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Bank Recapitalisation and Farm Loan Waivers: Two Sides of the Same Coin

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There have been announcements of farm loan waiver in the Indian states that have just had elections. It defies logic why governments have not been able to address the basic ills that confront Indian agriculture such that, time and again, ad hoc solutions have been used to address farmers' distress. This situation is akin to a further dose of recapitalisation of the public sector banks by the Indian government without it really addressing the basic inadequacies that led to an acute stress on the banks' balance sheets.

On the one hand, state governments in India seem to be competing with one another in announcing a waiver of agricultural loans while, on the other hand, the central government is in the midst of bank recapitalisation. One needs to recognise that loan waivers and the recapitalisation of banks are different sides of the same coin. Neither can deliver succour to the affected party unless the root causes leading to the problem are eliminated. However, waivers seem to be a race in which all political parties take pride in – jostling with one another to make their announcements.

Early last year, the Indian government announced a hefty package of ₹2.11 trillion (S$41.2 billion) to recapitalise public sector banks. The amount was to be disbursed in four years. Out of this provision, ₹880 billion (S$17.2 billion) has already been disbursed. It is no secret that the need for such recapitalisation came about because of the huge non-performing assets (NPAs) that the banks had built up in the last decade. How did such a situation come about? The reasons include the poor quality of project appraisal, lack of risk management expertise, asset liability mismatch in lending to infrastructure projects, delays in statutory clearances and a rather liberal approach to lending merely to enhance the credit portfolio of each bank. It is also a fact that this condition afflicted private and foreign banks too.

Whilst recapitalisation will help banks come out of the prompt corrective action condition imposed by the regulator and indeed overcome regulatory capital issues, it is unlikely to ensure that the fundamental causes are addressed. Perceptible changes in the way in which public sector banks function and the deep commitment to a lending and banking culture, which should be the core constituent of a professional banker, does not seem to have been induced.

There is an aversion to lend to agriculture, the small and middle enterprise segment and of course, larger corporates. So does the recapitalisation seek to provide a quick fix solution, thereby adding to the very culture that, in fact, created the problem? Recapitalisation will merely make the NPAs to equity capital ratio appear better.

A mega national level farm loan waver was announced by the United Progressive Alliance in 2008, just ahead of the 2009 general elections. It is not disputed that farmers who had borrowed various sums from different institutions were facing stress and needed some relief from their debt burden. However, what is debated is whether that the 'one time offer' should have been made applicable pan India and to all hues of farmers who had borrowed from public sector banks. What has followed is a domino effect as waivers are now being sought and granted, with states such as Uttar Pradesh and Maharashtra committing large amounts.

It can certainly be argued that farm loan waivers are an immediate palliative for the financially distressed and debt-ridden farmers. However, subsequent waivers in different parts of the country have created an expectation among farmers of receiving the relief and, hence, disincentivising the culture to repay. The announcement of a waiver in Uttar Pradesh, Maharashtra and Punjab in 2017 encouraged farmers in the three states which just went to the polls, namely, Rajasthan, Madhya Pradesh and Chhattisgarh, to also seek waivers. Political parties, seeking farmer support in the hustings, made promises of such waivers. The immediate impact of the announcement of a waiver is that banks face a disruption in the repayment cycle. Since there is a substantial time gap between the announcement of the waiver and the actual disbursement of the amount to be reimbursed by the government, the liquidity available with the banks is depleted. This, in turn, adversely impacts the further lending cycle. The bigger downside of such announcements is that farmers who were prompt in repayment feel deprived and cheated. Small and marginal or tenant farmers, who had borrowed from non-public sector sources or under informal arrangements, are not covered under the scheme of waiver, creating further discord in the farming community.

Political parties need to recognise that short-term largesse is encouraging a culture among farmers to default on their loans, even if they have the capacity to repay. If Indian agriculture is to be made commercially viable, the focus will have to be on crop insurance, input credit, targeted subsidies on fertilisers and insecticides, and improving irrigation facilities. Improved farm productivity and better marketing infrastructure would enhance the long-term sustainability of agriculture operations. These solutions are not unknown. Unless this aspect of the long-term solution is addressed, short-term ad hoc palliatives will tantamount to large sums of money being poured into waivers, thereby depriving competing demands on the budget towards primary health, drinking water and primary education, without really solving the real problem.

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