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EXAMINING FARM LOAN WAIVERS

Relevant for: Indian Economy | Topic: Issues related to direct & indirect Farm Subsidies and MSP

To do or not to do? According to reports, the Central government is discussing a scheme to waive outstanding farm loans in the aftermath of widespread farmers' protests between March and December 2018 . Till now, at least 11 States have announced schemes to waive outstanding farm loans: Madhya Pradesh, Uttar Pradesh, Karnataka, Tamil Nadu, Maharashtra, Chhattisgarh, Punjab, Andhra Pradesh, Telangana, Assam and Rajasthan. The pitch for waivers among States has added to the pressure on the Central government for a nationwide farm loan waiver.

Economists and bankers are sharply divided on whether farm loan waivers are desirable. One section of economists and hard-nosed bankers argues that loan waivers represent poor policy for a variety of reasons. First, loan waivers have "reputational consequences"; that is, they adversely affect the repayment discipline of farmers, leading to a rise in defaults in future. Second, earlier debt waiver schemes have not led to increases in investment or productivity in agriculture. Third, after the implementation of debt waiver schemes, a farmer's access to formal sector lenders declines, leading to a rise in his dependence on informal sector lenders; in other words, waivers lead to the shrinkage of a farmer's future access to formal sector credit.

Why do farmers need more than loan waivers

These arguments need careful and critical assessment. To begin with, there have only been two nationwide loan waiver programmes in India after Independence: in 1990 and 2008. The accompanying image gives data on agricultural non-performing assets (NPAs) of banks before and after the 2008 waiver, and throws up two conclusions.

First, farmers are most disciplined in their repayment behaviour. In September 2018, agricultural NPAs (about 8%) were far lower than in industry (about 21%). Furthermore, agricultural NPAs were on a continuous decline between 2001 and 2008. Second, there is no evidence to argue that the 2008 waiver led to a rise in default rates among farmers. The lowest of all NPAs after 2001 was recorded in March 2009 (2.1%), which was just after the implementation of the 2008 scheme. The reason was the government's cleaning up of the account books of banks. Once this was complete, it was totally expected that NPAs would rise again to settle at a slightly higher level. This was exactly what had happened: agricultural NPAs rose and settled at about 5% by 2011.

Lifelines beyond farm loan waivers

For two reasons, the rise of agricultural NPAs, from 2% to 5%, is no evidence for indiscipline in farmer repayment behaviour. One, NPAs in agriculture remained stable at around 4 to 5% between 2011 and 2015. This was despite the fact that agricultural growth averaged just 1.5% between 2011 and 2015. Two, D. Subbarao, the former Reserve Bank of India Governor, had pointed out in a 2012 speech that the rise in agricultural NPAs between 2009 and 2011 was due to the "general economic slowdown" after 2009 and the introduction of new norms in the "system-wide identification of NPAs".

Agricultural NPAs began to rise again after 2015. There is enough evidence to suggest that this rise was not the result of any moral hazard; it was real, policy-induced and a direct consequence of acute agrarian distress that spread across rural India after 2015. In particular, the demonetisation of November 2016 aggravated already brewing agrarian distress by sucking cash out of the rural areas, crashing output prices and disrupting supply chains.

The second argument — that loan waivers do not promote investment or raise productivity — is a bit absurd because nowhere has investment or productivity figured as the official objectives of these schemes. The third argument — that loan waivers shrink access to formal credit sector for farmers — is only partly true. But the culprits here are banks and not farmers. After every waiver, banks become conservative in issuing fresh loans to beneficiaries, as they are perceived to be less creditworthy. For instance, a Comptroller and Auditor General (CAG) report on the waiver in 2008 found that 34.3% of the beneficiaries were not issued debt relief certificates after the waiver, which meant that they could not avail of a fresh loan the following year. As a result, the scheme's objective of expanding the issue of fresh loans to farmers was not fully achieved. But to cite such opportunistic actions of banks to deny fresh credit to farmers would be perverse policy.

Think beyond loan waivers

For every economic enterprise, it is only natural that when the bottom-line shrinks, a reduction of debt burden becomes inevitable. This is applicable for both (non-agricultural) firms and farms. Firms have always received debt waivers, though they are tactfully termed as "loan restructuring" or "one-time settlements". Just as for firms, farms also need a reduction of debt burden, followed by fresh infusion of credit, when their economic cycle is on a downturn. The demand for loan waivers in India is absolutely logical when viewed from such a standpoint.

On the other hand, to consider loan waivers as a panacea for the agrarian distress would also be wrong. To begin with, access to India's rural banks is skewed in favour of large farmers. While public banks actively service the credit needs of large farmers, a majority of small and marginal farmers are not proportionately included. The latter are forced to rely on informal sources, particularly moneylenders, for much of their credit needs. As a result, the benefits of loan waivers accrue disproportionately to large farmers while only marginally benefiting the small and marginal farmers.

But is this a good reason to disallow a loan waiver scheme, as the Prime Minister suggested in a recent interview? No. The solution lies in carefully designing waiver schemes that ensure universal coverage for small, marginal and medium-sized farmers while covering both the formal and informal sources of debt. The Kerala Farmers' Debt Relief Commission Act, 2006 is an excellent model in this regard. This scheme defines debt as "any sum borrowed by a farmer from the creditor", with the creditor defined as "any person engaged in money lending, whether under a licence or not". The commission's mandate included the right "to fix, in the case of creditors other than institutional creditors, a fair rate of interest and an appropriate level of debt, to be payable…" That is, the commission could waive, reschedule or reduce any debt on a need-basis after a detailed hearing of both the parties. Legislations such as Kerala's are blueprints to design comprehensive, inclusive and less-leaky loan waiver schemes in other States.

Finally, while loan waiver schemes are like a band-aid on a wound, it is the larger agrarian distress that demands urgent policy attention. Unless there are steps 'to raise productivity, reduce costs of cultivation by providing quality inputs at subsidised rates, provide remunerative prices following the recommendations of the Swaminathan Commission, ensure assured procurement of output, expand access to institutional credit, enhance public investment for infrastructural development, institute effective crop insurance systems and establish affordable scientific storage facilities and agro-processing industries for value addition', farmers will continue to be bonded to low income equilibrium and repeated debt traps.

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