Internal Working Group to Review the Recommendations of the NCEUS Report on Conditions of Work and Promotion of Livelihoods in the Unorganised Sector

Reserve Bank of India
Mumbai
May 2008

May 14, 2008

To
The Principal Adviser,
Department of Economic Analysis and Policy,
Reserve Bank of India
Mumbai

Dear Sir,

Internal Working Group to Review the Recommendations of the Report on Conditions of Work and Promotion of Livelihoods in the Unorganised Sector (NCEUS)

Kindly refer to the constitution of the Internal Working Group (IWG) to examine the feasibility of implementing the Recommendations of the NCEUS Report relating to Indian financial system. The IWG members hereby submit the Report on the subject for consideration.

The IWG has adopted a consultative approach to arrive at decisions, besides undertaking its own analyses of various relevant issues to achieve broad consensus on various recommendations. The IWG had the benefit of interaction with various external agencies and individuals whose suggestions and observations have been given due weightage, wherever necessary. We are thankful to the Bank for this opportunity to work and learn.

Submitted please.

Yours faithfully,

(**K.U.B. Rao**)
Convener

Shri A.P. Gaur Director/DESACS/Member	Smt. Rosemary Sebastian GM/RPCD/Member	Shri Sathyan David GM/UBD/Member
Smt Dr. K. Jayanthi Anand Director/DEAP/Member	Smt. Reena Banerjee DGM/DNBS/Member	Shri G. Ramesh DGM/DBOD/Member

ACKNOWLEDGEMENT

The Members of the Internal Working Group (IWG) are grateful to the Bank for entrusting the task of examining the recommendations of the 'Report on Conditions of Work and Promotion of Livelihoods in the Unorganised Sector' (Chairman : Dr. Arjun K. Sengupta), relevant to the financial sector and suggest the way forward and action points. The Members are deeply indebted to Dr. Rakesh Mohan, Deputy Governor and Smt. Usha Thorat, Deputy Governor, Reserve Bank of India for providing very useful insights and guidance. The IWG gratefully acknowledges the valuable inputs received from the Government of Andhra Pradesh, Government of Maharashtra and various institutions such as Indian Banks' Association (IBA), NABARD, Small Industries Development Bank of India (SIDBI), Regional Rural Banks (RRBs), namely, Prathama Bank and Aryavrat Grameen Bank, Sa-Dhan, National Federation of Urban Co-operative Banks and Credit Society Limited (NAFCUB), National Federation of State Co-operative Banks Limited (NAFSCOB) and Finance Industry Development Council (FIDC).

The IWG acknowledges the support in terms of providing the research inputs, conducting meetings, drafting of the Report, *etc.,* by the officers of the Secretariat *i.e.,* Division of Rural Economics, Department of Economic Analysis and Policy. Efforts made by Dr. Ramesh Golait, Shri S.M. Lokare and Shri Pankaj Kumar at various stages of preparing this Report are gratefully acknowledged. Support received from the Division of Industrial and Services Studies and the Division of National Income, Savings and Flow of Funds is also placed on record. Administrative assistance was received from S/Shri S.S. Sarvankar and R. J. Ubale, Secretarial assistance rendered by Smt. K.K. Parkar and the services of Shri R.V. Thakur is appreciated.

Internal Working Group

Abbreviations	
ACC	Artisans Credit Card
ACD	Agricultural Credit Department
ADB	Asian Development Bank
AIDIS	All India Debt and Investment Survey
ANBC	Adjusted Net Bank Credit
ARDC	Agriculture Refinance and Development Corporation
BCs B	anking Correspondents
BDO	Block Development Officer
BPLR	Benchmark Prime Lending Rate
BRI	Bank Rakyat Indonesia
BRIC	Brazil, Russia, India, China
CAPART	Council for People's Action in Rural Technology
CEO	Chief Executive Officer
CGFTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CGMSE	Credit Guarantee Fund Scheme for Micro and Small Enterprises
CGS	Credit Guarantee Scheme
CGTSI	Credit Guarantee Fund Trust for Small Industries
CMP	Common Minimum Programme
CSOs	Civil Society Organisations
DBOD	Department of Banking Operations and Development
DEAP	Department of Economic Analysis and policy
DESACS	Department of Statistics and Computer Services
DICGC	Deposit Insurance and Credit Guarantee Corporation of India
DLCC	District Level Clearance Committee
DNBS	Department of Non-Banking Supervision

EFTPOS	Electronic Funds Transfer Point of Sale
EXIM	Bank Export Import Bank of India
FIDC	Finance Industry Development Council
GCC	General Credit Card
GPC	General Purpose Credit
HTM	Held To Maturity
IBA	Indian Banks' Association
IDBI	Industrial Development Bank of India
IT	Information Technology
IWG	Internal Working Group
KCC	Kisan Credit Card
KVIC	Khadi and Village Industries Commission
KYC	Know Your Customer
LUCC	Laghu Udyami Credit Card
OECD	Organisation for Economic Cooperation and Development
ME	Medium Enterprises
MFDEF	Micro-Finance Development and Equity Fund
MFDF	Micro Finance Development Fund
MFIs	Micro Finance Institutions
MIS	Management Information System
MLIs	Member Lending Institutions
MSEs	Micro and Small Enterprises
MSMED	Micro, Small and Medium Enterprises
NABARD	National Bank for Agriculture and Rural Development
NAFUS	National Fund for Unorganised Sector
NAFCUB	National Federation of Urban Co-operative Banks and Credit Society Ltd.
NAFSCOB	National Federation of State Cooperative Banks Limited

NBC	Net Bank Credit
NBFCs	Non-Banking financial companies
NCEUS	National Commission for Enterprises in the Unorganised Sector
NDC	‘No Dues’ Certificate
NEDFC	North Eastern Development Finance Corporation
NEF	National Equity Fund
NFSIT	National Venture Fund for Software and IT Industry
NFUEs	Non-farm Unorganised Enterprises
NGO	Non-Governmental Organisation
NHB	National Housing Bank
NPAs	Non-Performing Assets
NSIC	National Small Industries Corporation,
OTS	One Time Settlement
PwC's	Price Waterhouse and Cooper’s
RBI	Reserve Bank of India
RD	Revenue Deficit
REGP	Rural Employment Generation Programme
RIDF	Rural Infrastructure Development Fund
RPCD	Rural Planning and Credit Department
RRBs	Regional Rural Banks
SACP	Special Agricultural Credit Plan
SBLP	SHG-Bank linkage programme
SBI	State Bank of India
SBP	State Bank of Pakistan
SCBs	Scheduled Commercial Banks
SCC	Swarojgar Credit Card Scheme
SCR	Sengupta Committee Report

SC/ST	Scheduled Caste/Scheduled Tribe
SEF	Small Enterprises Foundation
SFCs	State Finance Corporations
SGSY	Swarnjayanti Gram Swarozgar Yojana
SHGs	Self help Groups
SICDP	Small Industry Cluster Development Programme
SIDBI	Small Industrial Development Bank of India
SIDCs	Small industrial Development Corporations
SIDO	Small Industries Development Organisation
SLBC	State Level Bankers Committee
SLCBGS	Small Loans (Co-operative Banks) Guarantee Scheme
SLGS	Small Loans Guarantee Scheme
SME	Small and Medium Enterprises
SSI	Small Scale Industries
SSME	Special Sub-Group of Micro Enterprise
SSSBEs	Small Scale Service and Business (industry related) Entities
TUFS	Technology Upgradation Fund Scheme
UBD	Urban Banks Department
UCBs	Urban Co-operative Banks
UPA	United Progressive Alliance
UTI	Unit Trust of India

Report of the Internal Working Group to Study the Recommendations of the NCEUS Report[1]

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References

[1] "Report on Conditions of Work and Promotion of Livelihoods in the Unorganised Sector" of the National Commission for Enterprises in the Unorganised Sector (Chairman: Dr. Arjun K. Sengupta), August, 2007.

Chapter I

I. Introduction

I.1. India's impressive growth performance in recent years particularly after the initiation of economic reforms has put it among the fastest growing economies in the world today. It is well known that the BRIC Report, 2004 has forecasted that India will be the third largest economy, after the US and China by 2050[2]. The recent PricewaterhouseCoopers (PwC's) 10th annual global CEO survey, also endorses this view and the CEOs, geographically, expect growth to continue in the widely-recognised BRIC (Brazil, Russia, India, China) nations, as well as other emerging and developed economies. As per the Economic Outlook for 2007-08 by the Economic Advisory Council, the Indian economy will grow by 9 per cent during 2007-08.

I.2. Nevertheless, the favourable impact of growth has not permeated downwards to the unorganised or informal sector having a large working population that is bereft of any continued source of livelihood and social security. Furthermore, the growth has not been homogeneous across sectors. It has been a matter of concern that unorganised sector, both farm and non-farm, has not participated equally in the growth story. Consequently, widespread poverty, poor work environment, lack of basic amenities and opportunities for improving living standards continue to exist in the unorganised economy including the rural and urban areas. It is imperative that India should unlock its potential in the unorganised sector to achieve sustainability of high growth. In recognition of this concern, the Common Minimum Programme (CMP) of the United Progressive Alliance (UPA) Government aimed to "enhance the welfare and well-being of farmers, farm labour and workers, particularly those in the unorganised sector and assure a secure future for their families in every respect".

II. Constitution of the National Commission for Enterprises in the Unorganised Sector (NCEUS)

I.3. In order to fulfill the above commitment and implement the CMP of the UPA Government - promising to initiate measures for the welfare of the common people by addressing, *inter-alia,* the concerns of the workers in the unorganised sector, the Government of India, among other measures, constituted a National Commission for Enterprises in the Unorganised Sector (NCEUS) under the Chairmanship of Dr. Arjun K. Sengupta, *vide* Ministry of Small Scale Industries Resolution No. 5(2)/2004-ICC dated September 20, 2004. The NCEUS was designed to act as an advisory body and watchdog for the informal sector with the following broad terms of reference:

(i) Review the status of unorganised/informal sector in India including the nature of enterprises, their size, spread, scope, and magnitude of employment;

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[2] Over the next 50 years, Brazil, Russia, India and China—the BRICs economies—could become a much larger force in the world economy. Using the latest demographic projections and a model of capital accumulation and productivity growth, Wilson and Purushothaman (2003) map out GDP growth, income per capita and currency movements in the BRICs economies until 2050.

(ii) Identify constraints faced by small enterprises with regard to freedom of carrying out the enterprise, access to raw materials, finance, skills, entrepreneurship development, infrastructure, technology and markets, and suggest measures to provide institutional support and linkages to facilitate easy access to them;

(iii) Suggest the legal and policy environment that should govern the informal/unorganised sector for growth, employment, exports and promotion;

(iv) Examine the range of existing programmes that relate to employment generation in the informal/unorganised sector and suggest improvement for their redesign;

(v) Identify innovative legal and financing instruments to promote the growth of the informal sector;

(vi) Review the existing arrangements for estimating employment and unemployment in the informal sector, and examine why the rate of growth in employment has stagnated in the 1990s;

(vii) Suggest elements of an employment strategy focussing on the informal sector;

(viii) Review Indian labour laws, consistent with labour rights and with the requirements of expanding growth of industry and services, particularly in the informal sector and improving productivity and competitiveness; and

(ix) Review the social security system available for labour in the informal sector, and make recommendations for expanding their coverage.

I.4. The NCEUS submitted its First Report on Social Security for Unorganised Workers on May 16, 2006 recommending the creation of an entitlement of a national minimum social security for all the eligible unorganised workers. The Government asked the Commission to examine the draft Unorganised Sector Workers Bill, 2004, and come up with appropriate alternatives. In response to this, the NCEUS also submitted to the Prime Minister, on July 7, 2007 a concise Report (being its Second Report) with two draft Bills, one on the Unorganised Sector Workers Social Security Bill, 2005 and the other on Unorganised Sector Workers (Conditions of Work and Livelihood Promotion) Bill, 2005 recommending legislation for a set of minimum conditions of work as well as a national minimum social security. These draft Bills are now at an advanced stage of discussions within the Government. Further, on May 5, 2006, the NCEUS submitted a report and recommendations on National Policy on Urban Street Vendors to the Ministry of Urban Employment and Poverty Alleviation.

III. The NCEUS Report

I.5. The NCEUS submitted to the Prime Minister on August 8, 2007, a detailed and analytical Report (being the Third Report and henceforth referred to as the NCEUS Report) on **"Conditions of Work and Promotion of Livelihoods in the Unorganised Sector"**, highlighting the conditions of work and issues in livelihood promotion and proposing a set of recommendations for the unorganised sector. The Report has suggested a package of measures for addressing some of the critical issues relating to farm and non-farm sectors. It has made some observations and recommendations relevant to the Indian financial sector largely drawing from the analysis done by a separate Task Force constituted by the Commission under the Chairmanship of Prof. V. S. Vyas, which dealt with credit related issues of the non-agricultural unorganised sector. The proposals and the main arguments contained in the above mentioned two major Reports and Task Force Report of NCEUS, formed the basis for the recommendations made in this Third Report, which is the focus of this Internal Working Group (IWG).

I.6. In sum, the NCEUS Report provides a rationale as well as a proposal for providing comprehensive protective legislation for agricultural workers and the unorganised non-agricultural workers, respectively. The proposed legislation includes provisions for regulating minimum conditions of work, social security, welfare, and livelihood promotion. The NCEUS strongly believes that the creation of an entitlement for a national minimum social security will be a historic decision towards ensuring at least a bare minimum protection to the vast multitude of unorganised workers in the country. The Commission's Report is indeed a monumental effort towards providing a structure and blueprint for assisting the constituents of the unorganised sector.

IV. RBI’s Mid-Term Review of the Annual Policy 2007-08

1.7. As part of the Reserve Bank’s initiative, the Mid-Term Review of the Annual Policy 2007-08 (October 2007) proposed to constitute an Internal Working Group to study various recommendations of the NCEUS Report relevant to the financial system and to suggest an appropriate action plan for implementation of the acceptable recommendations.

V. Constitution of the Internal Working Group

I.8. As a follow up to the announcement made in the Mid-Term Review of the Annual Policy 2007-08, the Reserve Bank constituted an Internal Working Group (IWG) in November 2007 to study the various recommendations of the Report of the NCEUS relevant to the financial system and suggest suitable action thereof. The Department of Economic Analysis and Policy (DEAP) was entrusted with the responsibility of coordinating this work.

The Members of the IWG comprised:

1.	Shri K.U.B. Rao, Adviser, DEAP	Convener
2.	Shri A.P. Gaur, Director, DESACS	Member
3.	Smt. Rosemary Sebastian, GM, RPCD	Member
4.	Shri Sathyan David, GM, UBD	Member
5.	Dr. K. Jayanthi Anand, Director, DEAP	Member
6.	Smt. Reena Banerjee, DGM, DNBS	Member
7.	Shri G. Ramesh, DGM, DBOD	Member

VI. Terms of Reference of the IWG

I.9. The terms of reference of the Group are:

1. To assess the progress made so far in respect of the issues relating to farm and non-farm sectors in particular and the Indian financial system in general as highlighted by the NCEUS Report;
2. To study the recommendations related to farm and non-farm sectors and suggest an appropriate action plan for implementation of acceptable recommendations; and
3. To examine any other related issues

VII. Approach of the Group

I.10. The IWG adopted broadly a consultative approach to examine and conceive an action plan for implementation of suitable recommendations related to the Indian financial system. The members of the IWG represented various Operational/Regulatory and Research Departments within the Bank. For this purpose, background notes were prepared by the members and DEAP separately examining each issue. The observations and the recommendations made by the NCEUS Report relevant to the financial sector were carefully analysed for making various suggestions. The notes were circulated among Members for examining their implementability and to suggest the future course of action in each case. Besides, comments were sought from various stakeholders and others such as, State Governments, select Regional Rural Banks (RRBs), Indian Banks' Association (IBA), National Federation of Urban Co-operative Banks and Credit Society Ltd. (NAFCUB), National Federation of State Co-operative Banks Limited (NAFSCOB), Finance Industry Development Council (FIDC), Sa-Dhan, National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI) and a few academicians (Details in Annex I). Based on the comments received from these entities and individuals and the interface the IWG had with some of these agencies through formal meetings, broad consensus was arrived at on various issues.

VIII. Organisation of the Report

I.11. The Report contains six Chapters. The introductory Chapter is followed by Chapter two, which briefly sketches the evolution and developments in financing the unorganised sector in India. Chapter three deals with the recommendations related to the priority sector lending policies. Chapter four discusses the issues and recommendations relating to improving the access to credit and financial services to the unorganised sector. Chapter five deliberates on other related issues and Chapter six summarises the recommendations of the IWG and the proposed action plan.

Chapter II

Financial Accommodation to Unorganised Sector in India – Brief Review of Major Developments – Role Played by Various Entities

II.1. The informal economy constitutes a large part of the respective economies of many developing and transition countries - comprising 42.0 per cent of value added in Africa, 41.0 per cent in Latin America, 35.0 per cent in the transition economies of Europe and the former Soviet Union, and 13.5 per cent in Organisation for Economic Cooperation and Development (OECD) countries (OECD, 2006[3]). Some economists consider the informal economy as a kind of deviating enterprise because it is not subject to legal control, while others consider it as an economy that manifests as a strategy to survive where formal economic structures fail to absorb employees.

II.2. The unorganised sector in India has been traditionally bigger than the organised sector in several key aspects notwithstanding the latter's greater share in the total resources. Despite its large size in the Indian economy, it is conceded that the unorganised sector is relatively a neglected sector in terms of support required for flourishing. Given the greater size, diverse composition and varied characters of the constituents of the unorganised sector, its requirement in terms of policy support and financial accommodation is understandably enormous.

Financial Accommodation to Unorganised Sector - Genesis in India

II.3. The provision and acceptance of loans was in vogue even in ancient times as the word *rina* (debt) is mentioned repeatedly from Rigvedic times onwards. In India, historically, money lenders have had a prominent position in financing the rural and unorganised economy. However, efforts to build up the institutional financing system for agriculture commenced with the adoption of the Co-operative Societies Act in 1904. The major thrust to institutional financing was given with the establishment of the Reserve Bank. The Reserve Bank's concern and involvement in the sphere of rural/unorganised credit stemmed from its very statute of incorporation. Specific provisions were made in the Reserve Bank of India (RBI) Act, 1934 both for the establishment of an Agricultural Credit Department (ACD) in the Bank and for extending refinance facilities to the co-operative credit system.

II.4. A major task was entrusted to the Reserve Bank in the era of development planning to put in place the necessary financial institutional mechanism to complement the planning efforts. This was crucial especially in the context of the weak financial system with an underdeveloped and evolving commercial banking set-up. Organised credit institutions had a negligible presence in rural India. In this backdrop, the need for building up of a sound and adequate institutional structure for rural banking and credit was paramount. To supplement the institutional build-up, the Reserve Bank also assumed special responsibilities for augmenting the flow of rural credit. The formulation of agricultural credit policy beginning 1951 was a major landmark in the Reserve Bank's

3 OECD (2006), Promoting Pro-Poor Growth Private Sector Development.

responsibilities for agricultural credit. The Reserve Bank organised a comprehensive All-India Rural Credit Survey under the direction of a Committee (Chairman: A. D. Gorwala) appointed in 1951. The recommendations of the Committee of Direction, which submitted its report in 1954, set the pace and directions for the subsequent years not only for the Bank's agricultural credit policy but also for the related polices of Central and State Governments.

Post-Independence Developments

II.5. After Independence, rapid and equitable economic development became the central focus of State policy. To cater to the needs of the rural areas, the All India Rural Credit Survey Committee recommended that the Imperial Bank, which was the functioning bank in India, should be taken over by a state-partnered and state-sponsored bank. By an Act of Parliament, the State Bank of India (SBI) was constituted on July 1, 1955. With its creation, more than a quarter of the resources of the Indian banking system, thus, passed to the direct control of the State. Subsequently in 1959, the State Bank of India (Subsidiary Bank) Act was passed, enabling the SBI to take over seven former state-associate banks as its subsidiaries (later named associated). This marked a significant step in the launch of a state-controlled banking system in India.

Social Control and Nationalisation

II.6. The landmark events to strengthen the institutional credit delivery mechanism were the policy of 'social control' launched in 1967 followed by the nationalisation of 14 private commercial banks in 1969. The objectives of bank nationalisation went far beyond the objective of social control. The objective of the 'takeover' as illustrated in the preamble of the Act was "to control the heights of the economy and to meet progressively, and serve better, the needs of development of the economy in conformity with national policy and objectives". In essence, the nationalisation of banks aimed at accelerating the pace of expansion of commercial bank branches in rural areas and augmenting the flow of bank credit to agriculture and to the weaker sections of the society (RBI, 2005).

Review of Efforts towards Rural Financing

II.7. Rural banking was traditionally a monopoly of the money lenders, till the colonial Government enacted Co-operative Societies Act in 1904 with a view to making the co-operatives as premier institutions for disbursement of credit. As mentioned earlier, the RBI Act vested a unique responsibility of rural credit with the central bank. All India Rural Credit Survey (1951) of the RBI opined that the co-operatives were "utter failure" in providing rural credit, but added that they had a vital role in agriculture credit. A Rural Credit Survey of 1966 also concluded the ineffectiveness of co-operatives but stressed the importance of their success for a predominantly agrarian economy like ours. Many State Governments made legislations for the registration and regulation of money lenders but with little emphasis on implementation. Nationalisation of banks in 1969 gave a boost to expansion of banks and banking in rural areas. The Reserve Bank hived off a part of its role in agricultural credit to a separate national level institution, *viz*., Agriculture Refinance and Development Corporation (ARDC) in 1975. Soon, legislation was enacted in 1976 to create Regional Rural Banks (RRBs), with participation from

Central and State Governments and the Nationalised Banks, which have their network spread almost all over the country. Subsequently, the ARDC was converted into National Bank for Agriculture and Rural Development (NABARD) in 1982.

II.8. The concept of priority sector was introduced in 1969 to underscore the imperatives of financing certain neglected sectors like agriculture. The channelling of credit to the priority sectors was sought to be achieved through the stipulation that a certain proportion of the total net bank credit be deployed in these sectors by specific target dates (Mohan, 2006). While the priority sector lending continued, the administered interest rate regime was dismantled during the reform period initiated in 1991. To make up for the shortfall in the priority sector lending by the banks, the Rural Infrastructure Development Fund (RIDF) was initiated to ensure the envisaged flow of bank resources to the rural and agricultural sector through the intermediation of the NABARD and the State Governments. Innovations in the area of rural credit included introduction of Kisan Credit Cards (KCC) and encouraging bank-Self-Help Groups (SHGs) linkages.

II.9. More recently, since 2004, vigorous efforts have been made to more than double the credit flow to agriculture. Emphasis has been laid on sound credit culture, effective and innovative credit delivery mechanism and appropriate credit pricing. New instruments for financial inclusion such as General Credit Cards (GCC) and no-frills accounts have been introduced. Micro finance programme has been intensified and new guidelines for the adoption of business facilitator model have been issued. Use of technology in rural banking is being encouraged. The issue of credit flow to the unorganized sector has been engaging the attention of the Reserve Bank on an ongoing basis, which is amply reflected in the several Committees/Working groups set up by the Reserve Bank (Annex II).

Institution Building by the Reserve Bank

II.10. The Agricultural Credit Department in the Reserve Bank was established mainly with the objective of coordinating the Reserve Bank's operations with those of other institutions engaged in agricultural lending. The RBI Act was amended in 1955 to enable the Bank to create two funds - National Agricultural Credit (Long-Term-Operations) Fund and the National Agricultural Credit (Stabilisation) Fund. The Reserve Bank set up the Agricultural Refinance Corporation in 1963 for extending medium and long-term finance to agriculture. With the establishment of the NABARD on July 12, 1982, the focus of the Reserve Bank with regard to rural credit has been more on co-ordination. This role of the Reserve Bank in this regard expanded after 1982 with the formation of the Rural Planning and Credit Department within the Bank.

II.11. In the absence of a well-developed capital market, the Reserve Bank played a proactive role in setting up a number of specialised financial institutions at the national and regional level to widen the facilities for term finance to industry and for institutionalisation of savings - a novel departure for a central bank. The examples are: the Industrial Development Bank of India (IDBI) and the Unit Trust of India (UTI) in 1964. The UTI came into existence as an offshoot of the Reserve Bank to help mobilise small savings for industrial investment and democratise industrial share-ownership.

II.12. Apart from the initiatives to build-up an institutional base, the Reserve Bank made the provision of annual allocation from its profits to the National Industrial Credit (Long-Term Operations) Fund for use of development banking. The Reserve Bank also administered, as the agent of the Central Government, various credit guarantee schemes for the small-scale industries (SSI) sector, which were designed to provide protection to banks and other institutions lending to such small scale units. The Export Import Bank of India (EXIM Bank) was established in January 1982, to which the export finance functions of the IDBI were transferred. The EXIM Bank was also made eligible to loans and advances from the National Industrial Credit (Long-Term Operations) Fund operated by the Reserve Bank. With the formation of the Deposit Insurance and Credit Guarantee Corporation of India (DICGC) in 1978 for giving protection to small bank depositors and providing guarantee cover to credit facilities extended to certain categories of small borrowers belonging to the weaker sections of society, institutional finance to the rural and unorganised sector received a further boost.

II.13. The genuine concern of the Reserve Bank in providing financial assistance to the poorest among poor manifests in its recent renewed emphasis on conscious steps to enlarge the ambit of financial inclusion. The measures include, impressing upon the banks to make available a basic banking 'no frills accounts' either with "Nil" or very little balances with a view to make such account accessible to a large sections of the population. Steps have been taken to simplify the "Know Your Customer" (KYC) procedure for opening "No Frills Accounts" so that the people from low income group do not face any problem in opening new accounts. Banks have been asked to consider introducing a General Purpose Credit Card (GPC) in the nature of involving credit up to Rs.25,000 without insisting on security or purpose at a deregulated interest in the rural and semi-urban areas. Banks have been also urged to scale up Information Technology (IT) initiatives for financial inclusion speedily while ensuring that solutions are highly secured and amenable to audit and follow widely accepted open standards to ensure eventual inter operability among the different systems. Infact, a special drive has also been initiated by RBI for 100 per cent financial inclusion in the identified districts all over the country. This special drive was aimed at extending the coverage to scheduled castes/scheduled tribes and minorities concentrated districts.

Financing the Informal Sector - Experience of Select Countries

II.14. Historically, Governments in many countries have sought to address the issue of inappropriate access to financial services of various disadvantaged sections of the society in various ways by making the necessary interventions on the supply side, which, *inter alia*, include nationalising private banks; establishing and promoting specialised banks including national savings banks and postal banks, branching regulations or directives, directives on portfolio composition, interest rate ceilings on credit to low-income households, and provision of credit at subsidized interest rates to certain sectors/segments (also called priority sectors) of the economy/society (Fernando, 2007[4]).

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[4] Fernando, Nimal A. (2007), *Low Income Households' Access to Financial Services: International Experience, Measures for Improvement, and the Future*, EARD Special Studies, Asian Development Bank, October.

The experiences of some countries in this regard are documented as follows:

Canada (*Access to Basic Banking Services Regulations)*

II.15. As a part of increasing financial inclusion across its population, the Canadian Government implemented the *Access to Basic Banking Services Regulations* on September 30, 2003. The regulations prevent banks from refusing to open a basic personal deposit account for someone because that person does not have a job, is or has been bankrupt, or is not depositing money into the account. The regulations also require banks to cash Government of Canada cheques to a maximum of Canadian $1,500 for non-customers at no charge, as long as proper identification is provided.

Brazil (*Banking Correspondents Model*)

II.16. Brazil is an instance of an economy, wherein a number of banks have developed a home-grown sophisticated delivery channel called the 'Banking Correspondents' (BCs) since 2000. Large banks in Brazil provide basic financial services through fully serviced retail agents called the BCs, including small supermarkets, petrol stations, pharmacies, post offices, and lottery kiosks. The banking correspondent model is technologically intensive and there are several reasons why BCs have emerged in Brazil. First, the Government has fostered innovation in delivery channels and in the last three decades, the Banco Central do Brazil has streamlined account-opening norms and gradually relaxed guidelines for using agents to deliver banking services, to make the model available for unbanked areas. By the end of 2005, some 58,000 banking correspondents were operating in the country (Fernando, 2007). This method has enabled banks to reach even remote rural areas where bank branches would probably be too costly to set up. Some of the poorest regions in Brazil including the Northeast part are served only by banking correspondents.

Indonesia (*The Unit Desas System of the BRI*)

II.17. The Bank Rakyat Indonesia (BRI), with its unit desa system, is a successful rural financial institution with a large microfinance portfolio. Before 1984, BRI unit desas were channelling subsidized credit, and mobilized very little savings. The Bank Indonesia provided funds to BRI at 3.0 percent per year for on-lending at 12.0 per cent per year to rice farmers under the Government's rice intensification program, known as Bimas (ADB, 2000[5]). In addition, the Government subsidized the administrative costs of BRI unit desas. The financial reforms of 1983, which liberalized interest rates, provided the opportunity for the Government to reform the unit desa system. Under the reform program, the unit desas adopted market-oriented interest rates on loans (about 33 per cent per year), and were transformed into full-service rural banking outlets. BRI also started to treat each unit desa as a profit or loss center. New savings products were introduced under the reform measures. The reforms led to the emergence of one of the most successful state-owned rural financial institutions in the world.

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[5] ADB. 2000. Rural Asia Study: Beyond the Green Revolution. Manila: ADB and Bank Rakyat Indonesia.

A major element of the reform program was the freedom given to BRI management to set cost-recovery and market-oriented interest rates on loans and deposits. The Government also ensured elimination of political interventions in the operation of the unit desa system and access to high-quality technical assistance to carry out the necessary reforms in operations. The reforms transformed the unit desa system into a viable operation and a robust entity by 1987. It has continued to generate profits with increasing outreach ever since on a continuing basis.

Philippines *(Microfinance Institutions and Cellphone Companies Partnership)*

II.18. Philippines has been making progress in improving the access to finance for its populace. There has been a rapid growth in the outreach of major microfinance institutions (MFIs) such as CARD NGO, TSPI, increasing involvement of rural banks in microfinance services and entry of two major cell phone companies -Smart and Globe Telecoms — that offer innovative cell phone based facilities to transfer money, pay bills, and make payments for purchases from stores, among other things. A few MFIs are using the facilities to disburse loans and collect loan repayments. This integration of cell phone technology with the microfinance institutions has significantly expanded the access to financial services for those in low-income groups and remote areas.

South Africa *(Group Lending Methodology of the Small Enterprises Foundation)*

II.19. South Africa presents an ideal case study of deepening of the financial market and improving the access to finance to previously disadvantaged South Africans, who had for long remained marginalized because of apartheid system. As in 1994, over 60.0 per cent of the adult population in South Africa remained excluded from any formal financial services sector (Kirsten, 2006[6]). According to the Finscope (2006) survey at least 49 per cent of the total adult population in South Africa did not have access to banking services. The South African Government and financial sector have recognised the absence of basic financial services, particularly in rural areas, as a major obstacle to growth and poverty reduction. The South African Government has tended to facilitate and regulate, rather than provide financial services directly. Direct provision of financial services by the Government relates only to the provision of wholesale finance in housing, agriculture and enterprise finance through Development Finance Institutions, such as NHFC, MAFISA and Khula. The Government launched the Financial Sector Charter in 2003, which embodies an agreement among the major players in the financial sector – banks, insurance companies, brokers and exchanges – on a set of service provision and empowerment targets in areas such as, banking services to low income populations, black employment and ownership in the financial sector, and support for black entrepreneurship. All financial services companies are

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[6] Marié Kirsten (2006) ‘Policy Initiatives to expand financial outreach in South Africa’, Paper Presented in the Global Conference on Access to Finance, May 31, World Bank, Washington, D.C.

expected to pursue these targets, to report periodically on their progress to a monitoring body set up under the Charter, and to be graded on their performance in the form of a public scorecard.

II.20. In recent years in South Africa, banking institutions, together with mobile phone companies have begun to expand the access to financial services. WIZZIT, a start-up mobile banking service provider, organized as a division of the South African Bank of Athens, targets low-income customers with an interest-bearing bank account that customers access with their mobile phone. Customers can use their mobile phones to make person-to-person payments and transfer money. In October 2004, with Government encouragement, the four largest South African banks and the postal bank began offering a low-cost transaction account (known as "Mzansi" account) intended for low-income customers.

II.21. Another significant initiative of the South African Government in improving the access to finance for its populace has been the setting up of the Small Enterprises Foundation (SEF) in 1992 with the objective of alleviating poverty in a sustainable manner by enabling the poor to increase their income through microcredit. SEF follows a solidarity group lending methodology, very similar to that pioneered by the Grameen Bank of Bangladesh. SEF has gained considerable international recognition for its poverty-targeting methodology and its success in reaching and ensuring positive impact on the very poor. The program has led to increase in income of the households, which has enhanced the sense of independence and self-reliance resulting in significant empowerment for SEF clients.

Bangladesh (*Group Guarantee Method pioneered by the Grameen Bank)*

II.22. Bangladesh is one of the economies that have been a leading example of improving access to finance for the poor and low income households during the last three decades. The Government provided necessary space for NGOs to play the lead role in pushing the frontier of finance for the poor. The Government also facilitated the establishment of the Grameen Bank. A large amount of grant funds from external sources and later concessional loans from a range of multilateral and bilateral funding agencies led to a strong microfinance sector and significant outreach of microcredit services. The Grameen Bank initially focused on providing credit facilities and paid little attention to voluntary deposit mobilization. This policy was changed in 2000 with increased emphasis on deposit mobilization. The new savings programs of the Grameen Bank have allowed millions of its members and non-members easy access to reliable deposit services. The growth in microfinance services in Bangladesh has not been confined to the large-scale institution and a number of medium-scale MFIs also expanded their outreach significantly in recent years.

Pakistan *(Financial Inclusion Strategy of the State Bank of Pakistan)*

II.23. In Pakistan, financial exclusion remains an acute problem, with a majority of the people with no access to formal financial services. The Government of Pakistan considers improving the access to credit and other financial services more important than the cost of credit. The State Bank of Pakistan (SBP), the central bank of the country has launched a broad based strategy for enhancing access to development finance to the country's poor and rural population. The objective of the strategy is to enhance the coverage of the financial system through a range of innovative approaches and institutional modalities to provide holistic services (Akhtar, 2007[7]). Over the next 5 years, the target will be to double the deposit base from the existing 26.6 million accounts in 2007 to 53 million by 2012, and to double the number of borrowers with a focus on low-income households. The strategy includes a far-reaching microfinance development plan to increase microfinance outreach from 1.2 million clients to 10 million, expansion of branch networks to underserved areas, promotion of Islamic banking, and promotion of application of new information and communication technology to reach rural people.

II.24. As could be gauged from the experience elsewhere, the models adopted by various countries to provide financial accommodation to informal sector vary. In some countries like Canada, the banking regulator has sought to increase financial inclusion across its populace by making it mandatory for banks to open basic transaction accounts for poor people. While in other countries like Brazil, banks have employed banking correspondents including small supermarkets, petrol stations, pharmacies, post offices, and lottery kiosks to expand their outreach to far-off remote places by making use of the information technology. Some countries like Indonesia have reformed their loss making and ineffective institutional set-up to make it market-oriented. In Indonesia, the Government reformed the unit desa system and made it more market oriented with viable operations. In countries like Philippines, the microfinance institutions (MFIs) have made alliance with cell phone companies to expand their outreach to low income groups and remote areas. Some countries like Bangladesh, which has been replicated by South Africa, have pioneered the group lending methodology. The State Bank of Pakistan has shown a keen interest in financial inclusion and devised a financial inclusion strategy.

II.25. The efforts of various economies in providing credit to the informal sector bring to the fore the fact that there is increased awareness in the financial circles about the need to improve the credit flow to this sector in their respective countries. The international experience suggests that while some countries have made a fair progress in improving the access to finance for low-income households, others have been unable to achieve successful results. The global experience on improving the access to finance suggests that there is no single and universally applicable model to fully meet the credit requirements of informal sector. A scrutiny of successes and failures of strategies offers important insights in framing the right kind of policies that are needed to make the financial sector more inclusive. Based on diversities of their socio-economic conditions and

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[7] Shamshad Akhtar (2007), 'Building Inclusive Financial System in Pakistan', BIS Review 87/2007.

different level of financial sector development, countries have adopted a range of approaches for improving the access to finance for its populace. A comparison of these models with the credit provision mechanisms in India to the unorganised sector reveals that the Indian financial system already has majority of these structures and mechanisms in place. Nonetheless, it is useful to review these relevant trends from time to time to fine tune and strengthen the flow of resources to the unorganised sector. That was what the NCEUS attempted with all seriousness in its Report.

Strengthening the Financing of the Unorganised Sector in India- Challenges in the Present Juncture

II.26. In the development strategy adopted by independent India, institutional credit was perceived as a powerful instrument for enhancing production and productivity and for alleviating poverty. A large number of agencies, including cooperatives, RRBs, commercial banks, non-banking financial institutions, self-help groups and widespread informal credit outlets together comprise the Indian credit delivery system for the unorganised sector. They act not merely as financial intermediaries but also play a key developmental role. The major achievements in the post-independent India have been widening the spread of institutional machinery for credit and decline in the role of non-institutional sources-particularly relieving the vast majority of population from the clutches of money lenders. The share of institutional credit, which was a little over 7.0 per cent in 1951, galloped manifold to over 66.0 per cent in 1991, reflecting concomitantly a remarkable decline in the share of non-institutional credit from around 93.0 per cent to about 31.0 per cent during the same period. Despite the impressive progress made by the Indian financial sector, there still remains a large section of poor population outside the banking network. More specifically, a disturbing trend in access to institutional finance has been witnessed in the 1990s. As per the All India Debt and Investment Survey (AIDIS), 2002 the recourse to financial accommodation from money lenders increased from 17.5 per cent in 1991 to 29.6 per cent in 2002. This brings to the fore the need to step up credit to unorganised sector from the formal financial structures. The challenge ahead lies in reaching this section of the population through increased degree of financial innovation and use of technology.

Chapter III

Issues Pertaining to the Priority Sector

<u>I. ISSUE: Priority Sector Targets</u>

(A) Agriculture credit

1. NCEUS Recommendation

The Commission recommends that during the Eleventh Plan period, the Government should revive a targeted programme focusing on small and marginal farmers, with an initial thrust on areas where the existing yield gap is also considered to be high. First, the priority sector guidelines need to be revised and a target of 10 per cent needs to be fixed for marginal and small farmers. At present, the revised priority sector lending guidelines announced by the RBI on 30th April, 2007 fix a quota of 18 per cent for agriculture, 10 per cent for weaker sections, including marginal and small farmers, and 12 per cent for other designated purposes. However, the agricultural quota includes direct agricultural loans to corporate entities up to Rs. 10 million and for even higher amounts for indirect agricultural activities. The limit of loan for activities eligible for direct agriculture has been raised to Rs. 2 million. The Commission recommends that the priority sector guidelines of the RBI be amended and a 10 per cent quota, out of the 18 per cent presently assigned for agriculture, be fixed for farmers with land holdings below 2 hectares. The weaker section quota for small and marginal farmers may then be released for other socio-economically weaker segments.

2. Relevant Observations Contained in the NCEUS Report

III.1. The NCEUS has expressed a concern that the position of institutional credit with respect to agriculture, and more so, with respect to marginal and small farmers continues to be unsatisfactory (Para: 12.49). The share of agricultural credit in the net bank credit (NBC) declined from 17.0 per cent in 1994 to 9.0 per cent in 2004. The NCEUS has also stated that the Government is currently seized with the issue of extending affordable credit to the agricultural sector and banks have been asked to increase credit by 25.0 per cent each year, and the rate of interest has been pegged at 7.0 per cent. Further, in the areas of high agrarian distress, debt waivers and moratorium on debt waivers have been declared. A Committee under Prof. R. Radhakrishna has also been appointed to look into all aspects related to agricultural indebtedness in the areas of high agrarian distress.

III.2. The announcement of Government Policy in 2004 requiring the doubling of agricultural credit in three years, has undoubtedly led to an increase in the volume of credit, but as a percentage of NBC, it still stands at a low of 11.9 per cent in 2006 (Para: 12.50). Hence, NCEUS is of the view, that in addition to the steps already taken by the Government and the banking system, a number of other measures need to be initiated on an urgent basis, focusing particularly on the issue of credit availability to marginal and small farmers. Against this background, the NCEUS has come out with the above recommendation.

3. Background and Review of Present Status

III.3. The issue of providing adequate credit to agriculture, small scale industries (SSIs) and other unorganised enterprises, particularly in the rural areas has received the attention of the authorities since the beginning of the planning era. At a meeting of the National Credit Council held in July 1968, it was emphasised that commercial banks should increase their involvement in financing the priority sectors, *viz.*, agriculture and SSIs. The description of the priority sectors was later 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. Although initially, there was no specific target fixed in respect of priority sector lending, in November 1974 the banks were advised to raise the share of these sectors in their aggregate advances to the level of 33 $^{1/3}$ per cent by March 1979. Subsequently, on the basis of the recommendations of the Group on the Modalities of Implementation of Priority Sector Lending Policy and the Twenty Point Economic Programme, all commercial banks were advised to achieve the target of priority sector lending of 40.0 per cent of aggregate bank advances by 1985. Broad sub-targets were also specified for lending to agriculture and the weaker sections within the priority sector. Since then, there have been several reviews and changes in the scope of priority sector lending and the targets and sub-targets applicable to various bank groups.

III.4. As an integral part of the financial sector reforms of 1991, the banking sector policies have been liberalized to enhance productivity, efficiency and competition. The Narsimham Committee Report (1993) suggested that 40.0 per cent direct credit to the priority sector should be phased out. While this recommendation has not been implemented, the prescriptions relating to priority sector lending have been modified and several new areas included from time to time. As a result, there is a view that enlargement of areas covered under priority sector has resulted in loss of focus. There have also been suggestions for a further review of the eligibility criteria and other related aspects. Further, it has been argued that only those sectors that impact large sections of the population, the weaker sections and the sectors, which are employment-intensive such as agriculture, and tiny/ small enterprises should be eligible for inclusion under the priority sector. The key tasks were to ensure a convergence among credit availability, effective credit delivery system and adequate credit absorptive capacity of the rural population.

III.5. In the above context, an *Internal Working Group on Priority Sector Lending* was set up in the Reserve Bank (Chairman: Shri C. S. Murthy) to examine the need for continuance of priority sector lending prescriptions; review the existing policy on priority sector lending including the segments constituting the priority sector, targets and sub-targets, *etc.;* and to recommend changes required in this regard. The recommendations of the Group have been examined and accordingly, the guidelines on priority sector lending have been revised recently on April 30, 2007. As per the revised guidelines, all domestic commercial banks are required to ensure that priority sector advances constitute 40.0 per cent of Adjusted Net Bank Credit[8] (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher (Table 1).

III.6. Both the Government of India and the Reserve Bank have undertaken several initiatives from time to time to improve the flow of credit to agriculture, particularly the small and marginal farmers (Annex III). For instance, Kisan Credit Card (KCC) Scheme has been in operation since 1998-99 to provide an easy and flexible avenue of credit to the farmers in general and small and marginal farmers in particular. The KCC scheme was further reviewed and modified in 2004 to include an entire gamut of credit needs of the farmers comprising short-term credit (crop loan), working capital credit for activities allied to agriculture and term credit. Under this scheme, limits may be fixed taking into account the entire production credit needs along with ancillary activities relating to crop production, allied activities and also non-farm short term credit needs, *viz.*, consumption needs. The issue of providing access to adequate credit to the unorganised sector has been addressed by the Government of India and the Reserve Bank from yet another angle by ensuring adequate credit flow to minority communities. Accordingly, all commercial banks, both in public and private sector have been advised to ensure smooth flow of bank credit to minority communities (Sikhs, Muslims, Christians, Zoroastrians) in July, 2007.

III.7 Furthermore, in order to empower the vast sections of rural households, Reserve Bank has advised the scheduled commercial banks and RRBs to introduce a GCC Scheme based on the assessment of income and cash flow of the households similar to that prevailing under normal credit cards but without insistence on security, purpose or end-use stipulations. The total credit facility to an individual borrower under the scheme would not exceed Rs. 25,000/-. Fifty per cent (now 100 per cent) of credit outstanding under the GCC Scheme would be treated as part of "Priority Sector Lending".

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[8] **ANBC:** For the purpose of priority sector lending, ANBC denotes net bank credit (NBC) plus investments made by banks in non-SLR bonds held in held to maturity (HTM) category. Investments made by banks in the Recapitalization Bonds floated by Government of India will not be taken into account for the purpose of calculation of ANBC.

Table-1: Extant Priority Sector Targets

Category of Advances	Domestic commercial banks	Foreign banks
Total Priority Sector advances	40.0 per cent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	32.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Total agricultural advances	18.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Of this, indirect lending in excess of 4.5 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher, will not be reckoned for computing performance under 18.0 per cent target. However, all agricultural advances under the categories 'direct' and 'indirect' will be reckoned in computing performance under the overall priority sector target of 40.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	No target.
Small Enterprise advances	Advances to small enterprises sector will be reckoned in computing performance under the overall priority sector target of 40.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	10.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Micro enterprises within Small Enterprises sector	(i) 40.0 per cent of total advances to small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs 5 lakh and micro (service) enterprises having investment in equipment up to Rs. 2 lakh; ii) 20.0 per cent of total advances to small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs 5 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 2 lakh and up to Rs. 10 lakh. (Thus, 60.0 per cent of small enterprises advances should go to the micro enterprises).	Same as for domestic banks.
Export credit	Export credit is not a part of priority sector for domestic commercial banks.	12.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.
Advances to weaker sections	10.0 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher.	No target.
Differential Rate of Interest Scheme	1.0 per cent of total advances outstanding as at the end of the previous year. It should be ensured that not less than 40.0 per cent of the total advances granted under DRI scheme go to scheduled caste/scheduled tribes. At least two third of DRI advances should be granted through rural and semi-urban branches.	No target.

This measure is expected to help financing of landless agricultural labourers and tenant farmers.

III.8 In order to ensure better financial inclusion, Reserve Bank has also advised banks to make available a basic banking ‘no-frills’ account with either ‘nil’ or very low minimum balances and charges to the vast section of rural population. Regional Rural Banks (RRBs) were also advised to consider providing these account holders with a small overdraft facility.

III.9. Considering that high indebtedness to money lenders can be an important reason for distress of farmers, a Technical Group (Chairman: Shri S.C.Gupta) to review the efficacy of the existing legislative framework governing money lending and its enforcement machinery was constituted by the Reserve Bank. The Group submitted its Report in July 2007. It has recommended a model law for the consideration and adoption by the State Governments with some modifications to the existing legislation, *inter-alia,* to facilitate quick, informal and easy dispute resolution; and better enforcement. The Group has also explored possibility of establishment of a link between the formal and informal credit providers, whereby an individual who is an ‘Accredited Loan Provider’ may serve as an additional credit delivery channel for the formal sector, provided there are safeguards in place. The Report of the Technical Group on Money Lending has been placed on the RBI’s website for comments. The Reserve Bank is closely following up these recommendations with the State Governments for initiating further action. Furthermore, another Internal Working Group set up in the Reserve Bank is examining the recommendations of Prof. R. Radhakrishna Committee on agricultural indebtedness in the areas of high agrarian distress.

4. Observations of the IWG

III.10. At the outset, it may be noted that the NCEUS has not suggested any increase in the existing ceiling of 40.0 per cent for priority sector. However, it has called for reallocation of available quantum of credit and reclassification of some categories under the present dispensation. Accordingly, NCEUS has stated that, of the 18.0 per cent credit earmarked for agricultural sector, 10.0 per cent may be exclusively set aside for small and marginal farmers. It has also suggested shifting the small and marginal farmers from the present weaker sections category to agriculture sector. Currently, small and marginal farmers are covered under the weaker sections[9]. The weaker section quota for small and marginal farmers may then be released for other socio-economically weaker segments. It advocates allocation of 12.0 per cent to socio-economically weaker sections for purposes of housing, education, *etc*., with a loan ceiling of Rs. 0.5 million. This would amount to an increase of 2.0 per cent additional quota in priority sector lending for weaker sections from current level of 10.0 per cent. Furthermore, it has recommended that instead of clubbing small and micro enterprises under ‘others' category as at present, an explicit target of 10 per cent be set for lending to these enterprises and within this, a 4 per cent sub-target be set with respect to micro enterprises with capital investment (other than land and building) up to Rs.0.5 million.

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[9] Presently, weaker sections category, *inter-alia*, includes small and marginal farmers, artisans, village and cottage industries, SC/ST beneficiaries, beneficiaries under Differential Rate of Interest Scheme, *etc*.

III.11. The IWG in order to consider the NCEUS recommendation on priority sector targets for agriculture analysed the data on agriculture credit by banks. The credit-limit-wise data shows that during the last 10 years (1996-2006), the share of loans below Rs.25,000, which are generally availed by the small and marginal farmers averaged at about 34.0 per cent of total outstanding credit to agriculture, while the share of loans between Rs.25,000 to Rs.2 lakh and above 2 lakh amounted to 31.0 and 36.0 per cent, respectively. Although during the last 10 years, the growth of outstanding loans to agriculture averaged at around 20 per cent, the outstanding loans below Rs.25,000 grew at a little over 5.0 per cent (Table 2).

Table 2: Size of Credit Limit-wise Classification of Outstanding Credit of SCBs (end-March)

(Amt. in Rs.crore)

Year	RS. 25,000 and below		*per cent share*	Rs. 25,000 to Rs 2 lakh		*per cent share*	Above Rs.2 lakh		*per cent share*	Total Bank Credit		Agriculture		*per cent share*
	No. of A/c	***Amt. out.***		***No. of A/c***	***Amt. out.***		***No. of A/c***	***Amt. out.***		***No. of A/c***	***Amt. out.***	***No. of A/c***	***Amt. out.***	
1996	23141796	1425370	**49.5**	981486	731128	**25.4**	65291	724398	**25.1**	56672429	25469211	24188573	2880896	**11.3**
1997	21314233	1487546	**47.0**	1111722	819922	**25.9**	98409	855947	**27.1**	55617917	28437330	22524364	3163415	**11.1**
1998	20269975	1628423	**46.2**	1328760	943954	**26.8**	121320	953875	**27.1**	53583956	32994444	21720055	3526252	**10.7**
1999	17794494	1564514	**38.3**	1829299	1216132	**29.7**	164592	1308280	**32.0**	52305456	38242504	19788385	4088926	**10.7**
2000	17532985	1606168	**35.2**	2786916	1479266	**32.4**	212990	1478393	**32.4**	54370397	46008070	20532891	4563827	**9.9**
2001	16428006	1693143	**32.7**	3159939	1721967	**33.3**	255344	1757923	**34.0**	52364395	53843379	19843289	5173033	**9.6**
2002	16169306	1667726	**26.1**	3846569	2085964	**32.6**	335309	2647164	**41.4**	56388379	65599308	20351184	6400854	**9.8**
2003	15821026	1791029	**23.6**	4618296	2608829	**34.4**	401112	3193665	**42.1**	59491187	75596882	20840434	7593523	**10.0**
2004	15123748	1804079	**18.7**	5534822	2935315	**30.5**	645598	4885111	**50.8**	66390290	88031202	21304168	9624505	**10.9**
2005	17751065	2211546	**17.8**	8089462	4236689	**34.1**	815781	5990252	**48.2**	77150794	115246794	26656308	12438487	**10.8**
2006	17802496	2297948	**13.3**	10052949	5424408	**31.4**	1212668	9546053	**55.3**	85435381	151384213	29068113	17268409	**11.4**
Average														
Share			***33.5***			***30.5***			***36.0***					***10.5***
Growth			***5.1***			***22.5***			***30.5***					***19.9***

Source: Banking Statistical Returns, RBI, various issues.

III.12. It is observed that the small and marginal farm holdings account for 36.0 per cent of agricultural land in the country and thus, there is a case for increasing the flow of credit to these segments. Therefore, IWG agrees with the recommendation in principle that within the priority sector there should be allocation for socio-economically weaker sections. This intent is served currently by having a stipulation that 10 per cent of ANBC should be earmarked for weaker sections that inter-alia covers small and marginal farmers, artisans, landless labourers, tenants, SC/ST beneficiaries, minorities, SHGs and beneficiaries of Government sponsored schemes. Currently, this purpose is also served under the Special Agricultural Credit Plans (SACP). Under this scheme, public sector banks were required to fix "self-set targets" for disbursement of agricultural credit on the basis of their previous year's disbursements. As recommended by the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Vyas Committee), banks were advised to make efforts to increase their disbursements to small and marginal farmers to 40 per cent of their direct lending to agriculture by March 2007. Pursuant to the announcements made in the Mid-Term Review of Annual Policy for 2004-05, the SACP mechanism has been made applicable to private sector banks also from the year 2005-06. The total direct finance to agriculture under SACP increased from Rs.67,917 crore in 2005-06 to Rs.91,695 crore in 2006-07, of which the share of small and marginal farmers increased from 40.8 per cent to 44.7 per cent during the same period.

III.13. Similarly, the disaggregated analysis of the credit extended by the scheduled commercial banks to agriculture, particularly to small and marginal farmers brings out some points. At end-March 2007, the share of agriculture in the total net bank credit (NBC) was little over 14.0 per cent. The share of weaker sections in the total NBC stood at around 6.0 per cent, while the share of small and marginal farmers in the net bank credit accounted for little over 3.0 per cent (Table 3).

Table 3: A Status Matrix of Priority Sector Advances of Scheduled Commercial Banks in India

Category	Percent of Net Bank credit (as at end-March)				Recommendation by the Sengupta Committee Report (in per cent)	Extant Guidelines on the Priority Sector Lending (in per cent)
	2004	2005	2006	2007		
Small and Marginal Farmers	2.5	3.4	3.3	3.1	10	No Specific Target. They are part of weaker sections, which is allocated 10 per cent of ANBC.
Weaker Sections	6.1	6.5	6.5	5.6	12	10
Agriculture	14.9	15.0	15.2	14.4	18	18
Small (investment in P&M above 25 Lakh)and Micro Enterprises (Investment in P&M up to 25 Lakh)	10.7	9.5	8.0	6.8	10	No Specific Target for Domestic Commercial Banks. However, 10 per cent of ANBC for Foreign Banks.
Special Category of Micro Enterprises (Investment in P&M up to 5 Lakh)	2.1	1.6	1.4	1.2	4	No Specific Target of Net Bank Credit for these units. However, 40 per cent of total SSI advances should go to these units.
Total Priority Sector	46.9	45.7	43.2	39.9	40	40

Source : Report on Trend and Progress of Banking in India (Various issues) and RPCD, RBI.
Note: ANBC: Adjusted Net Bank Credit.

III.14. As per the latest data available, the outstanding credit to small and marginal farmers by public and private sector banks increased from Rs. 42,123 crore as at end of March 2006 to Rs.54,272 crore as at the end of March 2007, thereby registering an increase of 28.8 per cent. The outstanding credit to weaker section also showed an increase from Rs. 82, 332 crore to Rs.98,970 crore during the same period and registered an increase of 20.2 percent. As at the end of September 2007, the outstanding credit to weaker section by these banks further increased to Rs.1,22,873.2 crore. The outstanding credit to Agriculture as at end March 2007 went up to Rs.2,54,648 crore, witnessing an increase of 32.6 per cent over the previous year. It further increased to Rs.2,58,122.2 crore as at end September 2007. Therefore, IWG is of view that the present norm (18.0 per cent of adjusted net bank credit (ANBC) for agriculture, (which covers small and marginal farmers) and 10.0 per cent of ANBC for weaker sections which also covers small and marginal farmers) is broad based and adequate to ensure flow of credit to weaker section. However, banks may be encouraged to take enhanced efforts to meet the stipulated targets.

III.15. If the NCEUS's recommended target is interpreted as 10.0 per cent out of overall target of 18.0 per cent prescribed for agriculture sector, then the scheduled commercial banks are already way ahead. The share of small and marginal farmers in the total advances to agriculture under priority sectors accounts for around 21.3 per cent (at end March 2007). This implies that of the 18.0 per cent target that is allotted to agriculture, small and marginal farmers have already availed almost double the target, *viz.,* 10.0 per cent that the NCEUS has suggested.

III.16. The feasibility of implementing this recommendation was discussed extensively by the members of the IWG with State Governments, bankers and academia. Based on the discussions, following points emerged:

III.17. It was felt that the reclassification suggested by NCEUS may also lead to crowding out of priority sector lending for other categories of borrowers from the sectors like retail traders, education loans, housing loans, micro credit and loans to state sponsored for SC/STs, which are presently under 'others' category.

III.18. As stated earlier, the priority sector guidelines have been revised recently in April 2007 based on the recommendations made by an Internal Working Group on Priority Sector Lendings (Chairman: Shri C.S. Murthy) set up in the Reserve Bank. The current guidelines have already focused on ensuring adequate credit flow to those sectors of the economy that impact large sections of the population, the weaker sections and the sectors, which are employment-intensive such as agriculture, and tiny and small enterprises[10].

III.19. The fragmentation of land holdings overtime have rendered the small farmer with a small piece of land with which it is not possible for him to meet both ends through agricultural operations. They are heavily indebted not only due to non-viability but also due to borrowings for day-to-day living and social needs like, marriage, festivals *etc*. This has also to be viewed against the average farm size in the US being at least 100 times larger than the average size in India. So the problem is in the definition of small size *vs*. viable size. It is important to recognize the viability aspect of agricultural operations and consolidating small farms to increase productivity. Alongside, efforts are required for farm education, dissemination of information / combined marketing effort, *etc.* The IWG while underlining the need for expanding the livelihood opportunities for the rural population, felt that income diversification opportunities should be created by promoting allied agricultural, agro-processing and other rural non-farm enterprises with a view to improving the sources of income of the farmers in general and the small and marginal in particular including landless agricultural labourer households.

III.20. Therefore, one significant issue is how to improve the viability of the proposals emerging from such segments particularly small and marginal farmers and micro enterprises. Keeping in view the financial viability of the banks and recovery prospects from the borrower, the IWG opines that the problem of low quantum of credit flow to the small and marginal farmers could also be resolved through other methods. These include focused attention to the loan

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[10]For a detailed presentation on the basis of recommendations please refer to C.S. Murthy's Report on this issue.

applications of these classes and proper assessment of loan accounts to address the credit risk thereof. In this context, ratings of borrowers have become important and institutions such as SIDBI and National Housing Bank (NHB) have developed indigenous rating models for the SME and housing sectors. The banks may be urged to adopt such techniques in the case of small and marginal farmers as well. Further banks may be advised to further simplify the procedures so as to smoothen and enhance the flow of credit to these segments.

III.21. An analysis of achievements of targets set for priority sector advances by scheduled commercial banks shows that while the overall target of 40.0 per cent has been achieved (Table 4), the sub targets on Agriculture and weaker sections have not been achieved by the banking system. Bank group-wise analysis suggests that the achievement of public sector banks is relatively better than the private sector banks in terms of sub targets. It needs to be noted that the performance of the private sector banks particularly with respect to weaker section is dismal (10.0 per cent). Thus, there is a need for banks to make concerted efforts to achieve the prescribed targets for priority sector.

III.22. As per the extant policy, domestic scheduled commercial banks having shortfalls in lending to priority sector target (40 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher) and / or agriculture target (18 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher) have been allocated amounts for contribution to the Rural Infrastructure Development Fund (RIDF) established with NABARD. For the purpose of allocation of RIDF tranche, the achievement level of priority sector lending as on the last reporting Friday of March of the immediately preceding financial year is being taken into account.

Table : 4 Advances of Scheduled Commercial Banks to Priority Sector								
(As on the last reporting Friday of March)								
	Public Sector Banks							
Year	Total Agricultural Advances		Weaker Sections		Others		Total Priority Sector Advances	
	Amount (Rs. Crore)	Per cent to NBC	Amount (Rs. Crore)	Per cent to NBC	Amount (Rs. Crore)	Per cent to NBC	Amount (Rs. Crore)	Per cent to NBC
2004	84438.00	15.41	41588.64	7.44	118429.36	21.29	244456.00	43.94
2005	109917.00	15.68	63492.11	8.85	133636.89	18.82	307046.00	43.23
2006	155220.00	15.20	78373.90	7.70	176154.10	17.33	409748.00	40.30
2007	205091.00	15.60	94284.88	7.20	221804.36	16.85	521180.24	39.60
	Private Sector Banks							
2004	14730.00	15.81	1495.49	1.34	33713.60	30.20	48920.00	47.35
2005	21636.00	12.09	1913.86	1.20	45997.19	28.73	65886.00	43.33
2006	36712.00	13.50	3909.26	1.60	66471.72	26.70	106586.00	42.80
2007	52055.93	12.82	5228.58	1.55	86483.14	25.69	143767.65	42.71
	All Public and Private Sector Banks							
2004	99168.00	14.93	43084.13	6.49	152142.96	22.91	293376.00	44.17
2005	131553.00	15.13	65405.97	7.52	179634.08	20.66	372932.00	42.89
2006	191932.00	15.15	82283.16	6.50	242625.82	19.15	516334.00	40.76
2007	257146.93	15.54	99513.46	6.02	308287.50	18.64	664947.89	40.19

Source: Compiled from Report on Trend and Progress of Banking in India, RBI (Various issues).

III.23. Despite the above policy, the performance of banking system in general and the private sector banks in particular, in meeting the sub-targets set for agriculture and weaker sections is far from satisfactory. As there is a perceived general reluctance/inability on the part of the banks in view of the issues related to viability, credit record of such small and marginal farmers, the commercial banks are at present not in a position to meet even the current 10 per cent target prescribed for weaker sections.

III.24. The IWG members firmly believe, in this context, that there is a need for a change in the mind set of all concerned. As banks have exhibited a sense of reluctance, even due to reasons beyond their control, there appears to be a need for putting in place a mechanism of incentives and disincentives to persuade banks to step up the flow of credit to this segment of borrowers. The IWG suggests that RBI may consider measures to penalize banks for failure to reach the sub target of 10.0 per cent set for weaker sections. This would probably act as an effective factor to prompt the hitherto unwilling bankers to step up their efforts to channel more credit to the unorganized sector rather than earmarking a particular target under the priority sector. Such a disincentive mechanism may be conceived by

Reserve Bank, so that assured flow of credit may be provided by the banks to small and marginal farmers, micro enterprises and weaker sections.

III.25. The IWG feels that banks need to adhere to the 10.0 per cent norm set for weaker sections scrupulously. IWG feels that banks should be encouraged to issue more and more General Credit Cards (GCC) which enables small borrowers credit facility, up to Rs. 25000/- at their rural and semi urban branches. This credit facility is a revolving credit based on assessment of household cash flows and the limits are sanctioned without insistence on security or purpose. The GCC could complement the existing “no frills” account policy. All lending through GCCs could be treated as indirect finance to agriculture or other priority sector.

5. Suggested Way Forward

III.26. As stated earlier, the IWG shares the concern of NCEUS that the access and availability of credit to small and marginal farmers is not satisfactory and calls for continuing emphasis on improving the situation. In view of the above, the following action points may be considered:

(i) The NCEUS recommendation is that within the priority sector there should be allocation of 12 per cent out of 40 per cent for socio-economically weaker sections. Currently, there is a stipulation that 10.0 per cent of ANBC (adjusted net bank credit) should be earmarked for weaker sections that inter-alia covers small and marginal farmers, artisans, landless labourers, tenants, SC/ST beneficiaries, SHGs and beneficiaries of specified Government sponsored schemes. Against this the public sector banks’ actual achievement was 8.6 per cent as on September 2007.

ii) The IWG suggests that RBI may consider measures to evolve a system of disincentive to banks for failure to reach the sub target of 10.0 per cent for weaker sections. (It is relevant to note that in the Annual Policy for the year 2008-09, it has been announced that shortfall in lending by banks to weaker sections will be taken into account for contribution to RIDF or funds with other financial institutions as specified by RBI with effect from April 2009.)

iii) IWG feels that banks should be encouraged to issue more and more General Credit Cards (GCC) which enables small borrowers’ credit facility, up to Rs. 25,000 at their rural and semi urban branches. This credit facility being a revolving credit based on assessment of household cash flows and the limits are sanctioned without insistence on security or purpose. The GCC could complement the existing “no frills” account policy. All lending through GCCs could be treated as indirect finance to agriculture or other priority sector. (It may be noted that the Annual Policy Statement of 2008-09 has now permitted banks to classify 100 per cent of the credit outstanding under GCC and overdrafts up to Rs.25,000/- against no frills accounts in rural and semi urban areas as indirect finance to agriculture under priority sector.)

(B) Priority Sector – Non-farm credit

1. NCEUS Recommendation

Based on the recommendations made by its Task Force on Credit, the NCEUS has made the following recommendation.

The Commission recommends that an explicit target of 10.0 per cent be set for lending to small and micro enterprises under the priority sector. Furthermore, within the 10.0 per cent quota set for the small and micro enterprises, the Commission recommended the following.

- ***A 4.0 per cent target be set with respect to micro enterprises with capital investment (other than land and building) up to Rs.0.5 million, which is to be gradually enhanced to 8 per cent of the net bank credit- this growth in credit to be achieved in a phased manner in 5 years (Box 12.4).***

2. Relevant Observations Contained in NCEUS Report

III.27. The NCEUS observed that there has been a dilution of the Priority Sector Lending Policy. The operational relevance of the priority sector lending has been weakened by the inclusion of a vast number of items (Section-12.27). Over the years, particularly after the mid-nineties, relatively high credit worthy activities like housing, education, transportation, and loans to professionals have been included in the priority sector. This has adversely affected the credit flow to the needy sectors (Section-14.27). There has clearly been a decline in the credit flow from public sector banks and commercial banks to the SSI sector and to the tiny enterprises, especially since the mid-1990s (Section-12.28). In this context, the observations of NCEUS Task Force on Credit could be seen below (*Box 12.4 of the NCEUS Report):*

- 93.8 per cent of the SSIs' investment in plant and machinery is less than Rs.0.5 million (3rd Census of SSI);

- 14.3 per cent of the SSI units in registered sector availed bank finance, while only 3.1 per cent of the unregistered units had access to bank finance (3rd Census of SSI, 2001-02);

- Almost equal number of enterprises (4.1 per cent) had access to institutional credit and to non-institutional credit including those from relatives and money lenders (NSSO 55th Round);

- The number of SSI accounts declined from 3.0 per cent of the total to 1.2 per cent and the credit from 11.5 per cent of the net bank credit to 4.1 per cent;

- There has been a decline in the SSI credit as per cent of net bank credit from 15.4 per cent in 1997-98 to 6.4 per cent in 2005-06.

III.28. Following the financial sector reforms and the imperative need to restructure the existing credit institutions, the nature of credit support to the SSI sector has undergone a change and the direct outreach of sector to the institutional sources, especially in rural areas, has declined. Currently, credit support to the small enterprises follows a multi agency approach through the following: direct lending, indirect lending in the form of micro credit through intermediaries, credit and enterprise development support through schemes, and schemes such as Credit Guarantee Scheme to commercial banks to encourage lending to the small enterprises (NCEUS, 2007).

III.29. The growth in the SSI credit has not kept pace with the growth in NBC. While NBC grew by 17.3 per cent in 2000-01, SSI credit grew by only 5.4 per cent that year and while NBC grew by 25.0 per cent in 2002-03, SSI credit recorded a negative growth of 3.6 per cent. In 2006-07 while NBC grew by 39.2 per cent, SSI credit grew by 25.7 per cent only. Furthermore, the share of SSI in Net Bank Credit has declined from 15.5 per cent in 1996-97 to as low as 7.2 per cent in 2006-07 (Table-5). It may also be observed that around 58.0 per cent of the total priority sector lending was extended to the SSI sector in 1969 – the year when priority sector lending was introduced. This share has been falling consistently. It was around 39.0 per cent in 1992 declining thereafter to 24.0 per cent in 2004 and to 18.1 per cent by 2007.

Table-5: Flow of credit from Commercial Banks to SSI Sector

Year	Net Bank Credit (Rs. Crore)	Annual Growth (per cent)	Credit to SSI (Rs. Crore)	Annual Growth (per cent)	SSI as percentage of Net Bank Credit
1994-95	192424		29175		15.2
1995-96	228198	18.6	34246	17.4	15.0
1996-97	245999	7.8	38196	11.5	15.5
1997-98	297265	20.8	45771	19.8	15.4
1998-99	339477	14.2	51679	12.9	15.2
1999-00	398205	17.3	57035	10.4	14.3
2000-01	467206	17.3	60141	5.4	12.9
2001-02	535063	14.5	67107	11.6	12.5
2002-03	668576	25.0	64707	-3.6	9.7
2003-04	664244	-0.6	71209	10.0	10.7
2004-05	877708	32.1	76592	7.6	8.7
2005-06	1266689	44.3	101285	32.2	8.0
2006-07	1763709	39.2	127323	25.7	7.2

Source: Compiled from Report on Trend and Progress of Banking in India, RBI (Various issues).

III.30. The share of Micro Enterprises with investment in plant and machinery up to Rs. 25 lakh as percentage of both gross bank credit and SSI credit declined over time before recouping somewhat in the recent years. This segment receives less than 3.0 per cent of gross bank credit and around one third of SSI credit (Table- 6).

III.31. The Third Census of SSI (2001-02) found that only 14.26 per cent of the registered units (registered with District Industries Centres of the State Governments) availed of bank finance, while only 3.09 per cent of the unregistered units had access to bank finance[11]. This means that about 97.0 per cent of the smaller among the small enterprises or the non-farm unorganised enterprises (NFUEs) have no access to the institutional credit. In other words, most of the non-farm unorganised enterprises existing in the form of tiny and micro enterprises used self-finance (savings) or borrowed funds from friends, relatives and moneylenders. Against this backdrop, the NCEUS has made the above recommendation and suggested for a clear stipulation of sub-targets in the SSI sector.

Table- 6: SCB's Credit to Micro Enterprises (Rs. Crore)

Sl.No	Segment of Credit	2002-03	2003-04	2004-05	2005-06	2006-07
1	Gross Bank Credit	7,78,043	9,02,026	10,45,954	14,43,920	18,41,878
2	Credit to SSI	64,707	71,209	83,498	101,285	127,323
3	Credit to Micro Enterprises with investment in P&M up to Rs. 5 lakh	15,080	13,677	14,482	17,308	21,768
4	3 as percentage of SSI credit	23.3	19.2	17.34	17.10	17.10
5	Credit to Micro Enterprises with investment in P&M between Rs. 5 lakh and Rs. 25 lakh	13,896	14,870	14,048	17,672	23,550
6	5 as percentage of SSI credit	21.4	20.9	16.82	17.4	18.5
7	Credit to Micro Enterprises with investment in P&M up to Rs. 25 lakh (3+5)	28,976	28,547	28,530	34,980	45,318
8	7 as percentage of SSI credit	44.8	40.1	34.16	34.50	35.60
9	7 as percentage of GBC	3.7	3.1	2.7	2.4	2.5

Source: Compiled from Report on Trend and Progress of Banking in India, RBI (Various issues).

3. Background and Review of Present Status

III.32. The Ministry of Small Scale Industries has been earlier using a term 'Small Scale Industries (SSI),' defined in terms of investment in plant and machinery. The enterprises with an investment of Rupees one crore in plant and machinery were categorised as 'Small Scale Industries' for the period 1990 to 2001. Thereafter, the limit was raised to

[11] According to the Third Census of SSIs (2001-02), of the total number of 10.5 million small enterprises in 2001-02, about 87 per cent units were unregistered (not registered with DICs), while 1.04 lakh units were factory units with power (employing more than 10 workers and registered under the Factories Act).

Of the manufacturing SSI units 99.5 per cent were tiny units now called micro units (having an investment in plant and machinery less than Rs. 25 lakh), about 94 per cent of the units were having investment in Plant and Machinery up to Rs 5 lakh. We may call this segment as ''Special Subgroup of Micro Enterprises" (SSME).

Rs. 5 crore for high-tech and certain export industries. A sub-segment of enterprises with investment in plant and machinery not exceeding Rs 25 lakh within the SSI sector was termed as ‘tiny units’. A minor segment of enterprises in the service sector also existed within the SSI fold, which was defined in terms of fixed investment not exceeding Rs 10 lakh. The segment was named as ‘Small Scale Service and Business Enterprises’ (SSSBE).

III.33. Further, with the enactment of Micro, Small and Medium Enterprises (MSMED) Act, 2006, a new norm of classification has been prescribed for both manufacturing and service enterprises. The positive feature of this Act is that it recognises micro enterprise sector (both manufacturing and services) as a separate category since clubbing of micro enterprises with the small and the medium enterprises greatly reduces the chances of the benefits flowing to the micro segment. Considering the definitions of the MSMED Act and that of the NCEUS together, micro enterprises could be defined as unincorporated enterprises with an investment in plant and machinery up to Rs. 25 lakh and employing less than 10 workers.

III.34. In terms of RBI (RPCD) Master Circular dated July 2, 2007 on lending to Small and Medium Enterprises sector, Small Enterprises have been classified into Small (manufacturing) Enterprises and Small (service) Enterprises with investments in plant and machinery of Rs. 5 crore and Rs. 2 crore, respectively. As a subset of Small Enterprises, Micro (manufacturing) and Micro (service) enterprises have been defined with investments in plant and machinery not exceeding Rs.25 lakh and Rs. 10 lakh, respectively.

III.35. Over time, in order to ensure that the banking system would assist the SSI sector, the Government had brought this sector under the Priority Sector Lending Programme. As per the policy package announced by the Government of India for stepping up credit to SME sector, banks are expected to fix self-set target for growth in advances to SME sector in order to achieve a minimum 20.0 per cent year on year growth in credit to SMEs with the objective of doubling the flow of credit to the SME sector within a period of 5 years, *i.e.,* from 2005-06 to 2009-10.

4. Observations of the IWG

III.36. In pursuance of the recommendations of the Internal Group on Credit Flow to the SME sector (Chairman: Shri C.S. Murthy), the Union Finance Minister had announced certain measures in the Parliament on August 10, 2005 for stepping up credit to small and medium enterprises (SMEs). As a follow-up to the announcement made, all public sector banks were advised on August 19, 2005 to take the following measures:

i) Units with investment in plant and machinery in excess of SSI limit and up to Rs.10 crore may be treated as Medium Enterprises (MEs). Only SSI financing will be included in the priority sector.

ii) All banks may fix self-targets for financing the SME sector so as to reflect a higher disbursement over the immediately preceding year, while the sub-targets for financing tiny and smaller units to the extent of 40 per cent and 20 per cent, respectively, may continue. Banks may arrange to compile data on outstanding credit to the SME sector as on March 31, 2005 as per new definition showing the break up separately for tiny, small and medium enterprises.

iii) Banks may initiate necessary steps to rationalise the cost of loans to the SME sector by adopting a transparent rating system with cost of credit being linked to the credit rating of an enterprise.

iv) In order to increase the outreach of formal credit to the SME sector, all scheduled commercial banks, including regional rural banks may make concerted efforts to provide credit cover on an average to at least 5 new small/medium enterprises at each of their semi-urban/urban branches per year. Based on the guidelines issued on lending to the SSI sector, the boards of directors of banks may formulate comprehensive and more liberal policies than the existing ones in respect of loans to the SME sector. Till the time banks formulate such a policy, the current instructions of the Reserve Bank will be applicable to advances granted/to be granted by banks to SME units.

v) In view of the benefits accruing on account of cluster based approach for financing the SME sector, banks may treat it as a thrust area and increasingly adopt the same for SME financing.

vi) Banks may ensure specialised SME branches in identified clusters/centres with preponderance of medium enterprises to enable SME entrepreneurs to have an easy access to the bank credit and to equip bank personnel to develop requisite expertise. The existing specialized SSI branches may also be re-designated as SME branches. For wider dissemination and easy accessibility, the policy guidelines formulated by boards of banks as well as the instructions/guidelines issued by the Reserve Bank may be displayed on the respective websites of banks as well as on website of SIDBI. Banks may also prominently display all the facilities/schemes offered by them to small entrepreneurs at each of their branches.

III.37. The above measures, except setting up of specialised SME branches in identified clusters/centres with preponderance of medium enterprises, were communicated to all banks for necessary action - private, foreign, regional rural and local area - in August 2005. The Reserve Bank has constituted empowered committees at the Regional Offices to review the progress in SME financing and rehabilitation of sick SSI and Medium Enterprises (ME) units, and coordinate with other banks/financial institutions and the State Governments in removing bottlenecks, if any, to ensure smooth flow of credit to the sector. These regional level Committees may decide the need to have similar committees at cluster/district levels. The commercial banks (including regional rural banks) with over 67,000 branches, are making concerted efforts to provide credit cover on an average to at least 5 new tiny, small and medium enterprises at each of their semi urban/urban branches per year.

III.38. Reserve Bank had issued a detailed master circular on the time to be taken for disposing of loan applications of SSI units, the limit up to which banks are obliged to grant collateral-free and composite loans, norms for computation of working capital credit limits to SSI units, opening of at least one specialized SSI branch in each district, *etc*. Taking these guidelines as indicative minimum, banks will formulate a comprehensive and more liberal policy relating to advances to SME sector.

III. 39. The NCEUS recommended that instead of clubbing small and micro enterprises under 'others" category[12] as at present, an explicit target of 10 per cent be set for lending to these enterprises and within this, a 4 per cent target be set with respect to micro enterprises with capital investment (other than land and building) up to Rs.0.5 million.

III.40. The IWG agrees with the Commission's recommendation in principle. The intent of Commission is currently served under the following guidelines.

(a) 40.0 per cent of the total advances to small enterprises sector should go to micro (manufacturing) enterprises having investment in plant and machinery up to Rs. 5 lakh and micro (service) enterprises having investment in equipment up to Rs. 2 lakh;

(b) 20.0 per cent of the total advances to small enterprises sector should go to micro (manufacturing) enterprises with investment in plant and machinery above Rs. 5 lakh and up to Rs. 25 lakh, and micro (service) enterprises with investment in equipment above Rs. 2 lakh and up to Rs. 10 lakh. (Thus 60.0 per cent of small enterprises advances should go to the micro enterprises).

III 41. IWG agrees with the NCEUS recommendations in principle. However, the objective of the Commission is taken care by having an allocation of 18 per cent for agriculture under priority sector against which the actual lending by public and private sector banks was Rs.2,58,122.2 crore (15.1 per cent) as on September 2007. Of the total credit of public and private sector banks at Rs.17,09,396.9 crore, the flow of credit to the small and micro enterprises was at Rs.1,72,916.8 crore (or 10.1 per cent of the adjusted net bank credit) as on September 2007 – higher than the target of 4.0 per cent recommended by the NCEUS. Within the loans to small and micro enterprises sector, banks are required even under the present policy to allocate 40 per cent to micro enterprise up to Rs 5 lakh and another 20 per cent for micro enterprises between Rs 5 lakh and Rs 25 lakh. Thus even as of now, 60 per cent of small and micro enterprises loans are required to be given to micro-enterprises.

III. 42. As per the extant guidelines on the priority sector lending, banks have been given adequate freedom to direct their lending to the micro enterprises. The issue of fixing sub-targets to Micro and Small Enterprises (MSEs) was examined in detail earlier in the context of prescription of sub-target to small and marginal farmers. IWG feels that there are already various targets/sub-targets prescribed for credit to different sectors/sub-sectors. Additional target separately for micro enterprises apart from creating more restrictions may create operational difficulties to banks. The IWG views that fixing more targets within the ambit of priority sector may negate the changing structure of production in a dynamic economy. The IWG also recognizes that there is a need to focus on improving credit absorption capacity of these units by improving their viability.

III.43. The IWG recognizes that under the current dispensation, 60.0 per cent of small and micro enterprises loans are required to be given to micro-enterprises and may endevour to reach these targets set for this class of borrowers.

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[12] 'Others' include small scale sector, agro industries, industrial estates, small and road transport operators, education, retail trade, small business, professionals, self-employed, consumption, housing, etc.

__5. Suggested Way forward__

III.44. In view of the above, the following action points may be considered:

The IWG is broadly in agreement with the intent of this recommendation. Of the total credit outstanding of the public and private sector banks, as on September 2007, at Rs.17,09,396.9 crore, the flow of credit to the small and micro enterprises was at Rs.1,72,916.8 crore (or 10.1 per cent of the adjusted net bank credit) - higher than the target recommended by the NCEUS. Setting an explicit target of 10 per cent could discourage further the flow of credit. The IWG is of the view that the present system of banks having a self set target for SME sector with an increase of 20 per cent each year is preferable. Within the aggregate loans to small and micro enterprises sector, banks are required to allocate 40.0 per cent to micro enterprises with investments in plant and machinery up to Rs 5 lakh and another 20.0 per cent for micro enterprises with investments between Rs 5 lakh and Rs 25 lakh under the present policy. Thus, even as of now, 60.0 per cent of small and micro enterprises loans are required to be given to micro-enterprises.

CHAPTER IV

ISSUES RELATING TO IMPROVING THE ACCESS TO CREDIT AND FINANCIAL SERVICES

I. ISSUE: Extending the Outreach of Commercial Banks in Unbanked Areas

(A) Clubbing of Commercial bank Branches

__1. NCEUS Recommendation__

The Commission has made various recommendations in its Report on credit to overcome the problem of shrinking outreach in rural areas. This includes clubbing of branches for assessment of profit and incentives for opening branches in unserved areas. It has recommended that the RBI issue necessary guidelines in this respect (para 14.27).

__2. Relevant Observation Contained in NCEUS Report__

IV.46 The Sengupta Committee Report has said that the position of institutional credit with respect to agriculture, and more so, with respect to marginal and small farmers continues to be unsatisfactory. The Report says, for instance, that the share of agricultural credit in the Net Bank Credit (NBC) declined from 17 per cent in 1994 to 9 per cent in 2004. However, the announcement of Government Policy in 2004 requiring the doubling of agricultural credit in three years, has led to an increase in the volume of credit, but as a percentage of NBC it still stood at a low 11.9 per cent in 2006. As far as marginal and small farmers are concerned, the Farmers' Surveys bring out a dismal picture in terms of their access to institutional credit (paras 12.49, 12.50).

3. Background and Review of Present Status

IV.47 The outreach of the banking services expanded during the financial reform period with the adoption of liberalized policies towards branch licensing, para banking and introduction of legislative amendments enabling introduction of new and innovative financial instruments. There is a significant rural presence of banks in India with the existing number of nearly 48,000 rural and semi-urban branches. To ensure greater access to various financial services by the disadvantaged sections of the society, the Reserve Bank has placed distinct emphasis on the process of financial inclusion. The process of financial inclusion consists of seeking each household and ensuring their inclusion in the banking system. The main features of the approach involve 'connecting' people with the banking system and not just credit dispensation; and using multiple channels such as civil service organisations, NGOs, post offices, farmers' clubs, panchayats, MFIs (other than NBFCs), etc., as Business Correspondents / Business Facilitators to expand the outreach of banks. Further, a decentralised approach is adopted which is state / region specific, and has close involvement and cooperation between the respective State Governments and banks.

IV.48 It was recognised that in many banks, the requirement of minimum balance and charges levied, although accompanied by a number of free facilities, deterred a sizeable section of population from opening / maintaining bank accounts. The RBI, therefore, advised the banks in November 2005 to make available a basic banking 'no-frills' account either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of population. This was aimed at achieving the objective of greater financial inclusion.

IV.49 In pursuance of the objective of increasing the outreach of the banking sector in every nook and corner of the country, banks have been permitted to use the services of Non-Governmental Organisations / Self Help Group (NGOs / SHGs), Micro Finance Institutions (MFIs) and other Civil Society Organisations (CSOs) as intermediaries in providing financial and banking services through the use of Business Facilitator / Business Correspondent Model as per the guidelines issued in this regard vide RBI circulars dated January 25, 2006 and March 22, 2006.

IV.50 RBI has taken a number of other measures to tackle financial exclusion by enhancing basic banking services. These include: simplified KYC norms, use of NGOs/people's organisations and post offices as intermediaries, use of IT solutions for branchless banking etc. The forum of SLBC (State Level Bankers Committee) /DLCC (District Level Clearance Committee) is being used to achieve the objective and SLBC Convenors have been advised to give special priority to districts with concentration of SC/STs and minorities.

IV.51 Banks are taking steps, based on Khan Committee recommendation, to appoint Business Correspondents & Business Facilitators; to bring into the banking fold financially excluded masses. Banks are also in the process of setting up credit counseling centers at villages to bring about awareness among the people of the various services and products available with the bank at lower interest as compared to the high interest charged by the Money Lenders, who provide easy and timely finance to the illiterate people in the rural areas.

IV.52 Information technology is critical to minimising transaction costs. The Government's on-going massive programme of rural employment and pension payments *etc.*, can be implemented with minimal transaction costs by recourse to financial inclusion through IT. Several districts have already been covered under total financial inclusion and a process of evaluation and feedback is underway. RBI is encouraging and aiding the process.

IV.53 In the context of increasing focus on financial inclusion, and the past episodes of financial distress observed in certain segments of the farming community, a need has been felt to provide a mechanism for improving the financial literacy and level of financial education among the consumers of banking services. Such education has become an imperative in the current era of financial deregulation, which has led to availability of a variety of complex financial products in the markets. A beginning has been made to enhance financial literacy and impart financial education to enable vast numbers of new entrants into employment and higher incomes to better manage their finances in a rapidly evolving market oriented financial sector.

3. Extant Policies on Opening, Shifting, Merger and Closure of a Bank Branch

IV.54 The opening of new branches and shifting of existing branches of banks is governed by the provisions of Section 23 of the Banking Regulation Act, 1949. In terms of these provisions, banks cannot, without the prior approval of the Reserve Bank, open a new place of business in India or abroad or change otherwise than within the same city, town or village, the location of the existing place of business.

IV.55 The branch authorisation policy framework of the Reserve Bank incorporates public interest dimensions such as:

(a) The RBI will, while considering applications for opening branches give weightage to the nature and scope of banking facilities provided by banks to common persons, particularly in under-banked areas (districts), actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services.

(b) An assessment will be made on minimum balance requirements and whether depositors have access to minimum banking or "no frills" banking services, commitment to the basic banking activity viz., acceptance of deposits and provision of credit and quality of customer service as, inter alia, evidenced by the number of complaints received and the redressal mechanism in place in the bank for the purpose.

4. Observations of the Internal Working Group

IV.56 RBI's thrust on increasing the outreach of the banking sector and directing it to rural areas and areas of financial exclusion is reflected in the present system of branch opening authorization, which gives due weightage to the nature and scope of banking facilities provided by banks to common persons, particularly in under-banked areas (districts), actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services.

IV.57 With a view to encourage banks to open branches in under-banked districts a list of under-banked districts has also been forwarded to banks under the Branch Authorisations Policy. As a result, banks have to keep in mind reaching the under-banked areas while drawing up their yearly plans for branch authorisations. Further it is stipulated that new private sector banks are to ensure that at least 25.0 per cent of their branches are in rural/semi-urban areas on an ongoing basis.

IV.58 However, financial inclusion objectives would not be fully met if the banks do not increase the banking outreach to the remote corners of the country. This involves affordable infrastructure and low operational costs with the use of appropriate technology. This would enable banks to lower the transaction costs to make small ticket transactions viable. RBI has vide circular of May 7, 2007 brought out this aspect and while acknowledging that a few banks have already initiated certain pilot projects in different remote parts of the country utilizing smart cards/mobile technology to extend banking services similar to those dispensed from branches, urged banks to scale up their financial inclusion efforts by utilizing appropriate technology. RBI has also asked banks to ensure that the solutions developed are highly secure, amenable to audit and follow widely accepted open standards to allow inter-operability among the different systems adopted by different banks.

IV.59 It may be mentioned that the new policy does not preclude the possibility of any urgent proposals for opening bank branches being considered by the RBI even outside the annual plan, especially in the rural / under-banked areas, anytime during the year. The new policy provides ample flexibility to the banks. The actual number of authorisations issued by the RBI under the new policy has been much higher than before. For instance, as against the a total of 881, 1125 and 1259 authorisations given by the RBI under the old policy regime during 2003-04, 2004-05 and 2005-06, respectively, the number of authorisations issued under the new policy during 2006-07 was 2028. Thus, as against the general perception that the new policy has been more restrictive in granting authorisations, the fact is that there has been a sharp increase of about 61 per cent in the total number of authorisations granted last year.

IV.60 However, similar improvements have not been observed in the case of utilising the authorisations received by the banks. Even though the banks were granted authorisations to the extent of 97.0 per cent and 62.0 per cent of the authorisations sought by them for the years 2004-05 (April-March) and 2005-06, respectively, as at end-March 2007, as much as 30.0 per cent and 38.0 per cent of the authorisations granted for those years had still not been utilised, even after more than a year or two of grant of the authorisations.

IV.61 RBI has laid down clear norms for merger/closure of bank branches in rural area. As a matter of policy, merger of a sole rural branch / semi-urban branch is not permitted, as merging the same with a branch outside the center would render the centre unbanked. Though the banks are expected to submit their branch requirements through their annual branch expansion plans, notwithstanding the above, banks may approach RBI for any urgent proposals regarding opening of branches, especially in rural/ under-banked areas (districts), anytime during the year, in addition to the approvals given under the annual plan, which are considered on merit.

IV.62 Banks have already been permitted to use the services of Non-Governmental Organisations / Self Help Group (NGOs/SHGs), Micro Finance Institutions (MFIs) and other Civil Society Organisations (CSOs) as intermediaries in providing financial and banking services through the use of Business Facilitator/ Business Correspondent Model as per the guidelines issued in this regard by RBI. As a result, it may be pointed out that more and more banks may go in for Business Correspondent /Business Facilitator rather than “brick and mortar” model of opening branches in rural/semi-urban areas. As evident from the data, the banking outreach has made significant progress particularly in the recent years as a sequel to RBI’s initiatives focusing on financial inclusion. After the nationalisation of major banks in India in 1969, there was considerable expansion of branch network to unbanked areas and stepping up of lending to agriculture, small industry and business. More recently, the focus is on establishing the basic right of every person to have access to affordable basic banking services. In this regard, one common measure of judging the degree of financial inclusion is the percentage of adult population having bank accounts. Going by the available data on the number of savings bank accounts and assuming that one person has only one account, (which assumption may not be correct as many persons could have more than one bank account) it is found that on an all India basis 59 per cent of adult population in the country have bank accounts – in other words 41 per cent of the population is unbanked. In rural areas the coverage is 39 per cent against 60 per cent in urban areas. The unbanked population is higher in the North Eastern and Eastern regions (Usha Thorat, 2007).

IV.63 It is pertinent to note that the recent Union Budget, 2008-09 announced the acceptance of the recommendations of the Committee on Financial Inclusion Viz., to advise commercial banks, including RRBs, to add at least 250 rural household accounts every year at each of their rural and semi-urban branches. Furthermore, the Union Budget, 2008-09 has proposed to allow individuals such as retired bank officers, ex-servicemen etc., to be appointed as business facilitator or business correspondent or credit counselor; banks to be encouraged to embrace concept of Total Financial Inclusion; Government to request all scheduled commercial banks to follow the example set by some public sector banks and meet the entire credit requirements of SHG members, namely, income generation activities, social needs like housing, education, marriage etc., and debt swapping. In the above milieu, the IWG shares the concerns expressed by the NCEUS Report and accepts that there is a need to expand the accessibility of banking services in rural areas by exploring various alternatives. The IWG views that Banks need to take steps to popularise the Business Correspondent and Business Facilitators (BCBF) model to target such under-served segment of population in the rural areas so as to provide banking services. Further, banks may also be encouraged to adopt innovative technologies and thereby improve banking accessibility to the unorganised sector. The current branch licensing policy also emphasizes extension of bank branches to unbanked areas and liberal branch licensing for

RRBs in these areas. Therefore, banks may strive to increase their customer base taking into account the existing vast potential in the rural areas.

5. Suggested Way Forward

IV.64 In view of the above, the IWG recommends the following action points:

(i) The IWG fully shares the concerns expressed by the NCEUS Report about the imperative need to improve the outreach and expand the accessibility of banking services in rural areas by exploring various alternatives. The IWG recognizes that the RBI's thrust on increasing the outreach of the banking sector and directing it to rural areas and areas of financial exclusion is amply reflected in the present system of branch opening authorization. The present policy accords due weightage to the nature and scope of banking facilities provided by banks to common persons, particularly in under-banked areas (districts), actual credit flow to the priority sector, pricing of products and overall efforts for promoting financial inclusion, including introduction of appropriate new products and the enhanced use of technology for delivery of banking services. With a view to encourage banks to open branches in under-banked districts a list of under-banked districts has also been forwarded to banks under the Branch Authorisation Policy. As a result, banks have to keep in mind reaching the under-banked areas while drawing up their yearly plans for branch authorisations. Further it is stipulated that new private sector banks are to ensure that at least 25.0 per cent of their branches are in rural/semi-urban areas on an ongoing basis. RBI has also laid down clear norms for merger/closure of bank branches in rural areas. As a matter of policy, merger of a sole rural branch / semi-urban branch is not permitted, as merging the same with a branch outside the center would render the centre unbanked.

(ii) In addition, IT based financial inclusion and adoption of BF/BC model by banks are recommended to increase the outreach of banks to underbanked / banked areas.

(iii) The IWG recommends that each State Level Banking Committee (SLBC) may be required to examine the areas where physical location of branches is required and that State Government should provide assistance to banks in opening branches at these centres.

STATISTICS RELATING TO SCHEDULED COMMERCIAL BANKS AT A GLANCE

	June	March	March	March	March	March	March	March	March
Indicators	1969	2000	2001	2002	2003	2004	2005	2006	2007
Number of Commercial Banks	89	298	300	297	292	290	289	222	183
Number of Bank Offices in India	8262	67868	67937	68195	68500	69170	70373	71685	73836
(a) Rural	1833	32852	32585	32503	32283	32227	30790	30436	30560
(b) Semi-Urban	3342	14841	14843	14962	15135	15288	15325	15811	16484
Total ((a)+(b))	5175	47693	47428	47465	47418	47515	46115	46247	47044
per cent of Rural and Semi-Urban in Total	62.6	70.3	69.8	69.6	69.2	68.7	65.5	64.5	63.7
(c) Urban	1584	10994	11193	11328	11566	11806	12419	13034	13840
(d) Metropolitan	1503	9181	9316	9402	9516	9750	11839	12404	12952
Population per Office	64000	15000	15000	15000	16000	16000	16000	16000	16000
Credit of Scheduled Commercial	44	669	779	893	1143	1330	1700	2209	2757
Scheduled Commercial Banks' Advances	504	155779	182255	205606	254648	263834	381476	510175	632647
to Priority Sectors (Rs. crore)									
Share of Priority Sector Advances in total credit	14	35.4	31	34.8	35.1	34.5	36.7	35.3	34.3
of Scheduled Commercial Banks (per cent)									

Notes :

1. Number of bank offices includes Administrative Offices.
2. Classification of bank offices according to population for the year 1969 is based on 1961 census and for the subsequent years up to March 2004, it is based on 1991 census. For March 2005 up to March 2007, classification of bank offices were based on 2001 census.
3. Population per office, per capita deposits and per capita credit are based on the estimated mid-year population figures, supplied by the Office of the Registrar General, India.
4. Scheduled Commercial Banks' advances to priority sectors and the related ratios are exclusive of Regional Rural Banks.

(B) Adoption of Agency Models by Commercial banks

1. NCEUS Recommendation

The Reserve Bank based on the recommendations of the H.R. Khan Committee, has permitted the banks to adopt the agency model consisting of business correspondents and business facilitators, by utilizing civil society organisations, and existing infrastructure. However, banks are not inclined to adopt this model because of cost considerations. Hence, the Commission has recommended that some incentives may be provided to the banks, in the form of tax or other benefits, to adopt this model (para 14.27).

2. Relevant Observations Contained in NCEUS Report

IV.65 The Report draws attention to the decline in the credit flow from public sector banks and commercial banks to the SSI sector and to the tiny enterprises, particularly since the mid-1990s. The Commission had set up a Task Force under the Chairmanship of Prof. V. S. Vyas, which submitted its findings on credit related issues of the non-agricultural unorganised sector. The Task Force reported a very limited outreach of institutional finance and sharp contraction of formal credit to the unorganised sector since 1991. Alternative ways of financing the sector's requirements including through micro-credit have had limited success (para 12.28).

3. Background and Review of Present Status

IV.66 As mentioned earlier, with an objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, banks have been permitted to use the services of Non-Governmental Organisations / Self Help Group (NGOs / SHGs), Micro Finance Institutions (MFIs) and other Civil Society Organisations (CSOs) as intermediaries in providing financial and banking services through the use of Business Facilitator / Business Correspondent Model in pursuance of the recommendations of the Khan Committee Report.

IV.67 The activities of “business facilitators” would include (i) identification of borrowers and fitment of activities; (ii) collection and preliminary processing of loan applications including verification of primary information/data; (iii) creating awareness about savings and other products and education and advice on managing money and debt counselling; (iv) processing and submission of applications to banks; (v) promotion and nurturing Self Help Groups/ Joint Liability Groups; (vi) post-sanction monitoring; (vii) monitoring and handholding of Self Help Groups/ Joint Liability Groups/ Credit Groups/ others; and (viii) follow-up for recovery. The scope of activities to be undertaken by the Business Correspondents will include (i) disbursal of small value credit, (ii) recovery of principal / collection of interest (iii) collection of small value deposits (iv) sale of micro insurance/ mutual fund products/ pension products/ other third party products and (v) receipt and delivery of small value remittances/ other payment instruments. The activities to be undertaken by the Business Correspondents would be within the normal course of the bank's banking business, but conducted through the entities indicated above at places other than the bank premises.

4. Observations of Internal Working Group (IWG)

IV.68 The IWG is of the opinion that according to para 4 of the Bank's circular on Financial Inclusion by Extension of Banking Services – Use of Business Facilitators and Correspondents (DBOD.No.BL.BC.58/22.01.001/2005-2006 dated January 25, 2006), banks may pay reasonable commission/fee to the Business Facilitators/Correspondents, the rate and quantum of which may be reviewed periodically. The agreement with the Business Facilitators/Correspondents should specifically prohibit them from charging any fee to the customers directly for services rendered by them on behalf of the bank. Hence the cost of the banks to the extent of payment of fees/commission to the Business Correspondents (BCs)/Business Facilitators (BFs) increases as the amount cannot be passed on to the customers.

IV.69 However, looked at from a broader perspective, opening of branches at each and every rural centers would also be unviable as the business is limited at these (rural) centers and for opening a branch, banks have to spend on the premises, staff, security etc. Whereas, banks can not open branches at every rural centre, BCs/BFs can be at every nook and corner at all the remotest places of the country and do not involve much of a setting up cost. Through BCs/BFs the banks can access a larger number of customers and the banking services can be accessed by the customers at every place. Hence, BCs/BFs are that way quite economical than the setting up of branches.

IV.70 Taking into this into account, the IWG is in agreement with the NCEUS recommendation to provide incentives to banks to adopt the agency model. Business Correspondent / Business Facilitator (BC/BF model) guidelines first came in January 2006. It is a branchless banking model mainly aimed to serve the under banked rural areas. Some of the major banks have adopted this model for delivery of branchless banking services in the under banked and under served areas of the country. Hence, it may be desirable to wait for some more time to see the acceptability of the BC/BF model. The IWG opines that in order to further promote the BC/BF model, the RBI may evaluate the response and explore the possibilities of incentivizing banks to adopt the agency model on a larger scale. The IWG also suggests that if reasonable cost of doorstep services can be recovered from the customers, banks may be incentivised to adopt the agency model in a greater way. The IWG is not in favour of tax sops as a general mode of providing incentives.

5. Suggested Way Forward

IV.71 In view of the above, the IWG recommends the following action points:

(i) Business Correspondent/ Business Facilitator (BC/BF model) guidelines first came in January 2006. It is a branchless banking model mainly aimed to serve the under banked rural areas. Some of the major banks have adopted this model for delivery of branchless banking services in the under banked and under served areas of the country. Hence, it may be desirable to wait for some more time to see the acceptability of the BC/BF model. The IWG opines that in order to further promote the BC/BF model, the RBI may evaluate the response and initiate policy measures to enable banks to adopt the agency model on a larger scale.

(ii) The IWG also suggests that if reasonable cost of doorstep services can be recovered from the customers, banks may be incentivised to adopt the agency model in a greater way.

(iii) However, the IWG is not in favour of tax sops as a general mode of providing incentive to adopt this model.

II. ISSUE: Cost of Credit

A) Cost of credit to the unorganised non-agricultural sector should be affordable and should be kept on par with the agricultural sector's rate of interest.

1. NCEUS Recommendation

The Commission has recommended that the cost of credit to the unorganised non-agricultural sector should be affordable and should be kept on par with the agricultural sector. It is also recommended that the rate of interest on loan up to Rs 0.5 million to farm and non-farm unorganised enterprises should be same as in the case of agriculture (para 14.27).

2. Relevant Observation Contained in NCEUS Report

IV.72 Overall, the expansion of the non-farm activities helps reduce poverty levels by providing employment outside agriculture at a higher remuneration. A shift of the labour force out of agriculture into the non-agricultural sector can only happen if our growth strategy generates high growth in labour intensive manufacturing and in productive services sectors. Given the limited scope for employment generation in agriculture and the increasing vulnerability of the small and marginal farmers as also of the agricultural labourers in the liberalized scenario, it is imperative that the Government takes initiatives that promote both the expansion of non-farm sector and employment opportunities in the rural areas. In view of the above the employment intensive farm and non-farm unorganised enterprises deserve the same treatment as agriculture (para 12.58).

3. Background and Review of Present Status

IV.73 Reserve Bank of India began prescribing the minimum rate of interest on advances granted by Scheduled Commercial Banks with effect from October 1, 1960. Effective March 2, 1968, in place of minimum lending rate, the maximum lending rate to be charged by banks was introduced, which was rescinded with effect from January 21, 1970, when the prescription of minimum lending rate was reintroduced. The ceiling rate on advances to be charged by banks was again introduced effective March 15, 1976, and banks were also advised, for the first time, to charge interest on advances at periodic intervals, that is, at quarterly rests. In the following period, various sector-specific, programme-specific and purpose-specific interest rates were introduced.

IV.74 Given the prevailing structure of lending rates of Scheduled Commercial Banks, as it had evolved over time, characterised by an excessive proliferation of rates, in September, 1990, a new structure of lending rates linking interest rates to the size of loan was prescribed. This significantly reduced the multiplicity and complexity of interest rates. An objective of financial sector reforms has been to ensure that the financial repression inherent in administered interest rate regime is removed. Accordingly, in the context of granting greater functional autonomy to banks, effective October 18, 1994, it was decided to free the lending rates of scheduled commercial banks for credit limits of over Rs. 2 lakh; for loans up to Rs. 2 lakh, it was decided that it was necessary to continue to protect these borrowers by prescribing the lending rates [lending rates not to exceed Benchmark Prime Lending Rate (BPLR)]. For credit limits of over Rs.2 lakh, the prescription of minimum lending rate was abolished and banks were given the freedom to fix the lending rates for such credit limits subject to BPLR and spread guidelines. Banks are now required to obtain the approval of their respective Boards for the BPLR, which would be the reference rate for credit limits of over Rs.2 lakh. Each bank's BPLR has to be declared and be made uniformly applicable at all branches. Therefore, banks are given appropriate operational freedom to decide the cost of credit keeping in view the cost of funds.

4. Observations of the Internal Working Group (IWG)

IV.75 As part of the ongoing economic and financial sector reforms, there has been phased deregulation of interest rates and withdrawal of the credit allocation policy since the early 1990s in the interest of making the financial sector more efficient, and towards better price discovery of interest rates (Mohan, 2007). There has been a view that the spread of financial services and financial inclusion can be better achieved through pricing that allows recovery of costs so that banks have an incentive to expand such services and outreach to rural areas and to disadvantaged groups in the unorganised sector. According to this view, placing interest rate caps reduces bank lending to the target groups due to the implied losses that banks may incur. The NCEUS report, however, has advocated introduction of specific administered interest rates for specific purposes and groups and also credit allocation for specific groups through specified quotas and targets. Hence, there is considerable tension between these two views and a balanced view needs to be taken towards achieving the common objective of extending affordable credit in an expanded manner to small borrowers and traditionally disadvantaged groups in the unorganised sector.

IV.76 At present, the fixation of lending rates above Rs 2 lakh is left to the freedom of the banks based upon their BPLR. For loans up to Rs. 2 lakh, it has been stipulated that lending rates are not to exceed BPLR to protect the small borrowers. Furthermore, RBI has issued guidelines on May 7, 2007 to all commercial banks excluding RRBs wherein the banks are advised that though interest rates have been deregulated, rates of interest beyond a certain level may be seen to be usurious and can neither be sustainable nor be conforming to normal banking practice. Boards of banks are advised to lay out appropriate internal principles and procedures so that usurious interest, including processing and other charges, are not levied by them on loans and advances and an appropriate ceiling may be fixed on the interest, including processing and other charges that could be levied on such loans, which may be suitably publicised. The IBA has also issued guidelines to banks for the calculation of BPLR.

IV.77 Farmers obtain short-term credit from the cooperative credit structure and Regional Rural Banks (RRBs), with refinance from NABARD. Increasingly, scheduled commercial banks are also lending more to farmers. In order to provide refinance at an economical rate so that the farmer ultimately gets the loan at a reasonable rate, the Finance Minister in the Union Budget 2006-07 announced an interest subvention scheme through NABARD. Accordingly, banks with the refinance from NABARD are required to ensure that the farmer receives short-term credit at 7 per cent, with an upper limit of Rs.3 lakh on the principal amount. This policy came into effect from Kharif 2006-07.

IV.78 As the interest subvention for short-term credit to agriculture was announced in view of deep agrarian crisis compounded by heavy indebtedness also causing suicides among the small and marginal farmers, the IWG is of the opinion that this scheme should continue to ameliorate the distressed condition of farmers. At the same time, the IWG is of the opinion that further broadening of sectors to be eligible for interest subvention scheme is undesirable in an environment of deregulated interest rates, especially in view of non-discriminatory special treatment accorded to all small borrowers, whether farm or non-farm, of loans up to Rs. 2 lakh.

IV.79 At present, interest rate of 7.0 per cent for agricultural loans up to Rs. 3 lakh extended by banks are covered by subvention from Government of India. This interest subvention was necessitated due to the exigencies faced by the agriculture sector due to prolonged natural calamities that lead to agrarian distress, farmer suicides etc. The IWG is of the view that the more pressing issue in this context is the availability of adequate amount of credit and not on the rate of interest at which the credit is provided. There is also an apprehension that if ceiling on rates of interest is imposed upon banks, without subvention from government, it may lead an outcome of drying up of credit to this sector. One of the major causes for low availability of bank finance to the non-agricultural small borrowers is the high risk perception of the banks in lending to and consequent insistence on collaterals which are not easily available with them. In the light of the need to improving the risk assessment capabilities of the banks and the proposed setting up of credit information bureaus in the country, in future, the risk assessment capabilities of the banks would increase and there would be a decline in the transaction costs. As a result, the rates of interest are expected to come down. The setting up of the credit information bureaus may be expedited to bring down the transaction costs and improve efficiency.

5. Suggested Way Forward

IV.80 In view of the above, the IWG recommends the following action points:

The IWG agrees that the cost of credit should be affordable and reasonable for non-agricultural purposes. However, it may be recalled that a conscious process of phased deregulation of interest rates was implemented in India as a part of the financial sector reforms and operational flexibility was given to banks to decide the rates of interest keeping in view various factors like the underlying risk, cost of funds and a reasonable margin etc. It may be noted that the interest subvention for short-term credit to agriculture was announced in view of deep agrarian crisis. Already non-discriminatory special treatment is accorded to all small borrowers, whether farm or non-farm, of loans up to Rs. 2 lakh. One of the major causes for low availability of bank finance to the non-agricultural small borrowers is the high risk perception of the banks in lending to and consequent insistence on collaterals which are not easily available with them. In the light of the need to improving the risk assessment capabilities of the banks and the proposed setting up of credit information bureaus in the country, in future, the risk assessment capabilities of the banks would increase and there would be a decline in the transaction costs. As a result, the rates of interest are expected to come down.

At present, under the deregulated interest rates regime, banks are given freedom to fix the interest rates based on the BPLR and spread considerations, which is in line with the broader policy objective of granting greater functional autonomy to the banks. RBI has now moved away from the administrative regime of interest rates. However, interest rates on loans up to Rs.2 lakh in the priority sector cannot exceed the declared BPLR. The IBA has also issued guidelines to banks for the calculation of BPLR. Thus, the IWG believes that the current policy does try to balance the two contrasting views. However, efforts clearly need to be made to promote better and more efficient credit delivery, at finer pricing of interest rates reflecting real risks, to the members of the unorganized sector.

(B) Rationalising and Reducing the Cost of Credit to Small and micro enterprises

1. NCEUS Recommendation

There is a need to rationalise and reducing cost of credit to small and tiny enterprises by controlling the rate of interest which need to be governed by the overall cost and not specific high cost of lending of small loans alone.

2. Relevant Observations Contained in NCEUS Report

IV.81 There has clearly been a decline in the credit flow from public sector banks and commercial banks to the SSI sector and to the tiny enterprises, particularly since the mid-1990s. The NCEUS has examined the credit related issues of the non-agricultural unorganised sector in detail. It set up a Task Force under the Chairpersonship of Prof. V. S. Vyas, which has submitted its findings. One of the concerns expressed by the Task Force is the high cost of credit faced by the small and tiny enterprises.

3. Background and Review of Present Status

IV.82 At present, loans up to Rs. 2 lakh are advanced by the banks at the Prime Lending Rate (PLR) (at present 11.5 per cent) and loans above this amount at 13.0 to 16.0 per cent rate of interest. Keeping in view the international practice and to provide operational flexibility to commercial banks in deciding their lending rates, banks can offer loans at below BPLR to exporters or other creditworthy borrowers, including public enterprises, on the basis of a transparent and objective policy approved by their respective Boards. Given the prevailing credit market in India and the need to continue with concessionality for small borrowers, the practice of treating BPLR as the ceiling for loans up to Rs. 2 lakh will continue. Further, the rate of interest of 7 per cent is charged from agriculture (on loan up to Rs. 3 lakh), and handloom sector under Government directions. The rate of interest to small enterprises is governed by PLR. In addition, a 2.0 per cent spread and various service charges are also included in the cost of credit to the small enterprises.

4. Observations of the Internal Working Group (IWG)

IV.83 The IWG is in favour of affordable and reasonable cost of credit. However, this may not be achieved by imposing controls over the rate of interest due to the following reasons. Past experience of controlling interest rates by imposing caps suggests that generally such caps tend to become the floor. This would, in all probability, result in interest rates hovering around the cap. At the same time, it needs to be appreciated that the bank advances would need to cover the cost of funds being incurred by them in addition to the operational costs for providing near doorstep services to their customers. Credit is normally priced according to the risk perception of the borrower, transaction cost and funding cost. The funding cost is neutral across borrowers. While operational costs would vary from bank to bank depending on its size, territory being covered, organisation, method of operation, level of technology absorption, etc. It would, therefore, not be appropriate to control interest rates to reduce cost of funds. Credit record bureaus and credit information companies should be quickly established so that such record is available to banks to enable them to price credit according to risk. Thirdly, although it is recognized that banks incur higher transaction costs on small loans, banks could explore ways to reduce their transaction costs by adopting innovative technology, multiple lower cost delivery channels and consider reducing the service charges on small loans.

IV.84 Considering that in meeting the twin objectives of employment generation and poverty alleviation, small and non-farm enterprises would play a significant role as the large industries are experiencing 'jobless growth' and agriculture is experiencing stagnation, micro enterprises in farm and non-farm sector need to be provided with adequate and timely credit. What is more critical is the provision of adequate credit at right time rather than at a subsidized rate.

IV.85 One of the major causes for low availability of bank finance to the micro and small enterprises (MSE) sector is the high risk perception of the banks in lending to the MSEs and consequent insistence on collaterals which are not easily available with these enterprises. The problem is more serious for micro enterprises of the first generation entrepreneurs requiring small loans. In this context the setting up of credit information bureaus may be expedited to improve the information flow and thereby the risk assessment capabilities of the banks.

5. Suggested Way Forward

IV.86 In view of the above, the IWG recommends the following action points:

The IWG is in favour of affordable and reasonable cost of credit. Past experience of controlling interest rates by imposing caps suggests that generally such caps tend to become the floor. It needs to be appreciated that the bank advances would need to cover the cost of funds being incurred by them in addition to the operational costs. Credit is normally priced according to the risk perception of the borrower, transaction cost and funding cost. The funding cost is neutral across borrowers. While operational costs would vary from bank to bank depending on its size, territory being covered, organisation, method of operation, level of technology absorption, etc. It would, therefore, not be appropriate to control interest rates to reduce cost of funds. Credit record bureaus and credit information companies should be quickly established so that such record is available to banks to enable them to price credit according to risk. With the establishment of credit information bureaus and the improvement in risk assessment, it is expected that the transaction costs would come down leading to a reduction in interest rates.

III. Setting up of a credit guarantee fund in NABARD

1. NCEUS Recommendation

In order to reduce the perceived risk of default of the excluded segment, as well as the larger segment of marginal and small farmers, due to which the banks do not approach these farmers actively, the Commission has recommended that the Government may set up a Credit Guarantee Fund in NABARD, on the lines of the CGF set up by the Ministry of Micro, Small and Medium Enterprises, which provides guarantee cover on loans to small units (para 14.23).

2. Relevant Observations Contained in NCEUS Report

IV.87 The NCEUS observed that 20.0 to 40.0 per cent of marginal and small farmers are excluded from the formal financial sector due to lack of patta and title deeds. The majority of these farmers are informal tenants. The RBI has issued guidelines, following the Swarnkar Committee recommendations that such farmers be extended credit on the basis of certificates issued by the panchayats. However, banks are hesitant to actively approach these farmers due to the perceived risk of default of these small and marginal farmers (para 14.23).

IV.88 In view of the disinterest shown by banks in advancing loans under Credit Guarantee Scheme which is available for loans up to Rs 2.5 million, obtaining bank loans without collateral has been one of the main problems of agricultural and non-agricultural workers. In this context, the NCEUS observed that the impact of the agrarian distress has been felt most by marginal and small farmers. The access of these farmers to institutional credit being limited, they are compelled to take recourse to non-institutional sources of credit. Failure to repay these loans on time is one of the several causes of the crisis leading to tremendous vulnerability of this group of farmers. The Government has already initiated a number of measures to alleviate the distress faced by farmers. But the affected farmers, particularly the marginal and small farmers are indebted to non-institutional sources, and due to absence of title deeds etc., (more so in the case of tenants), they are not able to approach the institutional agencies. It is in this background, the NCEUS recommended that the Government may set up a Credit Guarantee Fund in NABARD.

3. Background and Review of Present Status

IV. 89 At present Credit Guarantee arrangements are covered under Schemes like credit guarantee schemes operated by Deposit Insurance and Credit Guarantee Corporation of India (DICGC), Rural Employment Generation Programme for Village Industries (REGP), and Credit Guarantee Fund Trust for Small Industries (CGFTSI) (detailed in Issue V).

IV.90 The Deposit Insurance and Credit Guarantee Corporation (DICGC) has been operating a few credit guarantee schemes, which include, Government of India Credit Guarantee Scheme for small scale industries that aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector. Effective from April 1, 1981, the DICGC extended its guarantee support to credit granted to small scale industries also, after the cancellation of the Government of India's credit guarantee scheme. With effect from April 1, 1989, guarantee cover was extended to the entire priority sector advances, as per the definition of the Reserve Bank of India. However, effective from April 1, 1995, all housing loans have been excluded from the purview of guarantee cover by the Corporation.

IV.91 Currently, there are three Credit guarantee Schemes operated by DICGC. These are as follows: (1) Small Borrowers’ Credit Guarantee Schemes: Under this, (i) Small Loans Guarantee Scheme, 1971 (SLGS 1971) and (ii) Small Loans (Co-operative Banks) Guarantee Scheme, 1984 (SLCBGS 1984), the DICGC had settled 3,74,23,627 claims for Rs.10,043.06 crore up to the year ended March 2007. Recoveries received under the Schemes during 2006-07, by virtue of Corporation’s subrogation rights, aggregated to Rs.6.11 crore as against Rs.8.37 crore during the previous year. The cumulative amount of recoveries received since the inception of the Schemes aggregated Rs.2,019.06 crore forming 29.10 per cent of total claims paid at Rs.6,938.84 crore. (2) Small Loans (SSI) Guarantee

Scheme, 1981: Recoveries made under this Scheme, during 2006-07 by virtue of the Corporation's right of subrogation amounted to Rs.0.68 crore as compared to Rs.1.03 crore during the previous year. Cumulative recoveries since 1981 aggregated Rs.265.94 crore as on March 31, 2007 forming 26.56 per cent of the total amount of claims paid at Rs.1001.13 crore. (3) Credit Guarantee Scheme for SSIs, Government's Credit Guarantee Scheme (since cancelled): The DICGC continues to act as an agent of the Government of India, to pursue with the credit institutions for recoveries in claim paid accounts under the erstwhile Government Scheme. No amount towards recoveries was received during the year ended March 31, 2007 under this Scheme.

IV.92 It may be noted that as on March 31, 2007, no credit institution was participating in any of the Credit Guarantee Schemes of the DICGC. No claim was received during the year 2006-07 under any of the credit guarantee schemes of the Corporation.

IV.93 The REGP Scheme, implemented by the Khadi and Village Industries Commission (KVIC) since April 1, 1995 provides credit to rural industries projects with a maximum investment limit of Rs.25 lakh. This scheme is linked with bank credit to generate employment in rural areas, develop entrepreneurial skill among rural unemployed youth and to facilitate participation of Banks in mobilization of credit to rural industries. Under the Scheme, installment of credit is released within 10 working day of the bank after successful completion of training. The Activities Covered under REGP Scheme include, agro based food processing, forest based industries, mineral based industries, rural energy bio–tech, annual husbandry, polymer / chemical based industries and service industries (Cooks etc). The flow of credit under the REGP is estimated at Rs.730 crore during 2005-06.

IV.94 Further, the banks find lending to small enterprises as a risky proposition. To take care of this problem, the Credit Guarantee Fund Trust Scheme for Small Industries was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly tiny units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/ third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI) and have contributed Funds in the ratio of 4:1 respectively. The Fund is operated by the Credit Guarantee Fund Trust for Small Industries (CGTSI) with headquarters in Mumbai and is in the nature of a special purpose Fund which extends guarantee cover for mitigating credit risk up to 75 per cent of the collateral free credits extended by eligible Member Lending Institutions (MLIs) subject to maximum credit of Rs. 25 lakh. Consequent to the announcement of the SME Credit Policy Package in August 2005, several changes have been introduced to make the Scheme attractive for tiny and rural enterprises. The guarantee fee has been reduced from 2.5 per cent to 1.5 per cent.

IV.95 The corpus of CGTSI is to be raised to Rs.2500 crore in next 5 years as per the Finance Minister's announcement in the Union Budget for 2006-07. The corpus of CGTSI, renamed as Credit Guarantee Fund Trust for Micro and Small Enterprises (CGFTMSE) stood at Rs.1,584 crore as on November 30, 2007 with the contribution of Rs.1,267 crore from GoI and Rs.317 crore from SIDBI. As on November 30, 2007, 66 eligible institutions comprising 28 Public Sector Banks, 13 Private Sector Banks, 22 Regional Rural Banks (RRBs), National Small Industries Corporation (NSIC), North Eastern Development Finance Corporation (NEDFC) and Small Industries Development Bank of India (SIDBI) have become Member Lending Institutions (MLIs) of CGFTMSE. As on November 30, 2007, 84507 proposals were approved for guarantee cover for aggregate credit of Rs.2294 crore. Compared to corresponding period in FY 2007 there has been a growth of 48.0 per cent in the number of cumulative approvals. Awareness campaigns through print media have been stepped up across the country to popularise the scheme among potential entrepreneurs and MLIs. All industrial and service activities other than retail trade are being covered under the scheme with effect from July 02, 2007. The eligible loan limit under the scheme has been raised from Rs.25 lakh to Rs.50 lakh. The coverage has also been raised to 80 per cent in respect of the loan to Micro Enterprises up to Rs.5 lakh and loan to Micro Enterprises operated and/or owned by women and for units in North Eastern Region. The Guarantee Fee has been reduced from 1.50 per cent to 0.75 per cent for all loans in North Eastern Region. It is also understood that some of the Banks are bearing a portion of the guarantee fee.

IV. 96 Banks have been giving publicity to various schemes/facilities like availability of collateral-free/composite loan and schemes under Technology Upgradation Fund Scheme (TUFS) /National Equity Fund (NEF)/ Credit Guarantee Fund Trust for Small Industries (CGTSI), etc. The State Bank of India, to increase awareness about the schemes/facilities to SSI sector, came out with a ‘Charter for SSI’ which was advertised in all leading newspapers. As advised by the Indian Banks’ Association (IBA), all 27 public sector banks have issued similar ‘Charter for SSI’.

IV.97 In the light of the recommendations of the Working Group (Chairman: Shri C.P. Swarnkar), constituted by the Reserve Bank for simplification of the procedures and processes for obtaining agricultural loans, especially by small and marginal farmers, the banks have been advised to immediately dispense with the requirement of "no due" certificate for small loans up to Rs.50,000 to small and marginal farmers, share-croppers and the like and, instead, obtain self-declaration from the borrower. In order to increase the flow of credit by the banks without insisting on collaterals, to overcome the problem faced by the banks in lending to landless labourers, share-croppers and oral lessees due to the absence of documents verifying their identity and status, as recommended by the Swarnkar Committee, banks have been advised to accept certificates provided by local administration/*panchayati raj* institutions regarding the cultivation of crops in case of loans to landless labourers, share-croppers and oral lessees.

IV. 98 It may be added that Short-term loans for raising crops, i.e., for crop loans covers traditional/non-traditional plantations and horticulture. Loans to small and marginal farmers for purchase of land for agricultural purpose are also provided by banks. Loans to distressed farmers indebted to non-institutional lenders, are provided against appropriate collateral or group security. Under direct finance for crop loans, banks provide advances up to Rs.10 lakh against pledge/hypothecation of agricultural produce (including warehouse receipts) for a period not exceeding 12 months, irrespective of whether the farmers were given crop loans for raising the produce or not. Loans are also granted for pre-harvest and post-harvest activities such as spraying, weeding, harvesting, grading, sorting, processing and transporting undertaken by households or groups/cooperatives of households.

4. Observations of the Internal Working Group (IWG)

IV. 99 On a review of the various existing credit guarantee schemes, it is noted that there are no schemes at present specifically to provide credit guarantee cover to loans extended to the agricultural sector, while the small enterprises covered under a CGFTMSE in SIDBI**.** Further, as announced by Governor, Reserve Bank of India, in the Annual Policy Statement 2006-07, RBI had constituted a Working Group on May 18, 2006 to suggest measures to assist distressed farmers including provision of financial counseling services and introduction of a specific Credit Guarantee Scheme under the DICGC Act 1961 for such farmers. The Working Group under the Chairmanship of Prof. S.S. Johl has since submitted its report to the Reserve Bank of India on November 14, 2006. In this context, on the lines of the CGF set up by the Ministry of Micro, Small and Medium Enterprises, which provides guarantee cover on loans to small units, an alternative proposal has been mooted by RBI based on Johl Committee recommendations on Measures to Assist Distressed Farmers, which is to offer a credit guarantee scheme through the DICGC. The scheme envisages that in the event of crop failure in the second consecutive year, banks will write off the rescheduled loan of the previous year up to Rs. 1 lakh, burden being shared by the banks and GoI. The RBI scheme proposed was applicable for all regions including rainfed regions.

IV.100 The recent Union Budget, 2008-09, announced two schemes: (i) *Crop Insurance*: National Agriculture Insurance Scheme (NAIS) to be continued in its present form for Kharif and Rabi 2008-09. Rs.644 crore provided for the scheme; and (ii) *Weather Based Crop Insurance Scheme* implemented as a pilot scheme in selected areas of five States to be continued; Rs.50 crore provided for this purpose in 2008-09. Besides, for plantation crops, crop insurance scheme for tea, rubber, tobacco, chilli, ginger, turmeric, pepper and cardamom is to be introduced. Although accepting in principle the need for a credit guarantee / insurance scheme, the IWG is of the view that weather, crop, livestock, health and other insurance for the weaker sections should be promoted. With regard to crop loans, various alternatives are required to be considered keeping in mind the insurance for crops and production while setting up the CGF. Past experience showed that Credit guarantee schemes always are not viable and if the coverage is too high, there could be moral hazards. The banks may become lethargic and complacent while undertaking credit assessment exercises.

5. Suggested Way Forward

IV.101 In view of the above, the IWG highlights the following points:

(i) As announced in the Annual Policy Statement 2006-07, RBI had constituted a Working Group on May 18, 2006 to suggest measures to assist distressed farmers including provision of financial counseling services and introduction of a specific Credit Guarantee Scheme under the DICGC Act, 1961 for such farmers. Based on the recommendations of the Working Group under the Chairmanship of Prof. S.S. Johl, on the lines of the CGF set up by the Ministry of Micro, Small and Medium Enterprises, which provides guarantee cover on loans to small units, an alternative proposal has been mooted by RBI to offer a credit guarantee scheme through the DICGC to distressed farmers.

(ii) It may be recalled that the recent Union Budget 2008-09, announced two schemes: (i) Crop Insurance: National Agriculture Insurance Scheme (NAIS) to be continued in its present form for Kharif and Rabi 2008-09 and Rs.644 crore is provided for the scheme; and (ii) Weather Based Crop Insurance Scheme implemented as a pilot scheme in selected areas.

(iii) However, the IWG cautions that earlier experience with Credit Guarantee schemes suggest that excessive guarantee coverage may lead to moral hazard. Besides, banks may become lethargic and complacent while undertaking credit assessment.

IV. ISSUE: Revision of the Credit Guarantee Scheme

1. NCEUS Recommendation

Loans under Credit Guarantee Scheme operated jointly by the Government of India and SIDBI up to Rs.0.5 million be made mandatory and guarantee cover be enhanced to 90 per cent on loans up to Rs.0.5 million; 1.5 per cent of guarantee fee on loan up to Rs.0.5 million should be met by the Government, out of the available corpus of proposed National Fund.

2. Relevant Observations Contained in the NCEUS Report

IV.112 Currently, credit support to the small enterprises follows a multi-agency approach through direct lending, indirect lending in the form of micro credit through intermediaries, credit and enterprise development support through schemes, and schemes such as Credit Guarantee to commercial banks to encourage lending to the small enterprises .

3. Background and Review of Present Status

IV.113 The loan limit under the scheme, which was Rs.10 lakh per borrower, has been enhanced to Rs.25 lakh per borrower in accordance with the Comprehensive Policy Package for SSIs announced on August 30, 2000 when the Scheme was formally launched. Further, through the Micro and Small Enterprise Package of February 2007, the collateral free loan limit has been raised to Rs. 50 lakh and guarantee cover has been raised to 80 per cent for loans up to Rs. 5 lakh and for women enterprises. As announced in the "Policy Package for Stepping up Credit to Small and Medium Enterprises 2005" and also in the Union Budget 2006-07, the guarantee fee has been reduced from 2.5 per cent to 1.5 per cent. Government has also decided to raise the size of the Fund to Rs.2,500 crore as initially proposed at the time of the formulation of the scheme.

IV.114 The scheme covers collateral free loan (term loan and/or working capital including non Fund based working capital) extended by eligible lending institutions to new and existing SSI units as well as Small Scale Service and Business (industry related) Entities (SSSBEs) including Information Technology and Software Industry up to Rs.25 lakh per borrowing unit. Apart from the Small Scale Industries falling within the purview of the Office of the Development Commissions (SSI), it has also been decided to bring Khadi and Village Industries, Coir and Handicraft Units within the fold of the scheme, if they intend to avail guarantee cover on bank loan.

IV.115 The Credit Guarantee Fund Trust Scheme for Small Industries was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly the tiny units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/third party guarantees. The guarantee cover under the scheme is up to 75.0 per cent of the credit subject to a maximum guarantee limit of Rs.18.75 lakh. However, the member lending institutions (MLIs) are allowed to extend additional credit facilities against collateral security and/or third party guarantee to the borrowers covered under the scheme in those cases where the credit facility covered under the scheme has already reached the ceiling of Rs.25 lakh.

IV.116 The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSI) now called Credit Guarantee Fund Trust for Micro and Small Enterprises (CGFTMSE) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI).

IV.117 As on September 30, 2007, 81,345 proposals from micro and small enterprises have been approved for guarantee cover for aggregate credit of Rs.2,152 crore, extended by 44 Member Lending Institutions (MLIs) in 35 States/UTs (Table 4). As a result of increased awareness campaigns of CGFTMSE (Credit Guarantee Fund Trust for Small Industries) and active support of all the stakeholders, the pace of proposals being accepted for guarantee cover has gone up significantly.

Table 4 : Operational Highlights of CGFTMSE				
Period	Active Member Lending Institutions (MLIs)	Number of Proposals Approved	Credit Amount Approved	Cumulative Guarantees Approved (Rs in Lakh)
2000-01	9	951	606	606
2001-02	16	2296	2952	3558
2002-03	22	4955	5867	9425
2003-04	29	6603	11760	21185
2004-05	32	9516	32677	53862
2005-06	36	16284	46191	100053
2006-07	40	27457	70453	170506
2007-08*	44	13283	44714	215220
Note: * Up to 30 September 2007. Source: SIDO.				

4. Observations of the Internal Working Group (IWG)

IV.118 The response of banks to Credit Guarantee Scheme is not satisfactory with the quantum of guaranteed loans still very less. The procedures for availing the schemes should be simplified for both the borrower and member lending banks and financial institution to make this scheme have its desired impact of encouraging loans to those entrepreneurs who can't arrange collaterals.

IV.119 Although the scheme has been in operation for the last six years, the coverage of loans is very low. Even if the scheme has started taking off smoothly in the recent years, the progress of the scheme has been tardy, when compared with the vast requirements of credit coverage of micro and unorganised enterprises in the country. Many banks do not find guarantee schemes preferable to collaterals. Most of the banks feel that loans with collateral gives them added comfort and as such are not inclined to sanction loans under guarantee scheme. Further, there is lack of awareness about this scheme at the banks' branch level.

IV.120 It is essential to extend the coverage of the scheme to the entire unorganised sector enterprises including handlooms, sericulture and micro enterprises. The guarantee fee increases the cost of loan, which mainly deters SSMEs in raising loans from the MLIs. The loan coverage up to 75 per cent of the loans is not a perfect substitute for collateral requirements and as such banks continue to prefer collaterals from their borrowers. The problem is more acute in cases of loan request by SSMEs as their credit worthiness is very low and limited capacity to arrange collateral for the loans. However, given the preponderance of SSMEs (94 per cent of total SSI) and their impact on creating livelihood opportunities, it is imperative to step up credit flow to them. It is pertinent to note that the recent Union Budget, 2008-09 has announced that: Credit Guarantee Trust with SIDBI had extended guarantees to 89,129 units for an amount of Rs.2,479 crore as on January 31, 2008; SIDBI to reduce the guarantee fee from 1.5 per cent to 1 per cent and the annual service fee from 0.75 per cent to 0.5 per cent for loans up to Rs.5 lakhs for micro, small and medium enterprises. In this context, the IWG notes that the earlier experience of Credit Guarantee Schemes showed that there could be a moral hazard if the coverage is too high and banks may act in a complacent manner while assessing the viability of credit proposals.

5. Suggested Way Forward

IV.121 The IWG notes the following points in this context:

(i) The IWG has taken note of the provisions of the recent Union Budget, 2008-09 that Credit Guarantee Trust with SIDBI would reduce the guarantee fee from 1.5 per cent to 1 per cent and the annual service fee from 0.75 per cent to 0.5 per cent for loans up to Rs.5 lakh for the micro, small and medium enterprises.

(ii) However, the IWG reiterates that earlier experience with credit guarantee Schemes suggest that if the coverage is too high it may lead to a moral hazard. Banks may become lethargic and complacent in undertaking appropriate assessment of the proposals.

V. ISSUE: Multipurpose Swarojgar Credit Cards

1. NCEUS Recommendation

Issue multipurpose Swarojgar Credit Cards for the self-employed persons in non- farm unorganised sector.

2. Relevant Observations Contained in the NCEUS Report

IV.122 To ensure better access to finance by the self-employed to meet their short-term financial needs including the emergency needs of the family, there is a need for issuing multipurpose Swarojgar Credit Cards for the self-employed persons in non- farm unorganised sector.

3. Background and Review of Present Status

IV.127 The genesis of the recommendation of the commission to issue multipurpose Swarojgar Credit cards for the self-employed persons in non-farm unorganised sector can be traced in successful operation of Kisan Credit Card (KCC) scheme for the agricultural sector, which has made rapid strides since its inception in 1998. As on February 28, 2007, a total number of 665.6 lakh Kisan Credit Cards had been issued by Commercial, Co-operative and Rural Regional Banks (Table 5). As a pioneering credit delivery innovation, Kisan Credit Card Scheme extended adequate and timely support to the farmers (through the banking system) for their cultivation needs including purchase of inputs in a flexible and cost effective manner. The Kisan Credit Card is envisioned to cover all the sections of people engaged in agricultural activities.

Table 5: Agency-wise, Year-wise Kisan Credit Cards Issued (As on February 28, 2007)				
				(lakh)
Year	**Co-operative Banks**	**RRBs**	**Commercial Banks**	**Total**
2002-03	45.79	9.64	27	82.43
2003-04	48.78	12.75	30.94	92.47
2004-05	35.56	17.29	43.95	96.8
2005-06	25.98	12.49	41.65	80.12
2006-07	22.97	14.06	37.67*	74.7
Total#	327.09	82.84	255.7	665.63

*: Data for commercial banks available up to December 31, 2006.
: Since inception of the scheme
Source: NABARD Annual Report, 2006-07.

IV.128 Various agencies have formulated different types of credit cards catering to the needs of some selected segments of the unorganised sector. These exist in the form of Laghu Udyami Credit Card, Artisan Credit Card and Swarojgar Credit Card. The Laghu Udyami Credit Card (LUCC) Scheme was launched on November 12, 2001 by the Indian Banks' Association. In the Scheme, Public Sector Banks provide simplified and borrower friendly Credit facilities to SSI, tiny enterprises, retail traders and artisans. The Artisans Credit Card (ACC) Scheme was introduced to meet the Working capital/Term loan requirement of artisans. All artisans involved in production/manufacturing process including the existing artisan borrowers (otherwise eligible for credit facilities for carrying out the proposed activities under any of the existing bank schemes) up to a credit limit of Rs 2 lakh were eligible for this scheme. Swarojgar Credit Card Scheme (SCC) is already in vogue since September 26, 2003, which aims to provide adequate and timely credit *i.e.,* working capital or block capital or both to small artisans, handloom weavers, service sector, fishermen, self employed persons, rickshaw owners other micro-entrepreneurs etc. from the banking system. The scheme is being implemented by all banks, SCBs/DCCBs/PACS/SCARDBS/PCARDBS and UCBs. The progress in its implementation is being monitored by NABARD.

IV.129 As on March 31, 2007 6.79 lakh SCCs were issued by banks involving credit limit of Rs. 2700.08 crore (Table 6). Year-wise progress of implementation of SCC Scheme is given below.

Table 6: Progress of SCC

Year	No of SCCs issued	Credit limit sanctioned (Rs crore)
2003-04	28,925	64.26
2004-05	150,615	468.27
2005-06	288,094	1410.65
2006-07	211441	756.9
Cumulative as on March 31, 2007	679075	2700.08
Source: NABARD.		

4. Observations of the Internal Working Group (IWG)

IV.130 The IWG agrees with the recommendation. All the credit card schemes are more or less targeted to the same category of beneficiaries *i.e.,* the self employed persons in the non-farm sector. A multipurpose credit card scheme could be better implemented and monitored. A single multi-purpose Swarojgar Credit Card for self-employed persons in the unorganised sector apart from being convenient in implementation would also ensure better access to finance to meet short-term financial needs of the enterprises including meeting the emergency needs of the family. No-frills accounts are already being promoted. Issue of credit cards will lead to extension of institutional credit cover in a meaningful way and will reduce dependence on moneylenders. There is scope for banks to come out with innovations in card products designed specially for the various segments of population in the unorganized sector.

5. Suggested Way Forward

IV.131 In view of the above, the IWG recommends the following action points:

(i) The IWG agrees with the recommendation. Banks should popularize Swarojgar Credit Cards and GCC for the non-farm unorganized sector.

(ii) Further, measures to allow credit information companies to be set up may be expedited as availability of credit record is a significant enabling factor in flow of credit to the unorganized sector.

CHAPTER V

OTHER ISSUES

I. ISSUE: Monitoring of Credit Flow by the RBI

(A) Credit Flow to Marginal-Small Farmers

1. NCEUS Recommendations

The Commission recommends that the Reserve Bank should separately monitor the credit flow to the marginal and small farmers.

2. Relevant Observations Contained in the NCEUS Report

V.1 The Commission is concerned that the position of institutional credit with respect to agriculture, and more so, with respect to marginal and small farmers continues to be unsatisfactory. The share of agricultural credit in the Net Bank Credit (NBC) declined from 17 per cent in 1994 to 9 per cent in 2004. The Government is currently seized of the issue of extending affordable credit to the agricultural sector. Banks have been asked to increase credit by 25 per cent each year, and the rate of interest has been pegged at 7 per cent. In areas of high agrarian distress, debt waivers and moratorium on debt waivers have been declared. A committee under Prof. R. Radhakrishna has been appointed to look into all aspects related to agricultural indebtedness in the areas of high agrarian distress, markets, procurement and risk. Also the risk factor has to be mitigated through appropriate farming strategies as well as adequate insurance. There is a need for insurance instruments that cover for production and also for market risks for all crops to reduce the financial risks and increase viability.

V.2 The Commission observed that the announcement of Government Policy in 2004 requiring the doubling of agricultural credit in three years, has undoubtedly led to an increase in the volume of credit, but as a percentage of NBC it still stands at a low 11.9 per cent in 2006. In this context the NCEUS viewed that as far as marginal and small farmers are concerned, the RBI does not maintain a separate record of their credit off-take but surveys such as the Farmers Survey bring out a dismal picture. The Commission is of the view, that in addition to the steps already taken by the Government and the banking system, a number of other measures need to be initiated on an urgent basis, focusing particularly on the issue of credit availability to marginal and small farmers.

V.3 Further the Commission had observed that the position of institutional credit with respect to agriculture, and more so, with respect to marginal and small farmers has been reviewed by the Commission and is found to be unsatisfactory. Surveys such as the Situation Assessment Survey of Farmers (2003) bring out their dismal state. In this context, the Commission recommended an immediate Action Plan that Reserve Bank should separately monitor the credit flow to this segment of farmers *i.e.*, marginal and small farmers.

3. Background and Review of Present Status

V. 4 The Commission has stated that RBI does not maintain separate record of credit off-take by small and marginal farmers. It has been a constant endeavour of the Reserve Bank to improve the access of credit to small and marginal farmers. The Reserve Bank does maintain a separate record in terms of both land-holding size and credit limit-wise credit off-take of various categories including the small and marginal farmers. A historic time-series data on land-holding size-wise credit availability is maintained, updated and published every year in the Hand Book of Statistics on the Indian Economy. Similarly, credit-limit-wise data is published in the Basic Statistical Returns every year.

V.5 The RBI collects data regarding credit disbursements to small and marginal farmers under the Special Agricultural Credit Plan (SACP). The public sector banks have been formulating SACP since 1994. Under this scheme, public sector banks were required to fix self-set targets for disbursement of agricultural credit on the basis of their previous year’s disbursements. Since June 2004 when “Doubling of Agriculture Credit Policy” was launched more emphasis is being given to make available financial assistance to small and marginal farmers. A separate record of credit off-take by these classes is maintained. The RBI, the NABARD and in the case of RRBs Sponsor Banks are calling data on monthly basis in order to monitor the credit flow to these segments .

V.6 As recommended by the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman : V. S. Vyas, 2004), banks were advised to make efforts to increase their disbursements to small and marginal farmers to 40 per cent of their direct lending to agriculture by March 2007. Pursuant to the announcements made in the Mid-Term Review of Annual Policy for 2004-05, the SACP mechanism has been made applicable to private sector banks also from the year 2005-06. Details in respect of loans provided by public sector banks to small and marginal farmers under SACP and its percentage to direct agricultural finance during the last three years could be seen from Table 1.

Table 1: Flow of Credit to Small and Marginal Farmers under SACP

			(Rs. in crore)
Year	**Direct Finance to Agriculture**	**Disbursements to small and marginal farmers**	**Percentage of Column (3) to Column (2)**
1	2	3	4
2004-05	50247.85	20776.77	41.35
2005-06	67917.47	27752.54	40.86
2006-07	91693.65	40965.29	44.68

4. Observations of the Internal Working Group

V.7 The Reserve Bank has been collecting data from the commercial banks through various special statistical returns for the purpose of monitoring the flow of credit to various sectors and also disseminating the same through several publications of the RBI. The IWG observes that at present, Special Returns-1(annual) have been prescribed by RBI for collection of data from Small and marginal farmers *i.e.,* according to land holding size covering short-term loan and term loans. The return also covers state wise information on small and marginal farmers. The information is required to be furnished by scheduled commercial banks on disbursement during the year and balance outstanding with reference to last Friday of June on number of accounts and amount.

V.8 Small and marginal farmers are also covered in one of the category of Weaker Sections in Priority Sector together with landless labourers, tenant farmers and share cropper. This category might be covering loans for other occupations (dairy, bee keeping, piggery etc) other than direct finance to agriculture (covered in Special Return I).

V.9 Data on Small and marginal farmers pertaining to Scheduled Commercial Banks' Direct Finance to Farmers according to size of land holdings (disbursements) short-term and long-terms loans are released by the RBI in its publication 'Hand Book of Statistics on the Indian Economy' as at the year end June (Table 59) giving the yearly position. Table No.60 in the above mentioned publication provides the information on outstanding position of short-term and long-term loans according to size of land holdings.

V.10 As detailed above, although the RBI separately monitors data regarding credit disbursements to small and marginal farmers under the Special Agricultural Credit Plan (SACP), the IWG agrees in principle with the NCEUS recommendation and recognizes the importance of collecting detailed data on credit to agricultural workers, such as small and marginal farmers, oral lessees, share croppers, informal tenant farmers, landless agricultural labourers etc., and disseminating the same.

5. Suggested Way Forward

V.11 The action point that emerge is:

The IWG agrees with the NCEUS and recommends that RBI should make available in timely fashion detailed information on the flow of credit to agricultural workers, such as small and marginal farmers, oral lessees, share croppers, informal tenant farmers. It may be stated that the Reserve Bank does maintain a separate record in terms of both land-holding size and credit limit-wise credit off-take of various categories including the small and marginal farmers. A time-series data on land-holding size-wise credit availability is maintained, updated and published every year in the Hand Book of Statistics on the Indian Economy. Similarly, detailed credit-limit-wise data is published in the Basic Statistical Returns every year. The RBI also collects data regarding credit disbursements to small and marginal farmers under the Special Agricultural Credit Plan (SACP).

(B) Monitoring Credit Flow to Micro Enterprises

1. NCEUS Recommendation

"As we have suggested in the case of credit to marginal and small farmers, the RBI should issue guidelines for monitoring of credit flow to the micro-enterprise sector, with capital investment up to Rs.0.5 million and between Rs.0.5 to 2.5 million".

2. Relevant Observations Contained in the NCEUS Report

V.12 The NCEUS observed that an analysis of the credit situation for the unorganised non-agricultural sector revealed the declining access of this sector to the institutional credit. The report *inter alia* recommended that the RBI should issue guidelines for monitoring of credit flow to small & medium enterprises and micro enterprises with investment in plant and machinery up to Rs.0.5 million and those between Rs.0.5 million to Rs. 2.5 million separately.

3. Background and Review of Present Status

V.13 According to RBI's instructions to banks, on lending to Small and Medium Enterprises, the Small Enterprises have been classified into Small (manufacturing) Enterprises and Small (Service) Enterprises with investments in plant and machinery up to Rs. 5 crore, and Rs. 2 crore, respectively. As a subset of Small Enterprises, Micro (Manufacturing) and Micro (service) enterprises have been defined with investments in plant and machinery not exceeding Rs.25 lakh and Rs. 10 lakh, respectively.

4. Observations of the Internal Working Group

V.14 The IWG observed that as per the extant guidelines to banks on lending to Small and Medium Enterprises sector, the sector has been classified into Small (manufacturing) Enterprises and Small (Service) Enterprises with investments in plant and machinery Rs.5 crore and Rs.2 crore, respectively. As a subset of Small Enterprises, Micro (Manufacturing) (Enterprise engaged in the manufacture/production or preservation of goods) and whose investment in plant and machinery (original cost excluding land and building and such items) and Micro (service) enterprises (Enterprise engaged in the providing/rendering of services) and whose investment in equipment (original cost excluding land and building and furniture, fittings and such items) have been defined with investments in plant and machinery not exceeding Rs.25 lakh and Rs. 10 lakh, respectively.

V.15 At present, there is a well-structured mechanism for policy formulation, disbursement and monitoring of the credit flow to the SMEs. There is a Standing Advisory Committee on Flow of Credit to SME sector, which is the highest forum under the aegis of the Reserve Bank for critically reviewing the flow of institutional credit to SME sector. The Deputy Governor of Reserve Bank chairs the Committee and the Executive Director, RBI, Development Commissioner and Additional Secretary, Ministry of SME, Government of India, Joint Secretary, Ministry of Agriculture, Government of India, eminent bankers, representatives of SME Associations, SIDBI, NABARD, KVIC and SFC are members of this forum. Reserve Bank had earlier advised all scheduled commercial banks except RRBs to set up cells at important regional centres, beside the cell at Head Office, to deal with the sector and man them with expert staff including technical personnel. Banks were also advised to open at least one Specialised SME branch in each district. Further banks were permitted to categorize their general banking branches having 60 per cent or more of their advances to SME sector as specialised SME branches for providing better service to this sector. Banks were advised to put in place a machinery at the regional offices to entertain complaints from the borrowers regarding their service to SME customers and to verify periodically that Reserve Bank guidelines are implemented by the branches in actual practice. The names and addresses of the officer with whom complaints are to be lodged were also to be displayed on the notice board of every branch.

V.16 At the Regional Offices of the Reserve Bank, empowered committees have been constituted with the Regional Director of the Reserve Bank as the Chairman and the SLBC Convenor, senior level officers from two banks having predominant share in SME financing in the State, representative of SIDBI Regional Office, the Director of Industries of the State Government, one or two senior level representatives from the SME/SSI Associations in the State, and a senior level officer from SFC/SIDC as members. The Committee meets periodically and reviews the progress in MSE (micro and small enterprises) financing. It also coordinates with other banks/financial institutions and the state Government in removing bottlenecks, if any, to ensure smooth flow of credit to the sector. These committees decide the need to have similar committees at cluster/district levels.

V.17 Banks are monitoring lending under this sector through their controlling offices. Further, some of the banks are opening specialised MSE branches in identified clusters/centres with preponderance of Medium Enterprises to enable the SME entrepreneurs to have an easy access to the bank credit and to equip bank personnel to develop requisite expertise. The core competence of these MSE branches are being utilised for extending finance and other services to MSE sector. They also have operational flexibility to extend finance/render other services to other sectors/borrowers. Boards of banks review the progress in achieving the self-set targets as also rehabilitation and restructuring of MSE accounts on a periodical basis. Existing MIS (Management Information System) captures data on credit flow under Micro, Small, Medium Enterprises targets. However, the IWG agrees in principle with the NCEUS recommendation and recognizes the need to collect and disseminate comprehensive data on credit to micro (both manufacturing and services) and small enterprises (including tiny) and publish the same.

5. Suggested Way Forward

V.18 The action point that emerge is:

Similar to small and marginal farmers, at present, there is a well-structured mechanism for policy formulation, disbursement and monitoring of the credit flow to the SMEs. There is a Standing Advisory Committee on Flow of Credit to SME sector, which is the highest forum under the aegis of the Reserve Bank for critically reviewing the flow of institutional credit to SME sector. At the Regional Offices of the Reserve Bank, empowered committees have been constituted, which meets periodically and reviews the progress in micro and small enterprises financing. Banks are monitoring lending under this sector through their controlling offices. The IWG agrees with the views of the NCEUS and recommends that RBI should make available in a timely fashion comprehensive information on flow of credit to micro enterprise (both manufacturing and services) and small enterprises (including tiny) as indicated by the NCEUS.

II. ISSUE: Compliance Issues

1. NCEUS Recommendation

The RBI has issued guidelines, following the Swarnkar Committee recommendations that such farmers be extended credit on the basis of certificates issued by the panchayats. These guidelines should be complied with by the banks and the procedures simplified to the extent necessary.

2. Relevant Observations Contained in the NCEUS Report

V.19 The commission viewed that about 20 - 40 per cent of marginal and small farmers are excluded from the formal financial sector due to lack of patta and title deeds. The majority of these farmers are informal tenants. The RBI has issued guidelines, following the Report of the Working Group to Examine the Procedures and Processes of Agricultural Loans (Swarnkar Committee) recommendations that such farmers be extended credit on the basis of certificates issued by the panchayats. In view of this, the impact of agrarian distress has been felt most by marginal and small farmers. Further, the access of these farmers to institutional credit being limited, they are compelled to take recourse to non-institutional sources of credit. Failure to repay these loans on time is one of the several causes of the crisis leading to tremendous vulnerability of this group of farmers. The Government has already initiated a number of measures to alleviate the distress faced by farmers. But the affected farmers, particularly the marginal and small farmers are indebted to non-institutional sources, and due to absence of title deeds etc (more so in the case of tenants), they are not able to approach the institutional agencies.

3. Background and Review of Present Status

V.20 The Reserve Bank issued circular to Banks as on April 30, 2007 in response to the recommendations of the Swarnkar Committee Report. At present, one of the hurdles faced by the farmers approaching for bank loans is the ‘No Dues’ Certificate (NDC) that they have to produce to the bank granting the loan, from various banks/co-operatives operating in the area. This entails a considerable amount of time and money for the farmers to be spent even to get a small loan. In order to obviate this situation, banks may immediately dispense with the requirement of "no due" certificate for small loans up to Rs.50,000 to small and marginal farmers, share-croppers and the like and instead, obtain self-declaration from the borrower.

V.21 One of the problems faced by banks in lending to landless labourers, share-croppers and oral lessees is the absence of documents verifying their identity and status. In order to overcome this problem**,** banks may accept certificates provided by local administration/*panchayati raj* institutions regarding the cultivation of crops in case of loans to landless labourers, share-croppers and oral lessees. Furthermore, the Annual Policy Statement for 2007-08 proposed to:

- dispense with the requirement of "no due" certificate for small loans up to Rs.50,000 to small and marginal farmers, share-croppers and the like and instead, obtain self-declaration from the borrower.
- accept certificates provided by local administration/*panchayati raj* institutions regarding the cultivation of crops in case of loans to landless labourers, share-croppers and oral lessees.”

V.22 To improve the access to savings and loan facilities to the underprivileged and unbanked population, banks are expected to adopt a flexible approach within the parameters of guidelines issued on KYC from time to time. The KYC guidelines issued provide sufficient flexibility to banks. In addition to introduction from any person on whom KYC has been done, banks can also rely on certificates of identification issued by the intermediary being used as Banking Correspondent, Block Development Officer (BDO), head of Village Panchayat, Post Master of the post office concerned or any other public functionary, known to the bank.

4. Observations of the Internal Working Group

V.23 The IWG agrees with the NCEUS recommendation. In order to ensure compliance of RBI guidelines by banks, the IWG views that there is a need to widely disseminate the same through various media and other means of communications, evolve a system of ensuring dissemination, and a grievance redressal mechanism in this regard.

5. *Suggested Way Forward*

V.24 The actions that emerged are:

The IWG strongly recommends that RBI guidelines based on the Swarnkar Committee should be widely disseminated through variety of media in local languages including newspaper, radio, TV, etc. The RBI may also evolve a system of ensuring dissemination at the local level as also a grievance redressal mechanism for not complying with the guidelines.

Chapter VI: Summary of the IWG Recommendations

Summary of the Recommendations made by the Internal Working Group on the Sengupta Committee (NCEUS) Report

The Internal Working Group (IWG) adopted broadly a consultative approach and held extensive deliberations with internal and external agencies to examine the NCEUS Report and conceive an action plan for implementation of recommendations related to the Indian financial system. Based on the discussions and analysis of facts, Internal Working Group has arrived at a consensus on the feasibility or other-wise of implementing each of the relevant recommendations made by the NCEUS Report. Accordingly, a summary of the recommendations and action points emerging out of the Internal Working Group is presented below.

I. <u>Action Points Relating to the Reserve Bank of India (RBI)</u>

Sr. No.	Recommendations of NCEUS Report	Observations / Recommendations of the Internal Working Group
1.	***Revision in the Priority Sector Targets:*** *The NCEUS recommends that the current priority sector guidelines of the RBI, which fixes a quota of 18 per cent for agriculture, 10 per cent for weaker sections, including marginal and small farmers, and 12 per cent for other designated purposes be amended. The NCEUS recommends the following revisions.* *Since the priority sector quota for agriculture is 18 per cent (of which 10 per cent should be reserved for the small and marginal farmers), and another 10 per cent for small and micro enterprises, this would leave a quota of 12 per cent from the total priority sector allocation of 40 per cent, which, in the Commission's view, should be allocated for socio-economically weaker sections, for purposes of housing, education, professions, etc. with a loan ceiling of Rs. 0.5 million.*	(i) The NCEUS recommendation is that within the priority sector there should be allocation of 12 per cent out of 40 per cent for socio-economically weaker sections. Currently, there is a stipulation that 10.0 per cent of ANBC (adjusted net bank credit) should be earmarked for weaker sections that inter-alia covers small and marginal farmers, artisans, landless labourers, tenants, SC/ST beneficiaries, SHGs and beneficiaries of specified Government sponsored schemes. Against this the public sector banks' actual achievement was 8.6 per cent as on September 2007. (ii) The IWG suggests that RBI may consider measures to evolve a system of disincentive to banks for failure to reach the sub target of 10.0 per cent for weaker sections. (It is relevant to note that in the Annual Policy for the year 2008-09, it has been announced that shortfall in lending by banks to weaker sections will be taken into account for contribution to RIDF or funds with other financial institutions as specified by RBI with effect from April 2009.)

Sr. No.	Recommendations of NCEUS Report	Observations / Recommendations of the Internal Working Group
		(iii) IWG feels that banks should be encouraged to issue more and more General Credit Cards (GCC) which enables small borrowers' credit facility, up to Rs. 25,000 at their rural and semi urban branches. This credit facility being a revolving credit based on assessment of household cash flows and the limits are sanctioned without insistence on security or purpose. The GCC could complement the existing "no frills" account policy. All lending through GCCs could be treated as indirect finance to agriculture or other priority sector. (It may be noted that the Annual Policy Statement of 2008-09 has now permitted banks to classify 100 per cent of the credit outstanding under GCC and overdrafts up to Rs.25,000/- against no frills accounts in rural and semi urban areas as indirect finance to agriculture under priority sector.)
2.	***Explicit Target for Small and Micro Enterprises:*** *The Commission recommends that an explicit target of 10 per cent be set for lending to small and micro enterprises. Furthermore, within the 10.0 per cent quota set for the small and micro enterprises, the Commission has recommended the following.* *i) A 4 per cent target be set with respect to micro enterprises with capital investment (other than land and building) up to Rs.0.5 million, which is to be gradually enhanced to 8 per cent of the net bank credit- to be achieved in a phased manner in 5 years.*	The IWG is broadly in agreement with the intent of this recommendation. Of the total credit outstanding of the public and private sector banks, as on September 2007, at Rs.17,09,396.9 crore, the flow of credit to the small and micro enterprises was at Rs.1,72,916.8 crore (or 10.1 per cent of the adjusted net bank credit) - higher than the target recommended by the NCEUS. Setting an explicit target of 10 per cent could discourage further the flow of credit. The IWG is of the view that the present system of banks having a self set target for SME sector with an increase of 20 per cent each year is preferable. Within the aggregate loans to small and micro enterprises sector, banks are required to allocate 40.0 per cent to micro enterprises with investments in plant and machinery up to Rs 5 lakh and another 20.0 per cent for micro enterprises with investments between Rs 5 lakh and Rs 25 lakh under the present policy. Thus, even as of now, 60.0 per cent of small and micro enterprises loans are required to be given to micro-enterprises.
3.	***Delinking of Subsidy from SGSY:*** *The NCEUS suggested that subsidy component of SGSY be pooled into the funds made available under the programme for capacity building and establishing infrastructure and backward-forward linkages*	The IWG supports this recommendation as capacity building and establishing infrastructure and backward/ forward linkages is more productive and enables effective utilization of subsidy.
6.	***Multipurpose Credit Cards:*** *Issue multipurpose Swarojgar Credit Cards for the self-employed persons in non- farm unorganized*	(i) The IWG agrees with the recommendation. Banks should popularize Swarojgar Credit Cards and GCC

Sr. No.	Recommendations of NCEUS Report	Observations / Recommendations of the Internal Working Group
	sector.	for the non-farm unorganized sector. (ii) Further, measures to allow credit information companies to be set up may be expedited as availability of credit record is a significant enabling factor in flow of credit to the unorganized sector.
7.	***Monitoring of Credit Flow:*** *The NCEUS recommends that:* *a) The Reserve Bank should separately monitor the credit flow to marginal and small farmers.* *b) The RBI should issue guidelines for monitoring of credit flow to the micro-enterprise sector, with capital investment up to Rs.0.5 million and between Rs.0.5 to 2.5 million.*	(i) The IWG agrees with the NCEUS and recommends that RBI should make available in timely fashion detailed information on the flow of credit to agricultural workers, such as small and marginal farmers, oral lessees, share croppers, informal tenant farmers. It may be stated that the Reserve Bank does maintain a separate record in terms of both land-holding size and credit limit-wise credit off-take of various categories including the small and marginal farmers. A time-series data on land-holding size-wise credit availability is maintained, updated and published every year in the Hand Book of Statistics on the Indian Economy. Similarly, detailed credit-limit-wise data is published in the Basic Statistical Returns every year. The RBI also collects data regarding credit disbursements to small and marginal farmers under the Special Agricultural Credit Plan (SACP). (ii) Similar to marginal and small farmers, at present, there is a well-structured mechanism for policy formulation, disbursement and monitoring of the credit flow to the SMEs. There is a Standing Advisory Committee on Flow of Credit to SME sector, which is the highest forum under the aegis of the Reserve Bank for critically reviewing the flow of institutional credit to SME sector. At the Regional Offices of the Reserve Bank, empowered committees have been constituted, which meets periodically and reviews the progress in micro and small enterprises financing. Banks are monitoring lending under this sector through their controlling offices. The IWG agrees with the views of the NCEUS and recommends that RBI should make available in a timely fashion comprehensive information on flow of credit to micro enterprise (both manufacturing and services) and small enterprises (including tiny) as indicated by the NCEUS.
8	***Compliance with the Guidelines:*** *The RBI has issued guidelines, following the Swarnkar Committee recommendations that such farmers be extended credit on the basis of certificates issued by the panchayats. The NCEUS observes that these guidelines should be complied with by the banks and the procedures simplified to*	The IWG strongly recommends that RBI guidelines based on the Swarnkar Committee should be widely disseminated through variety of media in local languages including newspaper, radio, TV, etc. The RBI may also evolve a system of ensuring dissemination at the local level as also a grievance

Sr. No.	Recommendations of NCEUS Report	Observations / Recommendations of the Internal Working Group
	the extent necessary.	redressal mechanism for not complying with the guidelines.

II. <u>Joint Action Points Relating to the Reserve Bank of India and Other Agencies</u>

Sr. No.	Recommendations of NCEUS Report	Recommendations of the IWG
1.	***Agency Model:*** *Banks are not inclined to adopt the agency model because of cost considerations. Hence, the Commission has recommended that some incentives may be provided to the banks, in the form of tax or other benefits, to adopt this model.*	(i) Business Correspondent/ Business Facilitator (BC/BF model) guidelines first came in January 2006. It is a branchless banking model mainly aimed to serve the under banked rural areas. Some of the major banks have adopted this model for delivery of branchless banking services in the under banked and under served areas of the country. Hence, it may be desirable to wait for some more time to see the acceptability of the BC/BF model. The IWG opines that in order to further promote the BC/BF model, the RBI may evaluate the response and initiate policy measures to enable banks to adopt the agency model on a larger scale. (ii) The IWG also suggests that if reasonable cost of doorstep services can be recovered from the customers, banks may be incentivised to adopt the agency model in a greater way. (iii) However, the IWG is not in favour of tax sops as a general mode of providing incentive to adopt this model.
2.	***Setting up of Credit Guarantee Fund in NABARD:*** *In order to reduce the perceived risk of default of the larger segment of marginal and small farmers, due to which the banks do not approach them actively, the Commission has recommended that the Government may set up a Credit Guarantee Fund in NABARD, on the lines of the CGF set up by the Ministry of Micro, Small and Medium Enterprises, which provides guarantee cover on loans to small units.*	(i) As announced in the Annual Policy Statement 2006-07, RBI had constituted a Working Group on May 18, 2006 to suggest measures to assist distressed farmers including provision of financial counseling services and introduction of a specific Credit Guarantee Scheme under the DICGC Act, 1961 for such farmers. Based on the recommendations of the Working Group under the Chairmanship of Prof. S.S. Johl, on the lines of the CGF set up by the Ministry of Micro, Small and Medium Enterprises, which provides guarantee cover on loans to small units, an alternative proposal has been mooted by RBI to offer a credit guarantee scheme through the DICGC to distressed farmers. (ii) It may be recalled that the recent Union Budget 2008-09, announced two schemes: (i) Crop Insurance: National Agriculture Insurance Scheme

Sr. No.	Recommendations of NCEUS Report	Recommendations of the IWG
		(NAIS) to be continued in its present form for Kharif and Rabi 2008-09 and Rs.644 crore is provided for the scheme; and (ii) Weather Based Crop Insurance Scheme implemented as a pilot scheme in selected areas. (iii) However, the IWG cautions that earlier experience with Credit Guarantee schemes suggest that excessive guarantee coverage may lead to moral hazard. Besides, banks may become lethargic and complacent while undertaking credit assessment.
3.	***Liberalizing the Credit Guarantee Scheme:*** *The NCEUS recommends that loans under Credit Guarantee Scheme up to Rs.0.5 million be made mandatory and guarantee cover be enhanced to 90 per cent on loans up to Rs.0.5 million; 1.5 per cent of guarantee fee on loan up to Rs.0.5 million should be met by the government, out of the available corpus of proposed National Fund.*	(i) The IWG has taken note of the provisions of the recent Union Budget, 2008-09 that Credit Guarantee Trust with SIDBI would reduce the guarantee fee from 1.5 per cent to 1 per cent and the annual service fee from 0.75 per cent to 0.5 per cent for loans up to Rs.5 lakh for the micro, small and medium enterprises. (ii) However, the IWG reiterates that earlier experience with credit guarantee Schemes suggest that if the coverage is too high it may lead to a moral hazard. Banks may become lethargic and complacent in undertaking appropriate assessment of the proposals.
4.	*The NCEUS recommends rationalization and reducing cost of credit to Small and micro enterprises by controlling the rate of interest which need to be governed by the overall cost and not specific high cost of lending of small loans alone.*	The IWG is in favour of affordable and reasonable cost of credit. Past experience of controlling interest rates by imposing caps suggests that generally such caps tend to become the floor. It needs to be appreciated that the bank advances would need to cover the cost of funds being incurred by them in addition to the operational costs. Credit is normally priced according to the risk perception of the borrower, transaction cost and funding cost. The funding cost is neutral across borrowers. While operational costs would vary from bank to bank depending on its size, territory being covered, organisation, method of operation, level of technology absorption, etc. It would, therefore, not be appropriate to control interest rates to reduce cost of funds. Credit record bureaus and credit information companies should be quickly established so that such record is available to banks to enable them to price credit according to risk. With the establishment of credit information bureaus and the improvement in risk assessment, it is expected that the transaction costs would come down leading to a reduction in interest rates.

Annex I

List of Institutions from which the IWG received Comments

1. Shri Y Krishna Rao, Officer on Special Duty, Finance (IF) Department, Government of Andhra Pradesh
2. Shri Subodh Kumar, Principal Secretary, Finance Department, Government of Maharashtra
3. Shri Unnikrishnan, Deputy Chief Executive, Indian Bank's Association
4. Shri Rakesh Rewari, Deputy Managing Director, SIDBI
5. Shri R.K. Das, General Manager, SIDBI
6. Shri G.S. Menon, Chief General Manager, NABARD
7. Shri N.K. Joshi, Chairman, Aryavrat Grameen Bank, Lucknow
8. Shri G.C. Mishra, Chairman, Prathama Bank, Moradabad
9. Shri D. Krishna, Chief Executive, NAFCUB
10. Shri B. Subrahmanyam, Managing Director, NAFSCOB
11. Shri Mathew Titus, Executive Director, Sa-Dhan
12. Ms. Chetna Gala Sinha, Chairman, MannDeshi Mahila Sah. Bank Ltd., Mhaswad
13. Dr. A. Amarender Reddy, Associate Professor, Administrative Staff College of India, Hyderabad
14. Dr. Pulapre Balakrishnan, Professor of Economics, IIM, Kozhikode

List of RBI Officials with whom the IWG had Interaction/Meetings

1. Shri B. M. Misra, Adviser, DEAP
2. Dr. D.P. Rath, Director, DEAP
3. Smt. Gunjeet Kaur, Director, DEAP
4. Shri P.K.Nayak, Assistant Adviser, DEAP
5. Shri L. Lakshmanan, Assistant Adviser, DEAP
6. Shri M. Ramiah, Assistant Adviser, DEAP
7. Shri R. Sudeep, Assistant General Manager, RPCD
8. Dr. Kumarjeet Mandal, Research Officer, DEAP
9. Shri Raj Rajesh, Research Officer, DEAP
10. Shri Naveen Kumar, Research Officer, DEAP
11. Shri Rakesh Kumar, Research Officer, DEAP

Annex II

List of Committees/Working Groups set up by the Reserve Bank

1. All India Rural Credit Survey Committee, 1954
2. All India Rural Credit Review Committee, (1966)
3. Working Group on Rural Banks, 1975 (Chairman: M. Narasimham)
4. The High Level Committee on Agricultural Credit through Commercial Banks', 1998 (Chairman: R. V. Gupta)
5. The Task Force on Revival Restructuring for Co-operating Banks', 1999 (Chairman: Jagadish Capoor)
6. Task Force to Study the Co-operative Credit System and Suggest Measures for its Strengthening, 2000 (Chairman: Jagadish Capoor)
7. Report of The Working Group on Flow of Credit to SSI Sector, 2004 (Chairman : A.S. Ganguly)
8. The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System', 2004 (Chairman: V.S. Vyas).
9. The Internal Working Group on Priority Sector Lendings', 2005 (Chairman: C.S. Murthy).
10. Internal Group to Examine Issues Relating to Rural Credit and Microfinance , 2005 (Chairman: H.R. Khan)
11. Working Group to Suggest Measures to Assist Distressed Farmers, 2006 (Chiarman : S.S. Johl)

12. The Expert Group On Investment Credit, 2005 (Chairman : Y.S.P. Thorat)

13. Report of the Working Group on Warehouse Receipts and Commodity Futures

14. ‘The Technical Group to Review Legislations on Money Lending’ 2007, (Chairman: S.C. Gupta).

15. Report of the Working Group to Examine the Procedures and Processes of Agricultural Loans, 2007 (C.P. Swarnakar)

Annex III

Policy Initiatives for Distressed and Small/ Marginal Farmers.

A number of steps that have already been initiated in this regard are set out below.

- In the light of the recommendations of the Working Group (Chairman: Prof. S.S.Johl), constituted by the Reserve Bank to suggest measures for assisting distressed farmers and in order to assist distressed farmers whose accounts have earlier been rescheduled/converted on account of natural calamities as also farmers defaulting on their loans, due to circumstances beyond their control, banks have been advised vide our circular RPCD.PLFS. BC. No. 32 /05.04.02/ 2006-07 dated November 13, 2006 to frame transparent One Time Settlement (OTS) policies for such farmers, with the approval of their Boards.

- It is well known that vagaries of weather play an important role in agrarian distress in our country. In order to provide relief to bank borrowers in times of natural calamities, Reserve Bank has issued standing guidelines to banks. These guidelines, *inter alia*, permit banks:

- to convert/reschedule loans and the interest due thereon for periods ranging from three to nine years depending upon the frequency of crop failures/intensity of damage to crops;

- to grant fresh crop loans to the affected farmers;

iii) to treat converted/rescheduled loans as current dues and as such not to compound interest in respect of loans so converted/ rescheduled;
iv) to relax security and margin norms; and
v) to provide consumption loans to agriculturists whose crops have been damaged.

- In order to mitigate distress of farmers in the six debt ridden districts of Vidarbha, Hon'ble Prime Minister had announced the following rehabilitation package in respect of agricultural credit:

a) The Package is applicable to the districts of Amrawati, Wardha, Yavatmal, Akola, Washim and Buldhana.
b) The entire interest on overdue loans as on 01.07.2006 will be waived off in the above mentioned six districts and all farmers will have no past interest burden as on that date, so that they will be immediately eligible for fresh loan from the banking system.
c) The overdue loans of the farmers as on 01.07.2006 will be rescheduled over a period of 3-5 years with a one year moratorium.
d) An additional credit flow of Rs. 1275 crore will be ensured in these six districts. Reserve Bank has issued circular to the commercial banks operating in Vidarbha region vide, RPCD.PLFS. BC. No. 12 /05.04.02 (Vidarbha)/ 2006-07 dated July 17, 2006.

e) Further, Government of India has recently approved a package, which, *inter alia*, has a component relating to agricultural credit, for mitigating the distress of farmers in 25 debt stressed districts of Andhra Pradesh, Karnataka and Kerala, as indicated below:

Name of the State/ affected districts
Andhra Pradesh (16): Prakasam, Guntur, Nellore, Chittoor, Cuddapah, Ananthapur, Kurnool, Adilabad, Karimnagar, Khammam, Mohbubnagar, Medak, Nalgonda, Nizamabad, Rangareddy, Warangal. Karnataka (6): Belgaum, Hassan, Chitradurga, Chikmaglur, Kodagu, Shimoga Kerala (3): Wayanad, Palakkad, Kasaragod.

The component relating to agricultural credit includes the following:

(i) The entire interest on overdue loans as on 01.07.2006 will be waived off in the 25 affected districts and all farmers will have no past interest burden as on that date, so that they will immediately be eligible for fresh loan from the banking system.

(ii) The overdue loans of the farmers as on 01.07.2006 will be rescheduled over a period of 3-5 years with a one-year moratorium.

(iii) A credit flow of Rs.13817.78 crore, Rs.3076.20 crore and Rs.1945.07 crore will be ensured in these affected districts of Andhra Pradesh, Karnakata and Kerala respectively in 2006-07.

Reserve Bank has issued circular to all scheduled commercial banks vide RPCD.PLFS.NO.BC. 31 / 05.04.02 /2006-07 dated October 18, 2006. As regards simplification of procedures and processes confronting the small and marginal farmers, the following steps have been taken:

- In the light of the recommendations of the Working Group (Chairman: Shri C.P.Swarnkar), constituted by the Reserve Bank for simplification of the procedures and processes for obtaining agricultural loans, especially by small and marginal farmers, the banks have been advised to banks to immediately dispense with the requirement of "no due" certificate for small loans up to Rs.50,000 to small and marginal farmers, share-croppers and the like and, instead, obtain self-declaration from the borrower.

- Further, as recommended by the Swarnkar Committee and in order to overcome the problem faced by the banks in lending to landless labourers, share-croppers and oral lessees due to the absence of documents verifying their identity and status, it has been advised that banks may accept certificates provided by local administration/*panchayati raj* institutions regarding the cultivation of crops in case of loans to landless labourers, share-croppers and oral lessees.

- Recognising that role of financial / credit counseling towards enhancing the quantity and quality of agricultural credit, RBI is taking a number of measures for increasing financial literacy and credit counseling. Financial literacy programs are being launched in each State with the active involvement of the State Government and the SLBC. Each SLBC Convener has been asked to set up a credit-counselling centre in one district as a pilot and extend it to all other districts in due course. These counseling centers will also be asked to recommend debt restructuring plans for households in respect of bank loans.

- RBI vide its circular dated June 24, 2004 had addressed the issue of farmers' indebtedness to the non-institutional lenders. In order to mitigate the acute distress that farmers might be facing due to the heavy burden of debt from non-institutional lenders (e.g. moneylenders) and to provide them relief from such indebtedness, banks were advised, subject to the guidelines to be approved by their Boards of Directors, advance loans to such farmers, against appropriate collateral or group security.

- Bank loans extended to distressed farmers against appropriate collateral or group security for redemption of debts due to private money lenders have been included under the category of Direct Agricultural lending under the revised priority sector guidelines.

- Banks were advised in December 2005 to introduce one time settlement scheme (OTS) for non-performing loans up to Rs 25000/- and provide fresh loans to such borrowers in order that they are not excluded from the formal system.

- In order to empower the vast sections of rural households, Reserve Bank has advised the scheduled commercial banks and RRBs to introduce a GCC Scheme based on the assessment of income and cash flow of the households similar to that prevailing under normal credit cards but without insistence on security, purpose or end-use stipulations. The total credit facility to an individual borrower under the scheme would not exceed Rs. 25,000/-. Fifty per cent of credit outstanding under the GCC Scheme would be treated as part of "Priority Sector Lending". This measure is expected to help financing of landless agricultural labourers and tenant farmers.

- Risk weight on loans up to Rs. 1 lakh against gold and silver jewellery has been reduced to 50 per cent from 125 per cent. It is expected that this measure will encourage banks to extend such loans to rural households and thus, draw them into institutional credit structure for their needs, for which they were hitherto dependent on local money lenders.

- RRBs and Co-operatives have a greater reach in rural areas and thus have the potential to replace the local money lenders in a big way. The latest initiatives include strengthening and recapitalisation of RRBs and Co-operatives. The steps in respect of RRBs include consolidation through mergers and extension to uncovered districts.

- In order to ensure better financial inclusion, Reserve Bank has advised banks to make available a basic banking 'no-frills' account with either 'nil' or very low minimum balances and charges to the vast section of rural population. Regional Rural Banks (RRBs) were also advised to consider providing these account holders with a small overdraft facility.

- RBI has taken a number of measures to tackle financial exclusion by enhancing basic banking services. These include: simplified KYC norms, use of NGOs/people's organisations and post offices as intermediaries, use of IT solutions for branchless banking etc. The forum of SLBC/DLCC is being used to achieve the objective and SLBC Convenors have been advised to give special priority to districts with concentration of SC/ST, minorities.

With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, RBI has allowed banks to use the services of Non-Governmental Organisations/ Self Help Groups (NGOs/ SHGs), Micro Finance Institutions (MFIs) and other Civil Society Organisations (CSOs) as intermediaries in providing financial and banking services through the use of Business Facilitator and Correspondent models. The activities of "business facilitators" would include (i) identification of borrowers and fitment of activities; (ii) collection and preliminary processing of loan applications including verification of primary information/data; (iii) creating awareness about savings and other products and education and advice on managing money and debt counselling; (iv) processing and submission of applications to banks; (v) promotion and nurturing Self Help Groups/ Joint Liability Groups; (vi) post-sanction monitoring; (vii) monitoring and handholding of Self Help Groups/ Joint Liability Groups/ Credit Groups/ others; and (viii) follow-up for recovery. The scope of activities to be undertaken by the Business Correspondents will include (i) disbursal of small value credit, (ii) recovery of principal / collection of interest (iii) collection of small value deposits (iv) sale of micro insurance/ mutual fund products/ pension products/ other third party products and (v) receipt and delivery of small value remittances/ other payment instruments. The activities to be undertaken by the Business Correspondents would be within the normal course of the bank's banking business, but conducted through the entities indicated above at places other than the bank premises.

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