ARCs for Agriculture Loans

This editorial is based on **“Farming Out”** which was published in Indian Express on 07/12/2021. It talks about the issue of bad loans in the agriculture sector and if creating an Asset Reconstruction Company (ARC) for the sector is a prudent way forward.

While farmers in India are struggling to get bank loans, as formal sector lenders have become even more risk averse amid the **Covid-19 pandemic**, the banks are challenged by huge **Non-Performing Assets (NPAs)** as they’re unable to recover farm loans.

In this context, the **Indian Banks’ Association** in a recently held meeting proposed the idea of floating an **Asset Reconstruction Company (ARC)** to improve the recovery from **bad loans in the agricultural sector.**

However, several issues exist with reference to setting up a single mechanism to tackle NPAs in the farm sector.

Agriculture and Bad Loans

- **Gross NPAs for Agriculture Sector:** As per the **RBI’s Financial Stability Report,** bad loans (gross NPAs) for the agricultural sector stood at 9.8% at the end of March 2021.
    - In comparison, they were at 11.3% and 7.5% for the industry and services sectors respectively.
- **Issues Raised by Farm Loan Waivers:** The announcement of farm loan waivers by states around elections **leads to “deteriorating credit culture”.**
    - Since 2014, at least 11 states have announced farm loan waivers including Rajasthan, MP, Punjab, Chhattisgarh, Andhra Pradesh, Telangana, Maharashtra, Punjab and UP.
    - It creates a **concern among banks regarding the rise of NPAs** in the farm sector and **leads to recovery challenges** for the banks.
        - They often **leave the banks reluctant to lend.**
    - Loan waivers **stress the budgets** of the waiving state or central government.
    - Also, these waivers are **poorly targeted**, and eventually reduce the flow of credit
- **Current Mechanism to tackle NPAs of Agri-Sector:** At present, there is **neither a unified mechanism to tackle NPAs** in the farm sector **nor a single law** that deals with enforcement of mortgages created on agricultural land.
    - However, the **recovery laws vary from state** to state wherever agricultural land is offered as collateral.
    - Enforcement of provisions on mortgaged farm land is generally done through the Revenue Recovery Act of states, **Recovery of Debt and Bankruptcy Act, 1993**, among other state-specific regulations.

Creating ARCs for Farm Sector

- **Recent Proposal:** To improve recovery of bad loans in the agriculture sector, leading banks have made a pitch for setting up an **ARC specifically to deal with collections and recovery of**

farm loans.
    - With a government-backed ARC having been recently set up to deal with bank NPAs to the industry, **this idea has acceptability among banks.**
- **Arguments in Favour of ARCs for Farm Loans:** As agricultural markets are dispersed, a single institution, as opposed to multiple banks, would be **more suited to deal with collections and recoveries** from farm loans, optimising the costs of the recovery.
    - Considering the **absence of a unified framework** to deal with the enforcement of mortgages created on agricultural land, there is a case for creating an effective mechanism for the recovery of dues.
- **Arguments Against Creating ARCs for Farm Loans:**
    - First and foremost, the requirement of the ARC is to have sufficient **availability of funds to match the huge amount of the NPA** market.
        - Even if sufficient funds are available with ARC, the **price expectation mismatch between selling bank (s) and buying ARC** and agreement on an acceptable valuation of the bad assets will also create a challenge for ARC.
    - As **local banks have far greater presence** on the ground than a single ARC, they are likely to be more capable of navigating the local terrain to recover their dues.
        - **Local bank officials may be more successful** in dealing with hundreds and thousands of these small borrowers than a single ARC.
    - As **rural land markets are characterised by lack of clear titles and multiple stakeholders,** ARCs specifically the farm sector is not an as prudent approach.
        - Moreover, even though land is a mortgageable asset, it is an emotive, political issue.
    - There is also a possibility that since agriculture is a state subject, such an approach could risk being seen as **encroaching on the rights of states.**

Way Forward

- **Observing the Success Rates of Other ARCs:** The government has already set up such a framework (of ARCs) for the resolution of corporate sector loans that have turned bad.
    - Considering that doubts have been expressed over the effectiveness of the architecture of ARCs, **a more prudent approach would be to assess its experience** and then chalk the way forward.
    - Moreover, if there is indeed a need to provide for a similar framework for agricultural loans, then the same architecture could be employed.
- **Alternatives to Help Farmers:** There are also other ways to help farmers such as **ensuring timely access to credit on more favourable terms.**
    - A broader policy framework should be available to facilitate farming to become a more remunerative occupation.
- **Easing the NPA Sale Procedure:** It is utmost necessary for a rigorous and a **realistic approach to pricing between the banks and ARCs.**
    - Therefore, it is an urgent need for all stakeholders, including the regulator, to come together to make the entire process of NPA sale, resolution, recovery and revival fast and smooth.

Drishti Mains Question

Discuss the problem of bad loans that exists in the agricultural sector and what steps can be taken to mitigate the problem.