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DAILY EDITORIAL ANALYSIS

TOPIC

REVIEWING PRIORITY SECTOR LENDING (PSL) NORMS

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Context

- As India's economic structure evolves, the Priority Sector Lending (PSL) framework requires a comprehensive review to address emerging challenges and opportunities.

What is Priority sector lending (PSL) in India?

- It refers to the mandatory lending targets set by the Reserve Bank of India (RBI) for banks and financial institutions to ensure that certain sectors of the economy receive adequate credit and financial support.
- It aims to promote inclusive growth, reduce regional imbalances, and support marginalized sections of society.

Priority Sector Lending (PSL) Norms

- It was initiated in 1972 on the recommendations of the **Banking Commission,** as part of a larger effort to democratize access to credit.
- It is **mandated by the Reserve Bank of India (RBI),** all scheduled commercial banks are required to allocate a specified percentage (currently 40% for domestic banks) of their **Adjusted Net Bank Credit** to designated sectors, like:
  - Agriculture, Micro and Small Enterprises (MSEs), education, housing, social infrastructure, and renewable energy.
- Formal PSL targets **imposed in 1980** following RBI guidelines.

Current Framework and Recent Revisions

- In 2020, RBI revised PSL guidelines to include:
  - Start-ups;
  - Renewable energy;
  - Health infrastructure;
  - Weaker sections with regional targets (e.g., aspirational districts);
- Recently, RBI has introduced **updated guidelines** for PSL, effective from April 1, 2025, with the aim to enhance credit flow to critical sectors of the economy while promoting financial inclusion and sustainable development.

Key Changes in the Guidelines

- **Enhanced Housing Loan Limits**: Housing loans now qualify for PSL classification under three categories based on population size:
  - ₹ 50 lakh for cities with populations above 50 lakh.
  - ₹ 45 lakh for cities with populations between 10 lakh and 50 lakh.
  - ₹ 35 lakh for cities with populations below 10 lakh.
  - Additionally, PSL limits on loans extended for the repair of existing homes have been scaled up to ₹10-15 lakh, from ₹ 6-10 lakh.
- **Renewable Energy Projects:** These have expanded eligibility, with loans up to ₹ 35 crore (earlier ₹ 30 crore) for solar and biomass power equipment and street lighting systems, and ₹ 10 lakh for individual households.
- **Farm Loans** (against hypothecation of produce):
  - **Individual Farmers**: ₹ 90 lakh
  - **Corporate Farmers:** ₹ 4 crore
  - **Farmer Producer Organisations (FPOs):** ₹ 10 crore.
- **Educational Loans:** ₹ 25 lakh (earlier ₹ 20 lakh)
- **Artisans and Women Borrowers:** ₹ 2 lakh (earlier ₹1 lakh)
- **Trans-genders and Joint Liability Groups** are eligible for loans under PSL.
- **Revised Targets for Urban Cooperative Banks (UCBs):** UCBs need to allocate 60% of Adjusted Net Bank Credit (ANBC) or Credit Equivalent of Off-Balance Sheet Exposures (CEOBSE) to PSL.

- **Expanded Definition of Weaker Sections:** The cap on loans to individual women beneficiaries has been removed, encouraging greater financial inclusion.
- **Differential Weight System:** Districts with lower per capita credit flow will have a 125% weightage for PSL achievement, while districts with higher credit flow will have a reduced weightage of 90%.

Challenges in the PSL Framework

- **Financial Inclusion Reports (2022–2024):** RBI emphasizes the limited penetration of PSL in remote and underbanked regions despite high target fulfillment on paper.
  - Structural bottlenecks and lack of credit absorption capacity remain issues.
- **Urban Bias of PSL Flows:** PSL loans often benefit urban MSMEs over rural beneficiaries, defeating its original intent.
- **NPAs and Credit Discipline:** According to a 2024 RBI bulletin, over 35% of PSL-linked loans to small and marginal farmers are stressed or overdue.
  - It raises concerns about credit quality versus quota fulfillment.
- **'Compliance-based' Lending:** It is observed that **'compliance-based'** lending has **overtaken 'impact-based' lending,** undermining genuine financial deepening.
- **Under-leveraged Sectors:** Some sectors under PSL, such as traditional agriculture or renewable energy, are under-leveraged due to operational complexities or low bank readiness.
  - Emerging areas like climate finance, digital infrastructure, and gig-economy MSMEs find little to no representation in current PSL norms.
- **Regional and Institutional Credit Gaps:** RBI data suggests significant credit skewness across states.
  - States like Maharashtra and Tamil Nadu exceed targets while others like Bihar and the Northeast lag.
  - Cooperative banks and RRBs are struggling with capacity and compliance issues, affecting grassroots PSL delivery.

Urgency of PSL Review

- **Misaligned Incentives:** Banks often resort to purchasing PSL certificates instead of lending directly to priority sectors, diluting the spirit of the mandate.
- **Outdated Target Classification:** Current PSL segments do not account for newer socio-economic realities like digital entrepreneurship or ecological sustainability.
- **Inadequate Risk Sharing Mechanisms:** High default rates persist due to lack of robust risk management tools tailored for PSL-linked sectors.
- **Regional Inequity:** Geographical imbalances in credit flow threaten inclusive growth objectives.
- **Inclusive Growth:** Expanding PSL coverage to include marginalized groups, such as transgender individuals and Joint Liability Groups, is a step forward but requires robust implementation.

Policy Recommendations	
Issue	**Recommendation**
Stressed PSL portfolios	Introduce blended finance models and credit guarantees
Skewed sector coverage	Expand PSL to include climate finance, rural tech, gig MSMEs
Regional disparities	Incentivize credit flow to underserved geographies
Over-reliance on PSL Certificates	Cap indirect compliance, promote direct engagement

Conclusion

- The RBI's revised PSL guidelines are a step forward in addressing India's developmental priorities.
- By increasing loan limits, redefining weaker sections, and introducing innovative measures like differential weightage, the framework aims to ensure equitable credit access and foster sustainable growth.

Source: BL

Mains Practice Question

[Q] How can the existing Priority Sector Lending (PSL) norms be restructured to better align with India's evolving economic priorities while addressing inefficiencies and promoting financial inclusion?