Priority Sector Lending (PSL)

Mains: *GS-III – Economy | Banking*

Why in news?

*Recently, the **State Level Bankers' Committee (SLBC)** of Jharkhand, highlighted that although banks have surpassed the overall PSL benchmark, their agricultural credit disbursement remains below the RBI's target.*

What is Priority Sector Lending (PSL)?

- **PSL –** It is an ***RBI's initiative*** that mandates banks to allocate a specific portion of their lending to specific sectors of the economy.
- **Inclusive Growth –** These sectors drive inclusive growth but often lack adequate credit.
- **Access to Affordable Credit –** PSL ensures vulnerable and underserved sections of the society can get loans at lower interest rates.
- **Reducing Inequality –** RBI identifies these sectors to bridge gaps and promote balanced economic growth.

• **SLBC –** It is an ***inter-institutional forum*** at the state level that coordinates between banks and the state government to ensure effective implementation of banking development programs, ***under the Lead Bank Scheme***
• **Origin –** Established ***by the RBI*** in 1969, following recommendations of the Gadgil & Nariman Committees.

What is the historical background & evolution of PSL?

- **Early Recognition –** PSL began in 1966, when Finance Minister Morarji Desai stressed expanding credit to small businesses and agriculture.
- **Bank Nationalisation –** In 1969, the nationalisation of major banks provided the institutional framework necessary to implement direct lending policies to underserved sectors.
- **Gadgil Committee, 1969 –** Proposed the Area Approach, which laid the foundation for the ***Lead Bank Scheme (LBS)*** to strengthen regional credit planning.
- **Nariman Committee, 1969 –** Endorsed the Gadgil Committee's recommendations and suggested that each public sector bank should adopt specific districts as Lead Banks to accelerate PSL.
- **Formalization Framework –** In 1972, PSL was formally established based on RBI's ***Informal Study Group report*** (1971) presented to the National Credit Council.
- **Initial Targets –** In 1974, Commercial banks were advised to gradually increase PSL

to 33.3% of credit by 1979.

- **Krishnaswamy Committee, 1980 –** Recommended revising the target to 40% of ANBC by 1985, with sub-targets for agriculture and weaker sections.
- **Usha Thorat Committee, 2009 –** Supported the continuation of the Lead Bank Scheme, recognizing its importance in expanding PSL coverage.
- **Nair Committee, 2012 –** Conducted the most comprehensive review of PSL, reinforcing its importance and suggesting refinements to improve effectiveness.
- **Updated Guidelines –** In March 2025, the RBI issued new PSL guidelines effective from April 1, 2025, expanding sectoral coverage and revising loan limits to ensure better targeting of credit.

What are the key sectors covered under PSL?

- Agriculture
- Micro, Small and Medium Enterprises(MSME)
- Export Credit
- Education
- Housing
- Social Infrastructure
- Renewable Energy
- Others

What are the RBI's PSL targets & sub-targets based on 2025 guidelines?

Type of Bank	Overall PSL Targets	Agriculture Credit	Small & Marginal Farmers (SMFs)	Micro Enterprises	Weaker Sections
Domestic Commercial Banks & Large Foreign Banks (20 plus branches)	40% of ANBC	18% of ANBC	10% of ANBC	7.5% of ANBC	12% of ANBC
Regional Rural Banks (RRBs)	75% of ANBC	18% of ANBC	10% of ANBC	7.5% of ANBC	15% of ANBC
Small Finance Banks (SFBs)	75% of ANBC	18% of ANBC	10% of ANBC	7.5% of ANBC	12% of ANBC
Urban Co-operative Banks (UCBs)	60% of ANBC (as of 2025 revision)	18% of ANBC	10% of ANBC	7.5% of ANBC	12% of ANBC

- **Adjusted Net Bank Credit (ANBC)** – The total loan amount given by a bank after making certain adjustments.
    - It is a regulatory metric used by RBI to fix banks' mandatory lending to sectors like agriculture, small businesses, and housing.
- **Priority Sector Lending Certificates (PSLCs) –** It is a ***Tradeable financial instruments***, introduced by RBI, in 2016, to enhance the flexibility and effectiveness

of the PSL framework.
    - **Mechanism –** Banks that achieve surplus lending in priority sectors can issue and sell certificates, while banks facing shortfalls can purchase them to meet their mandated PSL obligations.
    - **4 types of PSLCs** are available for trading – Agriculture, Small & Marginal Farmers, Micro Enterprises, General.

What are the major highlights of the key trends & measures in PSL?

- **Growth in PSL (2019–2024)** – Overall PSL credit disbursement to priority sectors like agriculture, MSMEs, and social infrastructure has ***increased by 85%*** over six years.
- **Role of FinTech –** Banks are partnering with FinTechs to improve customer services. Key areas -
    - **Digital account opening** using e-KYC and V-KYC with AI for face and name recognition.
    - **Faster loan processing** through digital journeys, account analysis, and alternate data for real-time decisions.
    - **Innovative products** developed using bank APIs to enhance customer experience.
- **Legal & Structural Reforms**
    - **Insolvency & Bankruptcy Code (IBC)** – Strengthened credit discipline.
    - **Central Repository of Information on Large Credits** – Monitoring high-value accounts for defaults/fraud.
    - **SARFAESI Act & Recovery of Debt Act** – Amended for more effective enforcement.
    - **Early Warning Systems** – Automated tools to detect stress and prevent NPAs.

How does Priority Sector Lending impact the economy and society ?

- **Financial Inclusion –** The policy ensures that marginalized groups have access to credit at affordable interest rates.
- **Balanced Development –** It helps reduce inequality and regional gaps by bringing unbanked rural populations into the formal financial system, especially the regions dominated by agriculture and small enterprises.
- **Job Creation –** PSL supports job creation by funding ***MSMEs and agriculture***—India's biggest employers.
    - MSMEs alone ***employ over 25 crore people*** and contribute ***45.73% of exports*** (2023–24).
- **Entrepreneurship Support –** It facilitates entrepreneurship by providing accessible credit to aspiring business owners, enabling them to start and grow enterprises that drive innovation and local development.
- **Encouragement for Innovation –** PSL's recognition of startups ensures that innovation and entrepreneurship receive institutional support, fueling India's growth story.
- **Liquidity Management –** PSLCs provide banks with a tool to balance compliance and liquidity, ensuring smoother financial operations.

- **Agricultural Modernization –** PSL goes beyond basic crop loans by supporting infrastructure development, technology adoption, and allied industries such as dairy and fisheries.
    - This comprehensive approach strengthens food security while driving growth in rural economies.

What are the challenges associated with PSL?

- **Non-Performing Assets (NPAs) –** Repaying loans in priority sectors is often problematic, contributing to higher NPAs.
    - **For example,** Agriculture loans are risky due to crop failures and weather, while small borrowers without collateral cause higher NPAs.
- **Compliance Pressure on Banks –** Banks are required to balance profits with RBI's mandated PSL targets, which can strain resources and limit commercial lending.
- **Misallocation of Resources –** Ensuring that credit reaches the intended beneficiaries continues to be a challenge, and asset quality issues often emerge when loans are disbursed without adequate monitoring.
- **Higher Operational Costs –** Managing PSL accounts requires extensive paperwork, monitoring, and outreach, and studies indicate that operational costs are higher than in regular lending.
- **Credit Assessment Challenges –** Traditional credit scoring doesn't work well for micro enterprises and small farmers, so banks use alternative methods that increase costs and slow processing.
- **Market Concentration –** Banks prefer safer PSL categories like housing loans, which leads to uneven distribution of credit, with agriculture and weaker sections often neglected.

What lies ahead?

- Priority Sector Lending (PSL) remains a cornerstone of India's financial inclusion strategy, channeling institutional credit to industries and segments vital for inclusive economic growth.
- Despite challenges in implementation and asset quality, the evolving PSL guidelines show the RBI's commitment to meeting new needs while ensuring equitable growth.

References

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