DISCUSSION PAPER

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Farm Loan Waivers in India:

Assessing Impact and Looking Ahead

SHWETA SAINI

SIRAJ HUSSAIN

PULKIT KHATRI

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Arcus Policy Research
B-2/1B, Ground Floor, Nidhi House
Safdarjang Enclave, Delhi -110029
editor@arcusresearch.
www.arcusresearch.in

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Shweta Saini, Siraj Hussain and Pulkit Khatri

Introduction

Agriculture indebtedness is considered as one of the main reasons for the agrarian distress and farm loan waivers are considered as the celebrated tool to alleviate this distress. Since 2012-13, thirteen states and union territories (UTs) have implemented farm loan waiver (FLW) schemes; some states have done so more than once. Out of the 21 political parties who promised a farm loan waiver, only four lost elections. Farm loan waivers have achieved, rather ostensibly, a political legitimacy overtime. Closer to election times, several political parties have been promising loan waivers as part of their election strategy.

But do these waivers really reduce farmer distress? If they did reduce, then why is it that the farmers demand another round of waivers in the next few years? Moreover, FLWs are expensive for the governments; some states fund their waivers by reducing allocations in their capital outlays while others fund it by additional borrowings thus pushing up their fiscal deficit (data from RBI 2018). Not much thought is given to the fiscal, economic, and even the social impact of FLWs on the economy, particularly on its credit culture. Therefore, it becomes necessary that concrete evidence in this regard is collated, and analysed. This study attempts to do that.

The research under this study has three aspects:

1. It looks at the history to trace the evolution, earliest mentions and use of farm loan waivers in India;
2. It looks at the current use of farm loan waivers in its various forms and design; and
3. It studies the impact of farm loan waivers on, *inter alia*, budgets of implementing states, economic and social situation of beneficiary and non-beneficiary farmers, and the banking sector's incentive to lend further in implementing states.

The research on the first two points pivots on secondary data and review of existing literature. The third aspect involves an exhaustive primary survey in three important agrarian states of the country: Maharashtra, Punjab and, Uttar Pradesh. It also involved an analysis of budgets of these three states. Data from the State-level Bankers Committee (SLBC) and Reserve Bank of India (RBI) was also analyzed for this study. We briefly outline key findings under each heading.

Key analysis and findings

History and evolution of FLWs

The first recorded instance (as per our research) of a loan waiver was in the regime of Firoz Shah Tughlaq (1351-1388) who wrote-off *sondhar* loans. In the fourteenth century, Muhammad bin Tughluq devastated the peasantry by imposing rigorous cesses (Randhawa 1982). But soon, he realised that to collect more taxes, he needed the sector to grow faster. So, he started a department called '*diwan-i-amir-i koh*' that gave farmers loans to promote agriculture. These loans were termed '*sondhar*' loans and were given on a large scale. Unfortunately, these measures did not prove to be very useful, and when Muhammad bin Tughluq died in 1351, his kingdom was left in an economic slump. To revive the economy, his successor, Firoz Shah Tughlaq started by writing-off *sondhar* loans (Singh 2009), making this the first recorded instance (as per our research) of a loan waiver, where loans were waived to alleviate farm distress and revive the agrarian economy. Over time, instances of loan waivers grew.

During the reign of King Akbar, loans were extended to cultivators to purchase seeds and cattle during times of distress. These loans were known as 'taqavi' loans, and involved an annual interest charge of 2 annas per rupee (or about 12.5 per cent)[1] (Habib 1964). Later, under British administration, these taqavi loans were also given to cultivators or landowners to undertake agricultural activities. Like our kisan credit card (KCC) system today, the imperial government back then gave crop loans under Agriculturists' Loans Act (ALA) 1884. Similarly, like the term loans of today, government back then gave loans for construction of wells, tanks, and other works for storage, supply or distribution of water for agricultural, or cattle under ***Land Improvement Loans Act (LILA)* 1883.** History has many instances of waivers on these taqavi loans.

Overall, we found that during times of distress, historic regimes and administrations settled unpaid dues of borrowing farmers mostly in three ways:

a) <u>Suspension of payment</u>: On a case-by-case basis, the collector had the right to suspend (or postpone) the payment of interest and/or principal amount due on the loan (Sivaswamy 1939);

b) <u>Reducing land revenue</u>: During times of distress, sometimes, instead of waiving the loan or interest, the collector allowed waiver (or remission) on the land revenue to be paid by the farmer. This offered help to distressed farmers while retaining the loan with interest as originally decided (Ray 1915);

c) <u>Remittance (or waiver) on loans</u>: History has several instances where the principal or the interest or both were remitted during times of distress (Ray 1915). However, larger

[1] During this period, local officials also advanced loans in the name of *takavi*, out of their own resources. Farmers had to pay interest on such loans. The farmers who obtained *takavi* from these officials had to pay 2 annas per rupee (or 1/8th of the principal) as profit (per month, or for each harvest) (Habib 1964).

number of cases are reported where remittances were offered on the interest component of loans (Settlement Committee 1916). The British Government permitted local governments dealing with *taqavi* loans to hand out remissions to the lenders "when a work failed from causes beyond the borrower's control and when recovery of the loan in full would imply serious hardships (on the borrower)".

It is interesting to note that the British government in the early 1900s considered loan waivers or remissions as 'state charities' (Famine Commission 1901, Irrigation Commission 1901-1903, Famine Codes as given in Ray 1915). The government was of the opinion that loans, even during tough times, should always carry interest at the usual rate. With due regard to subsequent cropping seasons and the circumstances of the borrowing farmer, "repayment of these loans should take precedence (even) over the recovery of arrears on land revenue." In times of famine or distress, the government preferred not to waive loans; instead, they tried to rely on offering a combination of free grants and repayable loans[2] (Ray, 1915).

So, how did the governments in the post-independent period move from this aversion to affinity towards FLWs?

FLW achieved a tacit political legitimacy over years

Since 2012, thirteen Indian states have implemented FLW schemes. Some states like Uttar Pradesh (2012 and 2017), Maharashtra (2017 and 2019), Karnataka (2017 and 2018), and Chhattisgarh (2012, 2016, and 2018) have implemented several FLWs. Out of the 21 political parties who implemented FLW, we found that only four lost the election following the promise and implementation of farm loan waiver schemes.

Table 1: List of FLW Schemes Implemented in India Correlated with Election Cycles

S. No.	Waiver Implemented by	Political Party	Time of election	Election Result
1	Haryana, 1987	Lok Dal	Early 1987	Won
2	Central Government, 1990	Janata Dal	December 1989	Won
3	Kerala, 2006	Communist Party of India (Marxist)	May 2006	Won
4	Tamil Nadu, 2006	Dravida Munnetra Kazhagam	May 2006	Won
5	Central Government, 2008	Indian National Congress (UPA)	May 2009	Won
6	Maharashtra, 2008	Indian National Congress (UPA)	October 2009	Won
7	Karnataka, 2012	Bharatiya Janata Party	May 2013	Won
8	Chhattisgarh, 2012	Bharatiya Janata Party	December 2013	Won
9	Uttar Pradesh, 2012	Samajwadi Party	2017	Lost

[2] There was a provision for free grants in the *takavi* system (Ray 1915).

S. No.	Waiver Implemented by	Political Party	Time of election	Election Result
10	Andhra Pradesh, 2014	Telugu Desam Party	Aug 2014	Won
11	Telangana, 2014	Telangana Rashtra Samithi	Aug 2014	Lost
12	Tamil Nadu, 2016	All India Anna Dravida Munnetra Kazhagam	May 2016	Won
13	Uttar Pradesh, 2017	Bharatiya Janata Party	March 2017	Won
14	Punjab, 2017	Indian National Congress	March 2017	Won
15	Maharashtra, 2017	Bharatiya Janata Party	October 2019	Lost
16	Karnataka, 2017	Janata Dal (Secular)	May 2018	Lost
17	Rajasthan, 2018	Indian National Congress	December 2018	Won
18	Madhya Pradesh, 2018	Indian National Congress	December 2018	Won
19	Chhattisgarh, 2018	Indian National Congress	December 2018	Won
20	Maharashtra, 2019	Shiv Sena	October 2019	Win/Lost[3]
21	Jharkhand, 2020	Jharkhand Mukti Morcha	December 2019	Won

***Source**: Compiled by authors.*

***Note**: Won or lost depends on the party affiliation of the chief minister. In Karnataka (2012), the party won, but the government resigned within a week's time. In the case of Maharashtra in 2019, Shiv Sena was a part of the alliance with the BJP when the loan waiver scheme was announced. Subsequently, in October 2019, the BJP did not form the Government but the Shiv Sena did as part of another alliance with the Congress and NCP.*

This high success rate, perceptibly, gave a tacit acceptance to the power of using loan wavers as a potent tool near elections.

But how did these waivers affect budgets of implementing state governments, farmers and the lending institutions like the banks? Did FLW trigger inflation in the states? We summarize our findings below.

1. State budgets:

FLWs resulted in deterioration in the quality of expenditure of the implementing state : To estimate how the state governments created fiscal space for implementing FLW scheme, we studied the budget documents of Maharashtra, Punjab and Uttar Pradesh. We identified three major routes through which fiscal space for FLW was created. The state government levied additional taxes or cess and generated money to support implementation of the FLW, or they increased the budget allocations through additional borrowing and higher fiscal deficit. The states also shuffled allocations between departments to find resources for FLW. In case of the

[3] Shiv Sena was in a pre-poll alliance with the Bharatiya Janata Party for the 2019 elections in the state. The coalition was unable to form the government. However, Shiv Sena came to power by making a post-poll coalition with pre-poll opponent parties namely, the Indian National Congress (INC) and the Nationalist Congress Party (NCP).

three studied states - Maharashtra, Punjab and Uttar Pradesh - a combination of the above routes was adopted. Table 2 summarises the trends in state budgetary expenditure variables.

Table 2 Trends in Studied Budgetary Expenditure Variables

Item	Punjab	Maharashtra	Uttar Pradesh
Total Budgetary expenditure (direction of change in the year of maximum FLW disbursal compared to the previous year)	Increased	Increased	Decreased
Fiscal Deficit (percentage of GSDP)	Increased	Decreased	Decreased
Revenue Expenditure (RE) (percentage of GSDP)	Increased	Increased	Increased a little
Outstanding liabilities (percentage of GSDP)	High	Decreased	Decreased
Market borrowings (INR)	Increased	At a high level, though amount decreased a little	Decreased
Development expenditure (DE) (percentage of GSDP)	Increased	Decreased	Decreased
Capital outlay (CO) (percentage of GSDP)	Increased	Decreased	Decreased

Source: *State budget documents*

In the year when the largest proportion of the announced farm loan waivers were disbursed by the state governments to the banks (we refer to it as the year of maximum disbursal (YMD)), Punjab saw an increase in its (i) total budgetary expenditure, (ii) fiscal deficit, and (iii) its market borrowings and outstanding liabilities. For Maharashtra, the total budgetary expenditure increased and the revenue expenditure was higher in YMD. In Uttar Pradesh, the state government reduced major budgetary expenditures on other schemes in the YMD.

An analysis of departmental budgets in the three states revealed interesting patterns around the YMD.

i. Major reallocation in budgetary expenditure between departments in the YMD was observed;
ii. Allocations of departments that suffered in the YMD were
    a. Maharashtra: Revenue and Forest, Industries and Labour, Agriculture department (allocation for FLW was done under CMT department), Environment and Housing.
    b. Punjab: Power, Water Resources, Public Works, and Health and Family Welfare.
    c. UP: Education, Social Welfare, Irrigation, General Administration, Energy, Agriculture (fisheries), Agriculture (industrial research), Agriculture (dairy) and within agricultural, Soil and Water Conservation and Agricultural Research and Education.

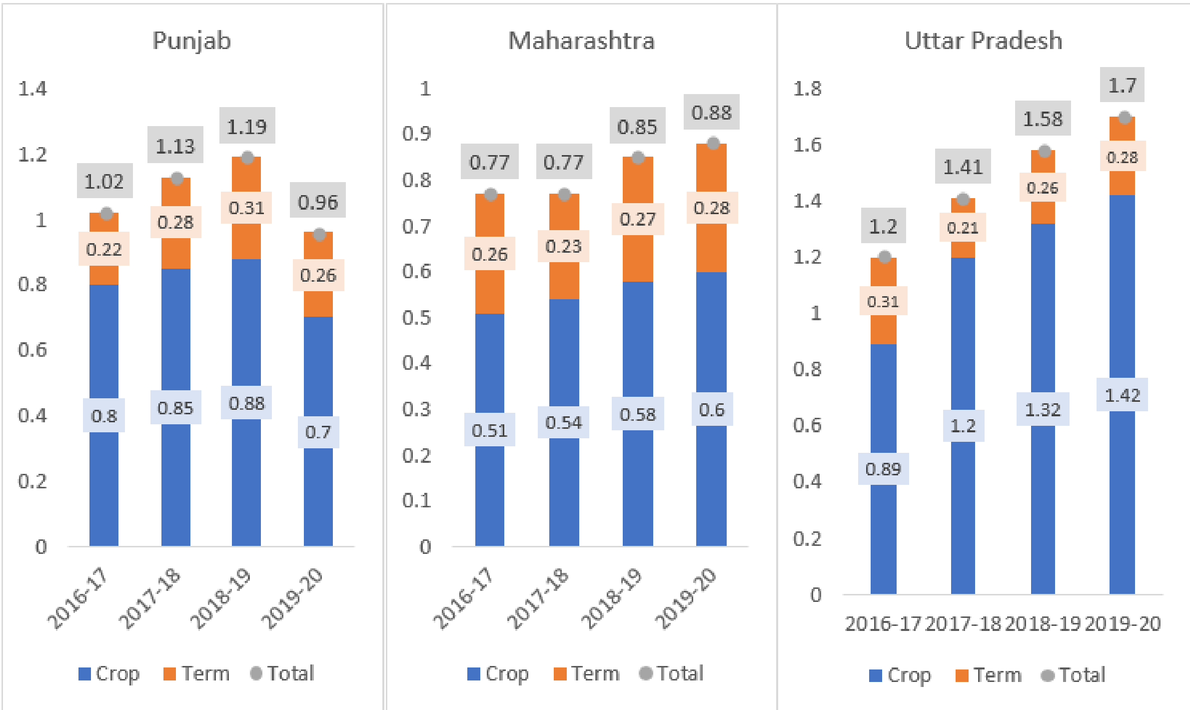
2. Inflation:

Implementation of FLW could not be connected with higher inflation: Technically, an FLW itself does not increase the availability of funds in the hands of the beneficiaries but it does address the debt overhang that restricts his/her ability to raise fresh credit. We looked at the trends in CPI (rural) but did not find any concrete statistical evidence that related higher inflation with implementation of farm loan waivers.

3. Lending Incentives of Banks:

Banks were reluctant to lend more money in YMD: After implementation of FLW, formal financial institutions like banks refrain from lending further in anticipation of higher defaults by the farmers. For this, we analysed data on annual agricultural credit targets (Figure 1), and actual disbursements from the three state's SLBC (Figure 2).

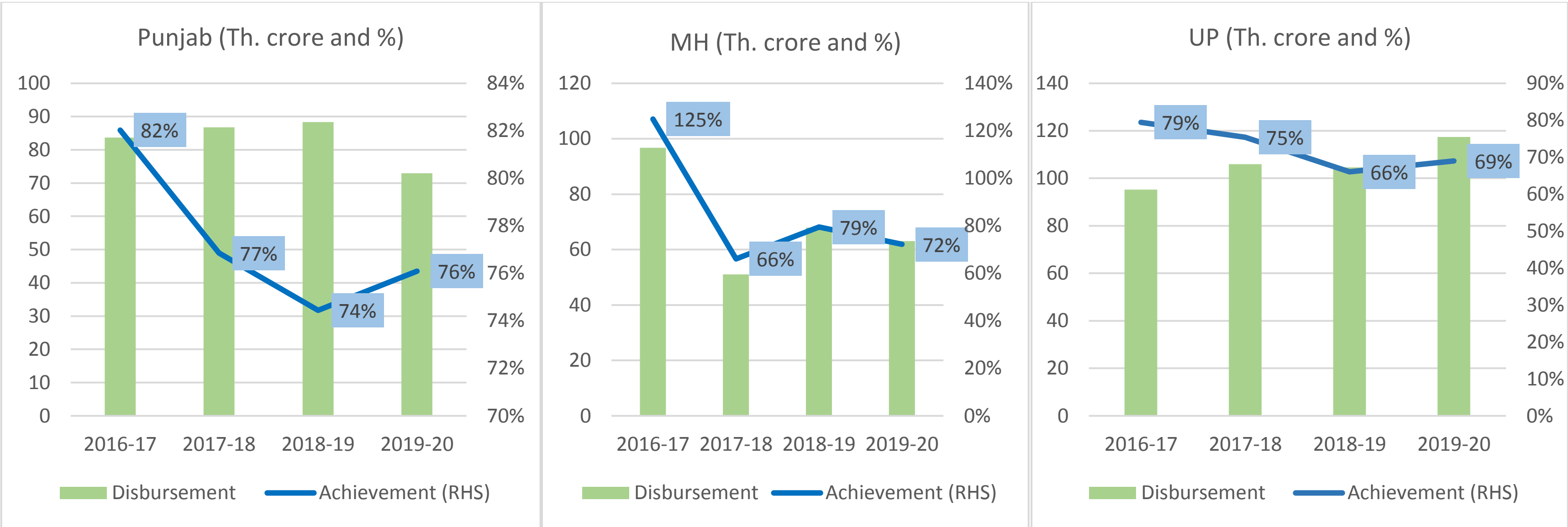
Figure 1: Analysing Credit Targets for Three States



***Source**: State Level Bankers' Committee of Punjab, Maharashtra and Uttar Pradesh Meeting Agenda and Minutes for the financial year 2016-17, 2017-18, 2018-19 and 2019-20.*
***Note:** Data for Punjab corresponds to ground level credit data. Data from SLBC Punjab show credit target and achievement under the ground level credit component*

In conclusion, we found that in the year when the maximum FLW was disbursed, even though the credit targets were not reduced (barring for term loans in Maharashtra), the actual credit disbursal decelerated drastically (for both short- and long-term loans) in the three states (Figure 2). The fall, however appears to be temporary as both target and actual disbursal of credit recovered in the subsequent years.

Figure 2: Achievement of Credit Targets in the Three States



***Source**: State Level Bankers' Committee of Punjab, Maharashtra and Uttar Pradesh.*
***Note:** Data for Punjab corresponds to ground level credit data. SLBC Punjab gives credit lending and achievement under the ground level credit component*

4. Impact on Farmers:

Being an FLW beneficiary did not have a significant impact on farmer distress levels: This is one of the biggest findings from the analysis of the responses to survey questionnaire from 3000 farmers. Using an Ordered Logit regression model, responses of farmers on their distress levels were studied to estimate the impact of FLW on the beneficiary farmer. Among other things, it was found that the effect of being an FLW beneficiary did not significantly affect, either positively or negatively, farmer's distress levels.

Other important results from the primary survey were:

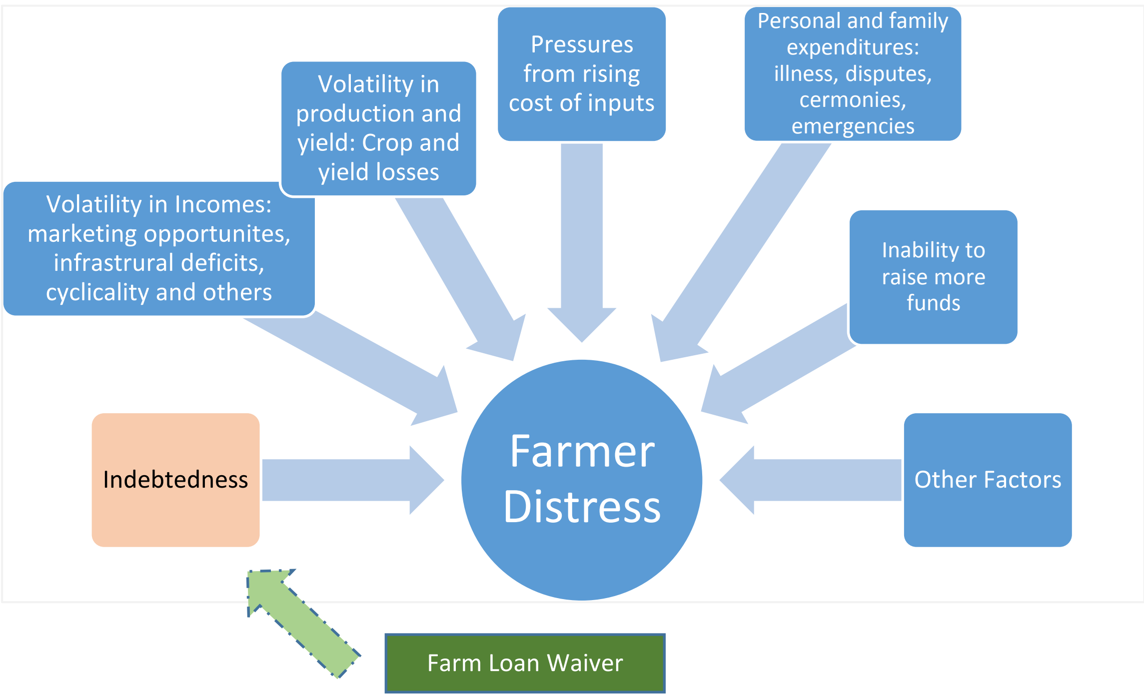
a. Possibility of default was higher on institutional loans than on non-institutional loans
b. Farmers in the three states did not rank indebtedness as the most important factor causing them distress. They treated it like several other factors causing distress.
c. Income instability due to increased cost of cultivation, damage to crop/livestock or fall in market prices received by farmers emerged as primary reasons for farmer distress in the three states.
d. Climate and weather-related issues caused much distress to the farmers who were observant of the continuous changes in the climate of their areas
e. The responses to survey also showed that farm loan waivers:
    i. Increased the chances of wilful defaults by farmers.
    ii. Incentivised farmers capable of repaying to default on agricultural loans.
    iii. Benefitted a small group of the actual distressed farmer population

Conclusion

New framework for Interpreting and Understanding Farmer Distress

In the beginning of the research, indebtedness was understood to be the most important factor causing distress to the farmers. By addressing this *cause*, a farm-loan waiver was understood to alleviate the farmer's distress (Figure 3).

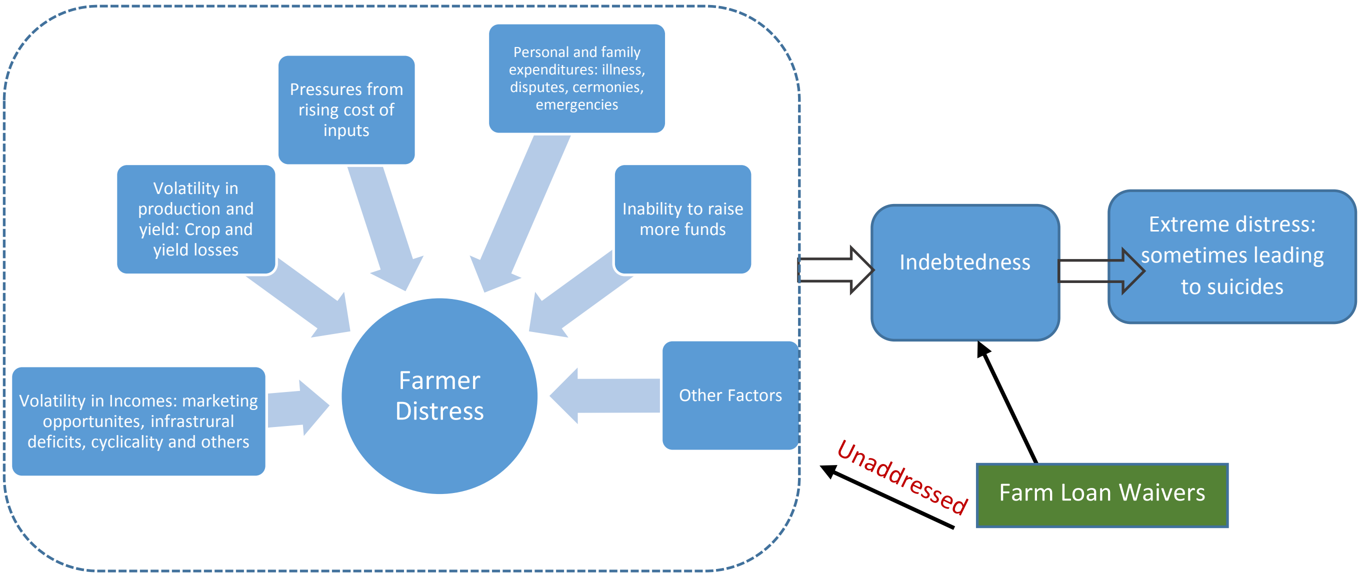
Figure 3 Framework of Farmers' Distress



Source: Interpretation of Authors

Based on the learning under this Project, we propose modifications (Figure 4) to the earlier framework of farmer distress.

Figure 4 New Framework of Farmers' Distress



Source: Interpretation of Authors

According to this new framework, 'indebtedness' is shown to be a result of distress and not the immediate cause itself.

A farmer is in distress because of factors like (also mentioned in the dotted box in Figure 4):

1. The losses suffered on crops because of factors beyond control;
2. Inability to realize remunerative prices for his produce;
3. Pressures from the rising costs of production reducing already thin margins;
4. Emergencies on account of personal and family grounds;
5. Inability to raise more funds.

Inability to earn enough income makes a farmer indebted and the losses makes him default. This default deepens his distress sometimes driving him to take an extreme step of committing suicide. A farm loan waiver addresses this indebtedness. But with unaddressed factors of distress (like ones mentioned in the dotted box), the condition of an FLW-beneficiary farmer only improves for a short time and it is only a matter of time that the beneficiary farmer is indebted again and driven to a point of needing another round of waiver soon. Therefore, in such a scenario, a farm loan waiver only proves to be a 'jury-rigged expedient' — a quick fix that needs to be applied at recurrent intervals.

Inherently, FLW had an emergency character to it, as it conceptually aimed to provide some immediate relief and 'hold the line' until some sort of long-term solution to the structural problems faced by farmers emerged. We need to revert to this thinking. Therefore, policy makers need to (i) acknowledge indebtedness as a symptom of farmer distress and FLW as a temporary solution to that symptom, and (ii) comprehensively work to empower farmers by finding sustainable ways to resolve the *real* causes of farmer distress.

Other Conclusions

1. **Indebtedness of farmers is inevitable:** A farmer in India is plagued by several distortions that makes the farming business unviable. The production cycle makes it impossible for farmers not to be indebted and the income instability makes it difficult for them to come out of the cycle of debt. Droughts, other natural calamities and losses in the sale of final produce quite frequently caused distress to farmers and consecutive losses impede their ability to pay back the loans, increasing the debt overhang. The cyclical nature of weather and climatic vagaries and the inability of farmers to realise remunerative prices for their final produce leads to deepening indebtedness and cause even more distress. To an extent, therefore, it appears as if indebtedness is a result and not a cause of distress.

2. **FLW adversely impacts credit culture of the society:** Rights and duties are closely correlated. If a borrower is relieved of his duty to repay, the moral tone of the whole community suffers. Excessive loan waiver programmes are most harmful as they lower the standard of commercial honesty. Undermining the honest determination to repay a debt and encouraging the shirking of obligations, amount to ruining the credit culture of society.

Way Forward

The farm loan waiver schemes were supposed to be a reaction to situations of extreme plight like drought or flood and were originally designed as one-off events to protect both the banks and the farmers from the problems of debt-overhang. However, by increasing the frequency of farm loan waivers and by quasi-universalizing its distribution, that is mostly unconnected to levels of farmer distress in an area, the benevolent purpose the scheme was to achieve appears to have been diluted leading to worsening credit culture in the country.

To support a distressed farmer in a sustainable manner that empowers him/her in both the short and long run, therefore, requires a rethink of policies. A few suggestions are made in the report. The most important one is to create a real-time dynamic distress index of farmers. This index should integrate the available high-frequency data on weather conditions, existing and upcoming climatic conditions, debt burden on farmers, data on agricultural commodity prices, etc., and monitor them on a real-time basis to track and predict the level of farmer distress. Technology breakthroughs like use of space technology, Artificial Intelligence and block chain in agriculture can be harnessed to bring dynamism and credibility to the system of data collection and its analysis. This tracking should ideally be done at a farmer level though it is difficult given the small size of most landholdings. Therefore, tracking a district can be a good beginning. Utilizing benefits of local presence of Gram Sabha, and the Farmer producer Organizations (FPOs) can improve the design and implementation of distress alleviating interventions.

Results from this index can be used by the policy makers to plan and design a timely and targeted method of supporting distressed farmers. Depending on the kind and severity of distress, the support can be given as a combination of unconditional grants, loan restructuring and/or a complete loan waiver. This type of data-backed real-time intervention will not only help alleviating distress of farmers, but will also provide governments with much needed policy bandwidth to effectively time and plan a targeted, and efficient policy support for the distressed farmer.

A farm loan waiver, on the other hand, may be reserved as a tool as it was originally designed to be: a one-off event meant for situations of extreme plight like severe and wide spread drought or flood. It was to provide temporary relief to the distressed farmer until underlying conditions improve. Therefore, rather than relieving all the borrowers, irrespective of the distress levels, from their responsibility to repay the loans, the governments should instead nurture a healthy credit culture and invest in farmers and their farming so as to empower the farmer via a robust ecosystem that helps him grow in a sustainable and a profitable manner. This will go a long way in making our farmers ***aatmanirbhar***.

Read the full report using this link.

Arcus Policy Research
B-2/1B, Ground Floor, Nidhi House
Safdarjang Enclave, Delhi -110029
editor@arcusresearch.in