CHAPTER I
THE FRAMEWORK

1. STATEMENT OF THE PROBLEM

The moment a developing country starts taking rapid strides on the path to accelerated economic development, it begins to experience a foreign exchange constraint in financing its import bill for a wide range of goods and services involving capital goods, technical know-how, essential raw materials, etc. This foreign exchange constraint can be overcome in three ways: (a) Foreign aid, i.e., inflow of external resources in the form of financial assistance or foreign capital investments, etc.; (b) Import restriction and/or import substitution; and (c) Expansion of export earnings or export promotion.¹

When imports are financed by foreign aid, the implementation of a country’s development plans becomes uncertain inasmuch as the quantum, quality and timing of such an aid depend on the relations between the two countries. More often than not, foreign aid is used to exert pressure on the foreign policies as well as the internal economic and political policies of recipient countries. When the recipient country adopts an independent

policy or resists any pressure, the 'aid' is stopped or reduced. Thus, the whole economic programme of the recipient country is disturbed. Again, in case of foreign aid, the sources of supply in respect of imports are usually restricted to the market of the lender and as such, taking the advantage of this situation, the prices are invariably marked up by the sellers of the lending country. Where the aid takes the form of loans, the recipient country has to pay huge amounts by way of interest on such loans. It would, thus, follow that dependence on aid, even if it were available according to the requirements of the developing country, is at best a precarious and temporary support.

Import substitution (or restriction) is used by many developing countries as a means to increase their net capacity to import only the capital goods required for economic growth. They do not spend their foreign exchange resources on the import of consumer goods and intermediate goods which could be locally produced. However, there are serious limitations to the strategy of development planning based on import substitution. While in some cases import substitution may be physically impossible for want of sufficient diversity of natural resources, in some other cases it may be economically inexpedient. Creation of import substitute industries carries with it the dis-advantages of narrowness of domestic markets, diseconomies
of scale, high cost of production, and retaliatory protective measures from other countries. Import substitution curbs competition at home and thus breeds inefficiency, and provokes other countries to retaliate by erecting tariff walls against the imports from such countries. Import substitution may also lead to inefficient allocation of the country's scarce resources.

In view of the serious drawbacks of foreign aid and import substitution, as mentioned above, it may be said that if the development of an economy is not to be hampered by a periodic emergence of exchange crisis, export promotion activities should figure prominently in the strategy of economic development of the developing countries. The export promotion helps economic growth of a country through the earnings of foreign exchange which are used for financing the import requirements and servicing the debt burden. Added to this, export promotion also offers escape from the limitations set by the narrowness of domestic markets which is the main handicap of developing countries. Given the limited domestic market, large scale development with maximum output and minimum cost of special resources is not possible. This problem can be solved if the increased production resulting from the expansion of one or more industries is exported and disposed of in the external markets. The increased earnings from exports will also set in its course a multiplier-accelerator process which
through increasing the effective demand of the people would extend the limits of domestic markets. The expansion of domestic market and higher levels of consumption result in the establishment of new industries at home which may or may not be directly connected with exports. Not only the fact that the export trade works as a strong motive force for the starting and developing of new industries, but also the overhead facilities which have to be provided for the export industries constitute an important source of large external economies to other enterprises as well.

In view of all this, export promotion appears to be the natural answer to some of the fundamental dilemmas of economic development. The exports constitute a key sector, the promotion of which is necessary for the developing countries. In fact, it is now universally recognized that export promotion is a vital pre-requisite for the economic progress of developing countries. However, while the need for export promotion in developing countries is great, most of them in their efforts to expand exports have to face formidable problems resulting from the structure of their export trade. The exports of developing countries are mainly in the form of agricultural goods, minerals, and comparatively easily manufactured consumer goods, such as textiles, leather manufactures, etc. The world market for such commodities,

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leaving aside the case of these countries producing petroleum and some metals, tends to increase sluggishly due to many structural factors at work in developed countries, viz., low income elasticity for basic goods in the developed countries, where income and food consumption are already high; wide spread use of synthetics and substitutes and diminishing input of raw materials in production; and increasing output of primary products in developed countries as a result of domestic policies as well as increases in productivity stemming from advanced technology. Therefore, the scope for long-term expansion of exports from developing countries will continue to be limited unless they change their export mix in favour of manufactured goods. It is here that the world demand is growing rapidly.\(^3\) Realizing the importance of exporting manufactured goods, some of the developing countries like India have started diversifying their export trade with increased accent on the export of engineering goods, capital goods, project equipment, complete plant and machinery and consultancy services. But, in exporting their manufactures, the developing countries are faced with numerous difficulties including the competition from the giant industrialized countries which have got established markets for their products.

The competition is not confined to price, quality, delivery and after-sales service, but it also extends to

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transactions involving countries to offer large value export orders as have ability and willingness to offer competitive credit terms.

The developed countries like the U.S.A., the U.K., Germany, France and Japan have established sophisticated export credit system to (i) provide adequate pre-shipment and post-shipment credit (supplier's credit and buyer's credit); (ii) cover the commercial and political risks associated with exporting on credit; (iii) provide export credit and credit insurance facilities on liberal terms and conditions. This enables the exporters of these countries to offer liberal credit terms to overseas buyers.

These developments in the export credit systems of the developed countries have added a new dimension to the problems faced by developing countries in their efforts to

promote exports. Developing countries being new entrants in the world market for manufactured consumer goods, light engineering goods, capital goods, etc., with greater needs for increasing and diversifying exports, have perforce to offer extended credit terms to meet credit competition from the suppliers of the developed countries. This, however, pre-supposes the existence of an efficient export credit system. It can hardly be overemphasized that if a country develops an efficient export credit system, it will contribute to the success of the export drive.

It is in this background that the present study seeks to examine "export credit and export credit insurance in India". Before doing so, it would be useful to clearly indicate the meaning and scope of the terms 'export credit' and 'export credit insurance' and also to state clearly the criteria that would be used in this study.

2. MEANING OF THE TERMS

(a) Export Credit

There does not appear to be any unanimity on the definition and scope of the term export credit or finance.


According to P. B. Satagopan, a very simple definition of export financing that can help in understanding the basics of the subject is that it is financing needed by an exporter for carrying out an export order. An exporter may need finance at two distinct stages of an export transaction: pre-shipment and post-shipment stages. This definition does not restrict export finance availability to any specific source of supply and may, therefore, be said to include not only the commercial banks but also all other sources from where the exporter obtains finance. According to Prof. K. N. Mehrotra, export credit refers to the credit extended to exporter for financing the export transaction. This definition does not restrict the scope of export credit to any specific type of credit or to any specific source of supply. Therefore, this may be said to include both pre-shipment and post-shipment credit secured by an exporter from an outside source such as bank. It does not include exporter's own funds as may be clearly inferred from the use of the term 'credit' in place of 'finance' in this definition. E. D. Sassoon Banking Company Limited, London, has defined export finance as "the credit necessary to cover the period from shipment until payment has been received in full, i.e., post-shipment finance." As is

7 P. B. Satagopan, op. cit., p. 5.
clear, this definition leaves out of its scope the pre-shipment credit, and exporter's own funds. According to William Burt, it refers to "the provision of financial assistance either to the seller or to the buyer by an outside source, such as bank, for the period during which the goods are in transit and any additional period that may be arranged to cover special circumstances." This definition too covers only post-shipment credit but it is broader than the previous definition as it includes under its purview 'buyer's credit' also. It excludes the pre-shipment credit and exporter's own funds. According to C.R. Basu, export credit means "the provision of funds to facilitate the carrying of commodities from the point of manufacture to the point of delivery". This definition covers only the credit needed by an exporter for the carriage of goods from the place of manufacture to the place of delivery. Obviously, this does not cover the credit needed by an exporter before the shipment of goods for financing the purchase, processing, manufacturing or packing of goods. Similarly, the credit needed by an exporter after the delivery of the goods to the foreign buyer, i.e., the credits which are generally known as deferred credits, are also not covered by this definition.


Logically speaking there appears to be no special reason for restricting the scope of export credit only to pre-shipment or only to post-shipment credit, as has been done in some of the definitions analyzed above. In the interest of export promotion, the export credit has got to be made available at pre-shipment as well as post-shipment stages so that the exporters do not face any difficulty (i) in financing the purchase or procuring the raw materials or manufacturing and/or packing the goods for export; or (ii) in obtaining finance against the shipping documents when they extend credit (short-term or medium and long-term) to the foreign buyers. The term export credit should, therefore, refer to credit provided at both pre-shipment and post-shipment stages. Further, as a measure of export promotion what matters is the credit or finance made available to the exporters by an outside source such as the banks. The use of the term export credit interchangeably with export finance would also suggest the adoption of such an approach. In view of this, it may be more appropriate if the export credit or finance is taken to mean the provision of finance to the exporter by the commercial banks. Accordingly, the term export credit or finance for the purpose of this study has been taken to mean the credit provided to the exporters by the commercial banks between the time of receipt of export order and the receipt of export proceeds, i.e., pre-shipment credit as well as post-shipment credit (including deferred payment export credit).
Before attempting to give the definition of export credit insurance, it would be useful to indicate the meaning of pre-shipment and post-shipment credit more clearly.

According to the Reserve Bank of India, the pre-shipment credit may constitute any loan to an exporter for financing the purchase, processing, manufacturing or packing of goods. This kind of credit is in the form of working capital advances, loans, cash credits and overdrafts - of self-liquidating nature being liquidated generally through the negotiation of relevant export bills, receipt of export proceeds from abroad, or out of export incentives, duty drawback claims, etc.

The post-shipment credit is defined by the Reserve Bank of India as "any loan or advance granted or any other credit provided by an institution to an exporter of goods from India from the date of extending the credit after shipment of the goods to the date of realization of the export proceeds and includes any loan or advance granted to an exporter, in consideration of or on the security of any drawback or any cash payment by way of incentive from the Marketing Development Fund or any other relevant source." Thus, the post-shipment

12 Memorandum on pre-shipment credit scheme to all scheduled commercial banks vide Reserve Bank Circular No. DBOD. No. BM/78/C.297 (M)-69 dated 20th June, 1969.

13 Memorandum on Export Credit (Interest Subsidy) Scheme to all scheduled commercial banks vide Reserve Bank Circular No. DBOD - No. BM/526/C.297(M)-66 dated 13th November, 1968.
credit includes any advance granted by a bank to an exporter after the goods have been shipped. Depending upon the length of credit provided by the exporter, post-shipment credit may be short-term, medium-term or long-term. The latter two are referred to as deferred credits. The deferred credit generally takes two forms: (i) supplier's credit, and (ii) buyer's credit. Under the supplier's credit, bank credit is provided to a supplier in one country who extends credit to a buyer in another country to whom he has sold some goods. The buyer's credit, on the other hand, is extended directly to the foreign buyer (or his banker) by the credit institution of the exporting country or the consortium of such credit institutions in order to enable him to purchase capital goods or services on cash basis. It may, however, be added that although the buyer's credit scheme involves a loan to a foreign buyer or his bank, the loan entails no transfer of funds from one country to another. The lending institution makes payment to the supplier against shipment in accordance with the instructions of the buyer (the borrower).

A special variant of buyer's credit is known as 'line of credit'. A line of credit is provided by a bank or a specialized financial institution, or any purchasing organization in the buying country. A line of credit can


15 P.B. Satagopan, op. cit., p. 11.
also be extended by one government to another. The effect of the line of credit is the same as that of the buyer's credit: the supplier is paid cash against exports, and the beneficiary of the credit makes payment to the lending institution after the agreed credit period.  

(b) Export Credit Insurance

According to P.B. Satagopan, "the export credit insurance is basically insurance to the exporter against the possibility that he may not receive payment or not receive it on time for an export he has made on credit terms." This definition restricts the export credit insurance to insurance policies and does not cover the bank guarantees offered to the financial institutions in respect of the export credit and guarantees given by them to the exporters. Moreover, it does not specify the risks which are covered by the export credit insurance. Prof. K.N. Mehrotra defines the export credit insurance in these words: "export credit insurance covers risks falling into two broad categories: commercial and political. Commercial risks cover both insolvency and protracted default or undue delay on the part of the buyer. Political risks, usually beyond the control of exporter or buyer include losses.

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16 P.B. Satagopan, op.cit., p.11.
17 Ibid., p.6.
caused by political events such as war, rebellion, expropriation, restrictions or import controls imposed by the buyer's government".\textsuperscript{18} This definition expressly states the risks covered under the export credit insurance. But it does not clearly bring out the function of export credit insurance, viz., issuing of insurance policies and issuing of bank guarantees. It may be pointed out that the export credit insurance is needed both by the exporters and the financial institutions against the various commercial and political risks. It may either take the form of insurance policies offered to exporters or guarantees offered to financial institutions. Therefore, a correct definition of the term 'export credit insurance' would cover both insurance policies and guarantees. Accordingly, for the purpose of this study, the export credit insurance has been defined as the insurance to the exporter and the financial institutions offered under policies and guarantees against the possible losses, caused by the occurrence of commercial and political risks associated with selling abroad on credit terms.

3. \textbf{CRITERIA}

As observed earlier, a successful export drive assumes the existence of an efficient export credit and credit insurance system. But how is efficiency of the system in

this regard to be understood? In other words, what are its indicators? One way to approach this problem is to apply the concept of efficiency as it is applied to an undertaking. When the concept of efficiency is considered in relation to undertakings or enterprises, i.e., at the micro level, the appropriate definition of efficiency can be said to be one that considers it synonymous with performance or achievement. Performance of an undertaking can be measured in various ways. However, mention may be made particularly of four approaches: profit maximization; cost reduction; physical performance and performance in terms of specified objectives.19 In the case of export credit and credit insurance system, all these approaches may not be said to be applicable directly. Only some of them may be applied while in respect of some others modifications may be required. Thus, the approach to efficiency in terms of objectives may be said to be directly applicable as the export credit and credit insurance system should also have certain objectives like an undertaking. There can hardly be said to be any difference in this respect. The objectives of an export credit and credit insurance system can be said to be: (1) to meet exporter's need for adequate credit and credit

insurance; (ii) to provide the export credit and credit insurance facilities at a reasonable cost, i.e., at rates which are competitive with those of other countries; and (iii) to provide export credit and credit insurance facilities easily and speedily.\textsuperscript{20} The approaches in terms of profit maximization, cost reduction and physical performance can not be so directly applied. Profitability, cost reduction and productivity of export credit and credit insurance system have not to be viewed from the point of view of related undertakings but from that of the exporters, if the focus is to be on export promotion as has been indicated earlier. Viewed in this manner, the cost reduction would mean provision of export credit and credit insurance at the minimum or comparable cost to exporters. Profitability and productivity would have to give way to convenient and speedy availability of export credit and credit insurance. The latter may be said to be possible when procedures concerning export credit and credit insurance are rational, i.e., simple and speedy. The above discussion would indicate that the approaches in terms of cost reduction and convenient and speedy availability of export credit and credit insurance

\textsuperscript{20} These objectives have been stated by P.B. Satagopan in the following words: "An exporter seeks finance for his export operations that is prompt and easy to obtain. He also wants to get his finance at a reasonable cost. Thus, availability and cost are the basic essentials of export finance. The government of the exporter's country should, therefore, establish suitable institutions, lay down policies and guidelines, and provide facilities to the financial institutions in order to achieve the objective of meeting its exporter's needs for adequate finance at a reasonable cost". (See P.B. Satagopan, op.cit., p.49).
are included in the objectives of export credit and credit insurance as well.

It may be stated that the three criteria discussed above, viz., (i) adequacy, (ii) cost, and (iii) rationality of procedures of export credit and credit insurance are complementary to each other, and together constitute the various parts of the scheme, used in this study for evaluating the efficiency of the export credit and credit insurance system. The various criteria in their operational form will be discussed in the relevant chapters.

4. RESEARCH METHODOLOGY

(a) Collection of Data

In the collection of data and information relating to this study both primary and secondary sources have been used. The important publications and reports used in the study include:— (i) the annual published reports of the Reserve Bank of India, viz., Statistical Tables Relating to Banks in India; Banking Statistics (Basic Statistical Returns); (ii) Annual Reports and Operational Statistics of the Industrial Development of India; (iii) Annual Reports of the Export Risks Insurance Corporation of India; (iv) Annual Reports of the Export Credit and Guarantee Corporation of India; (v) Monthly Statistics of Foreign Trade of India published by Department of Commercial Intelligence and Statistics, Calcutta; (vi) Reports of various Study Groups/
Working Groups appointed by the Government of India from time to time; (vii) Specialized studies made by the Indian Institute of Foreign Trade, New Delhi; Indian Institute of Management, Ahmedabad; National Council of Applied Economic Research, New Delhi; National Institute of Bank Management, Bombay; Agency for International Trade Centre UNCTAD/GATT, Geneva; Organization for Economic Co-Operation and Development, Paris; International Monetary Fund, Washington; and United Nations Organization, New York. Moreover, certain data were directly obtained from the Reserve Bank of India and the Export Credit and Guarantee Corporation of India.

Besides getting information from the above sources, the questionnaire and interview techniques were also applied for obtaining information from the Export Promotion Councils, Commercial Banks, Industrial Development Bank of India and Export Credit and Guarantee Corporation of India relating to the adequacy, cost and procedures of export credit and credit insurance. These questionnaires were pre-tested and suitably modified before sending in the same. The questionnaires were mailed to 17 Export Promotion Councils, 14 Nationalised banks, 12 Foreign Banks in India, Industrial Development Bank of India, and Export Credit and Guarantee Corporation of India. The response of the Export Promotion Councils was very encouraging. All of them answered the questions.

21 In view of the vast number of exporters of different sizes and variegated trades it was thought proper to send questionnaires to the Export Promotion Councils, as they were considered to be having better knowledge of the issues relating to export credit and export credit insurance.

22 The Questionnaires are reproduced in Appendices I-IV.
raised in the questionnaire. Out of 14 nationalised banks, 12 banks sent their questionnaires duly filled up while 2 declined. Out of 12 foreign banks in India, only 3 banks responded. The questionnaires mailed to the Industrial Development Bank of India and to the Export Credit and Guarantee Corporation of India were duly responded.

The researcher, during the course of study also came into contact with a number of exporters, officials of the export promotion councils, bank managers, officials of the Industrial Development Bank of India and managers of the Export Credit and Guarantee Corporation of India at Ludhiana, Delhi and Bombay. The views and information obtained from them have also been incorporated at appropriate places.

For the analysis of figures relating to export credit, the year 1969 was taken as the base because the Reserve Bank of India started publishing figures relating to export credit only from this year. Moreover, many events concerning the provision of adequate and timely credit at comparable rates of interest took place around this year, as can be seen from the following instances:

(1) In 1968, the National Credit Council (NCC) was set up to determine, inter alia, priorities for loans and advances, or for investment. The Council, having regard to the availability of resources and requirements of different sectors, defined priority
sectors to include agriculture, small scale industries and exports.

(ii) In 1968, the Reserve Bank of India started fixing ceiling on export credit interest rates and introduced Export Credit (Interest Subsidy) Scheme to induce banks to advance credit at the reduced rates.

(iii) In 1968, the Industrial Development Bank of India introduced Participation Export Finance Scheme to supplement the resources of commercial banks in providing deferred payment export credits.

(iv) The Government of India nationalised 14 major banks in 1969 which, inter alia, aimed at ensuring an increased flow of credit to priority sectors including exports.

(v) The Reserve Bank of India started Pre-shipment Credit Scheme in 1969.

(vi) The Government of India passed Export Policy Resolution in 1970 which, inter alia, focussed on the need for providing adequate and timely credit at comparable interest rates as a measure of export promotion.

With regard to the export credit provided by the Industrial Development Bank of India, the figures were
available for the whole period since the inception of each scheme and hence analysis was made for each scheme since its inception. Similarly, figures relating to the export credit insurance under each scheme were available for all the relevant years and hence the performance of the Export Credit and Guarantee Corporation of India in providing export credit insurance facilities was studied since its inception.

(b) **Plan of Study**

The study is divided into six chapters. The chapter I states the problem, meaning of the terms and the criteria for testing the efficacy of the export credit and credit insurance. This chapter also gives the research methodology used in the study. The chapter II examines the development of export credit and credit insurance in India. The chapter III examines the availability and adequacy of export credit and credit insurance in India. In the chapter IV is analysed and evaluated the cost of export credit and credit insurance. In the chapter V the procedures of export credit and credit insurance have been examined. The last chapter, i.e., the Chapter VI, summarizes the main findings of the study and contains the policy implications.