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Opinion | Solutions beyond farm loan waivers

Studies point out that small farmers use money saved from loan waiver for consumption activities and not on investment to increase agricultural productivity

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Photo: Pradeep Gaur/Mint

Among all the states in India, Rajasthan has one of the lowest farmer suicide rates. However, this does not mean that farmers in Rajasthan have been immune to increasing levels of agrarian distress. And last year's farmer protests highlighted the extent of India's nationwide agrarian distress.

In some states, people argue that loan waivers are the solution. But new research commissioned by Tata Trusts and Copenhagen Consensus for the India Consensus project, Rajasthan Priorities, which aims to identify policies for the state that will do the most social good relative to their costs across all sectors of government, shows waivers are extremely expensive while having a limited impact and other policies could help many more farmers for every rupee spent.

Only 15% of the marginal farmers (with less than 2 hectares of landholding) have access to formal credit, and loan waiver schemes typically cater to farmers who have availed of formal loans. In fact, previous waivers have led to banks reducing credit outlay for small farmers during their next loan cycle, thereby diminishing their chances of getting formal loans. Loan waivers actually do harm to the small farmers, as with less credit outlay from the formal sector, the small farmers increasingly have to depend upon the informal sector. The cost difference for loan rates between the formal and informal sectors vary between 30-45%, annually. Studies also point out small farmers use money saved from loan waiver for consumption activities and not to augment investment to increase agricultural productivity. This results in lower agricultural produce for small farmers during next loan cycles. On the contrary, the big and mid-size farmers (with more than 2 ha of landholding size) actually gain from farm loan waivers. With the small farmers receiving less money from banks, this incremental loan is actually made available for the big farmers who use it to buy farm equipment such as tractors and combine harvesters.

Loan waivers, though costly, are often identified as a politically advantageous, rapid solution. Last year, Uttar Pradesh, Maharashtra and Punjab undertook large-scale farm debt waivers, costing half a percentage point of the entire gross domestic product (GDP) of India, and Andhra Pradesh recently announced a loan waiver costing ₹24,000 crore. To reduce farm distress, there are better alternatives to loan waivers. For instance, government can spend money for building more canals and warehouses, on rural electrification, and to operate more e-markets. Each one of these interventions comes with a cost and an associated benefit. As an economist, one would argue government should spend each additional rupee to alleviate farm distress in a way where the impact is more, with a higher benefit-to-cost ratio.

One study looks at responses to farmer distress in Rajasthan. Results from our analysis show that waiving formal loans for land holders with less than two hectares would cost ₹11,731 crore. The benefits will be slightly lower at ₹9,537crore. Giving out a rupee to achieve just 80 paise of benefit is a poor deal. It also means a 15% reduction in smallholder credit over the following years, cutting revenue for the most vulnerable farmers by 13.5%. Most egregiously, spending thousands of crores on less effective policy leaves less for much more effective ones.

In our study we also examined benefit-to-cost ratio of other interventions that we mentioned above. It makes economic sense to build more warehouses and storage facilities. This will reduce waste of perishable fruits, vegetables and milk that command a higher market price than staple crops. Most small farmers do not risk growing perishable crops. Nearly 20% of India's fresh produce is wasted because of storage problems. Also, small farmers, because of the lack of adequate storage facilities, often sell their output forward to the village-level aggregators (*arthiya*) from whom they typically take loans for growing crops at a higher rate.

The National Centre for Cold Chain Development (NCCD) has estimated Rajasthan's total requirement for storing milk, fruits and vegetables at 74,889 tonnes. Providing pack houses and trucks would cost ₹5,985 crore. The benefits in terms of the reduced wastage in milk, fruits and vegetables, are worth more than 15 times that figure.

In Rajasthan, the largest producer of coarse grains, the research suggests that e-markets could result in better prices. Unlike e-markets, regulated markets have problems associated with lower market size, lack of price discovery because of buyer cartelization, and lack of information related to product standards. Rajasthan has 114 agricultural markets that are yet to be "e-enabled". Factoring in the one-time total, fixed cost of introducing e-*mandi*, and operational costs increasing over time, the annualized cost of setting up and running e-*mandis* over 20 years is ₹131 crore. Farmers would realize better prices with reduced information asymmetry and direct market access, meaning a 13% price increase— basically a transfer from middlemen to farmers. The research suggests that farmers would gain ₹8,523 crore over 20 years. Benefits are an astonishing 65 times the costs. This makes it an incredibly powerful policy for Rajasthan.

Farmer distress requires a serious response—but as in everything, there are choices. Economic analysis clearly shows that each rupee could achieve vast benefits—or could do as little as 80 paise. It is important to follow the evidence.

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