Farm Loan Waiver – Double Edged Sword

What is the issue?

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- Farm loans waiver worth of Rs.850 million was announced by various state governments.
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- This can affect credit offtake and induce further stress for banks and amount to another agrarian crisis.
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What is the causal relationship between credit growth and loan waivers?

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- Usually, rural banks mobilise funds through deposits in specific regions and lend to agricultural activities (credit growth).
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- The increase in credit growth (lending to various sectors by banks) in rural banking has shown a declining trend.
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- This denotes that the rural banks are not in position to mobilise the required amounts of deposit to make proportionate lending.
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- This affects credit-deposit ratio and risk weighted capital adequacy ratio, return on assets and economic value of equity.
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- The trend of credit – deposit ratio owing to farm loan waivers can induce stress in rural banking and therefore, banks will be reluctant to lend further to the farm sector.
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- It can produce a trickle-down effect on credit offtake, deposit mobilisation, bank operation and performance.
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What are the other effects?

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- The formal institutional credit (by financial institutions) to farm sector has increased to 89% in 2016 from 76% in 2010.
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- And the informal credit (by money lenders) has decreased from 22% in 2010 to 11% in 2016.
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- Thus, the share of informal credit in total outstanding debt in farming sector has gone down with RBI and various state government initiatives.
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- The farm loan waivers affect bank’s lending capacity and credit-deposit ratio.
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- The rural cooperatives and regional rural banks could not channelise investment credit to farm sector.
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- This could push small/marginal farmers to the brink and compel them to depend on varying informal sources for credit.
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- The magnitude of direct institutional credit will be reduced, and Indirect or informal credit will see a rising trend.
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- Farmers have to then bear exorbitant rates of interest, ranging between 24-36% per annum.
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- Eventually, credit lending rates and magnitude of NPAs will go up in the foreseeable future.
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- This can downgrade the rating of banks and destabilise the functioning of the credit market in general.
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- Thus, farm loan waivers worsen the plight of farmers in the long term and make it difficult to rejuvenate the credit culture between institutional lenders and farmers.
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Source: Financial Express

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