks, both in public sector and private sector, were advised to achieve the targets of priority sector lending at 40 per cent and agriculture at 16 per cent of total advances by 1985.</p> <p>The recommendation was accepted and banks were advised that direct advances to weaker sections should reach a level of 50 per cent of total lending to agriculture by 1983.</p> <p>The definition of priority sector was amended to include housing loans and consumption credit as suggested.</p>
2.	<p>Working Group on the Role of Banks in Implementation of New 20-Point Programme (Chairman: Shri A. Ghosh), 1982</p> <p>The Group recommended that there was no need to alter the existing target of 40 per cent of total credit to priority sector. The Group suggested a target of 14 per cent of total bank credit for direct finance to agriculture and allied activities against the existing target of 16 per cent for both direct and indirect finance.</p> <p>It suggested that definition of weaker sections should correspond to beneficiaries under the 20-Point Programme and also include artisans, village and cottage industries and beneficiaries of IRDP and DRI</p>	<p>Banks were advised to achieve direct agriculture lending of 15 per cent of total bank credit by March 1985, 16 per cent by March 1987 and 17 per cent by March 1989 and 18 per cent by March 1990 respectively.</p> <p>The definition of weaker sections was accepted. Banks were advised that advances to weaker sections should</p>

	<p>scheme and SCs/STs. Advances to weaker sections should account for 25 per cent of priority sector lending by March 1985.</p>	<p>reach a level of 25 per cent of priority sector advances by March 1985.</p>
3.	<p>Committee on the Financial System (Narasimham Committee), 1991</p> <p>The Committee recommended that directed credit programmes should be phased out. It proposed that priority sector should be redefined to comprise the small and marginal farmer, the tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections. The target for this redefined priority sector should be 10 per cent of aggregate credit.</p>	<p>The recommendation was not accepted.</p>
4.	<p>High Level Committee on Agricultural Credit through Commercial Banks (R.V.Gupta Committee), 1996</p> <p>The committee noted that the target of 18 per cent for lending to agriculture was fixed when the reserve requirements were 63 per cent. Due to progressive reduction of the reserve requirements over the years, the total lendable resources of banks have increased substantially. The committee estimated that the base on which the target of 18 per cent was calculated had doubled; thus the banks would have to double their lendings to agriculture just to maintain the same share in conditions where agricultural production itself was growing at 2.1 per cent per annum. The committee also noted that the system of fixing targets on outstandings had its drawbacks; outstandings decrease with improved recoveries, as was the case between 1991 and 1995, when recoveries went up from 48.8 per cent to 59.5 per cent. The combined effect of improved recovery and write-offs was to reduce the share of net lending to agriculture without actually slowing the pace of lending to the sector.</p> <p>The committee suggested that banks should set targets for themselves for agricultural lending based on the flow of credit. They needed to prepare Special Agricultural Credit Plans (SACPs), with Reserve Bank indicating every year the expected increase in the flow of credit over the previous year. The committee felt that once such plans were put in place, the 18 per cent target based on outstandings would cease to have much relevance.</p>	<p>The system of preparing SACPs was introduced for public sector banks. However, despite monitoring of credit through SACPs, the target of 18 per cent has not been reached.</p>
5.	<p>Committee on Banking Sector Reforms (Narasimham Committee), 1998</p> <p>The Committee observed that directed credit had led to an increase in non-performing loans and had adversely affected the efficiency and viability of banks with 47 per cent of all NPAs emanating from the</p>	

	<p>priority sector. The Committee recognized that the small and marginal farmers and the tiny sector of industry and small businesses have problems with regard to obtaining credit and some earmarking may be necessary for this sector. Under the present dispensation, within the priority sector, 10 per cent of NBC is earmarked for lending to weaker sections. The Committee recommended that given the special needs of this sector, the current practice may continue.</p> <p>The Committee also noted the changes in the scope of beneficiaries under the priority sector since its earlier report and proposed that given the importance and needs of employment oriented sectors (like food processing and related service activities in agriculture, fisheries, poultry and dairying), these sectors should also be covered under the scope of priority sector lending. The Committee observed that a sudden reduction of priority sector targets could have the danger of a disruption in the flow of credit.</p> <p>It recommended for the removal of concessional rates of interest on loans up to Rs 2 lakh and a phased move away from overall priority sector targets and sub-sector targets.</p> <p>Debt securitisation concept was suggested within the priority sector. This would enable banks, which are not able to reach the priority sector target, to purchase the debt from other institutions.</p>	<p>The scope of priority sector was further enlarged with activities like food-processing, related service activities in agriculture, fisheries, poultry and dairying in 1999.</p> <p>It was decided that rates of interest on loans up to Rs 2 lakh should not exceed the PLR of the bank. Banks were given freedom to decide their PLR subject to approval of their Boards.</p> <p>It was noted that banks, which do not achieve the targets contribute the shortfall to RIDF. Thus all banks (directly or indirectly) fulfil the target. The concept will not help in augmenting the flow of credit to the priority sector; hence the recommendation was not considered. This was, however, done in 2004 in agriculture, SSI and housing sectors.</p>
6.	<p>Expert Committee on Rural Credit (Vyas Committee), 2001</p> <p>The Committee recommended that the mandated rates of 18 per cent of credit outstanding for agricultural loans and 40 per cent for priority sector loans should be reviewed after five years. It also</p>	<p>Although Reserve Bank has not formally reviewed agriculture credit targets in the intervening period; it has regularly advised banks to take steps to achieve</p>

	recommended a substantial reduction in RIDF interest rates to levels just enough to cover the interest cost of deposits. The committee suggested retaining the upper limit of 4.5 per cent on indirect credit while reckoning the achievement of 18 per cent target for agricultural lending.	the level of 18 per cent in a time-bound manner. RIDF interest rates have been restructured and a system of graded rates, with lesser interest rate payable to banks having higher shortfall, has been introduced.
7.	<p>Technical Group on Computation of Priority Sector Lending Targets (Chairman: Shri B.R.Verma), 2000</p> <p>The Group recommended that the priority sector lending targets could be linked to the previous year's NBC and upscaled by the estimated growth in credit during the year.</p> <p>The Group also recommended withdrawal in a phased manner of the facility of exclusion of FCNR(B)/ NRNR deposits from NBC for computation of priority sector lending targets.</p>	<p>In view of the concerns shown by the Standing Committee on Finance on performance of banks in lending to priority sector, the issue was dropped.</p> <p>The recommendations of the Group were again examined afresh in 2004 and it was decided that the present definition of NBC may not be changed.</p>
8.	<p>Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Vyas Committee), 2004</p> <p>The committee recommended that all public and private sector banks should increase their direct lending to agriculture to 12 per cent of NBC in the next two years and to 13.5 per cent in the two years thereafter. Banks that have already reached this level may at least continue to maintain the position; it would be best if they would further improve their direct lending.</p> <p>Indirect lending to agriculture may be reckoned to the extent of 6 per cent in the first two years for assessing banks' performance against the 18 per cent target. Thereafter, the ceiling of 4.5 per cent should apply.</p> <p>The committee felt that the entire issue of fixation of targets for lending to priority sector including agriculture needed a comprehensive review. Pending such a review, the existing target of 18 per cent of net bank credit for lending to agriculture should continue.</p>	<p>The recommendation has been forwarded to Government of India for their views. The reply is awaited.</p> <p>An Internal Working Group has been set up in Reserve Bank to review the policy on priority sector lending and related issues.</p>
9.	<p>Working Group on Flow of Credit to SSI Sector (Ganguly Committee), 2004</p> <p>The Group recommended revision of tenure as also interest rate structure of deposits kept by foreign banks with SIDBI in lieu of their shortfall in priority sector lending.</p>	<p>The tenure of deposits placed by foreign banks with SIDBI has been increased from one to three years from the year 2005-06. The rates of interest have also been linked inversely to the shortfall in target/ sub-targets varying between Bank Rate and up to 3% below Bank Rate.</p>

Classification of priority sector advances

SECTION I

Detailed classification containing the list of items in different segments of priority sector advances is given below.

1. AGRICULTURE

1.1 Direct Finance to Farmers for Agricultural Purposes

1.1.1 Short-term loans for raising crops i.e. for crop loans. In addition, advances up to Rs. 10 lakh to farmers against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, where the farmers were given crop loans for raising the produce, provided the borrowers draw credit from one bank.

1.1.2 **Medium and long-term loans (Provided directly to farmers for financing production and development needs).**

(i) ***Purchase of agricultural implements and machinery***

- (a) Purchase of agricultural implements - Iron ploughs, harrows, hose, land-levellers, bundformers, hand tools, sprayers, dusters, hay-press, sugarcane crushers, thresher machines, etc.
- (b) Purchase of farm machinery - Tractors, trailers, power tillers, tractor accessories viz., disc ploughs, etc.
- (c) Purchase of trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipment, etc. to assist the transport of agricultural inputs and farm products.
- (d) Transport of agricultural inputs and farm products.
- (e) Purchase of plough animals.

(ii) ***Development of irrigation potential through -***

- (a) Construction of shallow and deep tube wells, tanks, etc., and purchase of drilling units.
- (b) Constructing, deepening clearing of surface wells, boring of wells, electrification of wells, purchase of oil engines and installation of electric motor and pumps.
- (c) Purchase and installation of turbine pumps, construction of field channels (open as well as underground), etc.
- (d) Construction of lift irrigation project.
- (e) Installation of sprinkler irrigation system.
- (f) Purchase of generator sets for energisation of pumpsets used for agricultural purposes.

(iii) ***Reclamation and Land Development Schemes***

Bunding of farm lands, levelling of land, terracing, conversion of dry paddy lands into wet irrigable paddy lands, wasteland development, development of farm drainage, reclamation of soil lands and prevention of salinisation, reclamation of ravine lands, purchase of bulldozers, etc.

(iv) ***Construction of farm buildings and structures, etc.***

Bullock sheds, implement sheds, tractor and truck sheds, farm stores, etc.

- (v) **Construction and running of storage facilities**
Construction and running of warehouses, godowns, silos and loans granted to farmer for establishing cold storages used for storing own produce.
- (vi) Production and processing of hybrid seeds for crops.
- (vii) **Payment of irrigation charges, etc.**
Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to Customs Service Units, payment of development cess, etc.
- (viii) **Other types of direct finance to farmers**
 - (a) Short-term loans
 - (1) To traditional/non-traditional plantations and horticulture.
 - (2) For allied activities such as dairy, fishery, piggery, poultry, bee-keeping etc.
 - (b) Medium and long term loans
 - (1) Development loans to all plantations, horticulture, forestry and wasteland.
 - (2) Development loans for allied activities.
 - (3) Development of dairying and animal husbandry in all its aspects.
 - (4) Development of fisheries in all its aspects from fish catching to stage of export, financing of equipment necessary for deep sea fishing, rehabilitation of tanks (fresh water fishing), fish breeding, etc.
 - (5) Development of poultry piggery, etc., in all its aspects including erection of poultry houses, pig houses, bee-keeping, etc.
 - (6) Development and maintenance of stud farms, sericulture including grainages, etc. However, breeding of race horses cannot be classified here.
 - (7) Bio-gas plants.
 - (8) Financing of small and marginal farmers for purchase of land for agricultural purposes.
 - (9) Financing setting up Agriclincs and Agribusiness Centres by agriculture graduates.
 - (10) Investment by banks in securitised assets, which represent direct advances to agriculture.

1.2 Indirect Finance to Agriculture

- 1.2.1
 - (i) Credit for financing the distribution of fertilisers, pesticides, seeds, etc.
 - (ii) Loans up to Rs. 40 lakh granted for financing distribution of inputs for the allied activities such as, cattle feed, poultry feed, etc.
- 1.2.2
 - (i) Loans to Electricity Boards for reimbursing the expenditure already incurred by them for providing low tension connection from step-down point to individual farmers for energising their wells.
 - (ii) Loans to SEBs for Systems Improvement Scheme under Special Project Agriculture (SI-SPA).

- 1.2.3 Loans to farmers through PACS, FSS and LAMPS.
- 1.2.4 Deposits held by the banks in Rural Infrastructure Development Fund (RIDF) maintained with NABARD.
- 1.2.5 Subscription to bonds issued by Rural Electrification Corporation (REC) exclusively for financing pump set energisation programme in rural and semi-urban areas and also for financing System Improvement Programme (SI-SPA). However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by REC shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.
- 1.2.6 Subscriptions to bonds issued by NABARD with the objective of financing exclusively agriculture/allied activities. However, the investments made by banks in such bonds issued by NABARD, shall not be eligible for classification under priority sector lending with effect from April 1, 2007.
- 1.2.7 Other types of indirect finance such as,
- (i) Finance for hire-purchase schemes for distribution of agricultural machinery and implements.
 - (ii) Loans for constructions and running of storage facilities (warehouse, market yards, godowns, and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.

If the storage unit is registered as SSI unit, the loans granted to such units may be classified under advances to SSI, provided the investment in plant and machinery is within the stipulated ceiling.
 - (iii) Advances to Customs Service Units managed by individuals, institutions or organisations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake work from farmers on contract basis.
 - (iv) Loans to individuals, institutions or organisations who undertake spraying operations.
 - (v) Loans to co-operative marketing societies, co-operative banks for re-lending to co-operative marketing societies (provided a certificate from the State Co-operative Bank in favour of such loans is produced) for disposing of the produce of members.
 - (vi) Loans to co-operative banks of producers (e.g. Aarey Milk Colony Co-operative Bank, consisting of licensed cattle owners).
 - (vii) Financing the farmers indirectly through the co-operative system (otherwise than by subscription to bonds and debenture issues) provided a certificate from the State Co-operative Bank in favour of such loans is produced.
 - (viii) Advances to State-sponsored Corporations for onward lending to weaker sections.
 - (ix) Finance extended to dealers in drip irrigation/sprinkler irrigation system/agricultural machinery, irrespective of their location, subject to the following conditions:

- (a) The dealer should be dealing exclusively in such items or if dealing in other products, should be maintaining separate and distinct records in respect of such items.
 - (b) A ceiling of up to Rs. 30 lakh per dealer should be observed.
-
- (x) Loans to National Co-operative Development Corporation (NCDC) for on lending to the co-operative sector for purposes coming under the priority sector.
 - (xi) Loans to farmers for purchase of shares in Co-operative Sugar Mills and Sugar Mills set up as Joint Stock Companies and other agro-based processing units. (Maximum 6 shares of Rs 1000 each or 3 shares of Rs 2000 each, i.e., Rs 6000 per eligible borrower irrespective of their land holding).
 - (xii) Loans to Arthias (commission agents in rural/semi-urban areas functioning in markets/mandies) for meeting their working capital requirements on account of credit extended to farmers for supply of inputs.
 - (xiii) Lending to Non Banking Financial Companies (NBFCs) for on lending to agriculture.
 - (xiv) Investment by banks in securitised assets, which represent indirect advances to agriculture.

2 Small Scale Industries

2.1. Small Scale and Ancillary Industries

Small scale industrial units are those engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery (original cost) does not exceed Rs. 1 crore. These would, *inter alia*, include units engaged in mining or quarrying, servicing and repairing of machinery. In the case of ancillary units, the investment in plant and machinery (original cost) should also not exceed Rs. 1 crore to be classified under small-scale industry.

The investment limit in plant & machinery of Rs.1 crore for classification as SSI has been enhanced to Rs.5 crore in respect of certain specified items under hosiery, hand tools, drugs & pharmaceuticals, stationery items and sports goods by the Government of India.

2.2 Tiny Enterprises

The status of 'Tiny Enterprises' may be given to all small-scale units whose investment in plant & machinery is up to Rs. 25 lakh, irrespective of the location of the unit.

2.3 Small Scale Service & Business Enterprises (SSSBEs)

2.3.1 Industry related service and business enterprises with investment up to Rs. 10 lakh in fixed assets, excluding land and building will be given benefits of small scale sector. For computation of value of fixed assets, the original price paid by the original owner will be considered irrespective of the price paid by subsequent owners.

2.3.2 An illustrative list of eligible activities as SSSBEs and the illustrative list of activities that will not qualify as SSSBE is given in *Annexures 1 & II* respectively.

2.4 Investment made by banks in securitized assets representing direct lending to the SSI sector would be treated as their direct lending to SSI sector under priority sector, provided it satisfies the following conditions:

i) The pooled assets represent direct loans to SSI sector which are reckoned under priority sector; and

ii) The securitized loans are originated by banks/financial institutions.

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

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

2.5.2 Government sponsored Corporation/organisations providing funds to the weaker sections in the priority sector.

2.5.3 Advances to handloom co-operatives.

2.5.4 Term finance/loans in the form of lines of credit made available to State Industrial Development Corporation/State Financial Corporations for financing SSIs.

2.5.5 Credit provided by banks to KVIC under the scheme for provision of credit to KVIC by consortium of banks for lending to viable Khadi and Village Industrial Units.

- 2.5.6 Funds provided by commercial banks to SIDBI/SFCs by way of rediscounting of bills of SSIs which are originally discounted by a commercial bank and rediscounted by SIDBI/SFCs will be eligible for inclusion under the priority sector as indirect finance to SSI.
- 2.5.7 Subscription to bonds floated by SIDBI, SFCS, SIDCS and NSIC exclusively for financing SSI units. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by the above specified institutions shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.
- 2.5.8 Subscription to bonds issued by NABARD with the objective of financing exclusively non-farm sector. However, the investments made by banks in such bonds issued by NABARD, shall not be eligible for classification under priority sector lending with effect from April 1, 2007.
- 2.5.9 (i) Financing of NBFCs or other intermediaries for on-lending to the tiny sector.
- (ii) All new loans granted by banks to NBFCs and other intermediaries for on-lending to SSI sector with effect from November 11, 2003.
- 2.5.10 Deposits placed with SIDBI by Foreign Banks in fulfilment of shortfall in attaining priority sector targets.
- 2.5.11 Bank finance to HUDCO either as a line of credit or by way of investment in special bonds issued by HUDCO for on-lending to artisans, handloom weavers, etc. under tiny sector may be treated as indirect lending to SSI (Tiny) Sector. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by HUDCO shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.

2.6 Industrial Estates

Loans for setting up industrial estates.

2.7 KVI Sector

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

2.8 Manufacture of common salt through any process including manual operation (involving solar evaporation) may be considered as an industrial activity and credit provided by banks to units engaged in the manufacture of common salt which satisfy the norms of SSI unit may be classified under advances to SSI.

2.9 Units engaged in ship breaking/dismantling are composite ones which also undertake the processing of scrap thus obtained and hence the entire activity can be covered under processing. Therefore, all small scale industrial units with original cost of plant and machinery not exceeding Rs. 1 crore and engaged in ship breaking/dismantling activity may be considered as small scale industrial undertaking and bank advances to such units reckoned as priority sector advances.

- 2.10** Bank loans to bought leaf factories manufacturing tea are to be reckoned as priority sector lending to small scale industry, provided the investment in plant and machinery (original cost) does not exceed the prescribed limits.
- 2.11** Water mills (Gharat) has been recognised as an industrial activity and shall be eligible for registration as small-scale industry.

3 OTHER ACTIVITIES/ BORROWERS IN THE priority sector

3.1 Small road & Water Transport Operators (SRWTO)

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

3.2 Retail Trade

Advances granted to

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

3.3 Small Business

Small Business would include individuals and firms managing a business enterprise established mainly for the purpose of providing any service other than professional services whose original cost price of the equipment used for the purpose of business does not exceed Rs. 20 lakh. Banks are free to fix individual limits for working capital depending upon the requirements of different activities.

Advances for acquisition, construction, renovation of house-boats and other tourist accommodation will be included here. Distribution of mineral oils shall be included under 'small business.' Advances to judicial stamp vendors and lottery ticket agents may also be classified under this category.

3.4 Professional & Self-Employed Persons

- 3.4.1** Loans to professional and self-employed persons include loans for the purpose of purchasing equipment, repairing or renovating existing equipment and/or acquiring and repairing business premises or for purchasing tools and/or for working capital requirements to medical practitioners including Dentists, Chartered Accountants, Cost Accountants, Practising Company Secretary, Lawyers or Solicitors, Engineers, Architects, Surveyors, Construction contractors or Management Consultants or to a person trained in any other art or craft who holds either a degree or diploma from any institutions established, aided, or recognised by Government or to a person who is considered by the bank as technically qualified or skilled in the field in which he is employed.
- 3.4.2** Advances to accredited journalists and cameramen who are freelancers, i.e. not employed by a particular newspaper/magazine for acquisition of equipment by such borrowers for their professional use.
- 3.4.3** Credit for the purpose of purchasing equipment, acquisition of premises (strictly for business) and tools to practising company secretaries who are not in the regular employment of any employer.
- 3.4.4** Financial assistance for running 'Health Centre' by an individual who is not a doctor, but has received some formal training about the use of various instruments of physical exercises.
- 3.4.5** Advances for setting up beauty parlours where the borrower holds qualification in the particular profession and undertakes the activity as the sole means of living/earning his/her livelihood.
- 3.4.6** Preference may be given by banks to financing professionals like doctors, etc., who are carrying on their profession in rural or semi-urban areas. The term also includes firms and joint ventures of such professional and self-employed persons. This category will include all advances granted by the bank under special schemes, if any, introduced for the purpose.
- 3.4.7** Only such professional and self-employed persons whose borrowings (limits) do not exceed Rs. 10 lakh of which not more than Rs. 2 lakh should be for working capital requirements, should be covered under this category. However, in the case of professionally **qualified medical practitioners, setting up of practice in semi-urban and rural areas**, the borrowing limits should not exceed Rs. 15 lakh with a sub-ceiling of Rs. 3 lakh for working capital requirements. Advances granted for purchase of one motor vehicle to professional and self-employed persons **other than** qualified medical practitioners **will not be included** under the priority sector.
- 3.4.8** Advances granted by banks to professional and self-employed persons for acquiring personal computers for their professional use, may be classified in this category, provided the ceiling of total borrowings of Rs. 10 lakh of which working capital should not be more than Rs. 2 lakh per borrower, is complied with in each case for the entire credit inclusive of credit provided for purchase of personal computer. However, home computers should not be treated on par with personal computers and excluded from priority sector lending.

3.5 State Sponsored Organisations for Scheduled Castes/ Scheduled Tribes

Advances sanctioned to State Sponsored Organisations for Scheduled Castes/ Scheduled Tribes for the specific purpose of purchase and supply of inputs to and/or the marketing of the outputs of the beneficiaries of these organisations.

3.6 Education

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

3.7 Housing

3.7.1 Direct Finance

- i) Loans up to Rs. 15 lakh in rural/ semi-urban areas, urban and metropolitan areas for construction of houses by individuals, with the approval of the banks' Boards, excluding loans granted by banks to their own employees.
- ii) Loans given for repairs to the damaged houses of individuals up to Rs.1 lakh in rural and semi-urban areas and to Rs.2 lakh in urban areas.

Loans granted by banks up to Rs. 5 lakh to individuals desirous of acquiring or constructing new dwelling units and up to Rs. 50,000/- for upgradation or major repairs to the existing units in rural areas under Special Rural Housing Scheme of NHB.
- iii) Investment by banks in the mortgage backed securities, provided it satisfies the following conditions:
 - (a) The pooled assets are in respect of direct housing loans which satisfy the definition for inclusion under the priority sector;
 - (b) The securitised loans are originated by the housing finance companies/banks; and
 - (c) The mortgage backed securities (MBS) satisfy the conditions laid down in paragraph 3 of DBOD's circular DBOD. No. BP.BC. 106/21.01.002/2001-02 dated May 24, 2002.

3.7.2 Indirect Finance

- i) Assistance given to any governmental agency for construction of houses or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of Rs. 5 lakh of loan amount per housing unit.
- ii) Assistance given to a non-governmental agency approved by the NHB for the purpose of refinance for reconstruction of houses or for slum clearance and rehabilitation of slum dwellers, subject to a ceiling of loan component of Rs. 5 lakh per housing unit.
- iii) All the investment in bonds issued by NHB/HUDCO exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be reckoned for inclusion. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by NHB/HUDCO shall not be eligible for classification under priority sector lending and such investments which have already been made/to be made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.

3.8 Consumption Loans

Pure consumption loans granted to the weaker sections of the community under the Consumption Credit Scheme should be included in this item.

3.9 Loans to NGOs / Self-Help Groups (SHGs) / MICROCREDIT

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

3.9.2 Lending to SHGs is to be included as a part of bank's lending to weaker sections.

3.9.3 Microcredit provided by banks either directly or through any intermediary should be included under priority sector.

3.10 Food and Agro-based Processing Sector

The following items within the food and agro-based processing sector would be eligible for classification as priority sector for lending by banks:

- Fruit and vegetable processing industry
- Food grain milling industry
- Dairy products
- Processing of poultry and eggs, meat products
- Fish processing
- Bread, oilseeds, meals (edible), breakfast foods, biscuits, confectionery (including cocoa processing and chocolate), malt extract, protein isolate, high protein food, weaning food and extruded/ other ready to eat food products
- Aerated water/ soft drinks and other processed foods
- Special packaging for food processing industries
- Technical assistance and advice to food processing industry

With regard to the size of the units within this sector, it is clarified that food and agro-based processing units of small and medium size with investment in plant and machinery up to Rs 5 crore would be included under priority sector lending.

While loans to units satisfying SSI definition may be shown under advances to SSI, loans to other units should be shown separately in the half-yearly statements on priority sector lending.

3.11 Software Industry

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

3.12 Venture Capital

Investment in Venture Capital will be eligible for inclusion in priority sector, subject to the condition that the venture capital funds/companies are registered with SEBI.

However, fresh investments that may be made by banks on or after July 1, 2005 shall not be eligible for classification under priority sector lending and the investments, which have already been made by banks up to June 30, 2005, shall not be eligible for classification under priority sector lending with effect from April 1, 2006.

3.13 LEASING AND HIRE PURCHASE

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

3.14 LOANS TO URBAN POOR INDEBTED TO NON-INSTITUTIONAL LENDERS

Loans to distressed urban poor to prepay their debt to non-institutional lenders, against appropriate collateral or group security, subject to the guidelines to be approved by their Boards of Directors, would be eligible for classification under priority sector. Urban poor for this purpose may include those families in the urban areas who are below the poverty line. Such loans to urban poor may be classified under weaker sections within the priority sector and may be reported in the returns being submitted to the Bank, under a separate sub-head, "Loans to urban poor indebted to non-institutional lenders" under the broad head "Other Priority Sector".

SECTION II

CERTAIN TYPES OF FUNDS DEPLOYMENT ELIGIBLE AS PRIORITY SECTOR ADVANCES

1. Investments in Special Bonds

1.1 Investments made by the banks in special bonds issued by the specified institutions could be reckoned as part of priority sector advances, subject to the following conditions:

- (i) **State Financial Corporations (SFCs)/State Industrial Development Corporations (SIDCs)**
 - (a) Subscription to bonds exclusively floated by SFCs & SIDCs for financing SSI units will be eligible for inclusion under priority sector as **indirect finance to SSI**.
 - (b) List of institutions in various States which are notified as SIDCs is given in *Annexure III*.
- (ii) **Rural Electrification Corporation (REC)**

Subscription to special bonds issued by REC exclusively for financing pump-set energisation programme in rural and semi-urban areas and the System Improvement Programme under its Special Projects Agriculture (SI-SPA) will be eligible for inclusion under priority sector lending as **indirect finance to agriculture**.
- (iii) **NABARD**

Subscription to bonds issued by NABARD with the objective of financing exclusively agriculture/allied activities and the non-farm sector will be eligible for inclusion under the priority sector as **indirect finance to agriculture/ SSI**, as the case may be.
- (iv) **Small Industries Development Bank of India (SIDBI)**

Subscriptions to bonds exclusively floated by SIDBI for financing of SSI units will be eligible for inclusion under priority sector as **indirect finance to SSIs**.
- (v) **The National Small Industries Corporation Ltd. (NSIC)**

Subscription to bonds issued by NSIC exclusively for financing of SSI units will be eligible for inclusion under priority sector as **indirect finance to SSIs**.
- (vi) **National Housing Bank (NHB)**

Subscription to bonds issued by NHB exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be eligible for inclusion under priority sector advances as **indirect housing finance**.
- (vii) **Housing & Urban Development Corporation (HUDCO)**
 - (a) Subscription to bonds issued by HUDCO exclusively for financing of housing, irrespective of the loan size per dwelling unit, will be eligible for inclusion under

priority sector advances as **indirect housing finance**.

- (b) Investment in special bonds issued by HUDCO for on-lending to artisans, handloom weavers, etc. under tiny sector will be classified as indirect lending to SSI (Tiny) sector.

- 1.1.1 The issue of bonds should be accompanied by a declaration from the issuing institution that the proceeds would be utilised for financing of borrowers under the priority sector as detailed above and no refinance would be availed of against such loans to the ultimate borrowers from any other agency.
- 1.1.2 The rate of interest and maturity period of bonds may be settled by banks with the respective institutions.
- 1.1.3 While reporting to the Reserve Bank, the quantum of investment in bonds (as they would appear under investments in the Balance Sheet) should be shown separately under the appropriate sub-head in the priority sector returns.

- 1.2 However, investments that may be made by banks on or after April 1, 2005 in the bonds issued by the specified institutions (except NABARD), i.e. REC, SFCs/SIDCs, SIDBI, NSIC, NHB and HUDCO shall not be eligible for classification under priority sector lending.

The investments, which have already been made by banks up to March 31, 2005, in the special bonds issued by the above specified institutions (except NABARD), shall not be eligible for classification under priority sector lending with effect from April 1, 2006.

1.3

The investments in the special bonds issued by NABARD shall not be eligible for classification under priority sector lending with effect from April 1, 2007.

1.4

2 Other Investments

- 2.1 Investment by banks in securitised assets representing direct (indirect) lending to agriculture would be treated as their direct (indirect) lending to agriculture under priority sector, provided the securitised loans are originated by banks and financial institutions.

- 2.2 Investments made by banks in securitized assets representing direct lending to the SSI sector would be treated as their direct lending to SSI sector under priority sector, provided it satisfies the following conditions:

i) The pooled assets represent direct loans to SSI sector which are reckoned under priority sector; and

ii) The securitized loans are originated by banks/financial institutions.

- 2.3 **Investment by banks in the mortgage backed securities, provided it satisfies the following conditions:**

- (a) The pooled assets are in respect of direct housing loans which satisfy the definition for inclusion under the priority sector;
- (b) The securitised loans are originated by the housing finance companies/banks; and
- (c) The mortgage backed securities (MBS) satisfy the conditions laid down in paragraph 3 of DBOD's circular DBOD. No. BP.BC. 106/21.01.002/2001-02 dated May 24, 2002.

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

3 Lines of Credit

- 3.1 Banks may consider on merit, proposals received from State Industrial Development Corporations (SIDCs) and State Financial Corporations (SFCs) for sanction of term finance/loans in the form of lines of credit.

3.2 Such term finance/loans to the extent granted for/to the Small Scale Industrial (SSI) units, will be treated as priority sector lending, subject to the observance of following conditions:

- (i) SFC/SIDC should maintain separate and distinct accounts of fresh disbursements made to SSI units and outstanding amounts thereagainst.
- (ii) Periodical statements to be obtained from SFC/SIDC to monitor the position.
- (iii) Annually, a certificate issued by SFC/SIDC statutory auditors certifying that the outstanding borrowings from banks were fully covered by the non-overdue loans outstanding in respect of fresh disbursements made to SSI units from out of term finance/lines of credit granted by banks.
- (iv) The rate of interest to be charged by banks on such term finance/ loans/ lines of credit will be in conformity with the directives on interest rates issued by the Reserve Bank from time to time.

4 Bills Rediscounting

4.1 Funds provided by commercial banks to SIDBI by way of rediscounting of bills of SSIs which are originally discounted by a commercial bank and rediscounted by SIDBI will be eligible for inclusion under the priority sector as indirect finance to SSI.

4.2 Funds provided by commercial banks to State Financial Corporations (SFCs) by way of rediscounting of bills of SSIs earlier discounted by the SFCs will be eligible for inclusion under the priority sector as indirect finance to SSI.

5 Deposits in Rural Infrastructure Development Fund (RIDF)

Outstanding balances of the deposits placed by banks in Rural Infrastructure Development Fund (RIDF) will be reckoned as their indirect finance to agriculture under the priority sector.

Annexure 3**Scheduled Commercial Banks' Advances Under Priority Sector**

(Amount in Rs. Crore)

As on Last Friday of March	Priority Sector (PS) Amount Outstanding	Bank Credit	PS Advances Annual Growth Rate (%)	Bank Credit Growth rate (%)	Share of PS to Bank Credit (%)
(1)	(2)	(3)	(4)	(5)	(6)
1995	69209	211560	17.1	26.8	33.7
1996	80831	254015	16.8	20.1	32.8
1997	93807	278401	16.1	9.6	34.8
1998	108905	324079	16.1	16.4	34.6
1999	126309	368837	16.0	13.8	35.3
2000	155779	454069	23.3	23.1	35.4
2001	182255	529271	17.0	16.6	31
2002	205606	609053	12.8	15.1	34.8
2003	254648	746432	23.9	22.6	35.1
2004	318609	865594	25.1	16.0	36.8
Average Growth		18.4	18.0		

Source : Statistical tables relating to Banks in India-various issues

Annexure 4

**Outstanding Advances of Scheduled Commercial Banks
to Agriculture**

(Amount in Rs. Crore)

As on Last Friday of March	Direct Finance To Agriculture		Finance for distribution of fertilizers and other inputs		Loans to State Electricity Boards		Other types of Indirect Finance		Total (Agriculture)		% Direct Finance to Agriculture
	No. of A/cs	Amount	No. of A/cs	Amount	No. of A/cs	Amount	No. of A/cs	Amount	No. of A/cs	Amount	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1995	19869694	21334	47534	536	66093	1165	322431	1164	20305752	24200	88.2
1996	19404350	23814	51816	756	71852	1058	289374	1860	19817392	27488	86.6
1997	18847314	27448	65721	968	68167	1222	276607	2785	19257809	32423	84.7
1998	17274942	29443	53656	1200	76906	1417	181282	3718	17586786	35777	82.3
1999	16880936	33094	59262	1491	75622	1627	168470	4999	17184290	41211	80.3
2000	16275952	36466	62513	1675	63218	1723	186797	9570	16588480	49434	73.8
2001	19035374	40485	80219	2304	53628	1697	148538	14824	19317759	59310	68.3
2002	15854277	46580	75002	3304	53886	1841	369297	13094	16352462	64819	71.9
2003	17003304	56858	11289	3241	46429	2967	195387	17483	17256409	80547	70.6
2004	19634319	70781	86606	4118	2502	3533	175836	20869	19899263	99302	71.3

Note : Other types of indirect finances include loans to farmers through PACS/PSS/LAMPS, etc.

Source: Statistical tables Relating to Banks in India, RPCD, RBI

**Scheduled commercial Banks Advances to Small Scale Industries,
Industrial Estates and Road and Water Transport Operators**

(Amount in Rs. Crore)

As on Last Friday of March	Advances To Small Scale Industries		Loans for Setting up of Industrial Estates		Advances to Road and Water transport operators		Total	
	No.of Accounts	Amount Outstanding	No.of Accounts	Amount Outstanding	No.of Accounts	Amount Outstanding	No.of Accounts	Amount Outstanding
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1995	2963458	29175	2450	65	723440	2979	3689348	32218
1996	2975898	34246	1803	43	716707	3392	3694408	37680
1997	3148261	38196	2482	51	671974	3832	3822717	42079
1998	2566266	45771	3244	191	609637	3811	3179146	49773
1999	2532999	51679	1289	110	773126	4207	3307414	55997
2000	2325051	57035	1402	71	558924	4893	2885377	61999
2001	2069955	60141	3077	167	580134	4973	2653165	65281
2002	1931195	67108	751	70	513149	5451	2445095	72630
2003	1816843	64707	2062	61	586112	6568	2405017	71336
2004	1806611	71209	1784	149	614973	8631	2423368	79989

Source : Statistical Tables Relating to Banks in India -various issues, RBI

Annexure 6
Advances to the Priority Sector by Public Sector Banks

(Amount in Rs. Crore)

As on Last Friday of March	Agriculture				SSI		Other Priority Sector*		Total #		Net Bank Credit
	Total		Direct		No.of Accounts (lakh)	Amount O/s	No.of Accounts (lakh)	Amount O/s	No.of Accounts (lakh)	Amount O/s	
	No.of Accounts (lakh)	Amount O/s	No.of Accounts (lakh)	Amount O/s							
1995	213	23513	207	20813	32	25843	116	12438	362	61794	169038
1996	208	26351	203	22892	33	29482	115	13751	356	69609	184391
1997	195	31012	191	25826	32	31542	107	16548	334	79131	189684
1998	192	34305	187	28303	30	38109	103	18881	325	91319	218219
1999	171	40078	175	31681	26	42674	96	24448	302	107200	246203
2000	163	46190	159	34432	23	45788	84	35829	274	127807	292943
2001	188	53571	185	38137	20	48400	80	40791	288	149115	341291
2002	161	63082	157	44908	22	49743	83	53712	269	171185	396954
2003	168	73507	164	51799	17	52988	79	71448	268	203095	477899
2004	177	86187	174	61957	16	58278	88	94959	286	245672	558849

- Include small transport operators, self-employed persons, etc.

Inclusive of funds provided to RRBs by their sponsoring banks, loan to software industry, food and agro-processing sector and Self Help Groups eligible for being treated under priority sector advances.

Source : Report on Trend and Progress of Banking in India - various issues

Annexure 7

Advances to the Priority Sector by Indian Private Sector Banks

(Amount in Rs. Crore)

As on last Friday of March	Agriculture		SSI		Other Priority Sector		Total Amount Outstanding	Percentage to NBC
	Amount O/s	Percentage to NBC	Amount O/s	Percentage to NBC	Amount O/s	Percentage to NBC		
1996	1233	6.7	3482	18.8	1568	8.5	6283	34.0
1997	1953	9.1	4754	22.2	2125	9.9	8832	41.2
1998	2746	9.7	5848	20.6	3020	10.6	11614	40.9
1999	3257	9.5	6451	18.9	4447	13.0	14155	41.4
2000	4239	9.1	7313	15.7	6467	13.9	18019	38.7
2001	5384	9.6	8158	14.4	7998	14.2	21550	38.2
2002	8022	8.1	8613	13.7	9074	14.4	25709	40.9
2003	11873	11.2	6857	8.2	17602	22.1	36705	44.4
2004	17652	12.3	7897	7.1	25834	23.1	52861	47.0

Source: Report on Trend and Progress of Banking in India - various issues

Annexure 8

Advances to the Priority Sector by Foreign Banks

(Amount in Rs. Crore)

As on Last Friday of March	Export Credit		Small Scale Industries		Priority Sector advances	
	Amount O/s	Percentage to NBC	Amount O/s	Percentage to NBC	Amount O/s	Percentage to NBC
1997	4474	27.5	1836	11.3	6139	37.7
1998	4950	24.5	2084	10.3	6940	34.3
1999	5678	25.0	2460	11.0	8270	37.0
2000	6372	23.0	2871	10.0	9699	35.0
2001	6863	20.0	3716	11.0	11835	34.0
2002	6948	18.0	4561	12.0	13414	34.0
2003	8195	18.7	3809	8.7	14848	33.9
2004	9809	18.7	5438	10.4	18276	34.8

Source : Report on Trend and Progress of Banking in India - various issues

Scheduled Commercial Banks' Advances under Priority Sectors: 2002 and 2003

(Amount in Rs. crore)

Sectors/Sub sectors	As on the last reporting Friday of March							
	2003			2002			Increase in 2003 over 2002	Increase in 2002 over 2001
	No. of Accounts	Amount O/s	% share in amount	No. of Accounts	Amount O/s	% share in amount		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
I. Agriculture	17346409	80547	32.1	16352462	64819	31.5	24.3	9.3
Direct	17003304	56857	22.7	15854277	46581	22.7	22.1	15.1
Indirect	343105	23690	9.4	498185	18239	8.9	29.9	-3.1
II. Small Scale Industries	1816843	64706	25.8	1931195	67108	32.6	-3.6	11.6
Of total SSI advances,								
(a) term loans	851726	13300		894181	11186		18.9	-6.2
Of (a) term loans (SSI),								
Comp. Loans to artisan, village	384827	1998		449519	1859		7.5	-11.2
Of total advances to SSI,								
(b) adv. to cottage, village and tiny industries	1114812	15003		508838	5770		160.0	-77.9
II. Advances to small scale industries								
(a) Advances to agro industries	91451	1533		79632	1344		14.1	-5.2
(b) Advances to units with P &M upto Rs.5 lakh	1192717	15080		1343012	15752		-4.3	5.7
(c) Advances to units with P &M between Rs.5-25 lakh	303671	13896		322431	12417		11.9	11.0
(d) Advances to units with P &M above Rs.25 lakh	115234	25429		173068	24939		2.0	-17.3
III Setting up of industrial estates	2062	61	0.0	751	68	0.0	-10.3	-59.3
IV Small road and water transport operators	586112	6568	2.6	513149	5452	2.7	20.5	9.6
V Retail trade	3259213	14662	5.8	3330939	11757	5.7	24.7	17.9
VI Small business	2235357	8320	3.3	2455780	7736	3.8	7.5	31.4

VII Professional and self employed	1137206	5329	2.1	1027218	SS4124	2.0	29.2	5.7
Educational loan	251107	3053	1.2	163096	1602	0.8	90.6	47.7
Consumption loan	257331	991	0.4	159834	667	0.3	48.6	-10.1
SC/ST orgn. For on lending to Priority sector	51402	1438	0.6	32352	1377	0.7	4.4	12.5
SSO for SC/ST for purchase of inputs	18506	386	0.2	4535	1485	0.7	-74.0	46.5
Housing loans (Direct)	1343766	35697		741311	17716		101.5	69.4
Housing loans (Indirect)	62088	15817		74130	11697		35.2	12.5
Total housing loans	1405854	51514	20.5	815441	29413	14.3	75.1	41.1
Funds provided to Regional Rural Banks	18	23	0.0	6960	664	0.3	-96.5	54.0
Advances to self help groups	281771	1222	0.5	137356	318	0.2	284.3	111.6
Advances to software ind. Having limit up to Rs.1 crore	4858	138	0.1	1692	108	0.1	27.8	18.4
Advances to food and agro based sector not satisfying SSI norms	32730	4727	1.9	7122	4708	2.3	0.4	-25.5
Investments in venture capital	142	110	0.0	175	119	0.1	-7.6	142.5
Export Credit (Pre-shipment and Post-shipment) by foreign banks								
SSI sector	256	1054		388	395		166.8	-50.9
Non-SSI sector	1572	7222		1448	4407		63.9	-28.4
Total export credit	1828	8276	3.3	1836	4804	2.3	72.3	-31.0
Total advances under priority sectors	28688486	250989	100.0	26938042	205606	100.0	22.1	12.8

Source : Statistical Tables Relating to Banks in India - 2003 and 2004 and RBI

Composition of NPAs of Public Sector Banks: 1995 to 2004
(As on March 31 of the year)

(Amount in Rs. crore)

Bank Group	Priority Sector		Non-priority Sector		Public Sector		Total
	Amount	Per cent	Amount	Per cent	Amount	Per cent	Amount
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A. State Bank of India and its Associates							
1995	6967	52.5	5496	41.4	809	6.1	13271
1996	7041	53.7	5263	40.1	816	6.2	13120
1997	7247	50.4	6291	43.8	829	5.8	14367
1998	7470	48.1	7390	47.6	662	4.3	15522
1999	8318	44.6	9668	51.9	655	3.5	18641
2000	8947	45.2	10266	51.9	560	2.8	19773
2001	8928	44.2	10050	49.8	1213	6.0	20191
2002	8977	47.0	9628	50.4	490	2.6	19096
2003	8053	47.5	8379	49.4	526	3.1	16959
2004 (P)	7136	47.1	7803	51.5	220	1.5	15159
B. Nationalised Banks							
1995	12242	48.7	12366	49.2	507	2.0	25115
1996	12065	45.6	13804	52.2	595	2.2	26464
1997	13527	46.3	15050	51.5	632	2.2	29209
1998	13714	45.5	15717	52.2	700	2.3	30130
1999	14288	43.2	17940	54.3	841	2.5	33069
2000	14768	44.1	18258	54.5	495	1.5	33521
2001	15228	46.2	17257	52.3	498	1.5	32983
2002	16173	45.7	18777	53.1	413	1.2	35363
2003	16886	47.1	18402	51.3	561	1.6	35849
2004 (P)	16705	47.7	17895	51.1	390	1.1	34990
C. Public Sector Banks (A+B)							
1995	21845	45.7	24717	51.7	1287	2.7	47848
1996	19106	48.3	19067	48.2	1411	3.6	39584
1997	20774	47.7	21341	49.0	1461	3.4	43577
1998	21184	46.4	23107	50.6	1362	3.0	45653
1999	22606	43.7	27608	53.4	1496	2.9	51710
2000	23715	44.5	28524	53.5	1055	2.0	53294
2001	24156	45.4	27307	51.4	1711	3.2	53174
2002	25150	46.2	28405	52.2	903	1.7	54458
2003	24939	47.2	26781	50.7	1087	2.1	52807
2004 (P)	23841	47.5	25698	51.2	610	1.2	50149

P: Provisional.

Source: Statistical Tables relating to banks in India - various issues.

Proposed classification of priority sector advances

SECTION I

Detailed classification containing the list of items in different segments of priority sector advances is given below.

1. AGRICULTURE

1.1 Direct Finance to Farmers for Agricultural Purposes

Short term loans

1.1.1

- (i) for raising crops i.e. for crop loans.
- (ii) advances up to Rs. 10 lakh to farmers against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, where the farmers have availed/ not availed crop loans for raising the produce, provided the borrowers draw credit from one bank.
- (iii) To traditional/non-traditional plantations and horticulture.
- (iv) For allied activities such as dairy, fishery, piggery, poultry, bee-keeping etc.

1.1.2 **Medium and long-term loans (Provided directly to farmers for financing production and development needs).**

- (i) ***Purchase of agricultural implements and machinery***
 - (a) Purchase of agricultural implements such as Iron ploughs, harrows, hose, land-levellers, bundformers, hand tools, sprayers, dusters, hay-press, sugarcane crushers and thresher machines.
 - (b) Purchase of farm machinery - Tractors, trailers, power tillers, and tractor accessories such as disc ploughs.
 - (c) Purchase of trucks, mini-trucks, jeeps, pick-up vans, bullock carts and other transport equipment to assist the transport of agricultural inputs and farm products.
 - (d) Purchase of plough animals.
- (ii) ***Development of irrigation potential through -***
 - (a) Construction of shallow and deep tube wells and tanks.
 - (b) Constructing, deepening, clearing of surface wells and boring of wells. Electrification of wells, purchase of oil engines and installation of electric motor and pumps, purchase and installation of turbine pumps.
 - (c) Construction of lift irrigation project.
 - (d) Installation of sprinkler and drip irrigation system.
- (iii) ***Reclamation and Land Development Schemes***

Bunding of farm lands, levelling of land, terracing, conversion of dry paddy lands into wet irrigable paddy lands, wasteland development, construction of field channels (open as well as underground), development of farm drainage, reclamation of saline lands and prevention of salinisation and reclamation of ravine lands.
- (iv) ***Construction of farm buildings and structures***

Bullock sheds, implement sheds, tractor and truck sheds and farm stores.

(v) **Construction and running of storage facilities**

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

(vi) **Production and processing of hybrid seeds for crops**

(vii) **Payment of irrigation and other charges**

Charges for hired water from wells and tube wells, canal water charges, maintenance and upkeep of oil engines and electric motors, payment of labour charges, electricity charges, marketing charges, service charges to Customs Service Units and payment of development cess.

(viii) **Other types of medium /long term finance to farmers**

- (a) Capital investment for developing plantations, horticulture, forestry and wasteland.
- (b) Development loans for allied activities.
- (c) Development of dairying and animal husbandry in all its aspects.
- (d) Development of fisheries in all its aspects from fish catching to stage of export, financing of equipment necessary for deep sea fishing, rehabilitation of tanks (fresh water fishing) and fish breeding.
- (e) Development of poultry, piggery and bee keeping in all its aspects.
- (f) Development and maintenance of stud farms and sericulture in all its aspects. However, breeding of race horses cannot be classified here.
- (g) Bio-gas plants.
- (h) Financing of small and marginal farmers for purchase of land for agricultural purposes.
- (i) Investment by banks in securitised assets, which represent direct advances to agriculture.

1.2 Indirect Finance to Agriculture (weightage of 25 per cent would be given for priority sector purposes)

- 1.2.1 (i) Credit for financing the distribution of fertilisers, pesticides, seeds and other inputs.
- (ii) Loans up to Rs. 40 lakh granted for financing distribution of inputs for the allied activities.
- 1.2.2 Financing setting up of agriclinics and agribusiness centres

- 1.2.3 Loans to farmers through PACS, FSS and LAMPS.
- 1.2.4 Deposits held by the banks in Rural Infrastructure Development Fund (RIDF) maintained with NABARD.
- 1.2.5 Subscription to bonds issued by Rural Electrification Corporation (REC) exclusively for financing pump set energisation programme in rural and semi-urban areas and also for financing System Improvement Programme (SI-SPA). However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by REC shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.
- 1.2.6 Subscriptions to bonds issued by NABARD with the objective of financing exclusively agriculture/allied activities. However, the investments made by banks in such bonds issued by NABARD, shall not be eligible for classification under priority sector lending with effect from April 1, 2007.
- 1.2.7 Other types of indirect finance such as,
- (i) Loans for constructions and running of storage facilities (warehouse, market yards, godowns, and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.
If the storage unit is registered as SSI unit, the loans granted to such units may be classified under advances to SSI, provided the investment in plant and machinery is within the stipulated ceiling.
 - (ii) Finance extended to dealers in drip irrigation/sprinkler irrigation system/agricultural machinery, irrespective of their location, subject to the following conditions:
 - (a) The dealer should be dealing exclusively in such items or if dealing in other products, should be maintaining separate and distinct records in respect of such items.
 - (b) A ceiling of up to Rs. 30 lakh per dealer should be observed.
 - (iii) Loans to Arthias (commission agents in rural/semi-urban areas functioning in markets/mandies) for meeting their working capital requirements on account of credit extended to farmers for supply of inputs.
 - (iv) Lending to Non-Banking Financial Companies (NBFCs) for onward lending to agriculture.
 - (v) Investment by banks in securitised assets, which represent indirect advances to agriculture.

2 SMALL SCALE INDUSTRIES

2.1. Small Scale and Ancillary Industries

Small scale industrial units are those engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery (original cost) does not exceed Rs. 1 crore. These would, *inter alia*, include units engaged in mining or quarrying, servicing and repairing of machinery. In the case of ancillary units, the investment in plant and machinery (original cost) should also not exceed Rs. 1 crore to be classified under small-scale industry.

The investment limit in plant & machinery of Rs.1 crore for classification as SSI has been enhanced to Rs.5 crore in respect of certain specified items under hosiery, hand tools, drugs & pharmaceuticals, stationery items and sports goods by the Government of India.

2.2 Tiny Enterprises

The status of 'Tiny Enterprises' may be given to all small-scale units whose investment in plant & machinery is up to Rs. 25 lakh, irrespective of the location of the unit.

2.3 Small Scale Service & Business Enterprises (SSSBEs)

2.3.1 Industry related service and business enterprises with investment up to Rs. 10 lakh in fixed assets, excluding land and building will be given benefits of small scale sector. For computation of value of fixed assets, the original price paid by the original owner will be considered irrespective of the price paid by subsequent owners.

2.3.2 An illustrative list of eligible activities as SSSBEs and the illustrative list of activities that will not qualify as SSSBE is given in *Annexures 1 & II* respectively.

2.4 Investment made by banks in securitized assets representing direct lending to the SSI sector would be treated as their direct lending to SSI sector under priority sector, provided it satisfies the following conditions:

i) The pooled assets represent direct loans to SSI sector which are reckoned under priority sector; and

ii) The securitized loans are originated by banks/financial institutions.

2.5 2.5.1 Agencies involved in assisting the decentralised sector in the supply of inputs and marketing of outputs of artisans, village and cottage industries.

2.5.2 Advances to handloom co-operatives.

2.5.3 Credit provided by banks to KVIC under the scheme for provision of credit to KVIC by consortium of banks for lending to viable Khadi and Village Industrial Units.

2.5.4 Subscription to bonds floated by SIDBI, SFCS, SIDCS and NSIC exclusively for financing SSI units. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by the above specified institutions shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification

under priority sector lending with effect from April 1, 2006.

- 2.5.5 Subscription to bonds issued by NABARD with the objective of financing exclusively non-farm sector. However, the investments made by banks in such bonds issued by NABARD, shall not be eligible for classification under priority sector lending with effect from April 1, 2007.
- 2.5.6 (i) Financing of NBFCs or other intermediaries for on-lending to the tiny sector.
(ii) All new loans granted by banks to NBFCs and other intermediaries for on-lending to SSI sector with effect from November 11, 2003.
- 2.5.7 Deposits placed with SIDBI by Foreign Banks in fulfilment of shortfall in attaining priority sector targets.
- 2.5.8 Bank finance to HUDCO either as a line of credit or by way of investment in special bonds issued by HUDCO for on-lending to artisans, handloom weavers, etc. under tiny sector may be treated as indirect lending to SSI (Tiny) Sector. However, the investments that may be made by banks on or after April 1, 2005 in the bonds issued by HUDCO shall not be eligible for classification under priority sector lending and such investments which have already been made by banks up to March 31, 2005 would cease to be eligible for classification under priority sector lending with effect from April 1, 2006.

2.6 KVI Sector

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

3 SMALL BUSINESS

3.1 Small road & Water Transport Operators (SRWTO)

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

3.2 Retail Trade

Advances granted to

- 3.2.1 Retail traders dealing in essential commodities (fair price shops) and consumer co-operative stores, and

3.2.2 Private retail traders with credit limits not exceeding Rs. 10 lakh.

(Retail traders in fertilisers will form part of indirect finance for agriculture and those to retail traders of mineral oils under small business).

3.3 Small Business Enterprises

Small Business would include individuals and firms managing a business enterprise established mainly for the purpose of providing any service other than professional services whose original cost price of the equipment used for the purpose of business does not exceed Rs. 20 lakh. Banks are free to fix individual limits for working capital depending upon the requirements of different activities.

Advances for acquisition, construction, renovation of house-boats and other tourist accommodation will be included here. Distribution of mineral oils shall be included under 'small business.' Advances to judicial stamp vendors and lottery ticket agents may also be classified under this category.

4 EDUCATION

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

5 Inter Bank Participation Certificates (IBPCs)

Investments of banks in IBPCs, on a risk-sharing basis, would be eligible for inclusion under the priority sector with a weightage of 25 per cent. The classification of these IBPCs would be done as per their underlying a