Impact of Farm Loan Waivers on State Finances

Why in news?

The RBI recently shared the report of an Internal Working Group (IWG) set up to primarily look at the impact of farm loan waivers on state finances.

What was the IWG for?

- A farm loan waiver by the government implies that the government settles the private debt that a farmer owes to a bank.
- Since 2014-15, many state governments have announced farm loan waivers for a variety of reasons including relieving distressed farmers.
- Farmers were, notably, struggling with lower incomes with repeated droughts and demonetisation.
- In this context, the RBI set up the Internal Working Group (IWG) in February 2019 to analyse the impact of farm loan waivers.

How have loan waivers been?

- Once announced, farm loan waivers are staggered over 3 to 5 years.
- Between 2014-15 and 2018-19, the total farm loan waiver announced by different state governments was Rs 2.36 trillion.
- Of this, Rs 1.5 trillion has already been waived.
- In comparison, the last big farm loan waiver by the Centre was announced by the UPA government in 2008-09 and it was Rs 0.72 trillion
- Of this, actual waivers were only Rs 0.53 trillion, staggered between 2008-09 and 2011-12.
- In other words, in the past 5 years, just a handful of states have already waived three-times the amount waived by the central government in 2008-09.
- The actual waivers peaked in 2017-18 in the wake of demonetisation and its adverse impact on farm incomes.
- It amounted to almost 12% of the states' fiscal deficit.

How do waivers affect state finances?

- Farm waivers eat into the government's resources, which, in turn, leads to one of the following two things:
    1. the concerned government's fiscal deficit (or, in other words, total

borrowing from the market) goes up
2. government has to cut down its expenditure

- Even at the state level, a higher fiscal deficit implies that the amount of money available for lending to private businesses (big and small) will be lower.
- It also means the cost at which this money would be lent (interest rate) would be higher.
- If fresh credit is costly, in turn, there will be fewer new companies and less job creation.
- So, if the state government does not prefer borrowing from the market and wants to keep to its fiscal deficit target, it will be forced to cut expenditure to manage.
- More often, states choose to cut capital expenditure instead of the revenue expenditure.
- [Capital expenditure is that which leads to the creation of productive assets such as more roads, buildings, schools etc.
- Revenue expenditure is in the form of committed expenditure such as staff salaries and pensions.]
- The point to note is that cutting capital expenditure undermines the ability to produce and grow in the future.

How significant are state finances?

- The National Institute of Public Finance and Policy (NIPFP) study of state finances reveals that all the states, collectively, now spend 30% more than the central government.
- Moreover, since 2014, state governments have increasingly borrowed money from the market.
- In 2016-17, the total net borrowings by all the states were almost equal (roughly 86%) of the amount that the Centre borrowed.
- In other words, state-level finances are as important as that of the centre's for India's macroeconomic stability and future economic growth.

What are the recommendations made?

- Farm loan waivers are not advisable as they hurt overall economic growth apart from ruining the credit culture in the economy.
- This is because they incentivise defaulters and penalise those who pay back their loans.
- The IWG thus recommends that central and state governments should undertake a holistic review of the agricultural policies and their implementation.

- They should also evaluate the effectiveness of current subsidy policies with regard to agri inputs and credit.
- This should be towards improving the overall viability of agriculture in a sustainable manner.

Source: Indian Express

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