Populist Measures

What is the issue?

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The BJP had promised that, if it came to power in Uttar Pradesh, it would waive loans taken by small and marginal farmers.

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Populist measures:

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- Other states have also got into the act and competitive populism reigns.
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- The Congress has demanded a nationwide loan waiver.
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- Though his state’s budget did not make any provisions for a farm loan waiver, the chief minister of Maharashtra, Devendra Fadnavis, did lead a delegation to New Delhi to demand similar measures for farmers in his state.
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- Other states like Punjab are also desirous of seeking the Centre’s help.
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What are the merits of this course of action?

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- The move will **stress a banking system** that requires no further shocks after it has been rendered fragile by a build-up of non-performing assets.
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- A further escalation in such unpaid loans following the declaration of a loan waiver — and the **behavioural changes** in its wake — might be one step too far for the most troubled banks.
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- In case of a loan waiver there is always a fall in credit discipline because the people who get the waiver have expectations of future waivers as well.
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- The moral hazard associated with frequent waivers is deeply problematic; it incentivises the worst kind of borrower behaviour.
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- **Each successive loan waiver increases the number of irresponsible borrowers.** Not to mention the cost of such waivers.
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- For instance, according to an SBI estimate, at Rs 27,420 crore, the proposed farm loan waiver in UP will eat up 8 per cent of the total revenue and upset the state's fiscal math for the coming financial year.
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What the experience says?

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- There is extensive experience of such **moral hazard situations**, and it is clear that while the relief is modest and temporary, the long-term ill-effects are many, severe and far more lasting.
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- The 2008 loan waiver undertaken by the Congress-led United Progressive Alliance government cost over Rs 70 lakh crore and helped drive up the fiscal deficit by a record amount that year.
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- The trouble is that the same waiver was seen by many as the key reason for the UPA's returning to power in the 2009 general elections.
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- But apart from naked **political ambition driven by populism**, there is little economic reasoning backing the introduction of loan waivers into the policy mix again.
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- This is not to say there cannot be specific cases, such as the occurrence of a natural calamity, that may merit some relief.
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- However, blanket loan waivers are a poor policy choice and should be avoided.
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Source: Business Standard

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