# Death of Austerity

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**https://scroll.in/article/845534/the-death-of-austerity-with-farm-loan-waivers-states-are-building-up-staggering-debt**

As Finance Minister of UPA, Mr. Chidambaram had to handle many difficult situations, and he managed most of these with an élan expected of a person well-versed in finance and economics as befits the Finance Minister of India. But the one instance where he had abjectly surrendered his objective judgment and financial prudence to populism, presumably at the command of his political bosses, was when he had to waived a whopping Rs 52000 crore of farm loans in his 2008 budget, ahead of the 2009 general elections that returned UPA to power. The loan waiver may or may not have played any part in UPA's election victory, but a dangerous precedent was created which had the potential of shaking our entire financial edifice. Indeed it is precisely doing that now, for which the blame squarely falls on Mr. Chidambaram's shoulders.

One thought that with Congress rule being a thing of the past, the period of peak populism was over. But the genie had already been unleashed, and it is proving impossible to bottle it again. UP has waived Rs 36,359 crore of farm loans upto Rs 1 lakh each after the new Government had assumed power, putting its finances in serious jeopardy as its fiscal deficit had already breached the 3% limit set by its FRBM Act in 2015-16. Maharashtra followed suit with a similar farm loan waiver, also upto Rs 1 lakh, that would cost the state exchequer Rs 34,000 crore. In a competitive populism by sacrificing all fiscal prudence, Punjab then announced farm loan waiver for double the amount, upto Rs 2 lakh each, which would cost the state more than Rs 10000 crore. Both Punjab and UP are among the most highly indebted states in the country. When it comes to populism and pampering of the vote banks, no political dispensation wants to be left behind. Haryana, Madhya Pradesh, Gujarat and Rajasthan are waiting in the wings too.

Gujarat, Karnataka and Himachal Pradesh will face the electorate within a year and are sure to promise waivers of farm loans, and may be more. The race for populism will only get hotter, because Chhattisgarh, Madhya Pradesh and Rajasthan will go to the polls before January 2019. Banks are already complaining that in anticipation of waivers, famers have already stopped repayment of the loans, which is only to be expected. Courts have also jumped into the fray, with Madras High Court directing the Tamil Nadu government to extend its crop loan waiver scheme to all farmers, including those with land holdings exceeding five acres - an order the Supreme Court had to stay recently. The Domino effect will spread among all states very soon, throwing our state finances to back to the olden days, before the Twelfth Finance Commission, when states had to borrow just to be able to repay, with repayments exceeding the borrowings for many. A recent Bank of America-Merrill Lynch research report estimated that the total farm loan waivers in the run-up to the 2019 polls can total 2% of India's GDP, amounting to $40 billion. The contagion is spreading like a cancer in our body-politick, with competing populism forming the economic and political agenda of all parties. Days of austerity and fiscal prudence seem to be over.

Not that Mr. Chidambaram's loan waiver had solved any of the problems of distressed farmers. The 2008 UPA loan waiver scheme was audited by the CAG, whose report revealed huge gaps in delivery, besides serious lapses and corruption. It was also bad in design, being limited to bank borrowings only. According to the NSSO 70th Round Survey, majority of small and marginal farmers were indebted to informal or non-institutional sources like local money lenders, traders, or bigger farmers; they will not get the benefits of these loan waivers. The smaller the land holding of a farmer, the less likely he is to get a bank-loan. Thus 85% marginal farmers with less than 0.01 hectare of land borrow from non-institutional sources, mainly money lenders (64%). This percentage gradually decreases to 35% for small farmers (with holdings between 1-2 hectares). Thus the intended objective of providing relief to small and marginal farmers in distress will remain a myth. All such waivers achieve is to vitiate the credit culture and loan discipline, and consequently worsen the banks' already precarious NPAs. By encouraging willful default in expectation of a future bailout, they disincentivise repayment and promote a culture of irresponsibility all the way.

Bad economics is never good politics and political parties need to realize this sooner than later. According to the just released RBI Report on "State Finances - A Study of Budgets" (2016-17), the States which cumulatively exercised more fiscal prudent than the Centre until about three years ago, are now sliding into a regime of higher deficits. Relaxations in market borrowings given by the Fourteenth Finance Commission (FFC) had led to an increase in the debt burden of the states and the consolidated fiscal position of states had deteriorated sharply between 2014-15 and 2015-16. Uttar Pradesh and Punjab are not even eligible for additional market borrowings, not having fulfilled fiscal prudence norms prescribed by the FFC. For Uttar Pradesh, the fiscal deficit would rise to Rs 49,960 crore in 2016-17, i.e. 3.9% of GSDP, while for Punjab it would Rs 13,090 crore or 2.9% of GSDP, as per the budget estimates. Actuals are likely to be far higher.

The states, boosted by 10% extra devolution provided by the FFC, have now taken to indulging in the kind of populism that was earlier a prerogative of the Centre under the UPA regime. The GFD-GDP ratio in 2015-16 had breached the FRBMA ceiling of 3% for the first time since 2004-05, and is likely to worsen in 2016-17. Even though the Centre has reversed the trend of profligacy so visible during the previous regime, as per the RBI Report, the combined fiscal deficit of the Centre and the states could soar to 7 per cent or even higher due to the swelling state deficits.

Apart from the farm loan waivers, another contributing factor is loans and advances for power projects related to the Ujwal Discom Assurance Yojana (UDAY) scheme, under which, the states had to own over 75 per cent of the outstanding Discom debt– 50% in 2015- 16 and 25% in 2016-17. Only 8 states had borrowed Rs 98,960 crore under UDAY during 2015-16 alone, hiking the states' consolidated GFD: GDP ratio by 0.7 percentage point during the year. The borrowing is done through UDAY bonds, interest on which becomes an additional liability for the States. States would also have to discharge additional liabilities in case these Discoms continue to incur losses. There is also the problem of guarantee commitments of state governments in respect of state public sector enterprises. Though a contingent liability, these are emerging as a major source of potential risk to debt sustainability of the states.

Austerity and old conservative ways are seemingly dead. But they will need resurrection, before it is too late.