

# An Empirical Analysis of India's External Debt and its Indicators

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**Abstract :** This study has been undertaken to analyse the various components of India's External Debt and its Indicators. External Debt means the portion of a country's debt that was borrowed from foreign lenders including commercial banks, governments or international financial institutions in the form of External Assistance, External Commercial Borrowings, Non-resident Indian Deposits, Rupee Debt and Short-term credit. India has been able to manage its external debt situation despite serious crises hitting our economy. India's external debt always remains within the manageable limits and the steady improvement in India's external indebtedness position has been due to prudent external debt management policy followed by the Government, raising sovereign loans on concessional terms with longer maturities, regulating external commercial borrowings through end-use, and rationalising interest rates on NRI Deposits. Nowadays careful management of external debt allowed India not to be wholly influenced by the conditionalities imposed by the multilateral funding agencies and to retain policy-making sovereignty. Analysis of External Debt Indicators shows the growth of the Indian economy as well as the less reliance on external debt, the rise in the short-term debt over these years, the relative greater capacity of India's export earnings to pay off the debt outstanding and the clear decline in the concessional aids received by India through multilateral and bilateral sources.

**Index terms :** External Debt, Indicators, External Assistance, External Commercial Borrowings, NRI Deposits

## 1.1 INTRODUCTION

The Indian experience with capital flows from 1950s to the second decade of this century reveals a paradigm shift from a prolonged period of capital scarcity to one of surplus. Capital flows may be either debt creating flows or non-debt creating flows. External Commercial Borrowings, External Assistance, NRI deposits and banking capital are debt creating flows. A debt flow is a type of foreign capital where there is obligation for the residents to repay it, whereas Foreign Direct Investments, Foreign Portfolio and Depository Receipts are non-debt flows. These inflows don't create any repayment burden.

While the hefty inflows of concessional External Assistance covered the current account deficits during the 1950s, 1960s, and 1970s, non-concessional Loans on market terms were the main sources of finance during the 1980s. In 1990-91, 90 per cent of the inflow was debt. Aftermath of the Balance Payments crisis, the aim was to encourage Foreign Direct Investments and Foreign Portfolio Investments and hence the composition of total capital inflows has changed gradually since then.

## 1.2 INDIA'S EXTERNAL DEBT

External Debt means the portion of a country's debt that was borrowed from foreign lenders including commercial banks, governments or international financial institutions in the form of External Assistance, External Commercial Borrowings, NRI Deposits, Rupee Debt and Short-term credit. These loans, including interest, must usually be paid in the currency in which the loan was made. External debt, otherwise known as foreign debt, is the component of total debt held by creditors of foreign countries that is non-residents of the debtor's country. Thus it is the amount that a country owes to foreigners, including the debts of both the country's government and its private sector.

## 1.3 COMPOSITION OF EXTERNAL DEBT

India has been borrowing both from internal and external sources since Independence. The borrowings of the Government are called Public Debt. Borrowing from internal sources is referred to as internal debt whereas borrowing from external sources is called external debt. The growth of external debt has more serious implications than the growth of internal debt. Thus, the complexities of issues involved in external debt are different from that of internal debt. In fact, the level of India's external debt and debt servicing burden have steadily gone up since Independence. Simultaneously, the composition and sources of India's external debt have undergone significant changes. Various components of debt creating flows are External Assistance, External Commercial Borrowings, Banking Capital, Rupee Debt, Short-term credit and Other Capital.

### 1.3.1 EXTERNAL ASSISTANCE TO INDIA

The economic development of a country is financed either by domestic savings or by allowing and encouraging foreign investment. But, when there is a gap between domestic savings and foreign investments and the foreign investments are not significantly forthcoming, a country can resort to seeking aid from external sources. India continues to be one of the largest recipients of foreign aid. Most of the foreign aid received by India goes to sectoral projects that finance activities including highways, bridges, mining, transport and communication. External Assistance may take the form of outright grants, loans repayable in rupees and loans repayable in foreign currencies. External assistance covers loans from both multilateral and bilateral organisations.

Multilateral Debts refer to loans and credits extended by World Bank, regional development banks and other intergovernmental agencies. Bilateral Debts are borrowings from governments, loans from autonomous bodies and direct loans from official exports credit agencies. India's major Bilateral Donors are Japan, Germany, United Kingdom, Russian Federation, United States of America, European Commission, France and Switzerland.

External Assistance was the key component of Total Capital Flows since liberalization; but external assistance declined steadily during the last two decades and India has gradually been repaying these debts since 2003-04. Conversely India has started extending its assistance to other countries in the form of both loans and grants. The major beneficiaries from India are Nepal, Bhutan, Bangladesh, Myanmar, Maldives and Sri Lanka. The share of External Assistances received in Total Capital Flows fell from 16.41 percent [US \$ 3736.5 Million of US \$ 22768 Million] in 1990-91 to 1.2 percent [US \$ 7718 Million of US \$ 643612 Million] in 2017-18.

### 1.3.2 EXTERNAL COMMERCIAL BORROWINGS BY INDIA

External Commercial borrowings (ECBs) provide Indian enterprises with foreign currency funds that may not be available in India. The cost of such funds proves to be cheaper in comparison to the cost of rupee funds. This includes market borrowings abroad by corporate entities and public sector undertakings and includes commercial bank loans and securitised borrowings. ECBs as permitted by the Government are being used as a source of finance for the Indian Corporates and Public Undertakings for the purpose of expansion of the existing capacity as well as fresh investment. Offers from unrecognised sources are not accepted. ECBs cannot be used for investment in the stock market and speculation in real estate. The term ECBs includes both the medium term borrowings with the maturity period of up to five years and long-term borrowings with the maturity of over five years.

External Commercial Borrowings stood at US\$ 4282 million during 1990-91 and grew over the period to US\$ 38,879 million in 2017-18. The annual compound growth rate of external commercial borrowings into India during these 22 years is worked out at 8.51 percent.

### 1.3.3 BANKING CAPITAL IN INDIA

Banking capital comprises three components:

- a) **Foreign assets of Authorised Dealers:** “Foreign assets” consist of (i) foreign currency holdings of Authorised Dealers, and (ii) rupee overdrafts to non-resident banks.
- b) **Foreign liabilities of Authorised Dealers:** “Foreign liabilities” of commercial banks consist of (i) non-resident deposits, and (ii) liabilities other than non-resident deposits.
- c) **Others:** “Others” under banking capital include movement in balances of foreign central banks and international institutions.

### 1.3.4 NON-RESIDENT DEPOSITS

Non-resident deposits constitute an important source of capital flows. The NRI Deposits are financial instruments that are being used by Non-resident Indians to store their savings in Indian Financial Institutions. The various NRI Deposits Schemes introduced by RBI are:

- The initial scheme in 1970 was a rupee-denominated account, the Nonresident (External) Rupee Account [NRE], with repatriable principal and interest.
- In November 1975, a foreign currency denominated repatriable deposit facility, the Foreign Currency Nonresident Account [FCNRA] was added.
- A non-repatriable scheme, the Foreign currency (bank and other) deposits [FC(B&O)D] was introduced in November 1990 which was open to both foreigners and NRIs.
- A new non-repatriable foreign currency scheme, the Foreign currency (ordinary) non-repatriable deposits [FCON] was introduced in June 1991.
- A non-repatriable rupee-denominated scheme, the Non-resident (non-repatriable) Rupee deposits [NR(NR)D] was introduced in June 1992 and the banks were allowed to fix interest rates on these deposits.
- In May 1993 a new repatriable foreign currency scheme, the Foreign currency non-resident (banks) [FCNRB], was introduced, wherein banks bear the exchange rate risks.

○ Later during 2005 Non-Resident Ordinary Rupee Accounts [NRO] was introduced denominated in Indian Rupees and the principal and interest are repatriable subject to the conditions prescribed by RBI.

NRI deposits gained momentum in 1980s in conjunction with the increasing number of Indians going to work over-seas, particularly in the Gulf countries. In order to draw their savings back to India, the government formulated NRI deposit schemes with attractive interest rates. After liberalisation four deposit schemes were wound up and at present three deposit schemes namely FCNR(B), NRE and NRO are in practice. NRI Deposits Inflows remained stagnant till 2002-03 with the inflow of approximately US \$ 10,000 million every year. Then increased gradually to reach US \$ 59,544 million in the year 2017-18. Since liberalisation NRI Deposits remain the important and stable source of capital flows.

### **1.3.5 RUPEE DEBT SERVICE**

India owes Rupee Debt to Russia from the times of the old USSR. Rupee Debt includes the outstanding defense and civilian state credits extended to India by the erstwhile Union of Soviet Socialist Republics (USSR) on favourable terms. The breakup of the erstwhile Soviet Union coincided with the Indian financial crisis of the early 1990s and resulted in a new bilateral trade regime including a debt repayment agreement. This debt repayment agreement provided for an annual repayment of about US\$ 1 billion equivalent in rupees to Russia over a period of 12 years with smaller amounts thereafter for a further period of 33 years. From the year 2011-12 India settles US \$ 75 million every year to Russia.

### **1.3.6 SHORT-TERM CREDITS TO INDIA**

This refers to debt with a maturity period of up to one year. This is usually trade related debt. Import linked short-term trade credit up to US\$ 20 million per import transaction with a maturity of one year is allowed under the Automatic Route. All applications for short-term credit exceeding US\$ 20 million for any import transaction are to be forwarded to the Chief General Manager, Exchange Control Department, Reserve Bank of India, External Commercial Borrowing Division, Mumbai. Short-term credit inflows show a gradual phase of rise and reached US \$ 29,992 in the year 2006-07; thereafter for the last ten years they witnessed massive inflows due to the favourable market conditions and reached US \$ 1,00,514 million in the year 2017-18.

### **1.3.7 INFLOWS TO INDIA UNDER ‘OTHER CAPITAL’**

“Other capital” comprises mainly the leads and lags in export receipts as estimated. The “lead and lag” occurs essentially because of the timing of recording of exports. The differences in timing of recording arises as customs data are reported when shipments take place, while banking channel data are reported when receipts are realised. Other items included under “other capital” are funds held abroad, India’s subscription to international institutions, and quota payments to the IMF remittances.

## **1.4 INDIA’S EXTERNAL DEBT POSITION**

India has been able to manage its external debt situation despite serious crises hitting our economy. Policy emphasis has been on resorting to concessional and less expensive fund sources, preference for longer maturity profiles, monitoring short-term debt, pre-payment of high cost debt and encouraging exports and non-debt creating financial flows. The analysis reveals a structural shift from the dominance of debt creating flows to the primacy of private capital flows. The proportion of debt-creating flow was only 30 per cent of the total inflow during 2005-06. But, from 2010-11 onwards the proportion of debt-creating

flows has escalated to almost half of the total inflow and it is important to note that an increased proportion of debt flow is hazardous and over dependence on these non-concessional loans led to sharp increase in debt-service obligations.

The rise in external debt during the last ten years was mainly due to higher commercial borrowings and short-term trade credits, following the high growth of the economy and strong domestic demand. The changing composition of debt in favour of commercial borrowing is also an indication of maturing market economy and the increasing role that corporate sector is playing in sustaining high growth rate. India's external debt mainly consists of major international currencies such as US Dollar, Japanese Yen, Euro, Pound Sterling, Special Drawing Rights (SDR) and the domestic currency, that is, Indian Rupee. The US Dollar denominated debt continues to be the largest with a share of 55.0 percent in the total external debt as at end-March 2018.

### 1.5 External Debt Indicators in India

External Debt Indicators determine the sustainable level of external debt. Debt "sustainability" can be defined as the ability of a country to meet its debt obligations without requiring debt relief or accumulating arrears. These indicators are primarily in the nature of ratios and thus facilitate the policy makers in External Debt Management exercise. These debt indicators are used for estimating current debt situation and its maturity structure, by identifying the vulnerabilities in the debt structure or the policy framework far enough in advance so that policy corrections can be introduced before payment difficulties arise. Table 1 gives the various external debt indicators used by India to manage the debt structure prevailing in India.

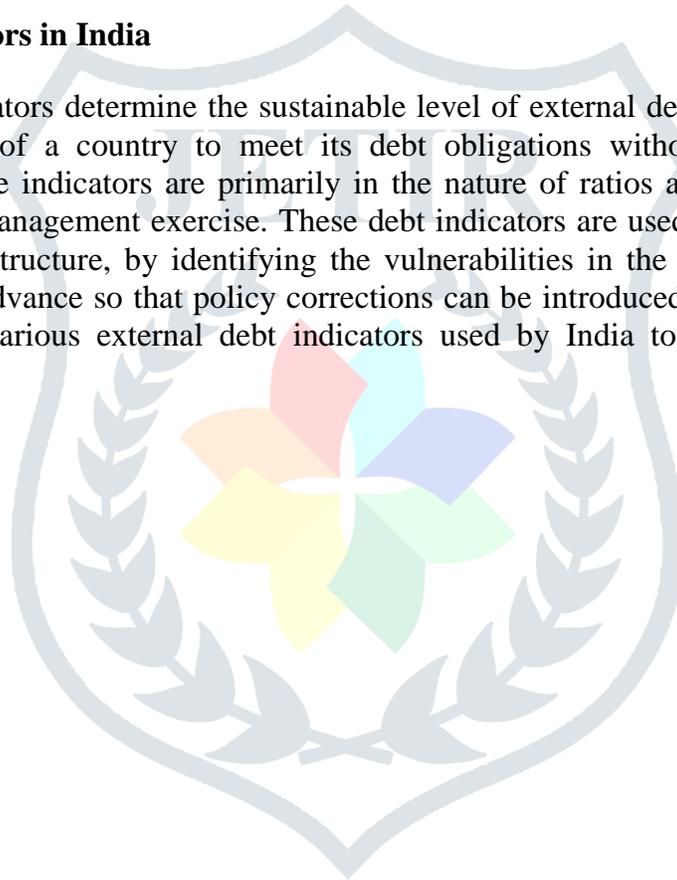


Table 1 - India's Key External Debt Indicators: 2000-01 to 2017-18

Year	Total External Debt (US\$ Millions)	Ratio of External Debt to GDP	Debt Service Ratio	Ratio of Foreign Exchange Reserves to Total Debt	Ratio of Concessional Debt to Total Debt	Ratio of Short-Term Debt to Foreign Exchange Reserves	Ratio of Short-Term Debt to Total Debt
2000-01	101326	22.5	16.6	41.7	35.4	8.6	3.6
2001-02	98843	21.1	13.7	54.7	35.9	5.1	2.8
2002-03	104914	20.3	16.0	72.5	36.8	6.1	4.5
2003-04	112653	18.0	16.1	100.3	35.8	3.9	3.9
2004-05	134002	18.1	5.9	105.6	30.7	12.5	13.2
2005-06	139114	16.8	10.1	109.0	28.4	12.9	14.1
2006-07	172360	17.5	4.7	115.6	23.0	14.1	16.3
2007-08	224407	18.0	4.8	138.0	19.7	14.8	20.4
2008-09	224498	20.3	4.4	112.1	18.7	17.2	19.3
2009-10	261014	18.3	5.5	106.8	16.8	18.8	20.1
2010-11	305931	17.8	4.2	99.6	15.5	21.3	20.4
2011-12	345819	20.0	5.6	85.1	13.9	26.6	21.7
2012-13	409400	22.4	5.9	71.3	11.1	33.1	23.6
2013-14	446200	23.9	5.9	68.2	10.4	30.1	20.5
2014-15	474700	23.9	7.6	72	8.8	25	18.0
2015-16	485000	23.5	8.8	74.3	9.0	23.1	17.2
2016-17(PR)	471900	20.2	8.3	78.4	9.3	23.8	18.7
2017-18(P)	529700	20.5	7.5	80.2	9.1	24.1	19.3

P: Provisional, , PR: Partially Revised

Source: www.rbi.org.in

**Ratio of External Debt to Gross Domestic Product:** It is a key indicator of the health of an economy. A low debt-to-GDP ratio indicates an economy that produces a large number of goods and services and probably earns profits that are high enough to pay back debts. The higher the debt-to-GDP ratio, the less likely the country will pay its debt back, and the higher its risk of default. India's external debt to GDP ratio was at 38.7 percent in 1991-92. After liberalization the ratio has been on the decline and it is down to 20.5 percent in 2017-18. This clearly indicates the growth of the Indian economy as well as the less reliance on external debt.

**Debt service ratio:** It indicates the ratio of debt service payments (principal + interest) of a country to that country's export earnings. A country's international finances are healthier when this ratio is low. Fall in India's Debt Service ratio from 16.6 percent in 2000-01 to a meager level of 7.5 percent during the financial year 2017-18 shows the relative greater capacity of India's export earnings nowadays to pay off the debt outstanding.

**Ratio of Foreign Exchange Reserves to Total Debt :** An increasing trend in the ratio of Foreign Exchange Reserves to Total Debt Stock can be witnessed from the fact that the reserves are abundant enough to cover the Total Debt Outstanding to an extent of 138 percent during the year 2007-08. But after ten years the ratio has come down and reached 80 per cent in the year 2017-18 due to the deterioration in the foreign exchange reserves coupled with the increase in external debt outstanding.

**Ratio of Concessional Debt to Total Debt :** This ratio fell down from 35.4 percent during 2000-01 to 9.1 percent during the year 2017-18, indicating the clear decline in the concessional aids received by India through multilateral and bilateral sources.

**Ratio of Short-term Debt to Total Foreign Exchange Reserves and the ratio of Short-term Debt to Total Debts:** The rise in these ratios, from 8.6 percent and 3.6 percent during 2000-01 to 24.1 percent and 19.3 percent in the year 2017-18, shows the rise in the short-term debt over these years. Large flow of such short-term credits with less maturity period will certainly pose serious problems when they mature. So the policy makers should pay attention to this alarming signal.

India's key debt indicators compare well with other indebted developing countries. According to the latest Global Development Finance of the World Bank, India's position was fifth, after China, Russian Federation, Brazil and Turkey, in terms of absolute debt stock amongst the top twenty developing debtor countries. India's external debt always remains within the manageable limits and the steady improvement in India's external indebtedness position has been due to prudent external debt management policy followed by the Government, raising sovereign loans on concessional terms with longer maturities, regulating external commercial borrowings through end-use and rationalising interest rates on non-resident Indian (NRI) deposits.

## 1.6 CONCLUSION

Gone are the days when India was considered as a third world country and was perilously on the verge of bankruptcy. When the country opened its doors to Liberalisation in the nineties, India adopted a cautious, gradual and step-by-step approach towards capital account convertibility. Initially non-debt creating financial flows were liberalised followed by liberalisation of long-term debt flows and partial liberalisation of medium term external commercial borrowing. Nowadays careful management of external debt allowed India not to be wholly influenced by the

conditionalities imposed by the multilateral funding agencies and to retain policy-making sovereignty.

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