# Are Loan Waivers a Panacea for Rural Distress?

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Small and marginal farmers are not the real beneficiaries of loan waivers. 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 costs, and falling agricultural productivity. Instead, supply-side interventions could make a real difference in farmers' lives as a long-term alternative to loan waivers.

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On the eve of Karnataka elections, farm loan waivers were one of the major election promises. Chief Minister H D Kumaraswamy eventually fulfilled his pre-poll assurance and announced farm loan waivers of up to ₹34,000 crore (with a cap of ₹2 lakh per family). Starting in 2017 Karnataka is the fifth state (after Uttar Pradesh, Punjab, Maharashtra, and Andhra Pradesh) to have implemented farm loan waiver programmes. Another poll-bound state, Rajasthan announced farm loan waivers, and the main opposition party, Indian National Congress, has promised farm loan waivers in Chhattisgarh if voted to power. As a result of farm loan waivers, there is a likelihood that during fiscal year 2018–19, India's fiscal deficit may widen to ₹1,07,700 crore. During 2016–17, the total amount of debt relief programmes announced by the governments of Uttar Pradesh, Maharashtra and Punjab amounted to ₹77,000 crore or 0.5% of India's gross domestic product (GDP) in 2016–17 (Kundu 2017). If all the states in India were to waive 50% of their farm debt, it would cost 1% of India's GDP in 2016–17 price.

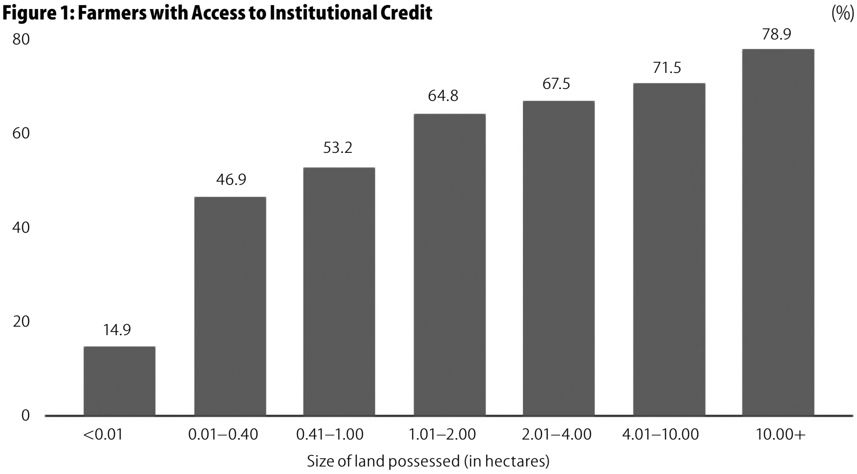
## Small Farmers and Waivers

Unfortunately, the real benefit to small and marginal farmers (with less than 2 hectares (ha) of landholding size) will not come from loan waiver programmes. This is because only 15% of small farmers have access to institutional credit (formal credit), and loan waiver schemes typically cater to farmers who have availed formal loans (Figure 1, p 15).

Once a loan waiver is announced, banks usually stop giving loans to farmers qualifying for loan waivers during the next loan cycles (Kanz 2016; Giné and Kanz 2018).[1] The banks lose on the interest payment, and at times it is not clear within what time frame any state government is going to repay the principal amount, leading to credit rationing. Then there are issues related to moral hazard whereby more productive farmers who can pay off their loan, deliberately default. Rath (2008) points out that those farmers, who had already repaid their loans before the announcement of loan waivers, feel cheated and therefore are reluctant to pay fresh loans. Some farmers believe that such write-offs will occur from time to time, and therefore are unenthusiastic about the repayment. Kanz (2016) shows that beneficiary farmers appear less concerned about the reputational effects of defaulting on their loans.

Evidence suggests that quite often small farmers use the money saved from loan waivers for consumption purposes instead of using it as an investment to augment farm productivity. Analysing the loan waiver programme announced by the Uttar Pradesh government in 2011, Chakraborti and Gupta (2017) find that as compared to the non-eligible households, eligible households in districts that received loan waivers had higher consumption expenditure by approximately ₹8,000 per year. Furthermore, the eligible households also tend to spend significantly more on social events such as weddings and family occasions. This study points out that within the same district, households that received loan waivers had no significant productivity difference when compared with the households which are not eligible. Households expect governments to intervene so that the credit institutions do not seize their collateral in the case of default. The expectation that they can avoid any penalty for non-repayment of a loan is likely to affect household decisions regarding the utilisation of loans. At a time when it is costly for banks to operationalise bank branches in remote rural areas, such a problem associated with moral hazard is the reason why state-owned as well as private commercial banks are reluctant to extend credit to a large number of small farmers. The bottom line is that small farmers lose out both in terms of access to formal loan and a lower agricultural output as debt forgiveness is likely to disincentivise farmers from using loans for productive investments.

Figure 1: Farmers with Access to Institutional Credit




Source: National Sample Survey Office's 2013 situation assessment survey of farm households, Government of India.

Yet, political parties use farm loan waivers as a strategy for winning elections. As has been seen time and time again, "farmers first" provides political mileage. With more than 55% of Indians earning their livelihood through the agricultural sector, it comes as no surprise that political parties like to place their bets on the farmers' cause.

## Real Gainers

The big and mid-size farmers (with more than 2 ha of landholding size) are the ones who gain the most from farm loan waivers. Giné and Kanz (2018) show that the loan waivers during the current loan cycle prompt banks to reduce credit outlay for small and marginal farmers during the next loan cycle. Post bailout, farmers below the 2 ha cut-off experience an 8% point reduction in formal lending. The implication of this finding is that the farmers with more than 2 ha receive more credit after the bailout that is made available to them at the cost of small farmers who qualified for loan waivers. The benefit to larger farmers is simply the total formal credit increase multiplied by the interest rate differential between formal and informal sectors. This amounts to ₹535 crore per year.

A K Tripathi (2017) shows that the average rate of interest on formal credit is 11.6%, while for informal credit it is 25.20%. Both these interest rates represent the weighted average of diverse sources of credit, including banks and government (formal) as well as moneylenders, shopkeepers, friends, family, and landlords (informal). Kanz (2016) indicates that farmers are able to substitute 75% of the formal credit gap with informal sources of debt. If this were to come from costly moneylenders, then the extra interest expense would be significant. He also suggests that the credit gap is mostly filled with loans from friends and relatives. However, the fact remains that in the advent of credit rationing, the small farmers increasingly rely on costly informal credit. For the farmers relying on costly informal loans, they invest 15% less on agricultural inputs in comparison to the farmers who do not face credit rationing (Kanz 2016). Costly informal loans reduce their purchasing power and to an extent reduce farm productivity, thereby cutting revenue for the most vulnerable farmers by 13.5%. Loan waivers mostly help richer and bigger farmers, leaving smaller farmers worse off in the future.

We studied responses to farmer distress in Andhra Pradesh and Rajasthan (Banik 2018 a,b). Of the two states, farmer distress appears more pronounced in Andhra Pradesh, which has one of the highest national rates of farmer suicides, at 47 per 1,000 population between 2010 and 2012. Nationally, between 2012 and 2015, over 10,000 farmers committed suicide.[2] In 2016, Andhra Pradesh announced a loan waiver costing the state exchequer ₹24,000 crore. In terms of generating a benefit–cost ratio, our work for Andhra Pradesh shows that waiving formal loans for landholders with less than 2 ha would cost ₹24,860 crore. The benefits will be slightly lower at ₹24,629 crore. Giving out a rupee to achieve just 99 paise of benefit is a poor deal (Banik 2018a). For Rajasthan, our analysis shows that waiving formal loans for landholders with less than 2 ha would cost ₹11,731 crore. The benefits will be slightly lower at ₹9,537 crore. Like in the case with Andhra Pradesh, for Rajasthan giving out a rupee to achieve just 80 paise of benefit is also a poor deal (Banik 2018b). Furthermore, spending thousands of crores on less effective policies leaves less for much more effective ones.

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. This has a wider implication on income distribution. Eighty-three percent of the farmers in India who qualify for loan waivers are marginal and small farmers. The median annual wage of these farmers is around $290, which is barely two months' minimum wage in Mumbai, the commercial capital of India. A low farm income not only exacerbates the rising income inequality, but also has been a reason for farmer suicides in India.

## Supply-side Interventions

What interventions, then, could be more helpful? One answer is reducing 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. Because of lack of storage facilities small and marginal farmers seldom venture to grow high-value crop. Only 22.2% of marginal famers (with less than 1 ha of landholding size) and 23.6% of small farmers (between 1 and 2 ha of landholding size) grow any high-value crops. Small and marginal farmers are likely to gain from shifting to high-value crops, after which the likelihood of a farmer being poor will be 3%–7% lower (Banik 2018a).

The National Centre for Cold-chain Development (NCCD) (2016) has estimated Rajasthan's total requirement for storing milk, fruits and vegetables at 74,889 metric tonnes (mt). 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 this amount. Similarly, for Andhra Pradesh, the current total storage requirement for storing milk, fruits and vegetables stands at 7,44,650 mt. The total number of pack houses required is 4,382, ripening chambers required is 5,708 and the total number of specialised trucks required for transporting fruits, vegetables and milk is 1,312. About 90% of the storage requirement already exists within the state, but the remaining infrastructure needs are non-existent. To fill this gap, a one-off investment of ₹2,686 crore is required. In sum, the benefits in terms of the reduced wastage in milk, fruits and vegetables for Andhra Pradesh are worth more than nine times that figure. It is worthwhile to build more storage and warehouse facilities.

Other supply-side interventions such as village electrification and canals will help. With irrigation coverage on small landholdings being less than 40%, a bad rainfall year means crop failure. Likewise, a reform in the Agricultural Produce Market Committee (APMC) Act is required. In a supply chain examination study involving trade in potatoes, it was found that the middlemen can charge a commission of up to a staggering 70% (Singh 2017). For instance, during June 2017 in the Azadpur and Ghazipur markets of Delhi, the middlemen were selling common variety of potatoes at ₹5–₹7 per kilogram (kg). If these rates were being offered to farmers they should have realised between ₹250 and ₹350 for a 50 kg sack. However, in reality, the maximum price the farmers were offered was ₹100 for a 50 kg sack. Hence, most often farmers do not know the actual market prices of the commodities and it is the middlemen who siphon off most of the profits. The lack of reforms in the APMC Act prevents small farmers to sell directly to supermarkets, exporters, and agro-processors (thereby, enhancing their income).

Financial literacy is also important. Lack of financial awareness has affected the growth and deepening of agriculture finance markets.[3] The National Centre for Financial Education (NCFE) conducted India's first-ever national benchmark survey of Financial Literacy and Financial Inclusion in 2015 which captured a broad array of information from 76,762 respondents. The survey highlighted that the farmers are not aware of basic financial products. For example, less than 1.67% of the farmers are aware of crop insurance products. The corresponding numbers for cattle/livestock insurance and agricultural futures are 0.66% and 0.38%, respectively. Even the introduction of e-mandis—online market where farmers can sell directly to the retailers bypassing the middlemen—are helping them a little. Evidence from Rajasthan suggests that the introduction of an e-market resulted in farmers witnessing a price premium of 13%. However, at present, e-mandis are catering to only 7% of the Indian farmers and handles only around 2% of the total value of agricultural output of the country.

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.

## NOTES

1 Through the Agricultural Debt Waiver and Debt Relief Scheme, 2008, the United Progressive Alliance government announced a ₹600 billion loan waiver package for 30 million small and marginal farmers. Both these papers examined the effects of the 2008 loan waiver scheme. The amount of loans waived was equivalent to 1% of India's GDP in 2016–17.

2 In addition to loans taken for agriculture, there may be other factors contributing to farm suicides. Citing reference from a report by the Indira Gandhi Institute of Development Research, Rath (2008) argues the reasons for farmers' indebtedness may arise because of the loans taken for weddings and drinking habits. Some farmers are mentally imbalanced, while others are committing suicide due to family or unknown reasons.

3 Agricultural finance refers to financial services ranging from short-, medium-, and long-term loans, to leasing, to crop and livestock insurance, covering the entire agricultural value chain—input supply, production and distribution, wholesaling, processing and marketing.

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