CHAPTER - VI
CONCLUSION

The major goal and need of the developing economies is to faster the process of economic development. In the pursuit of this goal these economies try to catch up with the growth/development standard that of the developed countries. According to major growth theories savings play crucial role in the growth/development process of developing countries. But because of the inherent distinctive features of these economies the savings potential is not high enough to meet the investment requirements. The demand for external debt, therefore, emanates from this fact. That is why the underdeveloped economies have to borrow heavily from international lending institutions like foreign government, World Bank, International Monetary Fund and other financial institutions.

The dual gap model justifies and explains the rationale of inviting foreign borrowing to developing countries. According to dual gap model in the developing countries, there exists a gap between the investment and saving (1-S) on the one hand, and between imports and exports (m-x) on the other hand. This model assign a double role to foreign borrowing in the process of economic development. In addition to bridge the gap between saving and investment, foreign borrowing also contributes to supplement the foreign exchange reserves which are useful to import necessary imports.

Indian economy is characterized by having low per capita income, unequal distribution of income, excessive population and its pressure on agriculture in GDP, chronicle unemployment and
slow rate of growth of domestic saving etc., has to borrow heavily to meet investment requirements and necessary imports. Excessive increment in the import bill after the two oil price shocks (in 1974 and 1979) and launching of the outward oriented strategy in 1978 laid foundation stone for heavy borrowing during the 1980s.

India's external debt position in post reform period has improved considerably following the introduction of policy reforms in managing the debt. The debt management policy has focussed on raising sovereign debt on concessional terms with longer maturities, regulating external commercial borrowings through end-use and all-in-cost restrictions, rationalising interest rates on Non-Resident Indian (NRI) deposits and monitoring long as well as short term debt.

The post reform period has also witnessed some shift in the structure of external debt. The contribution of long term debt in the total debt has improved marginally while the share of short term debt has gone down. However, it is important to note that the share of short term debt had a tendency to rise in the second decade of the reform period. This calls for further reform measures to keep the share of short term debt low.

Another important change in the structure of India's external debt during the period of study was the dominant share of government debt in the total debt during the first decade of reform and that of non-government debt in the second decade of reforms. This could be attributed to rising private sector activities and the steep rise in FDI in post 2004 period. India was also able to keep external debt service payment under control which in turn led to the sustainability of debt.
Finally, for India to move on sustainable path there is a need to put the external debt towards developmental activities which could generate revenue to repay debt. In the past particularly in the decade of 1980's the external debt lead to crisis because it was used substantially for non-developmental purposes like Lok Sabha elections etc.

External debt as such is not a burden if it is used to generate an equivalent or higher revenues.

Chapter one includes the comprehensive introduction of the structural analysis of external debt since 1980, objectives, methodology and limitations of the study.

Chapter two deals with the survey of related literature. A comprehensive review has been done of the Structure of external debt in India and World.


After having reviewed the literature, it can be concluded that there is significant relationship between External Debt and Economic Growth. It has also been established by many authors that to understand the role of external debt in economic growth, the structural analysis could be helpful.

Chapter three deals with the Growth of India’s External debt since 1980. India’s external debt has grown very sharply since 1980. There is a serious concern in the country about the
size of external debt and debt service burden. The total external
debt stock of India has grown from US $ 20582 million in 1980-
81 to US $ 85285 million in 1991-92. At the end of March 1994-
95 it has reached to US $ 99008 million. It further increased from
US $ 101,326 million in 2000-01 to US $ 134,002 million in
2004-05. In the year 2009-10 it was US $ 266,935 million and US
$409484 million in 2013-14

The total external debt in 1979-80 was US $ 20582 million
and increased to US $ 68698 million in 1989-90. In terms of
exports of Goods and Services it was worth US $ 18134 million
in 1979-80 to US $25629 in 1989-90. The GNP was US $ 172672
million in 1979-80 and increased upto US $ 292183 million in
1989-90. The Annual average growth rate in the Pre Reform
period of GNP is 4.6 percent and Exports of Goods and Services
is 5.2 percent, which is much less than the growth rate of external
debt i.e.11.2 percent. Moreover, the compound growth rate of
GNP and Exports of Goods and Services in the Post-Reform
period is higher than that of Total External Debt.

The indicators of External Debt. It is found that if the
three of the four following indicators of debt and debt service
have values greater than empirically observed critical values, a
country is defined as debt burdened:

(1) The ratio of debt to GDP
(2) The ratio of debt to foreign exchange reserve.
(3) The ratio of debt service
(4) The ratio of short term debt to total debt

The critical values indicated in the World Economic
Outlook are as follows:
(5) Debt to GDP 50%
(6) Debt to foreign exchange reserves 27.5%
(7) Debt Service to Ratio 30%
(8) Short term debt to total debt 20%.

It has been observed earlier that India’s relative position with regard to debt indicators has not deteriorated significantly in relation to other developing countries. However, when the debt indicators are measured against India’s own context the fact emerges that they have undergone significant deterioration since 1980.

Chapter four deals with the Structural Analysis of India’s External Debt Since 1980. It has been revealed that several changes have taken place in the composition of external debt in India over the period 1980-2014. The percentage share of official credit in total external debt declined from 76.1 percent in 1980 to 36.5 in the year 2014. In absolutes terms it was US $ 16287 million in 1980 and US $ 43982 in 1992 it rise upto US$ 81195 million in 2000 and US$ 106205 million in 2010 which works out to be 79.1 per cent in 1981 and 57.1 per cent of the total external debt in 1992 and 80.9% in 2000 and 36.5% in 2010. The share of long term debt to total external debt also increased from 90.7% in 1980 to 96.5% in 2000 but it drop down to 80.5% in 2010.

The share of private publically guaranteed credit has multiplied to more than three times over the period under study. In 1980 it was 10.1 per cent whereas in 1992 it rise to 30.8 per cent of the total external debt. In 2000 it rise to 15.5% and 43.9% in 2010. The IMF has been playing a crucial role in providing debt to India. In 1980 the use of IMF credit was US $ 977 million

This change (shift) in the composition of external debt has aggravated the debt service payment problem to an alarming extent. The total debt service was US $ 1441 million in 1980, US $ 5274 million in 1987 and US $ 6637 million in 1992. It was 6726 million in 2000 and rise upto 20610 in 2013.

The capital inflow and debt service payments have also been discussed in this chapter. It is noticed that Resource transfer to India has badly affected by the deterioration in the terms of lending. India has experienced considerable change in terms of lending since 1980. The ratio of debt service payment as percentage of debt outstanding is used as an acceptable measure for terms of lending. The debt service as percentage of debt outstanding has consistently increased over the years. The debt service payment was 6.8 percent in 1980. In 1986 and 1988, it rose to 11 per cent and 10.8 per cent respectively whereas it declined to 8.6 per cent in 1992. It declined to 8.3 percent in 2002 and went upto 18.5% in 2013.

It has been found that increased debt servicing and thereby decline in resource transfer has been caused by the changes in rate of interest, maturity period and grace period. The average rate of interest has remained very high since 1980s. It was 5.5 per cent in 1980, 5.8 per cent in 1985, 6.2 per cent in 1988 and 5 per cent in 1992 on all types of credit. Interest rate on official credit has also rise continuously from 1980 to 1986. It was 2.5 per cent in 1980, 5.2 per cent in 1986 and then it softened a little bit to 4.1 per cent in 1992. It again increased to 5.2 percent in 2001 and declined drastically to 0.8% in 2010. Average rate of
interest on private credit has softened substantially from 15.8 per cent in 1980 to 6.8 per cent in 1992 and from 4.4 percent in 2002 to 31.3 percent in 2010. But still it was greater than the interest rate on official credit and all credit.

The currency composition of India's external debt with respect to developing countries has been discussed in this chapter. It has been revealed that US dollar denominated debt remains dominant. The share of US dollar debt to table external debt stood at 34.6 percent in 1980 which rise up to 38.1 percent in 1990 and it increased to 42.3 percent in 2000 to reach up to 57.2 percent in 2013, followed by Indian rupee which was merely 12.2 percent in 1980 and rise upto 20.7 percent in 1990 to reach 18.6 percent in 2000 and currently it is 24 percent of external debt.

Similarly we can talk about the share of pound sterling which is third highest in terms of currency composition of India's external debt. Its share was 3.7 percent in 1980 and increased to 4.2 percent in 1990 to reach 3 percent in 2000 and finally fell to 0.7 percent in 2013.

The share of Euro was almost stagnant from 3.7 percent in 1980 to 3.5 percent in 2013.

We have also analyzed the Structure of External Debt in fourth chapter. In the context of external debt, it is important to know its structure as well. This is because high short term debt tends to inflate the servicing burden and exposes the economy to refinancing or rollover risk. It has been noticed that the behavior of India's external debt in terms of short term and long term since 1980-81. We found that the long term debt on an average constituted a little more than 90 percent of India's external debt
in the pre-reform period. This share increased marginally to a little over 92 percent during the post-reform period.

On the other hand the share of short-term debt witnessed a squeeze from 9.55 percent in the pre-reform period to 7.84 percent in the reform period. However, within the reform period, the share of short term debt tended to increase from 2001-02 particularly after 2006-2007. This trend was not favorable from the viewpoint of servicing the debt.

Among the long term debt; multilateral debt, commercial borrowings, bilateral debt and NRI deposits, constituted the significant share of external debt in the reform period. Taken together on an average these components accounted for about 87 percent of total external debt during the reform period while the remaining 13 percent was accounted by other components (i.e. borrowings from the IMF, export credit and rupee debt).

The borrower classification of external debt during the reform period indicates the major shift in the share of government debt in total debt. This share was around 60 percent till 1995 and started declining thereafter reaching the level of 26 percent in 2010. This was due to the decline in the rupee denominated debt and the IMF debt and the rising role of private sector and Indian corporate during the reform period.

**Servicing of Debt:**

Details of debt service payments on India's external debt during the reform period have also been discussed. India's debt service payments had a fluctuating trend during the reform period. It increased at the rate of 3.88 percent per annum during the period 1990-91 to 2000-01 and jumped to the level of 14.23
per annum during 2001-02 to 2009-10. For the reform period as a whole the growth rate was 8.53 percent per annum.

Debt service payments include repayment of principal and the payment of interest. It has been revealed that the amount of repayments was always larger than the amount of interest payments during the period of study. As a result the share of repayments in the total debt service payments increased from 55.98 percent in 1990-91 to 69.49 percent in 2009-10 with some fluctuations in between.

An analysis of the burden of servicing the external debt reveals a big surge in debt service payments in respect of commercial borrowings during second decade of reform. The rest had a declining trend particularly the servicing of debt in respect of borrowings from the IMF and the rupee debt.

An attempt has also been made here to Analyse India’s External Debt vis-à-vis of other Developing Countries. International comparison based on World Bank's 'International Debt Statistics 2014' indicates that India continues to be among the less vulnerable countries and India's key debt indicators comparing well with other indebted developing countries. India's key debt indicators, especially debt to GNI ratio, debt service ratio and short-term to total external debt ratio continue to be comfortable.

External debt data at end-March 2014 of the Russian Federation and China are not available in the QEDS database. In the past, external debt in absolute terms of these countries was higher than that of India.

India's external debt position in post reform period has
improved considerably following the introduction of policy reforms in managing the debt. The debt management policy has focused on raising sovereign debt on concessional terms with longer maturities, regulating external commercial borrowings through end-use and all-in-cost restrictions, rationalizing interest rates on Non-Resident Indian (NRI) deposits and monitoring long as well as short term debt.

The post reform period has also witnessed some shift in the structure of external debt. The contribution of long term debt in the total debt has improved marginally while the share of short term debt has gone down. However, it is important to note that the share of short term debt had a tendency to rise in the second decade of the reform period. This calls for further reform measures to keep the share of short term debt low.

Another important change in the structure of India’s external debt during the period of study was the dominant share of government debt in the total debt during the first decade of reform and that of non-government debt in the second decade of reforms. India was also able to keep external debt service payment under control which in turn led to the sustainability of debt.

The major findings of the study are as follows:

1. The study reveals that India’s external-debt has increased significantly during the period under study. Despite this, as compared to the international setting India’s position was found to be much better.

2. The annual percentage increase in external debt was faster during the first half in comparison to the second half of the
study period.

3. The proportion of long terms debt in total external debt declined marginally

4. The proportion of multilateral credit had also declined.

5. There had been a drastic decline in the bilateral credit.

6. The other components of debt viz. private publically guaranteed and non-guaranteed, and IMF borrowing and external commercial borrowings, exhibit significant increase.

7. The utilisation of foreign loans had remained considerably less than the authorisation.

8. The net transfer to India remained much short. However, it reflects a distinguishing feature that India has never been insolvent.

9. The pace of disbursement of loans not only declined significantly but also turned negative for some years.

10. Debt service payment had risen consistently because of high rate of interest. The average rate of interest on private credit was found to be higher than the official credit.

11. The terms of external borrowing deteriorated considerably during the study period.

12. The behaviour of various ratios relating to India's external debt manifests that external debt had been sustainable and manageable. The creditworthiness of India remained in comfortable position. Moreover, the ratio of trade deficit to exports of goods declined significantly.

13. The external debt of the country had mounted to high
figures. Several internal and external factors were responsible for this state of affairs. Among the internal factor, slow rate of growth of domestic saving and adverse balance of payments situation on the one hand, and among the external factors deterioration of terms of trades external borrowing and heavy dependence for loan requirements on IMF and financial institutions, on the other hand, are worthnoting.

In Chapter V an attempt has been made to examine the impact of external debt on economic growth. In an open economy, when domestic savings prove to be inadequate and insufficient in relation to the targeted rate of growth, then these domestic savings can be supplemented by many kinds of external assistance. The 'Dual Gap Model basically explains the role of foreign borrowing in the development process. To understand the mechanism of the dual gap analysis start with a particular target rate of growth and to achieve this target growth rate, the savings and investment goods imports will be required. The Harrod-Domar growth model also explains the relation between growth, and savings expressed in terms of incremental capital-output ratio (R) which is the reciprocal of the productivity of capital.

It has been found that External debt is positively associated with the economic growth. The econometric estimates is the positive and statistically significant relationship between external debt and economic growth. The estimated coefficient for external debt also appears to be robust to the inclusion of additional control regressors : T and PL. The other controlling variables such as investment, gross enrolment ratio, openness to international trade and growth of population have shown the
expected positive and significant relationship with the GDP growth. And these specifications explain 47 percent of the variation in growth in the sample period.

We proved in the previous econometric estimates that, external debt appears to enhance the rate of investment, and in this section econometric estimates verify that a positive relationship exists between investment and economic growth. Thus, an increase in the level of external debt, all else being equal, would appear to induce the rate of investment over time and, in turn, indirectly enhance economic growth. We should believe that this first evidence on the indirect influence of external debt on economic growth is intriguing as it supports the contention that external debt has an indirect effect on economic growth through its beneficial impact on investment.

SUGGESTIONS FOR POLICY IMPLICATIONS

1. Bilateral credit is the major source of concessional loans. To lessen the burden of external debt, it must be increased the share of concessional borrowings in the total external debt obligations. Also, debt should be rescheduled to be repaid later when the economy acquires sufficient reliance and exchange surplus. Efforts must be made to waive of the repayment of some loans from countries like Australia, Canada, USA Japan and Germany by converting them into grants.

2. India should minimise the borrowings from the private sources and IMF because of serious implications of such type of borrowings. On these loans, the rate of interest is high and the conditionalities are stringent which enhance the problem
of debt servicing.

3. The country should minimise the dependency on tied loans as immense problems are associated with these loans.

4. India should accelerate the utilisation of foreign loans by streamlining and speeding up the relative projects.

5. A huge part of the foreign loans are repatriated to foreign funding agencies in the form of debt service payments which results in shortage of net transfers available for the development process of the economy. It is, therefore, required that India should secure loans from such sources like bilateral, IDA which extend loans on softer terms.

6. To make the terms of borrowing favourable such type of loans should be contracted that have longer maturity and grace periods. The share of loan contracted at variable rate of interest should also be minimised.

7. To reduce the burden of external debt, rate of domestic savings and investment must be accelerated through a network of financial institutions. It will enhance the productive capacity of the country.

8. India should adopt a strategy of export and import substitution to bridge the gap between exports and import or to reduce the trade deficit. Exports play major role in improving the creditworthiness of a country. These mobilise foreign exchange which is useful in interest payments and repayments of past loans, and in financing the Import obligations. To promote efficient export and import competing sectors, the scarcity of foreign exchange should be translated into a higher market exchange rate and a more
neutral trade regimes. India should develop sophisticated technology to fully exploit the resources. Greater efficiency of resource use will increase the productivity of additional investment and produce more output from existing resources. They will quicken the recovery of creditworthiness for any given rate of consumption of growth, or allow the achievement or creditworthiness with lower consumption constraints. This requires that private and public sectors are guided by incentives which reflects the opportunity cost of resources and the benefits to society.

There is a strong need to control a decline in the share of official debts in total debt and a decline in the share of concessional debt as there are likely to increase the debt burden in the years to come. If necessary steps are not taken well in time the problem of external debt will be aggravated in future.

To sum up, it can be said that there has been phenomenal growth in India's external debt since 1980s and the country has accumulated mammoth stock of external debt. However comparing to other developing countries India's position is much better. The country has never been insolvent. But a caution might be needed to strengthen the creditworthiness as well solvency of the country in the near future.