CHAPTER I

INTRODUCTION

Foreign aid or foreign resources for economic development have raised considerable debate in academic as well as non-academic circles. Apart from their multi-disciplinary significance, even from the purely economic point of view foreign resources in a country's economic development programme have multi-dimensional effects. For, they exercise an impact on the whole gamut of macro-economic variables.

Ordinarily foreign aid is presumed to be a supplementary source for development resources, in the process of development it generates several complementaries which affect the rate, the direction and the whole configuration of the development process. The present study is an attempt to set in relief the impact of foreign aid against the whole macro-economic background of the Indian economy both in terms of its external and internal economic relationships.

The study no doubt is a retrospection but it is not
made to lack occasions for introspection for the prospective years. The general structure of the work is detailed in the tail part of this chapter. However, it will be found worthwhile to dwell, briefly on the switch-over that came to prevail in the Indian attitude towards foreign aid and the issues which ordinarily have become pertinent in the economics of foreign aid.

In the particular area of external assistance and economic development several minds have been agitated and exercised. Some introductory reference to the nature of these earlier studies is made in this chapter only to indicate the specific theme of the present study. The earlier studies are cited in the text at different places according to their relevance.

The Problem

With the advent of the era of planning in India the shortage of investible resources came to the fore. The lack of resources was particularly marked with the beginning of the Second Five Year Plan, which attempted at structural transformation of the industrial base. The paucity of resources for investment was sought to be tackled by requesting the developed countries and IBRD to help India in augmenting the availability of resources for domestic capital formation. Therefore, the influx of external resources came to be relied upon for supplementing the domestic resources for investment. The inflow of
external resources or foreign capital for India's economic development has taken place on both private and official account. However, the dominant position in the inflow of foreign capital to this country has been taken by official transfers popularly known as external assistance or foreign aid. The external assistance to India has come largely in the form of loans repayable with interest charges. Therefore, the progress of planned development in India synchronized with a very sharp rise in her external indebtedness.

The external debt of India, excluding P.L. 480 debts, at the end of March 1956 stood at more than three times of the debt in March 1951. The Second Plan witnessed an enormous increase in debt. At the end of the Second Plan the level of external debt was more than six times of the 1956 level. In the subsequent plans the necessity of external assistance remained persistent; even after the Second Plan and the volume of external debt accordingly went on increasing in a snowball way. At the end of the Fourth Plan the external debt constituted 11 per cent of the gross domestic product (GDP) at current prices. In real terms, however, the ratio of external debt to GDP worked out to as much as 26 per cent. In the same year the debt service on external loans took away 24 per cent of the export earnings. The debt service ratio had
reached a peak of 30 per cent in 1971-72, while debt service obligations amounted to 60.0 per cent of the gross aid flows at the end of the Fourth Plan. The rising prices of imported goods required by India have also resulted in higher levels of debts and hence of service payments. Due to growing external indebtedness and service payments India was forced to seek debt relief from her creditors from 1966-67 onwards. The fact of seeking and obtaining debt relief from her creditors indicates, ipso facto, India's failure to raise her debt servicing capacity.

In view of the phenomenal growth in India's external debt and debt servicing difficulties the hypothesis examined in this study is that debt servicing capacity of India has not increased pari passu with the increase in her external payment obligations. The alternative hypothesis of the present study is that economic development in India has gone hand in hand with the growth in her LONG TERM debt servicing capacity. That the debt servicing difficulties India faced during the time period of 1950-51 to 1973-74, were of temporary nature taking the form of liquidity crisis. That the liquidity problem was largely a product of comparatively hard terms, both as regards interest rates and maturity periods, of the foreign debt contracted during the Second Plan and the early years
of the Third Plan.

The Conceptual Framework of the Study

The debt servicing capacity of a developing country can be analysed in terms of benefits and costs of foreign capital in the growth process. The benefit of foreign capital is that by supplementing the domestic resources it helps raise the rate of investment and, therefore, the rate of growth of domestic product. The cost of foreign capital may be expressed in terms of payment of debt service. As such, the success of a developing country to service its debt, in the long run, depends primarily on the contribution of foreign capital to the country's growing income stream, and on the country's ability to preempt from that income stream a volume of savings adequate to service debt and to support its development programme. In view of this reasoning high levels of external debt and debt-service payments, by themselves, do not constitute the debt problem.

The above stated framework is suitable for analysing the debt servicing capacity of a developing country in the long run. The present study is also concerned with the analysis of debt servicing capacity of India over a period of time. In point of fact a thorough appraisal of the capacity to service external debt cannot be divorced from the general problem of economic growth, particularly when
the main focus of analysis is on a developing country like India. For, the infrastructural projects, a pre-requisite for sustained growth, and other development projects which are financed by foreign capital have long gestation periods. Moreover, they do not yield returns in foreign exchange which is significant for avoiding foreign exchange crisis in the short run. The analysis of debt servicing capacity of a developing country should therefore concentrate on the long run aspects of economic growth and debt and take into account the potential servicing capacity brought into being by the use of external resources.

The Significance of the Study

IDRD has provided certain studies on the debt servicing problems. The analysis of debt servicing problems by the IDRD studies is global in nature. They have concentrated on the developing countries and treated them as a group. Because of this the IBRD studies have not been able to make an indepth study of a particular country like India. In India also the attempts to examine the debt problem have been sporadic which have at the most just touched the fringe of the problem. Owing to the purpose these studies were supposed to serve they were unable to undertake a detailed examination of India's debt problem.

Thus there existed a lacuna in the field of research
in debt servicing problems of India. It is this gap in the research on India's debt servicing problems which the present study is aimed to bridge. The existence of such a gap in the research in the sphere of debt problem of India is also indicated by an ICSSR commissioned survey on researches in foreign aid to India. The present study has kept in view this particular suggestion of the ICSSR survey.

Concepts and the Sources of Data

It is obvious that a specialised study will require to eliminate ambiguity so that no confusion may prevail in its argumentation. It is with this objective in view it will be quite appropriate at this juncture to clarify the specific connotations in which certain concepts and expressions are used in this work.

First is the concept of 'external assistance' which is obviously the central concept in the study. The expressions 'foreign aid', 'foreign resources', 'foreign capital' occurring in the text are to be read as synonymous with the term 'external assistance'. For the purpose of this study external assistance is composed of loans as well as grants taken on official account. In the case of the loans comprehended in external assistance, they are officially guaranteed. Thus, though the proceeds of the loans flowed to the non-official agencies to the extent that their repayment was guaranteed by the Government of India, such loans formed the part of 'external assistance'. The concept external debt thus indicates only loans the
repayment of which is guaranteed by the Government. It indicates thus external assistance net of the grant component therein. The statistical informations used for analysis in the study are drawn from the EXTERNAL ASSISTANCE, a publication of the Government of India, Ministry of Finance. The statistical informations presented in this publication are based on the above stated connotations of external assistance, and for the purpose of this study the same has been followed. There are several other concepts generally occurring in economic literature on this subject, but they are not so specific to the present work. These concepts are even then made clear in the footnotes whenever such clarifications are required.

Sources of Data

Mention may also be made about the sources of data. It is the usual experience with any researcher that he has to confront data gaps of one or the other kind. Under the constraints he is compelled at times to track-shunting of his discussion and emerge with so called serendipitous conclusions which he might not have originally aimed at. However for the purpose of the study the hypothesis stated earlier was strictly kept in view. This required a lot of sifting of data. Now, as it is the case in India, different publications are presenting statistical
informations not in close conformity with each other. That is why in collating the statistical material the central concept of external assistance as clarified earlier was kept in view. The sources of statistical informations chosen for this study are only official publications. For, it may be presumed with the same justification that there may be some consonance in the values of different variables figuring in the study. These publications have been cited at relevant places.

Period of Study

As stated earlier the problems of debt servicing confronted by the country especially after the Second Plan were of typical nature in as much as they stemmed from the general liquidity crisis of the global nature and it would prove too hasty and uninformed a conclusion pertaining to the debt servicing capacity of the country if it is based on the experience of these exceptional circumstances. India's debt problem has to be viewed in a longer and broader perspective for the purpose of arriving at a more reasonable view about its debt servicing capacity. That is why the present study has taken the time span of nearly twenty-four years within its purview so that a panoramic view can be presented of the economic development and the debt servicing capacity for the reasons stated earlier while stating the
conceptual framework of the study.

Organization of the Study

The whole work is divided into ten chapters of varying length. The study though is a case study of India, it is thrown against theoretical discussion which developed in academic circles. It was, therefore, found worthwhile and also convenient to discuss these developments so that the macro-economics of foreign aid may be brought in clear relief. The three chapters following the present one are devoted to this particular aspect of the study, though, of course, there is no clear cut watershed provided. The subsequent chapters deal with the Indian case. While discussing the Indian case the references to theoretical implications are only cited wherever found relevant. This is done in order that the argumentation may flow uninteruptedly and may not become confused.

Within this broad framework each chapter deals with a differentiated theme in terms of emphasis and analysis. Thus second and the third chapters are addressed respectively to the analysis of the domestic and international aspects of growth. These two aspects have been separately dealt with so that each can be viewed within its own penumbra. Though, ordinarily these two aspects are highly interdependent.
The subject matter of the fourth chapter comprises of the two crucial aspects, namely costs and benefits, of foreign aid. Herein are examined the different implications of these concepts and the various views about their evaluation.

The fifth chapter is an attempt to present in a critical way the factual informations regarding India's external debt position as it developed during the period of the study. Informations regarding magnitude, sources, interest rates and maturity periods are presented in details.

The sixth chapter examines the absorptive capacity of India with regard to foreign assistance. An attempt is made here to quantify the impact of foreign aid on the macro-economic variables like saving, investment and national income.

The seventh and the eighth chapters are dealing with the developments in the industrial sector and the foreign trade sector in their relevance to foreign aid. The nineth chapter constitutes the critical examination of the debt servicing capacity in terms of its different determining variables such as interest rates, maturity periods and grace periods. In the concluding part of this chapter the thesis of the work is elaborated as to the fact that India's debt servicing capacity has shown a
uni-directional growth with economic development.

The tenth chapter is just an epilogue containing some additional observations which emerged in some pensive moments occurring after the fullstop of the previous chapter, the mention about which was found worthwhile.

Most of the chapters are divided into sections so that the specific theme discussed may be very well highlighted. Sections are indicated by Roman figures.

**Statistical Informations**

As stated earlier a lot of sifting of data was called for, for deriving and establishing certain conclusions. The resultant statistical informations are presented in the body of the text wherever the argumentation is following the factual position. Other statistical particulars are provided in the statistical appendix. Certain tables are worked out at length, the objective being that the whole view, instead of being only a piecemeal and detached one, may be comprehensive and integrated one. For, the impact of foreign aid can be better grasped with a long perspective.
NOTES AND REFERENCES

1. The countries with a low level of income per head of population are called 'pre-industrialized', 'primary producing', 'backward', 'under-developed', 'less developed', 'developing', and 'emerging' nations by social scientists. For the sake of convenience and clarity the present study has chosen the expression 'developing countries' which is free from the ambiguity of the terms 'primary producing', 'rich', and 'poor' countries.


3. The two terms 'economic growth' and 'economic development' should be distinguished from each other. For,
a country may experience development in terms of rising investment in infrastructure and other sectors of the economy with or without growth, because of the long gestation periods and low income yields typically associated with the early stages of capital formation. Similarly growth may take place without development. However, growth implying a structural change is a long run phenomenon; whereas development of an economy is constituted by its growth in terms of changing structure. Therefore, growth and development in the long run are synonymous terms and are used interchangeably in the present study. A discussion of growth and development aspects may be found in the following works: Maurice Bye, "The Role of Capital in Economic Development" in H.S. Ellish and H.C. Wallich (eds.), Economic Development for Latin America, op. cit., pp. 110-111; W. Arthur Lewis, The Theory of Economic Growth (London: George Allen and Unwin Ltd., 1963, sixth impression), p. 11.
