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Farm loan waiver: Fiscal headroom for states?

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Farm loan waiver has become a touchy issue with the farming community pressurizing the government to have their loans written off though loan waivers. Uttar Pradesh has already sanctioned loan waivers of Rs. 35,500 crore. Maharashtra government has also spoken of a loan waiver of around Rs. 30,000 crore.

Recently in many states, farmers' agitations for demand for loan waiver have spread (especially in Haryana, Rajasthan and Punjab). With the central government declaring that the entire waiver has to be borne by the state governments, the ability to invoke the same depends on their fiscal positions.

However, certain inherent problems are involved in the whole issue of farm loan waivers which have to be addressed by states going in for such schemes.

- The model for waiving off the loans has to be drafted by the state governments to cover the right set of farmers
- The case of adverse selection cannot be ruled out
- It creates a moral hazard as farmers will be tempted not to repay future loans
- Such schemes penalize farmers who have repaid their loans on time
- RBI is against such waivers
- With loan being waived the fiscal norms of the states could be violated
- Such waivers will be inflationary to the extent that the beneficiaries will have money to spend

The study tries to assess the ability of the states to be able to take on the additional burden given their fiscal situation.

A. Fiscal Deficit flexibility Provisions

In April 2016, the Cabinet had given its approval to the 14th Finance Commission's recommendation on the fiscal deficit targets and additional fiscal deficit to be allowed to states. 14th Finance Commission has anchored the fiscal deficit threshold limit of 3% of GSDP for the states. Over and above this, it has provided additional headroom to a maximum of 0.5% of GSDP in a year.

Availing of such flexibility is subject to certain conditions:

Revenue Position: The primary condition to avail any of these fiscal flexibility provisions is to have a comfortable revenue position. States can avail the additional fiscal deficit if and only if it does not have revenue deficit for the year in which the borrowing limits are to be fixed and the immediately preceding year.

If the states meet the above criteria the next set of conditions are,

Debt to GSDP ratio: For a particular year at which the borrowing limits are to be fixed, the states will be eligible for flexibility of 0.25% over and above the fiscal deficit limit of 3% of GSDP if and only if their debt-GSDP ratio is less than or equal to 25% in the previous year.

Interest Payments to Revenue Receipts Ratio: Furthermore, the states will be eligible for additional borrowing limit of 0.25% of GSDP in a particular year for which the borrowing limits are to be fixed, if the ratio of interest payments to revenue receipts of the states is less than or equal to 10% in the preceding year.

The states can avail either of the two flexibility provisions or both depending upon the criteria they fulfil. If a state satisfies only one of the two criteria then it can have a maximum fiscal deficit limit of 3.25% of GSDP. On the other hand, if any state conforms to both the criteria then it can have a maximum fiscal deficit –GSDP limit of 3.5% in any given year.

In addition, if a state is unable to utilize its sanctioned borrowing limit of 3% of GSDP in any particular year during the first four years of the award period, it is then have an option of availing this un-utilized borrowing amount only in the following year but within the award period (2016-17 to 2019-20). The stated criteria for 19 states have been summarised in the following table.

How do the states stack up here?

Table 1 provides information on the states which can qualify for these additional benefits.

On the basis of the above norms, it can be seen that out of 19 states only 10 had revenue surplus in FY17 and FY18 and thus are eligible for additional headroom for borrowing up to 0.5% over and above fiscal deficit target of 3% in FY18.

- Among these 10 states, Bihar, Chhattisgarh, Karnataka, Odisha, Telangana and Madhya Pradesh can have fiscal deficit limit of 3.5% as their interest to revenue receipt ratio and Debt to GSDP ratio is within the prescribed limits.
- On the other hand, Goa and Gujarat will have 3.25% of fiscal deficit limit as their debt to GSDP ratio is within the limit but interest to revenue receipt ratio is more than 10%.
- Similarly, Jharkhand and Jammu and Kashmir can opt for 3.25% of fiscal deficit as their interest to revenue receipt ratio is within limits but debt to GSDP ratio has crossed 25% mark.

  States that do not qualify for this additional limit can however still go in for waivers provided their fiscal deficit ratio is less than 3% - with the difference between the two being the space provided while adhering to the FRBM norms. It may be pointed out that presently the centre is not willing to finance such waivers nor has it permitted states extra space for fiscal deficit except what is provided by the FC. Such space was provided for states when the UDAY Scheme was implemented when states took on the debt of the DISCOMs.

Table1: Fiscal Indicators of States

States	Revenue surplus (FY17 & FY18)	Interest/Revenue Receipt (FY17)	Debt/GSDP (FY17)	FD Limit
Bihar	Yes	6.64	16.80	3.5
Chhattisgarh	Yes	4.61	16.43	3.5
Karnataka	Yes	9.3	15.67	3.5
Odisha	Yes	5.8	16.44	3.5
Telangana	Yes	8.85	15.31	3.5
Madhya Pradesh	Yes	7.88	24.63	3.5
Goa	Yes	13.4	24.95	3.25
Gujarat	Yes	15.9	15.26	3.25
Jharkhand	Yes	7.27	25.16	3.25
Jammu and Kashmir	Yes	9.57	47.3	3.25
Assam	No	NA	NA	3.0
Andhra Pradesh	No	NA	NA	3.0
Kerala	No	NA	NA	3.0
Rajasthan	No	NA	NA	3.0
Haryana	No	NA	NA	3.0
Maharashtra	No	NA	NA	3.0
Himachal Pradesh	No	NA	NA	3.0
West Bengal	No	NA	NA	3.0
Tamil Nadu	No	NA	NA	3.0
Sikkim	No	NA	NA	3.0

Source: Budget Documents of 2017-18

B. Farm loan waiver: Fiscal leeway?

The fiscal position of the states as per 2017-18 budgets has been provided in Table 2 below along with outstanding agricultural loans as on March 2016. The latter gives an idea of where the farm loans reside of which a certain proportion would be non-performing. Fiscal leeway of the states has been computed on the basis of existing fiscal deficit and additional headroom available as per the 14th finance commission's fiscal flexibility provision for each state. **The *ceteris paribus* assumption made here is that states will stick to their revenue and expenditure targets set in the budget and will not have to compromise on any of these headings.**

- 14 states have additional fiscal headroom over and above the existing fiscal position within the fiscal consolidation targets. Together, these 14 states have fiscal leeway of Rs. 88,228 crore.
- On the basis of fiscal position, Maharashtra has the highest fiscal headroom of Rs. 38,789 crore that it can sustain over and above the current fiscal deficit in order to be on the fiscal consolidation path.
- Similarly, Gujarat (Rs 18700 cr) and Karnataka (Rs 11,500) can go have more than Rs. 10,000 crore of fiscal leeway with existing fiscal deficit targets.
- Karnataka, Bihar, Madhya Pradesh, Telangana and Chhattisgarh, those were eligible for additional fiscal flexibility provisions of 0.5% above 3% fiscal target, were seen to have fiscal leeway over the existing fiscal conditions.
- Andhra Pradesh and Odisha do not have any fiscal headroom to account for any additional expenditure within the fiscal consolidation roadmap.

- Kerala, Jammu & Kashmir and Himachal Pradesh are not abiding the fiscal consolidation roadmap with fiscal deficit exceeding the limit of 3%.

Table 2: Fiscal Position of States in FY18

States	Fiscal Deficit (Rs cr)	Fiscal Deficit (% of GDP)	FD Limit (%)	Additional Fiscal Space (Rs. Cr.)	Agri Loans (as on 2016) (Rs. Cr)
Maharashtra	38,789	1.50	3.00	38,789	87,051
Gujarat	23,214	1.80	3.25	18,700	44,833
Karnataka	33,359	2.60	3.50	11,547	87,634
West Bengal	19,351	2.46	3.00	4,248	29,531
Bihar	18,112	2.87	3.50	3,976	30,167
Tamil Nadu	41,977	2.79	3.00	3,160	116,878
Jharkhand	6,948	2.29	3.25	2,913	6,112
Haryana	16,155	2.60	3.00	2,485	39,560
Goa	827	1.32	3.25	1,210	779
Assam	2,350	2.76	3.00	204	9,438
Telangana	26,096	3.48	3.50	150	43,518
Rajasthan	24,754	2.99	3.00	83	66,047
Madhya Pradesh	25,689	3.49	3.50	74	50,589
Chhattisgarh	9,647	3.49	3.50	28	10,831
Andhra Pradesh	23,054	3.00	3.00	-	82,073
Odisha	14,434	3.50	3.50	-	18,038
Kerala	25,756	3.40	3.00	(3,030)	51,344
Jammu and Kashmir	9,354	6.20	3.25	(4,451)	55,911
Himachal Pradesh	49,458	3.50	3.00	(7,065)	5,906

Source: Budget documents of 2017-18, RBI and CARE's estimates

Conclusion

It can be noted that, the state of Maharashtra has the capacity to provide for the entire loan waiver through its own resources provided other norms are met.

For the other states, the decision will be contingent upon the state's fiscal position. Hence, no state can just follow the other state with regard to loan waiver without assessing their financial situation since the centre has made it clear that there will not be any assistance provided in this regard; thus this decision becomes even more important.

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