Think beyond loan waivers

Valuing the produce: A farmer carrying his harvested paddy on a buffalo cart in Mayong village in Morigaon district, Assam.

Indian agriculture is characterised by low scale and low productivity. About 85% of the operational landholdings in the country are below 5 acres and 67% farm households survive on an average landholding of one acre. More than half of the area under cultivation does not have access to irrigation. Agriculture income generated at average size of landholding is not adequate to meet farmers' needs.

The problem is exacerbated by weather and market risks. According to the latest National Sample Survey on Situation Assessment Survey of Agricultural Households (NSS-SAS), 13.9% farm households experienced negative return from crop production during 2012-13. Non-farm income comprised 40% of the income of farm households, but access to non-farm sources of income is highly skewed as about 40% of farm households reported zero income from such sources.

Modern agriculture requires investment in farm machinery and use of purchased inputs like seed, fertiliser, agri-chemicals, diesel and hired labour. Most often, savings generated from unremunerative crop enterprise are inadequate for such investments. Rising expenses on health, education, social ceremonies and non-food items put additional financial demand on farm families. Consequently, majority of the farmers have to take loans from institutional or non-institutional sources or both. The share of institutional loans disbursed during a year to agriculture and allied sectors has risen from 8.9% of the value of output in 2000-01 to 31.4% in 2015-16.

The lowdown on farm loan waivers

The amount of short-term institutional loans for agriculture exceeds the total cost of inputs including hired labour at an all-India level and in many States. This indicates that a part of crop loans is likely spent on non-agricultural purposes. A more worrisome fact out of NSS surveys on Investment and Debt (NSS-I&D) is that the loans taken by cultivators from non-institutional sources, which involve high interest rate, is rising faster than from institutional sources. These indicators point to a worrying development — much of the growth in household demand in rural India has been debt-ridden and not supported by growth in income.

Recently a few States like Uttar Pradesh, Maharashtra, Punjab and Karnataka have responded to farm distress by rolling out farm loan waiver schemes as a measure of immediate relief to those farmers who qualify certain criteria. The demand for such measures is spreading to other States too.

The ultimate goal of farm loan waiver is to lessen the debt burden of distressed and vulnerable farmers and help them qualify for fresh loans. The success of the loan waiver lies on the extent to which the benefits reach the needy farmers. Loan waivers suffer from several drawbacks in this respect. First, it covers only a tiny fraction of farmers. According to 2012-13 NSS-SAS, 48% of the agricultural households did not have any outstanding loan.

Further, out of the indebted agricultural households, about 39% borrowed only from non-institutional sources. The farmers investing from their own savings and those borrowing from non-institutional sources are equally vulnerable to weather and market risks. But all such households are outside the purview of loan waiver.

Farm loan waiver may dent State finances, risk slippage: Fitch Ratings

Second, it provides only a partial relief to the indebted farmers as about half of the institutional borrowing of a cultivator is for non-farm purposes. Third, in many cases, one household has multiple loans either from different sources or in the name of different family members, which entitles it to multiple loan waiving. Fourth, loan waiving excludes agricultural labourers who are even weaker than cultivators in bearing the consequences of economic distress. Fifth, it severely erodes the credit culture, with dire long-run consequences to the banking business. Sixth, the scheme is prone to serious exclusion and inclusion errors, as evidenced by the Comptroller and Auditor General's (CAG) findings in the Agricultural Debt Waiver and Debt Relief Scheme, 2008.

According to the CAG report, 13.46% of the accounts which were actually eligible for the benefits under the scheme were not considered by the lending institutes while preparing the list of eligible farmers. On the other hand, in 8.5% of the cases, the beneficiaries were not eligible for either debt waiver or debt relief but were granted the benefits. Further, 34.28% of the beneficiaries were not issued debt relief certificates which would have entitled them to fresh loans. Beside these errors in implementation, the loan waiver as a concept excludes most of the farm households in dire need of relief and includes some who do not deserve such relief on economic grounds.

Apart from above drawbacks, such schemes have serious implications for other developmental expenditure, having a much larger multiplier effect on the economy. For instance, loan waiver may cost Uttar Pradesh at least 36,000 crore, which is 4.4 times the State's capital expenditure of 8,191 crore (Budget estimate) in agriculture, including irrigation and flood management, in 2016-17. A similar amount spent on improvement of agriculture infrastructure and other developmental activities would create a base for future growth and development of the sector.

It appears that loan waiving can provide a short-term relief to a limited section of farmers; it has a meagre chance of bringing farmers out of the vicious cycle of indebtedness. There is no concrete evidence on reduction in agrarian distress following the first spell of all-India farm loan waiver in 2008. In the longer run, strengthening the repayment capacity of the farmers by improving and stabilising their income is the only way to keep them out of distress.

For providing immediate relief to the needy farmers, a more inclusive alternative approach is to identify the vulnerable farmers' based on certain criteria and give an equal amount as financial relief to the vulnerable and distressed families. For instance, in Uttar Pradesh 23.2% (41.87 lakh) agricultural households (180.49 lakh) are estimated to have income below poverty line. With 36,000 crore, each of these households can be given 85,980. This looks to be a more inclusive approach and provides farmers flexibility to spend this money.

In our view, the sustainable solution to indebtedness and agrarian distress is to raise income from agricultural activities and enhance access to non-farm sources of income. The low scale of farms necessitates that some cultivators move from agriculture to non-farm jobs. Improved technology, expansion of irrigation coverage, and crop diversification towards high-value crops are appropriate measures for raising productivity and farmers' income. All these require more public funding and support and there is a danger of these getting adversely affected by resources diverted towards loan waiver. Another major source of increase in farmers' income is remunerative prices for farm produce. This requires removal of old regulations and restrictions on agriculture to enable creation of a liberalised environment for investment, trading and marketing. Agrarian distress and farmers' income will be addressed much better if States undertake and sincerely implement long-pending reforms in the agriculture sector with urgency.

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The new U.S. Fed Chairman is unlikely to opt for policies that might upset the President's plan

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