Print This Pa

Podcast | Digging Deeper - Do farm loan waivers work?

Rakesh Sharma and Seetal R Iyer

If you want to see an Indian farmer on screen, tough luck. You might have to buy a ticket to an international film festival. The farmer has all but disappeared from the mainstream Hindi film industry, the same industry which gave us *Mother India, Do Bigha Zameen,* and *Upkar*. While smaller films focussing on the plight of the Indian farmer *have* been made (and feted elsewhere), you are unlikely to know of them.

They barely get a wide release, and the entertainment media do not want to touch them - the Indian farmer and his stories simply do not appeal to the candyfloss imagination that Bollywood caters to. How can one have an item number shot in Monaco in a story about a farmer in Vidarbha?

The rural landscape itself seems to have vanished from the stories we tell on celluloid. Can you think of one big 'Bollywood' film in recent times that has featured a big star and focussed on the lives of rural Indians? There was *Lagaan*, but cricket was its hook. There was *Kadvi Hawa* last year, but did you watch it? *Peepli Live*, in recent memory, came closest to addressing the issues of the farmer to a mainstream audience largely due to it being an Aamir Khan production.

moneycontrol Podcast

SUBSCRIBE

In this 2010 film by Anusha Rizvi, Natha, a farmer, is encouraged by his own brother to commit suicide so his family could get a loan waiver and financial compensation after his death. The news of his impending suicide somehow attracts media attention, and reporters, OB vans and all, descend upon his village to capture the drama. While Natha, now obligated to kill himself, clearly does not want to, and runs away, even as another villager away from the spotlight Hori, who digs dirt for a living, dies.

The seen and unseen stories of Natha and Hori play out in the real world in similar ways - the inability of farmers to pay off debts and therefore resorting to suicides is a narrative we hear all too loudly ahead of any election, but the underlying reasons - the unseen - of a mental health epidemic in rural India, of poor agrarian reforms, of rising input costs and diminishing returns, of fragmented land holding, are barely ever spoken of.

The plight of the farmer, though, finds itself in centre stage in the run up to any election in India. Politicians of every stripe make promises of farm loan waivers ahead of every election. But barely heard are promises to usher in long term agrarian reforms.

Farm loan waivers are like a unicorn - it is the promise of the magical that hides the realities of the practical. They are also like Andy Warhol's fifteen minutes of fame. Loans waived for now... but what next? And how do they impact the larger economy? These are the questions we will address as we dig deeper into the issue of farm loan waivers.

Competitive populism

Hours after being sworn in as the 18th Chief Minister of Madhya Pradesh, ending the 15-year-long drought for the Congress in the state, Kamal Nath sanctioned the waiver of farm loans up to 2 lakh rupees in the state, as was promised in the election manifesto, and announced by Congress President Rahul Gandhi in June earlier this year.

Rajesh Rajora, Principal Secretary, Farmers' Welfare and Agriculture Development Department, issued an order soon after which read, " Madhya Pradesh Government has taken a decision to write off short-term crop loan of eligible farmers up to the limit of Rs two lakh, as on March 31, 2018, from nationalised and cooperative banks." Rajora said an estimated 34 lakh farmers will benefit from the loan waiver whose size he pegged between Rs 35,000 crore and Rs 38,000 crore.

Gandhi tweeted soon after: "1 done. 2 to go."

Chhattisgarh, where Congress won as well, followed next with Chief Minister Bhupesh Baghel announcing the waiver of short-term agriculture loans to the tune of over Rs 6100 crore of over 16.65 lakh farmers drawn from cooperative banks and

Chhattisgarh Gramin Banks. Fulfilling another pre-poll promise, the cabinet in Chhattisgarh decided to hike the minimum support price (MSP) of paddy to Rs 2,500 per quintal.

Upon being asked if loan waiver was the best option to revive the agrarian economy, Kamal Nath, who believes farm loan waivers are "a necessity" had a now-familiar tune to sing: When nationalised banks can write off 40-50 percent of loans of big industrialists, why can't cultivators get the same relief? The anger of the rural-dweller has recently manifested in massive farmer protests in the both the national capital and the country's financial hub this year.

One of their most important demands - complete loan waiver. In a year marked by high-profile scams in the banking sector in the country, to the farmer, his demand doesn't sound illogical at all. Loan waivers, whether farm loan or corporate NPAs, both represent a moral hazard, true. That corporate NPAs are a different kettle of fish is not a nuance an angry farmer faced with his dire realities is prepared to understand. And what the farmer dangles before the government is his vote. One wheat farmer in Madhya Pradesh, echoing millions others, said to Reuters: "I will vote for the party that will write off our loans." Quid pro quo.

The election results in Rajasthan, Madhya Pradesh and Chhattisgarh are being read as a rebuke to PM Modi. The Indian Express noted, "The Congress' relentless pursuit of boxing in the Modi government over agricultural issues seems to have paid off as out of a total of 424 rural seats in Madhya Pradesh, Chhattisgarh, Rajasthan, the BJP won just 153 seats as compared to 294 in 2013 – nearly 50 per cent fewer seats."

With little time left before the general elections, and to ensure the support of India's 263 million farmers and their dependants, reports indicate that the Modi government may be announcing a massive loan waiver - something it has not done since coming to power - to the tune of about Rs 4 lakh crore ($56.5 billion). Congress Chief Rahul Gandhi, on Tuesday, said that if his party is elected at the centre in 2019, it would waive of all farm loans. Gandhi also said that he “won't let the Prime Minister sleep” till a nationwide farm loan waiver is announced. Gandhi's farm-loan-waiver promise has certainly paid the Congress rich dividends this election season.

And with a new governor at the RBI, and the possibility of tapping into the excess capital reserves of the central bank now seeming easier than it did during Urjit Patel's time, it's not hard to see what Modi's next step might be.

In a completely unpredicted development, the theme for the 2019 elections, ladies and gentlemen, is farm loan waivers.

Farm loan waivers – A brief history

Gone are the days of free television sets and gold trinkets. Farm loan waivers, it seems, are the new political currency.

Farmers make up over half the labour market in India and are crucial in elections. The first national loan waivers date back to 1990, when the union government waived Rs 100 billion ($5.6 billion) in farm loans. In 2008, the government announced another major round of loan waivers totalling Rs 650 billion, about 1.3 percent of India's GDP.

Over the following nine years, until 2017, the central and state governments waived nearly Rs 890 billion ($14 billion) in loans to 48 million farmers. Since 2017, Uttar Pradesh, Madhya Pradesh, Maharashtra, Punjab, Karnataka, Telangana, Andhra Pradesh, Rajasthan, and Chhattisgarh have all announced (or completed the promised) farm loan waivers. Tamil Nadu, under Jayalalithaa, had done so in 2016. Karnataka, with a waiver announced of Rs 44,000 crore tops the list, with

Madhya Pradesh, Uttar Pradesh, and Maharashtra following closely behind, each with upwards of 30,000 crore rupees waived. This brand of competitive populism, ahead of 2019, has spread to Gujarat and Assam as recently as today with these states also announcing a waiver of farm loans and electricity bills.

In 2017, waivers announced in the four states of Uttar Pradesh, Maharashtra, Punjab, and Karnataka, came at a cost of $13.6 billion. By 2019, farm loan waivers will amount to 2-2.5 percent of the GDP, or about $40 billion, said BofA-ML last year.

Are farm loan waivers an effective solution?

No.

As Nilanjan Banik writes in the Economic and Political Weekly (EPW), "Waivers of farm loans may help any political party win an election once. For them to win an election twice, however, it is important to undertake policy measures that will make a real difference to the life of poor farmers."

What are waivers useful for? Garnering votes. Agriculture employs nearly 45 percent of India's workforce even though its contribution to the GDP is about 15 percent.

Research studies, like Banik's, over several years have indicated over and over again that farm loan waivers are at best a Band-Aid solution and at worst instruments that engender moral hazard. Additionally, formulae to waive farm loans are not uniform across states.

Rajasthan, for example, calculates waivers based on amount of crop damaged, size of land holdings, and harvest volume. Other states have fixed limits for the amount to be waived. The UPA government 2008 waiver covered only marginal and small farmers (those holding less than 2 hectares of land). Others got a 25 percent waiver. On the flipside, many farmers who do own more than 2 hectares of land are rendered ineligible even though much of the land owned may be uncultivated.

From a macroeconomic perspective, ex-RBI Governor Urjit Patel stated that the farm loan waiver scheme “undermines an honest credit culture, impacts credit discipline, blunts incentives for future borrowers to repay, in other words, waivers engender moral hazard.”

The RBI also warned that loan waivers will crowd out private borrowers in favour of government lenders and will worsen inflationary risks, limiting the RBI's ability to lower interest rates. His predecessor Dr Raghuram Rajan also reiterated this concern and added that the waivers often go to the "best connected rather than to the poorest."

The Economic Times put it succinctly when it listed seven reasons why farm loan waivers do not make sense:

1. Waivers create pressure for similar action in other states aka Monkey See Monkey Do
2. They do not address the underlying reasons for agrarian stress.
3. Waivers do not benefit all borrowers equally.
4. Rich farmers benefit from borrowings more because they have access to formal bank credit and are more likely to have financial literacy and awareness.
5. Loan waivers impact credit culture and create moral hazard - those farmers who *can* repay loans also stop doing so. Who does not like freebies?
6. Access to more credit becomes difficult for farmers
7. Overall development suffers as states are forced to cut spending elsewhere.

Let's break that down a little more:

How do farm loan waivers work?

Politician promises taxpayer money to waive farmer's loans in exchange for his vote. Taxpayer money is then used to repay these loans thus denting the fiscal standing of the government promising these loans. Writing for Firstpost, Dinesh Unnikrishnan says, "Since banks do not get money on time from governments, this puts them on a back foot, forcing to go slow on further lending to farmers."

A report from Kotak Institutional Equities pointed to a strong dip in agricultural loans in Tamil Nadu and Andhra Pradesh two-three years after the announcement of waivers there. The report adds, "While the available data does not clearly substantiate our hypothesis given the other extraneous variables like monsoon, other government initiatives, etc., back of the envelope calculations suggest a modest slowdown.

Additionally, agriculture loan growth has been broadly strong in the years prior to the announcement of a loan waiver in most cases apart from Punjab. Additionally, the growth of agriculture loans in these states has been higher than the industry average or their regions prior to the announcement under most circumstances."

State governments that have announced these waivers have since seen their debt-to-GDP ratio increase, Unnikrishnan points.

Unfortunately, however, agriculture is a season-dependent trade. Should there be another spell of poor rains, or a glut resulting in lower market prices, the farmer is yet again saddled with loans he cannot repay, and yet again, the politician enters to cash the farmer's vote for a waiver.

Who benefits from farm loan waivers, even if for the short term?

Rich upper caste farmers. Or at any rate, farmers with access to formal bank credit, meaning farmers with some functional financial literacy. And politicians seeking power.

The work of C Shankar Rao, assistant professor at the Council for Social Development, Hyderabad, published in the Economic and Political Weekly (EPW), sheds more light on this. More than 85 percent of India's farmers are either small (0.1 to 1 hectare total land farmed) or marginal (1.1 to 2 hectares). Semi-medium to large landowners constitute the remaining 15 percent of the farmer population in the country. This distinction is crucial to understand the debt-seeking patterns within the farmer community.

There are three main sources of credit for farmers: among formal sources, Scheduled Commercial Banks (SCBs) and co-operatives; among informal sources, private money lenders (PMLs).

It should come as no surprise then that small and marginal farmers mostly borrow from PMLs as they are less likely to have anything to offer in terms of collateral to formal sector credit sources. As SCs constitute the largest chunk of small and marginal farmers, it is also them that have the smallest formal sector credit.

More than a fourth of the total credit taken by Indian farmers came at interest rates of 36 percent per annum - clearly interests levied by private money lenders. Upper castes often also have an advantage accessing cooperative credit, research has gone to show.

(It is to be noted, however, that rich SC farmers, too, do better when it comes to accessing formal credit.)

Nilanjan Banik in the EPW again: "Loan waivers are not the solution to the farming crisis. In the year following loan waivers, small farmers lose out on three counts: lower access to formal loans, falling agricultural revenue because of higher informal loan cost, and falling agricultural productivity."

The Times of India reported the stories of several farmers from across the country who were eligible for waivers but eventually only ended up receiving a fraction of what was promised owing to the fine print in these loan waiver schemes.

Simply put, farm loan waivers are only helpful to those who have taken loans from a formal credit source. 85 percent of the country's farmer population constitutes of small and marginal farmers, a large section of whom most often do not even have access to formal bank credit and are at the mercy of private money lenders who levy exorbitant interest rates.

Even more simply put, loan waivers impact those who are *in the system.* The tragedy though is that the section of the farmer population that is in direst need of help is *out of the system* and therefore stands to gain nothing.

PRS Legislative Research reiterated this point: "Marginal and small farmers accounted for 82 percent of all indebted households and 56 percent of the outstanding loans by value. However, only a small proportion of the indebted marginal and small farmers had taken loans from institutional sources such as banks and cooperatives.

Informal sources such as moneylenders, family and friends accounted for 62 percent of indebted households among marginal farmers. Such farmers would not benefit from any scheme that restructures debt taken from banks and cooperatives."

How does it impact the economy?

The fiscal standing of the governments granting these waivers suffers as a result of loan waiver schemes. Tanika Chakraborty and Aarti Gupta of IIT Kanpur, presenting their research in Ideas for India, went on to note: "Our research provides evidence that a blanket waiver scheme is detrimental to the development of credit markets.

Repeated debt-waiver programmes distort households’ incentive structures, away from productive investments and towards unproductive consumption and wilful defaults. These wilful defaults, in turn, are likely to disrupt the functioning of the entire credit system."

Let's examine the impact on banks first. In the aftermath of every loan waiver announcement, a spike in NPAs has been observed, simply because even honest taxpayers stop repayments in the hope that their liabilities too might get included in the waiver package. A Kotak Institutional Equities report states an example: "As we saw in Karnataka, gross NPLs in MP have been rising in recent years. It was at 8 percent in FY2017 which increased to 11 percent prior to the elections." That phrase again - moral hazard. Moral hazard, which incentivises defaulting on loans. In Dec 2017, The Times of India reported that in some states, the default rate had increased by up to 50 percent in the aftermath of a loan waiver announcement. HFDC Bank reported a 60 percent rise in agricultural loan delinquencies in the quarter ending June 30, 2017.

Public sector banks (PSBs) will be the most negatively affected by the loan waivers. As of 2017, Nomura estimated that state-owned banks hold two-thirds of loans to be waived. The loan waivers would further exacerbate the PSBs asset quality problems and their already weakened capital levels.

The Hindu Business Line noted, “Economists caution that farm loans waivers would widen a fiscal deficit the government has aimed to cap at 3.3 percent of its gross domestic product (GDP), or Rs 6.24 lakh crore. Even without the farm loan waiver, some credit rating agencies have estimated the country's fiscal deficit at Rs 6.67 lakh crore - or 3.5 percent of GDP, on muted tax collections. The loan waiver also risks deepening the malaise at public sector banks saddled with most of India's $150 billion in stressed loans."

In its 2016-2017 annual report, the central bank cautioned against such “unconditional bailouts”, saying they could affect fiscal credibility in the medium term. The report also noted that the benefits of the waivers were "highly skewed and concentrated in states where concentration of land holdings was low on account of land reforms." It added that such random policy shocks “have an enduring impact on market borrowings of governments, as evident from past episodes of such waivers. They increase the interest rates the governments need to pay for the loans they borrow."

As for states granting these waivers, some have already seen their fiscal deficits worsen due to the impact of the UDAY (Ujwal DISCOM Assurance Yojana) scheme, which passed on a part of the debt burden of state electricity distribution companies onto the state government. Compromises on productive spending are inevitable - something's gotta give. The states' fiscal deficit widens, as has already been seen. As per the RBI, the gross fiscal deficit (GFD) rose to 3.1 percent breaching the threshold of 3 percent GFD/GSDP ratio recommended by the Finance Commission.

What then are the alternatives to farm loan waivers?

In a nutshell, it is safe to say that farm loan waivers are nothing more than a temporary dike made of mud in the face of a deluge of problems faced by the agrarian sector. It is no more than a populist ploy aimed at getting votes. As P Sainath said, "waivers are merely a tool, not a transformation; mechanism not a solution; relief not an answer to the greater problem."

M S Swaminathan, Father of the Green Revolution, said in an interview to Al Jazeera, "Loan waivers, though temporarily necessary for the revival of farming, do not provide conditions for a secure credit system in the long term."

Even in large scale reforms, patience is a virtue. It is beyond any doubt that India finds herself in the grip of an agrarian crisis. But the need of the hour is thoughtful long-term planning. Surgery, not band-aids. To incorporate the many reforms that have been suggested is beyond the scope of this piece, and will therefore be dealt with on a follow-up piece, but let's take a quick look at some of them.

Many experts have suggested the implementation of the National Commission on Farmers (NCF). Chaired by M S Swaminathan, it recommended minimum support price for grains, protection of small farmers and addressing risks in overtaking agriculture as a profession. The commission observed that farmers need to have access over resources such as land, water, bio-resources, credit and insurance, technology and markets and that agriculture needs to be shifted to the concurrent list instead of the state list at which it is currently at.

Nilanjan Banik wrote about some reforms from a cost-benefit perspective. He wrote, "The 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."

Noting that 20 percent of India's fresh produce is wasted because of storage problems, he advocated the building of more warehouses and storage facilities. "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." Research also shows that e-markets could result in better prices for farmers. A similar view was echoed by researchers at ICRIER.

Fragmented land holding, depletion of water table level, poor irrigation systems, deteriorating soil quality, rising input costs and diminishing returns, the vagaries of monsoon... these are only a few of the issues faced by the Indian farmer, none of which are truly addressed by loan waivers. What loan waivers do is address a temporary problem with a temporary, and largely ineffective, solution.

For effective long term reform, and to realise the government's dream of doubling farmer income by 2022, policymakers ought to think beyond electoral politics and enact structural changes that go beyond election season rhetoric and populist schemes.

The recent farmer protests seen in Mumbai and New Delhi hint at another crisis within the agrarian community - a crisis of identity. The socio-economic transformation that India has seen post-liberalisation has largely been felt in urban India. The traditional dominance of the farming community is being threatened in the new economic order where formal education and jobs matter more than farm incomes do.

Adding to the crisis of collective identity is an epidemic of mental health disorders. Farmer suicides are tragic, this is undeniable. And most narratives tend to cite poor farm outcomes and burgeoning loans as the reasons for these suicides, sidestepping another brewing crisis within the agrarian community - that of clinical depression.

For the record, as of 2011, the latest year for which suicide data were computed, suicide mortality is *lower* among farmers than non-farmers (Basu, Das and Misra, EPW, 2016). Dr Neeraj Kaushal, Professor of Social Policy at Columbia School of Social Work, has gone on to note that while the economic distress of a poor harvest may no doubt contribute to the farmer suicides, it is also just as important to address the mental health problems that the community may be suffering from, but is too afraid to address.

Any reform in the agrarian sector would be incomplete if it didn't also consider the well-being - physical and mental - of the agriculturist.

Jai Jawaan Jai Kisaan, otherwise, would be merely lip service.