Priority sector lending

What is the issue?

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In FY16 the Reserve Bank of India (RBI) initiated two significant steps on priority sector lending.

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What is priority sector lending?

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- Priority Sector refers to those sectors of the economy which may not get timely and adequate credit.
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- Priority Sector Lending is an important role given by the Reserve Bank of India (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors.
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- The sectors may be agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.
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- This is essentially meant for an all round development of the economy as opposed to focusing only on the financial sector.
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- As per the RBI circular released in 2016, there are **eight broad categories** of the Priority Sector Lending.
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- They are: (1) Agriculture (2) Micro, Small and Medium Enterprises (3) Export Credit (4) Education (5) Housing (6) Social Infrastructure (7) Renewable Energy (8) Others.
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- The others category includes personal loans to weaker section, loans to distressed persons, loans to state sponsored organisations for SC/ST.
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How is RBI revamping PSL?

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- The current banking and economic situation demands a fresh round of thinking regarding priority sector lending (PSL) guidelines.
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- Reserve Bank of India (RBI) initiated two significant steps.
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- First, it revamped PSL norms by including some new sectors such as social infrastructure, renewable energy and medium enterprises among others.
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- Second was the introduction of the scheme of priority sector lending certificates (PSLC) to facilitate the achievement of PSL targets by banks.
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- This is to incentivise banks having surplus in their priority sector lending to sell this surplus to peers that are falling short.
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- The total volume traded at the end of September 2016 was about Rs 140 billion.
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Whether PSL is increasing?

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- Trends indicate that barring renewable energy and to some extent trade, credit to new sectors has not shown any significant expansionary trend.
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- During April-December 2016, RBI data indicates that the incremental credit growth to priority sector expanded at a very slow pace of 0.8 per cent.
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- In FY16, public sector banks (PSB) priority sector loans had registered a strong growth of 13.4 per cent, compared to the overall PSBs' credit growth of 2.1 per cent (renewable energy and trade contributed most).
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- On an average, the new sectors have contributed around two per cent to the priority sector lending growth.
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- Despite this, in the last five years, PSBs have been unable to achieve the PSL

targets.
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- But private sector banks achieved their PSL target in the last three rows in a row.
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- However, this may not be an appropriate comparison, as PSB PSL loan portfolio is three times higher than their private sector banks' counterparts.
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- Further, the Nabard balance sheet for FY16 shows a total of Rs 1,89,420 crore in rural infrastructure development fund (RIDF) and other funds being deposited by banks because of shortfall in their PSL targets over the years.
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- The amounts deposited in RIDF and other such funds are also counted towards PSL achievement.
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- However, if these amounts are excluded, the banking system will indeed have an overall shortfall in PSL.
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What role does RIDF play?

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- RIDF came into existence in FY 1996, with the primary purpose of encouraging commercial banks to meet their PSL targets through interest rate policy instrument.
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- That is, lower interest on investment under RIDF as compared to net returns on priority sector advances.
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- Currently, the interest rate levied on RIDF varies from two per cent below bank rate to four per cent below bank rate depending on the extent of shortfall in PSL targets.
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- This directly impinges on the profitability of PSBs.
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- In a scenario of stressed profitability, PSBs can hardly afford this hit, which has a direct bearing on their profitability and retained earnings as also the need for the government to infuse capital.
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How should the PSL be tweaked?

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- There should be some clear definitional changes in PSL at least with reference to the quantitative caps.
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- MSME lending is an integral part of the priority sector. However, the definition of MSME is very old dating back to 2006.
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- Therefore, broadening the definition in line with the current economic conditions is required.
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- There needs to be a serious re-look at the cap of Rs 5 crore per borrower for building social infrastructure activities like schooling in Tier II and Tier VI centres.
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- The cap of Rs 15 crore for borrowers related to public utilities under renewable energy must be increased manifold to make it a meaningful proposition in accordance with the current vision.
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- Another area worth considering is expanding the definition of rural infrastructure to include rural roads, power plants, bridges etc.
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- We should also consider including food credit under PSL as such credit is primarily used for procurement of food grains, ensuring food security, especially for weaker sections of society.
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- Alignment of priority sector guidelines with the affordable housing definition will incentivise banks to lend more to the affordable housing segment.
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- It might be worthwhile to make an objective assessment of whether we should include municipal bonds under PSL norms.
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- As it will meaningfully facilitate rising of funds for the necessary improvement in social and economic infrastructure of cities.
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Source: Business Standard

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