

STRUCTURE AND MANAGEMENT OF INDIA'S EXTERNAL DEBT

DR. ALOK SHEEL

Chapter V

SUMMARY AND CONCLUSION

The problem of external indebtedness of developing countries has been a major issue in development economics since the debt crisis of 1982. A debt crisis, however, is only one manifestation of an external payments problem, and so debt flows to developing countries should, ideally, be seen as part of a much larger process of capital flows. Historically, such flows have had a debt bias, although the pattern has been changing quite sharply since the debt crisis. Till very recently, therefore, external indebtedness of developing countries has been growing sharply as it simply reflected growing current account imbalances and capital flight, mainly as a result of macro-economic imbalances magnified by external shocks.

Table 1.1: External Flows to LDCs (% of Total)

Year	Debt	Equity	Grants
1985	57%	22%	21%
1990	43%	28%	29%
1992	40%	39%	21%
1994	29%	55%	16%
1995	37%	49%	14%

External debt is a powerful, double-edged tool. Used prudently, it can enhance investment levels and growth rates in the economy. However, there is also the danger that apparently cheap external finance is used to finance fiscal deficits, defer/avoid adjustment in the event of external shock, or to finance capital flight, in which event the macro-economic repercussions are likely to be disastrous, as in the case of Latin America.

It is not easy to determine what is a sustainable level of external debt. Some countries like Korea, with large aggregate debt levels (measured in terms of the

debt-GNP ratio) have not only avoided debt servicing crises, but have effectively used external finance to enhance growth rates. Debt-GNP ratios, moreover, do not reflect the cost at which debt has been contracted, or the composition of debt. They can also be deceptively low if exchange rates are overvalued. India, for instance, despite being near the top in the external debt league tables, has a comparatively low level of external debt measured on present value basis on account of a large element of official and concessional financing.

Debt servicing ratios, therefore, emerge as a more reliable index of likely debt servicing problems. This ratio, however, is quite volatile, as it can swing sharply under the impact of external shocks, both positive as well as negative. The issue is further complicated by the problem of servicing non-debt flows, which can not only be costlier than the servicing of debt over the long term, but also serve to inject greater volatility into external payment ratios. With the shift of flows from debt to equity, it is conceivable that a future external payments crisis in developing countries may well be equity, rather than debt, related.

The adverse consequences of an external debt/payments crisis is cessation and reversal of external flows (except perhaps in the exceptional case of official flows which, however, have been diminishing in importance everywhere except in Africa), which translates into negative growth rates. India escaped the negative aspects of the debt crisis on account of a conservative external borrowing policy, as it adjusted rather than borrowed in response to the oil price shocks. However, an inward oriented development strategy, with its implicit anti-export bias, fiscal imbalances, combined with partial liberalisation of imports (in the absence of structural adjustment) led to a ballooning debt, mainly commercial, from the second half of the eighties. India's external debt tracked its current account deficits fairly closely, but it is also possible that capital flight through trading channels was also partly responsible for the rapid growth in debt. Both the debt-GNP and debt-servicing ratios worsened very quickly, and India narrowly avoided defaulting on its external commitments in 1991-92, when the gulf crisis exposed India's vulnerability to POL induced shocks. India lost market access for a time on account of the downgrading of its credit rating, and it was only through the use of its gold reserves that it was able to service its external liabilities.

There has been a major restructuring and 'liberalisation' of the Indian economy following the BOP crisis of 1991-92. The trade and industrial regimes have been opened up, the exchange rate has been corrected, the rupee has been 'floated', and restrictions on the current account removed in keeping with article VIII of the IMF. Growth rates have quickly resumed, after an initial drop, exports have shown surprising buoyancy, and there has on the whole been a revival of international confidence in the Indian economy, reflected in credit rating upgradation, reverse capital flight, and a surge in foreign investment flows.

Foreign currency reserves, which had dipped to about US \$ 1 Billion at the height of the BOP crisis climbed to an all time high of US\$ 20 Billion before tapering off. The growth in external debt has been checked, and the debt servicing ratios have been falling fairly rapidly over the last two years, making the external debt appear increasingly sustainable. There has also been a conscious attempt to restrict the growth of debt, pushing Indian companies to use the equity route. However, lax fiscal management may well thwart attempts to keep external debt within prudent limits.

It is large portfolio flows, rather than direct foreign investment, which are mainly responsible for the improvement in reserves, apart from the growth in NRI deposits and reverse capital flight. While the policy to keep external commercial borrowing in check has been largely successful, NRI deposits continue to grow, and there is a growing danger that the fiscal discipline may spill over into the external sector. Although such large flows have in them the potential of enhancing and sustaining growth rates, they also constitute a species of positive external shock. Management of the volatilities involved in such flows, and their monetary fall-out, consequently occupies the centre stage in the management of the external sector at present.

REFERENCES

The Amex Bank Review, Vol. 20, No.3, March 22,1993 (Global Economics Unit, American Express Bank, Ltd., London)

The Amex Bank Review, Vol. 20, No.4, April 26,1993 (Global Economics Unit, American Express Bank, Ltd., London)

Bajpai, N (1994), "*India's External Debt. Retrospect and Prospects*", *Economic and Political Weekly* (New Delhi), August 20, 1994

Basham, A.L (1967) **The Wonder that was India** (Fontana)

Berthelemy, J & Vourc'h, A (1994) **Debt Relief and Growth** (OECD, Paris)

Bhagwati, J (1988), "*Export Promoting Trade Strategy. Issues and Evidence*", **Research Observer**, 3, No.1 , January 1988.

Bhagwati, J & Srinivasan, T.N (1993), *India's Economic Reforms* (Ministry of Finance, New Delhi, India)

Bruno, M (1988), "*Opening Up: Liberalisation and Stabilisation*", Dornbusch, R & Helmers, F.C.C.H, ed., **The Open Economy**. (World Bank and OUP)

Casson, M & Pearce, R.D (1987), "*Multinational Enterprises in LDCs*", Gemmell, N, ed., **Surveys in Development Economics**. (Basil Blackwell, Oxford)

Cline, R (1995), **International Debt Re-examined** (Institute for International Economics, Washington)

Colman, D & Nixon, F (1994), **Economics of Change in Developing Countries**. (Harvester Wheatsheaf, Herts)

Cooper, R.N and Sachs, J.D (1985), "*Borrowing Abroad: The Debtor's Perspective*", Smith, G.W & Cuddington, J.T, **International Debt and the Developing Countries. A World Bank Symposium**. (The World Bank, Washington)

Cuddington, J.T (1989) "*The Extent and Causes of the Debt Crisis of the 1980s*", Husain, I & Diwan, I, ed., **Dealing with the Debt Crisis. A World Bank Symposium**. (World Bank, Washington)

Dadush, Uri, Dhareshwar, Ashok and Johannes, Ron (December 1994), "*Are Private Capital Flows to Developing Countries Sustainable?*", ***Policy Research Working Paper 1397***, (The World Bank, International Finance Division)

Dean, A (1990), "*Domestic and International Financial Imbalances and Adjustment*", Llewelyn, D.T & Milner, C, ed., ***Current Issues in International Monetary Economics*** (Macmillan Education Ltd, Hampshire & London)

Dicken, P (1986), ***Global Shift. Industrial Change in a Turbulent World*** (Harper and Row, London)

Economic Survey 1994-95 (Government of India, Ministry of Finance, Economic Division, New Delhi, 1995)

Economic Survey 1995-96 (Government of India, Ministry of Finance, Economic Division, New Delhi, 1996)

Economic Survey 1995-96: An Update (Government of India, Ministry of Finance, Economic Division, New Delhi, 1995)

Economic Survey 1996-97 (Government of India, Ministry of Finance, Economic Division, New Delhi, 1997)

Eichengreen and Portes (1989), "*Dealing with Debt: The 1930's and the 1980's*", Husain, I & Diwan, I, ed., ***Dealing with the Debt Crisis. A World Bank Symposium***. (World Bank, Washington)

Fishlow, A (1988), "*External Borrowing and Debt Management*", Dornbusch, R & Helmers, F.C.C.H, ed., ***The Open Economy***. (World Bank and OUP)

Griffith-Jones, S and Sunkel, O (1986), ***Debt and Development Crisis in Latin America. The End of an Illusion***. (Clarendon)

Griffith-Jones, S (1988), "*Debt Crisis Management. An Analytical Framework*", Griffith-Jones, S, ed., ***Managing World Debt***. (Harvester Wheatsheaf)

Harberger, A.C, "*Lessons for Debtor Country managers and Policymakers*", Smith, G.W & Cuddington, J.T, ***International Debt and the Developing Countries. A World Bank Symposium***. (The World Bank, Washington)

India's External Debt. A Status Report. (Government of India, Ministry of Finance, Department of Economic Affairs, 1993)

India's External Debt. A Status Report. (Government of India, Ministry of Finance, Department of Economic Affairs, December 1995)

India's External Debt. A Status Report. (Government of India, Ministry of Finance, Department of Economic Affairs, February 1997)

IMF BOP Statistics (1990-91), **Balance of Payments Statistics Yearbook 1990-91**, Vol.42, Part 1 (IMF 1991)

IMF BOP Statistics (1993), **Balance of Payments Statistics Yearbook 1993**, Vol.44, Part 1 (IMF 1993)

Khan, M.S & Knight, M.D, (1983), "*Determinants of Current Account Balances of Non-Oil Developing Countries in the 1970's: An Empirical Analysis*", **International Monetary Fund. Staff Papers**, Vol 30, No.4, Dec 1983. (IMF Washington)

Krugman, P (1988) "*External Shocks and Domestic Policy Response*", Dornbusch, R & Helmers, F.C.C.H, ed., **The Open Economy**. (World Bank and OUP)

Krugman, P (1989), "*Market-Based Debt-Reduction Schemes*", Frenkel, J, Dooley, M & Wickham, P, ed., **Analytical Issues in Debt**. (International Monetary Fund, Washington)

Morales, Juan-Antobio (1993), "*Bolivian Trade and Development 1952-87*", Dornbusch, R, ed., **Policy Making in the Open Economy. Concepts and Case Studies in Economic Performance**. (World Bank and Oxford University Press)

Moran, T.H (1985), **Multinational Corporations. The Political Economy of Foreign Direct Investment** (Lexington Books, Mass, U.S)

Park, Yung Chul (1985), "*Korea's Experience with External Debt Management*", Smith, G.W & Cuddington, J.T, **International Debt and the Developing Countries. A World Bank Symposium**. (The World Bank, Washington)

Pass,C, Lowes,B and Robinson, A (1995), **Business and Macroeconomics**. (Routledge, London)

Report of the High Level Committee on Balance of Payments (RBI, Bombay, April 1993)

Reserve Bank of India (September 1996), **Reserve Bank of India Annual Report 1995-96.**

Sachs J.D and Larrain, L.B (1993), **Macroeconomics in the Global Economy.** (Harvester Wheatsheaf, NY and London)

Sarkar, S (1983), **Modern India: 1885-1947** (Macmillan)

Thapar, R (1966), **A History of India**, Vol.1 (Penguin)

The Economist, September 25, 1993, *Third World Finance. Survey.*

Trevino, A.G (1988) , "*Debt Restructuring: Mexico as a Case Study*", Griffith-Jones, S, ed., **Managing World Debt.** (Harvester Wheatsheaf)

Williamson, J (1988) "*Exchange Reserves as Shock Absorbers*", Dornbusch, R & Helmers, F.C.C.H, ed., **The Open Economy.** (World Bank and OUP)

World Bank (Washington, 1995), **Economic Developments in India. Achievements and Challenges.**

World Bank (Washington, August 8, 1996), **India Country Economic Memorandum. Five Years of Stabilisation and Reform: The Challenges Ahead.**

World Development Report 1985 (World Bank & OUP, Washington, 1985)

World Debt Tables 1989-90. External Finance for Developing Countries. (World Bank 1990)

World Debt Tables 1992-93. External Finance for Developing Countries. (World Bank 1993)

World Debt Tables 1993-94. External Finance for Developing Countries. (World Bank 1994)

World Debt Tables 1994-95. External Finance for Developing Countries. (World Bank 1995)

World Debt Tables 1995-96. External Finance for Developing Countries. (World Bank 1996)

World Investment Report 1994. Transnational Corporations, Employment

and the Work Place. (United Nations, New York, 1994)
