Farm Loan Waiver:
Right Choice for Supporting Agriculture?

N.Srinivasan*

The Agricultural Debt Waiver and Debt Relief Scheme 2008 has been announced and implemented. As per initial estimates given out by the Government, 39 million farmers received state-supported relief of waiver of their defaulted farm loans. The overall bill for the nation is expected to be about Rs 72000 crore. The major budget announcement on waiver of farm loans has been lauded and criticized in equal measure. Farmers, especially the small ones, need all the support that is possible. The terms of trade in farming have not been so positive and profitability of agriculture has been weak. Even an increase in global commodity prices does not translate into higher incomes for the Indian farmers on account of a commodity trade policy that is weighed in favour of the consumers. Given that there is agreement across the political and economic spectrum that farmers need support, is the loan waiver the best instrument is a question that begs an answer.

Looking to the low profitability of farming and the risks that the farmers face from weather, markets and credit institutions, a relief measure cannot be faulted. The waiver is perhaps a recognition of the small farmers' plight and the lack of profitability in agriculture. Low productivity, unfavourable terms of trade, natural calamities, weather risks, lack of access to technology, low availability of inputs including finance, etc. have been the common reasons for under performance of agriculture. The indebtedness of farmers and defaults – to both banks and informal lenders – are a result of lack of profitability in agriculture. But the waiver treats default as a cause and looks at remedying the situation by extinguishing default. This would be at best a temporary solution as long as the basic causes of low profitability in agriculture are not addressed.

Credit as the vehicle for routing relief to farmers is a flawed choice. There is no evidence to suggest that increasing credit flow has resulted in increased production in agriculture or profitability. While credit flow to agriculture has been increasing at a rapid pace, the share of agriculture in GDP has consistently declined. The declining trend is likely to continue as in the case of any fast developing economy. Credit does not have a significant influence on production and productivity. Further, the interest cost of credit does not form a significant part of value of production. Any attempt to influence farm profitability through increased credit and liberal terms is unlikely to succeed. At best, credit provides liquidity and smoothens consumption and production needs of the farmer. As per NSSO survey and other studies, most farmers have not borrowed, and there can be no influence of credit on their agricultural operations. Hence, credit as a vehicle of relief is not a "fit" instrument.

The waiver, in form and delivery, does not seem to have been designed well. The waiver fails the test of equity, by a large margin. It does not mitigate the debt burden of all farmers, but only those borrowing from banks; it does not discriminate between those who are willful defaulters and those who are involuntary defaulters thereby rewarding morally hazardous behaviour; it also does not distinguish between farmers who carry higher risks on account of dry conditions and those who are not subjected to vagaries of weather on account of assured irrigation. The waiver continues to put more money in the hands of farmers who

* *Freelance Consultant in Rural Finance and Development, Pune.*

have been in receipt of funds of government through public procurement, etc. schemes. Such a waiver scheme is bound to cause competitive claims for relief from other sectors and other activities allied to agriculture.

As per the NSSO survey in 2002, incidence of debt among farmer households was 48.4 per cent. One out of two farmer households had no bank loan and they would not get the benefit out of this waiver, though the reason for their not having any debt might be exclusion and lack of access. Of every 100 indebted households, 56 had dues to the formal sector and 64 had dues to the informal sector (quite a few had debts to both formal and informal lenders). The waiver does not cover informal debt. Further, among the small farmer households (less than 2 ha land holding), incidence of borrowing is less at 46 per cent, whereas of the larger farmers (more than 4 ha) 66 per cent had taken loans. The waiver would benefit larger farmers more than the small farmers. The smaller farms had more access to informal sources than the formal institutions and consequently would benefit less from the waiver on this score too. The distribution of benefits of waiver across states is likely to be skewed as farmers in some states have traditionally been heavy borrowers from the banking system.

Table 1: States With Incidence of Farmers Debt at Higher Than All India Average

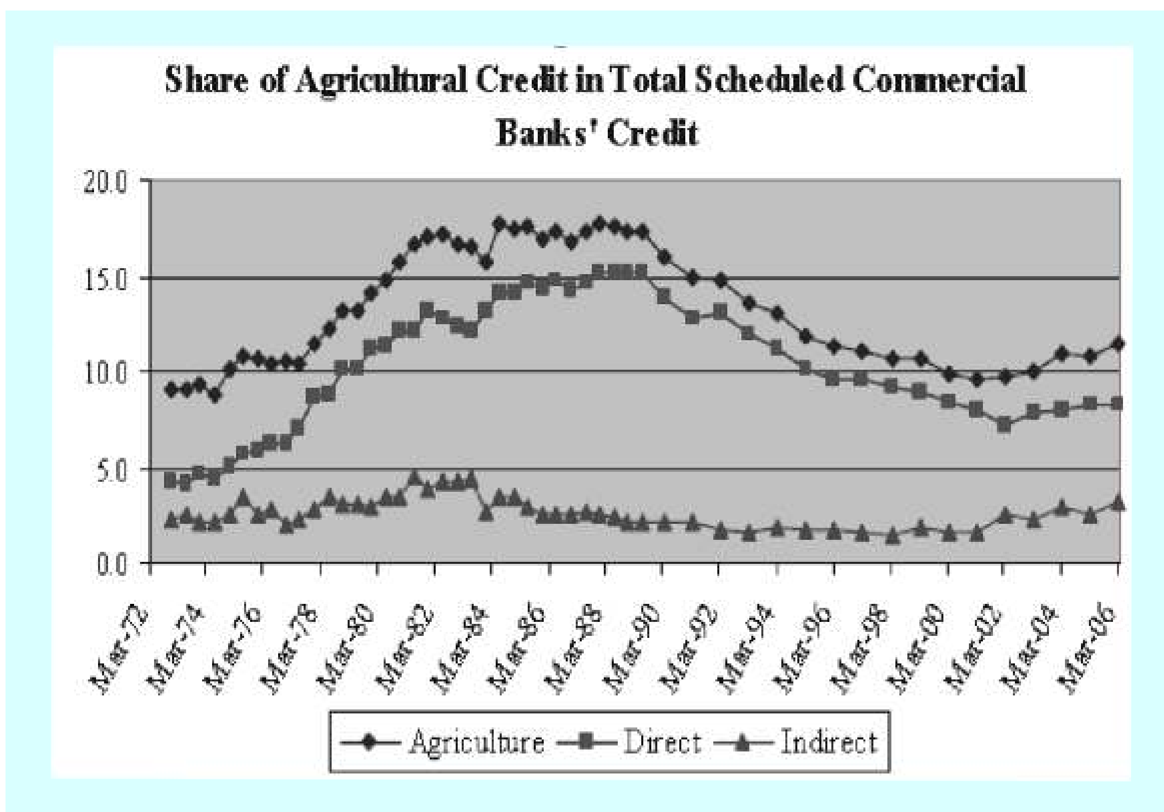
State	% of indebted farmer households	Average debt per farmer household (in rupees)
All India	48.4	12585
Andhra Pradesh	82.0	23965
Gujarat	52.0	15526
Haryana	53.0	26007
Karnataka	61.4	18135
Kerala	64.4	33097
Madhya Pradesh	50.8	14218
Maharashtra	54.8	16973
Punjab	65.4	41576
Rajasthan	52.4	18372
Tamil Nadu	74.5	23963

The states of Andhra Pradesh, Karnataka, Kerala, Tamil Nadu and Punjab are likely to get a major part of the waiver benefit not only on account of the higher proportion of borrowing households but also on account of the higher average bank debt they incur. Haryana and Rajasthan also have reported higher average debt at farm level and hence, would benefit more from the waiver.

A rudimentary analysis brings out that the relief per household on an average would be Rs 15000 (based on the 4 crore households that the budget referred to). The country level average farmer-debt in 2002, as per the NSSO survey, was only Rs. 12585. But the fact that farm credit from formal institutions have more than doubled in the last three years has to be factored into the analysis. Default is a very poor criterion for selection of beneficiaries for relief. Moral hazard issues are compounded; with indisciplined farmers being rewarded, the other regular users of farm loans have been provided the wrong kind of motivation to default in future. While most undeserving farmers would benefit, not all those deserve would get the support.

The scheme does not target any region or crop that is important from a food security point of view. It does not seek to incentivize farmer behaviour that would promote food security. The targeting of the scheme towards drylands and unirrigated areas would have ensured that farms therein would continue to be in the business of farming. By targeting the scheme towards desired food crops and oilseed crops, production of these could have been encouraged which would have served larger interests of the nation.

The loan waiver does produce a temporary positive effect on farm incomes. The avoided repayments would enable farmers to retain more of their incomes. But future credit availability is not assured for the beneficiaries of waiver. Coming on the top of vigorous expansion of farm credit, at the behest of government in the last three years, the loan waiver is likely to dampen the enthusiasm of banks to expand agricultural credit. One of the reports mentioned that the loss to commercial banks would be Rs. 11000 crore, the amount towards unapplied interest, penal interest and other charges that they would have to bear without reimbursement from the government. The experiences of the past show that there are many ways of denying credit to farmers who chose to benefit from default of bank loans. Delay in sanctions, high collateral requirements, reduction of quantum of loans, lengthy and complex documentation requests, etc. are some of the well known methods of denial of credit. These would be employed to good effect in the post- waiver situations by banks to cut their exposure to farm sector.



The chart[1] shows the long term trends in credit flow to agriculture from commercial banks. After the last such waiver scheme (Agricultural and Rural Debt Relief Scheme 1990), agricultural credit as a share of commercial banks' gross credit flow has been continuously declining. In the recent past, the agricultural credit flow share had started moving up, with considerable prodding by the Government of India with its "doubling of credit flow" programme initiated in 2004. (The programme achieved doubling of credit flow almost within two years, reflecting that banks would enlarge exposure to agriculture sector, if the policy environment was right). The current waiver would result in a reduction of credit flow to the sector that adversely affects even the non-benefitting population among the farmers. If the waiver impact on credit flow to agriculture is as prolonged as in the previous occasion (almost 13 years), then this relief measure would have done more harm than good. The economic survey 2008 as well as Eleventh Plan Approach point towards falling capital formation levels in agriculture sector and the need for shoring up the same. But, thanks to the loan waiver scheme, bank loans for investments in assets and improvements necessary to enhance productivity would be rendered difficult, compelling the farmers to access funds from the informal sector. In this sense, future incomes of farmers could be adversely affected on account of waivers.

The Government has clarified that the waiver will also apply to defaults of SHGs and members that had taken loans for agricultural purposes. This is the first time that a waiver scheme is targeted at SHGs[2]. This is fraught with risks; 44 million member households of SHGs postponing their repayments in order to secure such concessions from the government is too large a risk that could set back the emerging microfinance sector by a few years. On the ground, the MFIs and NGOs are already asked questions by the microfinance clients about the reasons for non-applicability of waiver programme to them. The contamination risk places a large and vibrant microfinance programme in jeopardy.

[1]Source: Expert Group on Farm Indebtedness 2007

[2]Direct Agricultural Loan as defined in paragraph 3.1 of the Scheme would also include loans extended to SHGs of individual farmers even if the disaggregated data is maintained at the level of the SHG and reflected on the books of accounts of the SHG. However, it must be ensured that the disaggregated data is maintained to the satisfaction of the lending institution concerned. Clarifications on Agricultural Debt Waiver Scheme issued by ministry of finance, Department of Financial Services, dated 18 June 2008.

Better means of providing relief to the farmer could have been found. One of them is that of mitigating the risks of farmer. Risks of farmer have been categorized into production loss, income loss and productive asset loss. Lack of rains, insect attack, input failure, etc. could result in reduced production which could lead to income loss. Even when the production is up to expected levels, the prices in the market could crash, resulting in low income. Natural calamities such as droughts, floods, earthquakes could destroy the assets of the farmers that are critical for the productive effort. Land, farm machinery, farm animals, etc. are lost or their quality adversely impacted resulting in their productive ability being impaired. If these risks could be mitigated through universal coverage of farmers under insurance schemes, the frequent resort to waivers might be rendered unnecessary.

If the National Agricultural Insurance Scheme, which insures farmers against crop failure, is made more effective with a more distributed, localized crop cutting as a basis for determining claims, it would become popular among all farmers across the country. The incremental costs of increasing number of crop cuttings and taking the claim settlement units to a lower geographical level cold easily be borne out the budget allocated for waiver. Even a large corpus fund (say for example Rs 50000 crore) for meeting claims and another (say Rs 10000 crore) for subsidizing small farmers premium payments would have been possible, if one considers the amount of funds available under the waiver. The corpus should be managed to produce best possible returns from which the claims could be met year after year.

Further, asset insurance, on similar lines, of all productive assets of the farmer could have been attempted with a one time premium payment being made by the Government covering the next five years in respect of each farmer. The administrative arrangement to underwrite so many policies and recording the information would no doubt be a mammoth challenge. But, with the availability of technology solutions and a large number of community based institutions and NGOs makes this task doable. Such risk mitigation arrangements would provide lasting relief to farmers without depending on special responses from the governments of the day. The more important aspects of such schemes are that they do not reward willful default and do not distort the credit and enterprise climate.

Accelerating investments in infrastructure especially in regions that are rain dependant would have afforded better results in terms of income effect on farmers. The incomplete irrigation projects, when completed could be a source of assured production and reduced weather risks!

An alternative is direct cash transfer to each small farmers producing strategically important crops; a fixed amount equivalent to 50 to 100 days of labour (as in case of NREGS) could be paid to small farmers, provided they carry out farming of specific crops that of importance to the country. Farmers producing food grains, oilseeds and pulses could have been targeted and a fixed amount per hectare cultivated (of course with a ceiling of two hectares or so) could have been given at the end of each cropping season. This would have ensured greater productive effort towards ensuring food security while offering income stability to the farmers.

The loan waiver scheme is an effort that cures symptoms than causes. It has high visibility, but unlikely to produce lasting results in the development of farm sector. The large amount of money being spent could have been used to usher in fundamental reforms in agriculture and make it market oriented and profit centred. The government intervention in farming should move towards improving profitability and target farm incomes through measures in the real sector than merely making marginal changes through the financial sector. The opportunity to do the right thing by the farmers and agriculture is not lost; but certainly the money is.

References:

1. Report of the expert group on Agricultural Indebtedness 2007

2. Situation Assessment Survey of Farmers Indebtedness, NSSO 59th round -2005

3. Guidelines on Agricultural Loans Waiver Scheme 2008, issued by Government of India, RBI and NABARD

Editor's Note: The views expressed are that of the author and not of the College. The article articulates the 'other' viewpoint and could be a pointer for further discussion amongst all the stakeholders, acade-micians, and others.

Prof. M. S. Swaminathan on "Farm Loan Waiver Scheme 2008"

Q: Could we start with your overall impressions of the loan waiver?

A: The National Commission on Farmers (NCF) actually recommended the loan waiver to the Ministry of Agriculture in 2005. The loan waiver is the beginning of a process in which our goal should be getting over 30 million small and marginal farmers back into the credit system and back to productive farming. If you could look at the loan defaulters, they are mostly in non-irrigated agricultural farming areas, which is where about 60 per cent of our farming occurs while the other 40 per cent is on irrigated land. Moreover, the declining levels of groundwater has meant that even those who work on irrigated land are beginning to rely more on rainwater, and sometimes the rain fails. If a farmer has to repay a loan every year, and the rain fails in a couple of years, it is better to waive the loans and start off with a clean slate. This would help farmers to get out of the debt trap, especially if following the waiver, farmers become eligible again for institutional credit. So, the loan waiver should be the beginning of a process, not the end of a process.

Basically, we have a system of agricultural credit that is not structurally sound. The reason why the current loan system has failed is because none of the support systems that farmers possess in other countries like Japan and the United States exist here. We do not have effective crop or weather insurance systems. When the rain fails, farmers still need to pay back their loans. As a result, the farmer goes to a moneylender to pay off existing loans. This is what happens often with micro-credit; people are socially pressured to pay off the loans.

Therefore, if we can write off loans totaling thousands of crore of rupees for industrialists, our poor farmers who have no support system and no technology, who dry their paddy on the road, deserve a waiver. In the 21st century, we are leaving more than 80 million small and marginal farmers without adequate support systems, no technological support, or social support. How will they pay back the loans? Of course, the only other option for them is to commit suicide.

Unfortunately, the government has not crafted the loan waiver scheme in a holistic manner the way the NCF recommended. I have been saying in recent articles that the loan waiver is important because there are no effective support services to insulate small farm families from risks beyond their control. No insurance, no support, no early warning system for rainfall, no immediate action to help them, except during famine when the government gives them free food. Under those conditions, my idea was that the loan waiver would help farmers. It's not a small number, including those who have had loan readjustments; 40 million out of 115 million, a little more than one-third.

Q: You mentioned that people would have hopefully come back to farming, what are the actionable steps, such as insurance that you mentioned, that we could take to help farmers?

A: We should provide support services such as seeds, technical advice, and appropriate mineral and bio-fertilizers, and pest management. Foreign experts who come here may not understand our agriculture very well. They try to influence policy, and it's a fiasco. One day they want to try Training and Visit (T&V) system of extension, and then other days they recommend other strategies.

Unfortunately, a lot of policy activity won't help at this point, because we are in grave circumstances. Last season there was no rain, until very late in the season, which damaged the farmers' crops. And, the water table has gone down deep, causing water prices to increase because the cost of pumping water is very high. The costs are too high, so farmers can't pay for the water. Subsidies could help. I think there is a grave economic and ecological crisis. If farm economics goes wrong, it is hard for anything else to go right in agriculture.

Q: Moving over to some of the criticisms of this package, many people have claimed that while the package is a significant respite to farmers with formal loans, the vast majority of farmers, those who are really in distress, don't have access to formal loans. How would you react to this criticism?

A: Number one, you can't generalize all small farmers. These criticisms are not new, and they get to an underlying

challenge. Generalizations are easy for our policymakers, and this influenced the set-up of the waiver policy and the eligibility criteria. It's a one size fits all approach to small farmers and their challenges. There are many different types of farmers, farmers working on arid land have different problems than those with irrigation, farmers that work in rain-fed regions face various challenges, and farmers with 5 hectares in unirrigated areas face different challenges than those with one hectare in irrigated areas.

Q: The point about the criteria for loan waiver eligibility, and the need for more variation, has come up several times. What are your thoughts on how the criteria could be improved?

A: With other government agricultural programs, such as the Land Ceiling Act, there are very different criteria for program eligibility. If a farmer works on irrigated land it must be at 10 acres or less, if rain-fed land, 25 acres or less, for Rajasthan 50 acres or less [to be eligible for the program]. We already have the kind of parameters we need for land reform. All we need to do is take the same type of approach with the loan waiver program. In one of my recent articles in The Hindu, I suggested that the land size requirements for small farmers that work in arid land should be higher than those farmers with irrigated land.

Policies shouldn't be designed only to be simple or easy to generalize. Policies should be made to ensure that those targeted, in this case struggling small farmers, have their livelihood security rejuvenated.

Q: Do you think there would be a way to include moneylenders' informal loans in the loan waiver program?

A: Moneylenders are an institution that has been around a long time and that provide credit in a relatively holistic manner. Moneylenders may not be the sole reason for recent suicides. In some villages I have visited moneylenders charge rates that are too high and they are not good, but the same can be said for some micro-finance institutions. On a broader level, our loan system for farmers is very narrowly circumscribed. If farmers want money after receiving an initial loan that is, if they want to renew a loan, it's very difficult for them. To create a thoughtful credit policy, the Cost and Prices Commission needs to look at our farmers' consumption and agricultural needs.

Q: You said that in essence, the loan waiver is a good policy. But, 60,000 crore rupees is a lot of money, and you also said that farmers need other types of support, such as technical advice and fertilizer. So, when we look at the efficient allocation of resources, would you allocate 60,000 crore rupees to the loan waiver, or with the criteria you have raised, would you allocate this money differently?

A: It's not that simple. With the loan waiver, you are reaching 40 million people that own land and are being re-launched into productive agriculture. If each of these farmers can produce half a ton more, we will create 20 million tons of additional output. Today, 20 million tons of rice may cost more than 20,000 crore rupees in the international market. So, people will find the loan waiver useful. I don't think it should be the endpoint, but it's certainly a starting point of getting them back into productive agriculture.

Q: When you look at last loan waiver, which happened around 1990, what lessons should we take away for our current situation?

A: There have been a lot of loan waivers, there have been loan bailouts that have damaged the credit system. We need to make the waiver one step in a process. We need to figure out a way to encourage the people receiving loan waivers to work really hard to produce more. There has to be a quid pro obligation. In this instance, I think there should be a minimum of 20 million tons of additional food made. With the current rice price of 677 US dollars per ton; that means 100 million tons of rice would be worth 67.7 billion US dollars, or about 250,000 crore rupees. So, the loan waivers need to be converted back to wealth.

Q: You have mentioned that this should be the first step to support farmers. What should come next?

A: It's simple, whatever the farmer needs. If a farmer is willing to take out credit, it could be seeds or fertilizer or diesel that they need most. Regardless of what an individual farmer chooses to invest in, it needs to result in production. Otherwise, if the farmer thinks we will once again waive the credit, and therefore the farmer does nothing, we will have more of the same. This loan waiver must be taken as an opportunity to revive agriculture. It should not be an indicator of future loan waivers.

[Excerpts from the interview with MS Swaminathan, Founder and Chairman, MS Swaminathan Research Foundation, published in the special June 2008 edition of "Eye on Microfinance" of the CMF-IFMR]