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Farm Loan Waivers in India: Good Politics but Poor Economics?

The government in the Indian state of Maharashtra has bitten the bullet. It has announced farm loan waivers which will cause a gap of about ₹32,000 crore (S$6.72 billion) in its budget. Much is being said about the political mileage that the party in power will get. This move, which followed the pre-poll announcement of farm loan waiver in another Indian state, Uttar Pradesh, has fuelled demands from farmers in other states too. Is the announcement such a political masterstroke? What will be its repercussions on the fiscal health of the state? The jury is still out. What is now becoming a pattern is the possibility of similar announcements being made by other state governments which will soon be going in for elections. Considering the fact that the fiscal health of most of the states is not good, the moves may crowd out capital expenditure, usually earmarked for asset creation.

Vinod Rai[1]

The demonstration effect generated by the Uttar Pradesh (UP) state government in India, in waiving farm loans up to ₹1 lakh (S$2,100) for small farmers who had borrowed from cooperative and public sector banks, has proved to be on expected lines, indeed. There was eagerness in the political circles in other states to display their loyalty to the farmers through

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similar announcements. Considering the fact that such waivers seem to have almost begun to guarantee electoral success to the party announcing them, there is now a competition among political parties to take the lead in promising such write-offs, if elected to power. Seen as a recipe for success, in election-bound Gujarat state, the Congress party has promised a waiver if elected to power. There is a flurry of demands from all parties for similar announcements in Madhya Pradesh, Rajasthan and Haryana. These states are due to go to the polls next year. In Karnataka, the incumbent government is already working on a proposal which will provide relief to about five million farmers with a package of about ₹50,000 crore (about S$10.5 billion). Karnataka, too, is due to have state elections. Obviously, the move is seen as a *mantra* for political victory.

How does it appear through the lens of an economist? It is undeniable that the loan waivers will definitely worsen the fiscal deficit and, hence, crowd out allocations for the creation of capital assets. In fact, the Maharashtra state government has just announced a cut of 30 per cent in revenue expenditure across departments and a 20 per cent cut in capital expenditure. With these cuts, the overall spending for the year will be much less than in the budget of 2016-17, and, in fact, even less than that in 2015-16.[2] Besides such arithmetic and the liability it imposes on the budgets of the state governments, which seem to be resorting to fresh borrowings to service past debts, there is the fact that the waivers encourage a culture of indiscipline in resorting to borrowings in the rural areas.

Speaking after the monetary policy announcement on 6 April 2017, Urjit Patel, Governor of the Reserve Bank of India, said, "Waivers engender moral hazard…Waivers undermine an honest credit culture…It leads to crowding out of private borrowers as high government borrowing tends to (impose) an increasing cost of borrowing for others."[3]

The Central government has taken the stand that it will not fund the loan waivers of any of the states and that they will have to find their own resources. However, it may be recalled that it was the Central government, under the leadership of the Congress party, which had announced farm loan waivers of about ₹72,000 crore (about S$15.12 billion). It is widely believed that it was that waiver which ensured that party's re-election in 2009.

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2 Hindustan Times, 2 July 2017.
3 www.Livemint.com, 7 April 2017.

The waiving of farm loans or the providing of temporary succour through interest subvention is certainly not a long-term solution to the ills that beset Indian agriculture. These are measures which the government should take recourse to in times of a steep decline in price or natural calamities. The distress in the agrarian sector seems to have become an annual phenomenon which keeps recurring in some part or other in the country. Successive governments have not been able to find long-term solutions. Millions of rupees seem to have been spent on irrigation facilities but the coverage under assured irrigation still continues to be miniscule. There needs to be easy availability of seeds, fertilisers, support price, storage and marketing so that, with increasing agricultural production, the prices realised by the farmers do not decline.

The figures put out by the government[4] indicate that, whereas the consumer price inflation in May 2017 was 2.18 per cent, the food price inflation went to the minus side. Despite the fact that India has had two consecutive years of drought, prices saw a steep decline when food production increased last year due to a good monsoon. A similar phenomenon has been noticed in regard to vegetable prices too – it is believed to be a lag-effect of demonetisation, since the chain of intermediaries running *mandis* (market places) was left without liquidity.

The UP government, which was the first state government to announce a waiver, cannot bear the liability imposed by the loan waiver in a fiscal year. The impact of the waiver will be to the tune of 2.6 per cent of its gross state domestic product.[5] The adverse impact on the budget will be huge; hence, it is considering the issuance of 'farmers relief' bonds. It is still not clear whether the entire principal and the interest amount will be provided for in the current budget. The issuance of such bonds (petroleum bonds issued by the previous United Progressive Alliance government at the Centre, or the 'Uday bonds' presently) has very severe inequity effects and adversely impacts the budget of the government at the time of maturity.

The Maharashtra government has entered into talks with banks to provide guarantees to the loan amounts in the form of bonds with a future validity to ensure a graduated liability over the

[4] https://data.gov.in.
[5] India had a total of 138.35 million agrarian holdings in 2010-11. The share of UP was 23.33 million or 16.9 per cent. Crop loans in UP would be around ₹692 billon (S$14.53 billion) by 31 March 2017. This will, in itself, be about 0.4 per cent of the gross domestic product of the country. Hence, an attempt by the Indian government to fund the waiver will increase its own fiscal deficit. Hemendra Hazari. 20/03/2017. https: thewire.

years to come. It is clear that the decision taken by the Maharashtra government is to ensure that it is not painted as a party which is not farmer-friendly.

Elsewhere, there are indications that the Punjab government is planning to take over the liabilities of the farmers. It will have to be very careful as its finances are not in good shape, with the amount payable towards free electricity to the farmers burgeoning over the years.

However, typically such populist decisions are announced nearer the elections, as is being planned by poll-bound states such as Gujarat and Karnataka.

The Maharashtra government runs the risk of a fresh demand being made next year in case there is a bad monsoon. Considering that elections are due there in 2019, the party will then come under pressure. Since the farmers form a huge section of the electorate in Maharashtra, such pressure could become very acute. Added to this will be the problem that, in a poll year, the flexibility available to the government to announce more populist schemes will be very limited. Maharashtra has also to factor in the additional burden it has to bear on account of the Seventh Pay Commission recommendations which will easily cost upwards of ₹20,000 crore (S$4.2 billion).

If the waiver is indeed good politics, does it imply that Maharashtra is in for elections earlier than the five-year term ending in 2019? There is indeed a lot of speculation on that possibility.

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