The politics of loan waiver

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In Kannada film industry, people often use the concept of a "single line story". A single line story is a gist that captures the "marketability" of the film; it is an indicator of box office performance and provides a prima facie case for funding by the producer. Similarly the election manifestos of political parties in our country also fall into the trap of showmanship of a single line story. What nobody seems to realise is that there have been surprise victories for people who have moved beyond these single line stories: The electoral defeat of a confident Chandrababu, the surprise victory of Mayawati who was almost written off, the victory of Narendra Modi who tried to used performance as a parameter for seeking votes, the brutal defeat of the BJP using the India Shining single line etc. As is common in the Indian film industry where rehashing the formula of successful movies is widespread, political campaigns seem to stand on the stilts of such borrowed imagination. In reality however there is no formula, no single line that can guarantee poll performance.

In earlier days, an election promise carried the identity of a political party. For instance the scheme of providing rice at Rs.2 per kilogram bore the stamp of the Telugu Desam Party. But with the recent spate of poll promises, it has become difficult to identify a political party with any particular promise. For instance, while the BJP government in Gujarat insists on collecting a full charge on electricity supplied and has been coming down heavily on power thefts, the same party has announced free power in Karnataka. The Congress Party has promised free televisions, a scheme actually launched by the DMK in Tamil Nadu. It has also promised rice at Rs.2 per kilo, a clear theft of the TDP's identity. It is now, therefore difficult to distinguish between the manifestos of regional and national parties, leave alone their ideologies and political leanings. One common promise that has captured the imagination of all political parties, irrespective of ideology is trying to "reform" the rural financial system through announcement of loan waivers, interest subsidies etc.

Most of our legislators are elected from rural constituencies and have a good understanding of rural problems, unlike the cartoons that portray them. On browsing through the proceedings of parliamentary standing committees, we realise that they are capable of engaging themselves in serious debate over important issues cutting across party lines. However, when it comes to the parliament proceedings or to the elections, the complexion of their rhetoric changes completely. In such situations, the legislators are beings capable of thumping desks and arguing vehemently about what could be a "party line" even though they might lack personal conviction on the matter. In this light, we need to worry about whether Finance Minister Mr. P Chidambaram believes fully in the merits of the Rs.60,000 crore loan waiver package that he announced in the budget speech or was it possible to use the same amount of resources more creatively for the benefit of agriculture? When we do ask these basic questions, we possibly can deconstruct the friction between what is desirable and what could make a good story that captures the imagination of a large number of voters.

The ominous sign of the current loan waiver is there for all of us to see in the policies of the State in the past few years. The state seems to have sought refuge in pumping credit, whenever there has been an agrarian crisis. This is a good "single line story" that the state can narrate to the population at large. It is only on close examination of the policies formulated by different governments in the past decades, do we realise how myopic they were and are. **(See: A snapshot of history of competitive destruction of rural financial institutions)**

A common myth

When one is formulating policies for rural areas, the predominant myth is that it should be fully embedded in agriculture. As per the 2001 census, 40% of the rural population were engaged in agriculture as cultivators. Around 33% of the rural population were agri-wage labourers. So, when we talk about programmes rooted in agriculture, we are talking about the direct benefit to these 40% people. Similarly when we talk about poverty, we again seem to equate it with rural areas. Thus several policies get formulated on a simple formula of **poverty=rural areas = agriculture**.

Even with the assumption of credit being the agricultural bottleneck, doubling of agricultural credit and the subvention provided for agricultural loans, should have resulted in some significant effect on agricultural output. But reality does not concur with this and the overall output has stagnated over the past few years. So, clearly output does not just increase by opening the credit tap. Higher output levels need better seed, fertilizer, water and markets. Without taking these four pillars of agriculture, there is little purpose in propping up the scaffolding of credit as a one point answer to agricultural crises. However for the government, doubling of agricultural credit in three years makes an interesting catch line which can be quantified and on which criteria the state can self applaud. It is possible to arm twist the banks to produce the concurring numbers. In comparison, how "sexy" is it to announce something pertaining to extension services in agriculture?

Since the onset of green revolution, the knowledge and skills of agriculture have moved out of the farmers' hands. Earlier farmers would save seeds from their produce and use it for the next season. However, with the onset of high yield variety of seeds, the farmer has to buy seeds every season. Every time the seed is bought, the package of practices suggested by the seed companies has to be followed. Agricultural technology has gradually moved out of farmers' hands and their unskilling has begun. The same story is applicable with other inputs such as chemical fertilisers and pesticides. When the state started abdicating its role in providing extension services the decline became steep. The extension services are now largely provided by interested parties like the seed, fertiliser and pesticide companies. Now, which extension worker of a pesticide company would advise the farmer against pesticide use in the best interest of the farm?

In addition, data for the last few years on capital formation indicates that private capital formation is growing at a faster rate than public capital formation. To simplify narration, let us take the example of water. If the State provides irrigation under a scheme of identifying a dam site and setting distributory canals, the benefit of water goes to the farmer. The expense incurred by the farmer possibly pertains to the last mile of taking water from the canal to the field. But if on the other hand, the farmer drills a borewell and lifts water through a pump, the entire expense [which is private capital formation] is his. He would also bear the risk cost of not finding water. He will have to borrow and service the loan from his own resources. In the first stage, it might still look attractive to him because the increased availability of water might result in increased yield which could service the loan. However, if for instance, the water table falls and he has to deepen the well and add more capacity to pump water out, there is increased investment, borrowing and servicing costs to possibly obtaining the same yield. This is akin to running on a treadmill - you need to run to stay where you are!!

One wonders how policy makers stay indifferent to the fact that while the retail revolution based on agricultural production is blossoming, farmer suicides are becoming widespread. All this at a time when the corporates are entering food and agri based organised retail in a major way- the list includes the Tatas with their Star India Bazaar, Amabani's Reliance Fresh, Birla's More of you, ITC's Choupal Sagar, Biyani's Big Bazaar, RPG's Spencers, Dairyfarm's Foodworld, Metro cash and carry from Germany, Walmart-Bharti ... the list just goes on. Why are these corporates investing in one part of the value chain when the other is struggling for survival? Is it not indeed a contradiction of an immense magnitude?

As per an article written by Rakesh Mohan, the Deputy Governor of Reserve Bank of India, only about 20-25% of the investment in agriculture is funded by credit. This percentage reduces to about 5% of the value of output. Therefore a policy that is centered on credit supply might be somewhat misplaced. If the overall investment funded through credit is 20% then what would be the impact of any interest rate concessions? Would there be any significant impact in the economics of agriculture by tinkering around with the interest rates of institutional credit? Could we, on the other hand try and increase the institutional share credit component of the investment from 20%? Yes, of course! However, it cannot happen if we are assaulting the institutions that have been laying the golden eggs of credit right from the 1960s.

On examining the broad numbers of indebted farmers committing suicide, we realise that these farmers are not necessarily the small and the marginal. From the statistics of the Reserve Bank, it is evident that while agricultural loans have doubled, the actual number of borrowing cultivators has gone down, thereby increasing the average amounts lent per account. In a situation where the average holding size is decreasing across the country, we do not require any sophisticated statistical exercise to declare that these loans are moving towards larger farmers. If the average loan size goes up, without a concurrent increase in the output we can at best draw one of the two following conclusions- the repayment capacity of the borrower must have significantly gone down, or the loan must have been diverted to some other purpose. Either way, it is very evident that there is a time bomb ticking in the doubled agricultural credit situation.

Who is benefitting from loan waiver?

Given this background it is indeed intriguing that to garner votes every party continues to announce schemes that are so destructive to the institutional fabric. Why do parties do this? One of the arguments extended is that such schemes are "populist" in nature. If the scheme is benefiting only 40% of the rural population that are cultivators, and within them, 60% of the people who are indebted to institutional sources, and given that they generally are better off with relatively larger land holdings, then where does populism stand? A large part of the cultivators are out of the realm of institutional credit. They do not directly or indirectly benefit from this scheme and can see through the hypocrisy of the promises made by the political parties. The promise of reduction in interest rates is one of the most ludicrous promises to be made. Therefore why would the rural masses vote based on such a promise? Why then are our politicians so oblivious to these ground realities?

Our political class has obviously not learnt anything from the success of microfinance where interest rates are incidental, while access to formal credit is given priority. What is the use of cutting interest rates on loans that can never be accessed? Would it not make better sense to assure access than a concession on a non-existent service? The example of the Gujarat government on power supply should be a lesson to political parties, where an assured power supply has brought people to willingly pay, and has also surprisingly voted back the same party to power.

The Reserve Bank and the state have taken several initiatives in fostering financial inclusion. One of the measures has been to ensure that wages to be given under the National Rural Employment Guarantee programme is to be disbursed through a bank account. The target is to ensure that every household has an active bank account. With the waiver programme, the state is now ensuring customers stay away from banks. In fact a NABARD committee had recommended that if a relief to the farming committee was to be given, it should be through a scheme of one time settlement by calling them to the bank branch and assessing the real need of each beneficiary. The committee had also recommended that the compensation to the banks was to be released by the State only after ensuring that the borrowers had got a fresh loan. By this count the banks and co-operatives could have worked towards retaining their customers. But the announcement of waiver and the interest subsidies announced in the manifestos of political parties only guarantees the poor's exclusion from the banking system. By following this trend, a few years hence, it will become inevitable for the state to devise a wholly new restructuring package for the rural financial sector.

Financial services must be provided; they are to be provided to the poor, to the agriculturalists, to the rural populace. This job is that of the financial institutions and it is better for the State to leave this job to the specialists and focus on the larger welfare of providing health services, education, roads and infrastructure and take up several other socially useful productive work, which not only makes farmers, but others also happy.

A snapshot of history of competitive destruction of rural financial institutions

The first big event that started the tragedy of rural finance can possibly be traced to 1989. However, different governments had given ominous signs that such a tragedy would occur. The rural credit policies between the decades of 50s and 60s were possibly forward looking. The All India Rural Credit Survey [Gorwala Committee] and the decennial All India Debt and Investment Surveys had indicated that a significant share of the credit in the rural areas was being met by the informal sources, particularly the money lender. The share of institutional credit was small in the overall pie of rural indebtedness. It was in that context that the Gorwala Committee had recommended state partnership in the field of rural co-operatives. A significant part of the rural credit policy was rooted in the recommendations of the Gorwala Committee in the 50s and the 60s. In the decade of 70 we saw the nationalisation of commercial banks, resulting in an increase in institutional credit in rural financial sector. There were two elements that were going hand in hand with the policy of state driven push to the financial services:

1. For every licence to open a branch in an urban location, the banks had to open 4 other branches in unbanked locations.
2. Not less than 18% of the net bank credit had to be compulsorily given to agricultural sector, and 13.5% of it had to go to agriculture "direct".

While point 1 above was given up in the early 90s [with the overall economic liberalisation programme], the second policy intervention continues even now. [The current branch licensing has reintroduced such a conditional branch expansion policy, though with a much liberal ratio]. This policy has been good. Now, the problem begins when the policy shifts from provision of adequate financial infrastructure to interference in modes of policy implementation. This is where the decline of the lofty State intent becomes evident. Significant milestones in the policy decline have been:

1. The Integrated Rural Development Project loans that were designed centrally [and possibly not relevant in many areas where they were disbursed] and forcibly implemented though banks and co-operative societies.
2. The Loan Mela programmes organised by ministers in several places.

With the above two programs, the formal financial sector ended up extending loans to the rural populace for purposes not voiced and possibly for purposes that were irrelevant. These programs became such a tragedy that Al Fernandes in his book indicates that the "loans" acquired the meaning of grants that were not to be returned. A fall out of the above trend was that the co-operatives no longer remained co-operatives, but became arms of the State. Banks distributed money to the pressures of loan melas. This scheme was a strong blow meted out by the State on the rural financial system. Loans were treated as government grants, the people who paid looked like fools, while the defaulters benefited. While the effect of this could [as in the case of the current loan waiver] not be measured immediately, the next decade proved quite costly to the State with the subsequent decline of the co-operatives, and the Regional Rural Banks incurring losses and several commercial banks taking a hit.

With the onset of liberalisation and opening up of the Indian economy, the banks were given a fair amount of autonomy. By having a policy that 40% of the net bank credit had to go to priority sectors and 18% of net bank credit had to go to agriculture, the State ensured that the availability of credit to agriculture would grow at least at the pace of the overall availability of credit per se. While after 1991 the state had taken a few steps forward with regard to how rural/agricultural banking is done in this country, the dawn of the 21st century seems to indicate that the State wanted to rapidly take a few strides backwards!! The country had to pay a price in the decade of 90s for the policies followed in the decade of 1970. It started with the restructuring of commercial banks by recapitalising them. The banks were then able to stand on their own feet and fulfil their responsibilities. So post 1991, we see that the banks largely assume responsibility for their performance, talk about their profitability and are actively tracked in the stock market. Commercial entities are expected to behave in this manner and be active participants in the commercial world. After the commercial banks, it was the turn of the Regional Rural Banks to get an overhaul. Once the state put in the recapitalisation package, the widespread expectation was that it would no longer interfere in the day-to-day functioning of the commercial entities.

Therefore when in 2002-03 the Vaidyanathan Committee was appointed to look at the co-operative sector, one was expecting that the State would also do its bit of damage repair for this sector as well, before withdrawing. One of the justifications given by the Vaidyanathan Committee was that since the State was responsible through its interference in the co-operative sector to correct the situation through an investment of around Rs.15,000 crores, this was seen as a one time investment. The precondition for this package was autonomy for the co-operative sector. In fact the Committee had specifically made a mention about loan waivers and its devastating impact on the financial systems. But the state never takes the reports of such committees in its entirety for implementation.■

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In the decade of the 50s the share of institutional credit in the overall indebtedness was only 7.3%. It was at this juncture that the Gorwala Committee had suggested the State partnership with co-operatives. By the decade of the 60s, the institutional share had increased to 18.7%. By 1971 it increased to 32%. With the nationalisation of some commercial banks and setting up of Regional Rural Banks, the fastest growth came in the decade of 70s. By 1981 the share of institutional credit had almost doubled to 63%. This continued on a growth path till about 1991, when the share had grown to 66% of the total indebtedness. However, after the 1989 waiver, the share of institutional credit fell to 61% by the 2002 figures. Interestingly the share of co-operatives started showing a decline by the beginning of 80s.