Restructuring Priority Sector Lending

This article is based on **"The priority sector lending India needs"** which was published in The Hindustan Times on 30/05/2021. It talks about the need for revision of Public Sector Lending as a concept and as a practice.

Covid-19 has forced us to re-examine many things from the past. The importance of health and education infrastructure has been sharply highlighted.

One such thing that needs to be re-examined can be **Priority Sector Lending (PSL)**. The concept of 'Priority sector lending' focuses on the idea of directing the lending of the banks towards a few specified sectors and activities in the economy.

Banks today, lend nearly 40% of their adjusted net bank credit (ANBC), a not inconsiderable ₹39,50,205 crore, to the priority sector. In the present context, there is the need to balance between economic growth and social development.

Thus, the Public Sector Lending as a concept and as a practice can be 'reprioritized'.

Priority Sector Lending In India: History & Background

- **Underlying Philosophy:** The Constitution of India inherently provided the aims and guidelines of inclusive growth and development through the 'directive principles of state policy'.
    - Further, the bend of the governance in India towards 'socialist principles' and 'socialism' was quite evident in the post-independence era.
    - This forms the underlying philosophy around the need for priority sector lending.
- **Triggering Point:** The most primary sector of the economy at that point in time i.e. agriculture was in need of funds but it was not the desired avenue for the commercial banks.

- **Origin:** Thus, in July 1966, the All India Rural Credit Review Committee recommended that the commercial banks should play a complementary role in extending the rural credit.
    - This moment can be traced as the origin of PSL in India.
    - However, the definition for PSL was only formalised based on a Reserve Bank of India (RBI) report in the National Credit Council in 1972.
- **Objective:** The PSL allows the commercial banks to generate high social returns along with the profits and it also contributes to economic development by increasing investment in the strategic sectors
- **Regulatory Control:** The Reserve Bank of India, which is the supervisory body of the banking sector in India, also referred to as the Apex Bank of the country, has from time to time issues instructions/guidelines/directives to the banks in India with regard to the PSL.
- **Constituents:** Presently, PSL includes eight identified sectors. The biggest is agriculture with an 18% target of total Adjusted Net Bank Credit.
    - The other important category is MSMEs.
    - In addition, five sectors are classified as PSL — housing, export credit, education, social infrastructure and renewable energy.

Associated Issues With the Rules

- **High Burden of NPAs:** Despite the tweaks, the classification retains a heavy focus on agriculture and small industries (defined as micro, small and medium enterprises or MSME) till today.
    - The banks lending to these categories have double digit **non-performing assets (NPA)** in their loan portfolios, making the sector economically unviable for them.
    - The banks then have to set aside the capital to account for assets that might be decreased due to NPAs which erodes the profitability of the banks.
- **Problem of Moral Hazard:** Granting loans to this borrower segment with the high probability of NPAs creates corruption opportunities for bank managers and creates moral hazards for the identified beneficiaries.
- **Economic Burden of Banks:** PSL diverts funds from the productive sectors, imposes economic burdens on the banks in the form of loan losses and payment defaults and also imposes opportunity costs of lending to non-priority sectors of the economy.
- **Capping Issues:** Educational infrastructure has a low credit limit of ₹5 crore. Also, health is only a sub-category of social infrastructure with a ₹10 crore limit for building hospitals.

Way Forward

- **PSL to Grants:** Converting some part of PSL to a grant paid directly by the government can unlock large amounts of efficiency in the system, and dramatically increase the valuation of public sector banks also.

- **Leveraging JAM for Social Development:** The full possibilities of **JAM** (full access to Jan Dhan accounts, universal Aadhaar numbers and near-universal mobile penetration) can address the issues that PS lending cannot achieve.
    - For example, JAM can institutionalise the functioning of direct benefit transfers (DBT).
- **Increasing Quota of Social Infrastructure:** Covid-19 has forced us to re-examine many things from the past. The importance of health and education infrastructure has been sharply highlighted.
    - Thus, PSL should be restructured to prioritize formation of social infrastructure.

Conclusion

The scheme of PSL (the fixation of the targets and the sub-targets) must be structured according to the type of bank along with various other considerations such as branch availability and the willingness of the bank to lend to a particular sector.

Drishti Mains Question

In the present context of the need to balance between economic growth and social development, can the Public Sector Lending as a concept and as a practice be 'reprioritized'?