REPORT TO THE CONGRESS 6

Developing Countries' External Debt And U.S. Foreign Assistance: A Case Study

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Department of State
Agency for International Development

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

This is our report on developing countries' external debt and U.S. foreign assistance, which focuses on India as a case study.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of State; and the Administrator, Agency for International Development.

Elmer B. Staats

Comptroller General
of the United States

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ABBREVIATIONS

AID	Agency for International Development
GAO	General Accounting Office
GOI	Government of India
IBRD	International Bank for Reconstruction and Development (World Bank)
IDA	International Development Association
IFY	India fiscal year
IMF	International Monetary Fund
OECD	Organization for Economic Cooperation and Development
SDRs	Special Drawing Rights

GLOSSARY

Aid India Consortium	A group of 13 nations, plus the World Bank and the International Development Association, joined together to assist in developing the economy of India.
Debt burden	Total principal and interest to be repaid on outstanding debt.
Debt relief exercise	Creditor nations' coordinated efforts, within a multilateral framework, to respond to a developing country's debt problems.
Debt service	The amortization of principal and interest on debt.
External public debt	Includes all debt repayable in hard foreign currency to external creditors that has an original or extended maturity of more than 1 year and that is a direct obligation of--or has repayment guaranteed by--a public body in the borrowing country.
Foreign trade gap	A negative balance of trade resulting from an excess of imports over exports.
Indian fiscal year	Begins on April 1 and, following the practice of the U.S. Government, is identified herein by the succeeding calendar year in which it ends. For example, Indian fiscal year 1973 began April 1, 1972, and ends March 31, 1973.
Net aid	A recipient country's net inflow of resources, measured by subtracting interest and amortization payments on outstanding debt from total aid receipts. From the donor's viewpoint, these elements comprise the net transfer, defined below.

Net commitments	Donor's total pledges to provide a given volume of resources within a specified period, less amounts deobligated or canceled.
Net transfer	Donor's net outflow of resources, measured by subtracting interest and amortization receipts from total aid disbursements.
Zero net aid	Point at which new lending receipts equal the amount of debt service on existing loans.

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D I G E S T

WHY THE REVIEW WAS MADE

In a growing number of developing countries, external public debt has become a heavy burden on further economic growth. By December 1970, 80 developing countries had accumulated over $66 billion of external debt. Debt service (interest and amortization) payments on this debt increased by about 18 percent in 1970, reaching nearly $6 billion. Such payments, which are expected to continue rising, represent a significant-to-critical drain on resources and underscore the developing countries' debt burden. (See pp. 5 and 6.)

The General Accounting Office (GAO) noted the debt burden of many developing countries, but limited its review and analysis to India. As a case study, India is a notable example of accelerating debt burden and affords considerable insight into the dimensions and significance of the developing world's debt-servicing problems. At December 31, 1971, India owed the United States over $3.3 billion repayable in dollars, or about 20 percent of the total dollar-repayable debt owed the United States by 80 developing countries. (See pp. 9 and 31.)

GAO made the review because the U.S. Government has a deep interest in the economic growth of the developing countries that it is assisting and in the interrelationship of such growth with foreign loans and repayments. (See pp. 27 to 30 and 46.)

FINDINGS AND CONCLUSIONS

From 1949 through March 1972, all foreign economic assistance to India totaled about $19.8 billion. The United States bilaterally has provided about 50 percent of that assistance, including over half of the grant funds and virtually all India's foreign loans repayable in nonconvertible local currency. About 35 percent (or $3.9 billion) of India's loans repayable in hard foreign currencies were received from the U.S. Government. The United States also has an indirect, but large, interest in India's $2.9 billion loans received from its second largest group of creditors, the International Bank for Reconstruction and Development (IBRD) and its soft-term affiliate, the International Development Association (IDA). (See pp. 71, 72, and 73.)

Although collectively India's donors have provided assistance on relatively easy terms, the accumulation of annual principal and interest payments rose from an average of $215 million in Indian fiscal years (IFYs) 1963-65 to $550 million in IFYs 1969-71. Gross aid disbursements to India decreased over the same period from $1.24 billion to $1.18 billion. (See p. 25)

Tear Sheet

The rise in debt service and decline of economic assistance has resulted in a decline in net assistance to India. These factors may force India to restrict necessary imports, which endangers its rate of economic growth and, ultimately, its ability to pay the growing external debt burden. (See pp. 29 and 31 to 33.)

The Consortium members collectively granted relief of about $395 million for interest and principal payments during 4 IFYs ended March 31, 1972. The objectives of the relief were to reduce the portion of export earnings required for debt payment and to free more of these resources for India's development. (See pp. 10, 11, and 14.)

Although these objectives were largely met during the relief years, the basic problems persist. Further relief was being arranged in December 1972. (See pp. 15 and 37.)

In effect, the United States, IDA, and some other Consortium countries have been providing India with net aid resources, while other (mainly Communist Bloc) countries have been repaid more--primarily in Indian exports--than they are lending to India. (See pp. 18, 19, and 22.)

The Consortium generally agrees that India's economic growth requires an inflow of net foreign assistance for some time to come. (See p. 26.)

Following the Indian-Pakistan war in December 1971, the U.S. aid relationship with India changed. Part of the development loan pipeline--about $87.6 million-- was suspended, and this suspension remained in effect until March 1973.

No development loans were made in fiscal year 1972 and no new loans or Public Law 480, title I, agricultural commodity sales have been made in fiscal year 1973. (See pp. 29 and 30.)

In IFYs 1971 and 1972 the United States bilaterally provided about 72 and 55 percent, respectively, of India's net aid from all sources. Because of easy U.S. terms, the continuation of the recent level and terms of U.S. grants and loans would net India over $100 million a year through the 1970s, even without any rescheduling of payments. (See pp. 17 and 30.)

Although the United States is the largest single creditor to the developing countries, all creditor nations are under increasing pressure to reschedule, refinance, or cancel outstanding debt. Any form of debt relief provided is comparable to new aid. And as the need for relief becomes more frequent, debt relief is increasingly an important form of economic assistance. (See p. 46.)

In GAO's opinion, debt rescheduling--as an example of debt relief--provides additional resources to assisted countries because the foreign exchange that would have been used to repay their debts remains available to pay for needed imports. (See pp. 35 and 46.)

The assistance which the United States provides developing countries through debt relief is not now included in the President's proposals to the Congress for new economic assistance. Nor is it shown in a meaningful manner in subsequent reports summarizing the actual assistance provided. GAO believes this assistance should be systematically and comprehensively reported to the Congress with the President's annual foreign assistance proposals. (See p. 46.)

RECOMMENDATIONS

Because of the growing importance of the developing countries' debt burden and the increasing frequency of debt relief exercises, the executive agencies should insure that the Congress is well informed with respect to the relationship of debt-servicing problems, debt relief, and economic assistance.

Although the executive agencies furnish the Congress with certain information on U.S.-provided debt relief, GAO recommends that the Secretary of State report more systematically and comprehensively to the Congress concerning:

--Individual countries' debt-servicing problems.

--The rescheduling of loans, which affects the availability of development loan repayment proceeds for recycling.

--Total U.S. resource transfers, including debt relief, together with analyses clearly presenting net aid flows to developing countries. The analyses should include all types and forms of debt relief granted by the United States. (See pp. 47 and 48.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

The Department of State and the Agency for International Development agreed generally with the recommendations and expressed the view that the debt service problems facing the Government of India (GOI) and the process followed by its Western creditors to assist in solving these problems were accurately reported. (See p. 48.)

In their joint letter, these agencies--believing it difficult to generalize from the circimstances of the Indian debt case--furnished additional comments designed to clarify, in a broader context, the U.S. approach to developing countries' debt problems. (See app. VII.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

Debt relief will be of growing importance in the immediate future, as developing countries experience difficulties maintaining their development programs under conditions of large and rising external debt burdens. The Congress, therefore, may wish to:

--Consider the need for it to play a larger role in determining U.S. policy concerning debt relief to developing nations and in related program oversight concerning the terms and conditions under which assistance in the form of debt relief may be granted.

--As a prerequisite in order to have essential information, consider legislation to require comprehensive annual reporting by the Secretary of State, to be submitted in January of each year and thus be available to the committees of the Congress in their considerations of authorization and appropriation proposals. Such reporting might make available for the Congress current summary perspectives of the worldwide dimensions of the debt burden problem, as well as the specifics of debt relief granted or proposed. (See pp. 49 and 50.)

CHAPTER 1

EXTERNAL DEBT OF DEVELOPING COUNTRIES

Most developing economies need resources from abroad to grow at reasonable rates. This need may well increase for some time, even with the best of self-help efforts, before the gap between resources required and the ability to generate them can be closed. Some of this resource gap continues to be filled by commercial export credits, bond issues, and private investment. However, developing nations usually need external capital well beyond what they can get from the international markets. Additional concessional financing, such as development loans and grants, for development is needed.

From 1963 through 1970 outright gifts or grants amounted to only about 17 percent of the foreign aid distributed. Most of the assistance which helps to develop these poorer countries is loaned and requires principal and interest payments in the future. The rapid rise in such payments represents a significant drain on resources and has caused concern over the debt burden of developing countries.

In his April 21, 1971, message to the Congress on proposed changes in the U.S. foreign assistance program, the President pointed out that one of the functions of the proposed U.S. International Development Corporation would be to "participate in * * * international efforts to alleviate the debt burdens of particular lower income countries." Previously, the President's Task Force on International Development, commonly known as the Peterson Task Force, referred to the debt burden of many developing countries as an urgent problem and concluded that the "future export earnings of some countries are so heavily mortgaged as to endanger continuing imports, investment, and development." Other groups concerned with foreign assistance and economic development, such as the Pearson Commission on International Development, the Development Assistance Committee of the Organization for Economic Cooperation and Development, and the World Bank, have noted that both debtor and creditor countries should give more attention to external debt and its management in developing countries.

Officials of developing countries have also expressed concern over their external debt. A representative at the September 1970 meeting of the International Monetary Fund (IMF) said:

> The problems created by ever-increasing international borrowing rates are now affecting all developing countries* * *. With interest rates rising, the cost of debt servicing is bound to rise at a faster rate than our current account receipts of foreign exchange. In terms of the usual concept of the debt service ratio, my country's position will, therefore, deteriorate in the next few years unless we are to cut back the rate of development spending as a whole. Economically, this would mean cutting back our rate of growth* * *. We are, therefore, faced with a dilemma beyond solution and unless some answer can be found to the present problem of high international interest rates, my country will have no alternative but to accept a deterioration in its debt service ratio with all that it implies for the longer term.

MAGNITUDE OF THE EXTERNAL DEBT

By the end of 1970, 80 developing countries had accumulated over $66 billion of external public debt.[1] In addition, residents of these countries owed an undetermined amount of private debt which was not guaranteed by public authorities. Total external public debt grew at an average annual rate of 12 percent between 1965 and 1970. Service (interest and amortization) payments on this debt increased almost as rapidly--11 percent each year--and reached nearly $6 billion in 1970. According to the World Bank, debt service payments are estimated to have increased in 1970 by 18 percent, about twice the average rate of the preceding 10 years. Moreover, such a high rate seems likely to continue.

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[1]Includes all debt repayable to external creditors in foreign currency that has an original or extended maturity of more than 1 year and that is a direct obligation of, or has repayment guaranteed by, a public body in the borrowing country.

The following statistics show the distribution by region of external public debt, debt service payments, and the respective growth rates from 1965 to 1970.

External Public Debt (Including Undisbursed) and Debt Service Payments of 80 Developing Countries, by Region

	Debt outstanding 12-31-70	Debt service payments in 1970	Percent of average annual rate of growth 1965-70: Debt outstanding	Percent of average annual rate of growth 1965-70: Debt service payments
	(millions)			
Africa	$10,693.5	$ 787.8	12	11
East Asia	9,195.3	614.2	19	26
Middle East	5,732.8	479.3	21	12
South Asia	14,741.6	746.4	11	14
Southern Europe	6,963.2	701.8	11	10
Western Hemisphere	19,698.5	2,560.0	10	8
Total	$66,698.5	$5,889.5	12	11

Sources: World Bank Annual Report, 1972, and GAO.

In 1965, 80 developing countries consumed about $8.4 billion in foreign aid, of which 68 percent came from loans. By 1970, 83 percent of the almost $11.2 billion in aid was from loans. With the rise in developing countries' external debt and debt service, there has been a further decline in the net transfer of resources from developed countries. The following graphs illustrate the allocations of externally provided resources[1] for 1965 and 1970, respectively.

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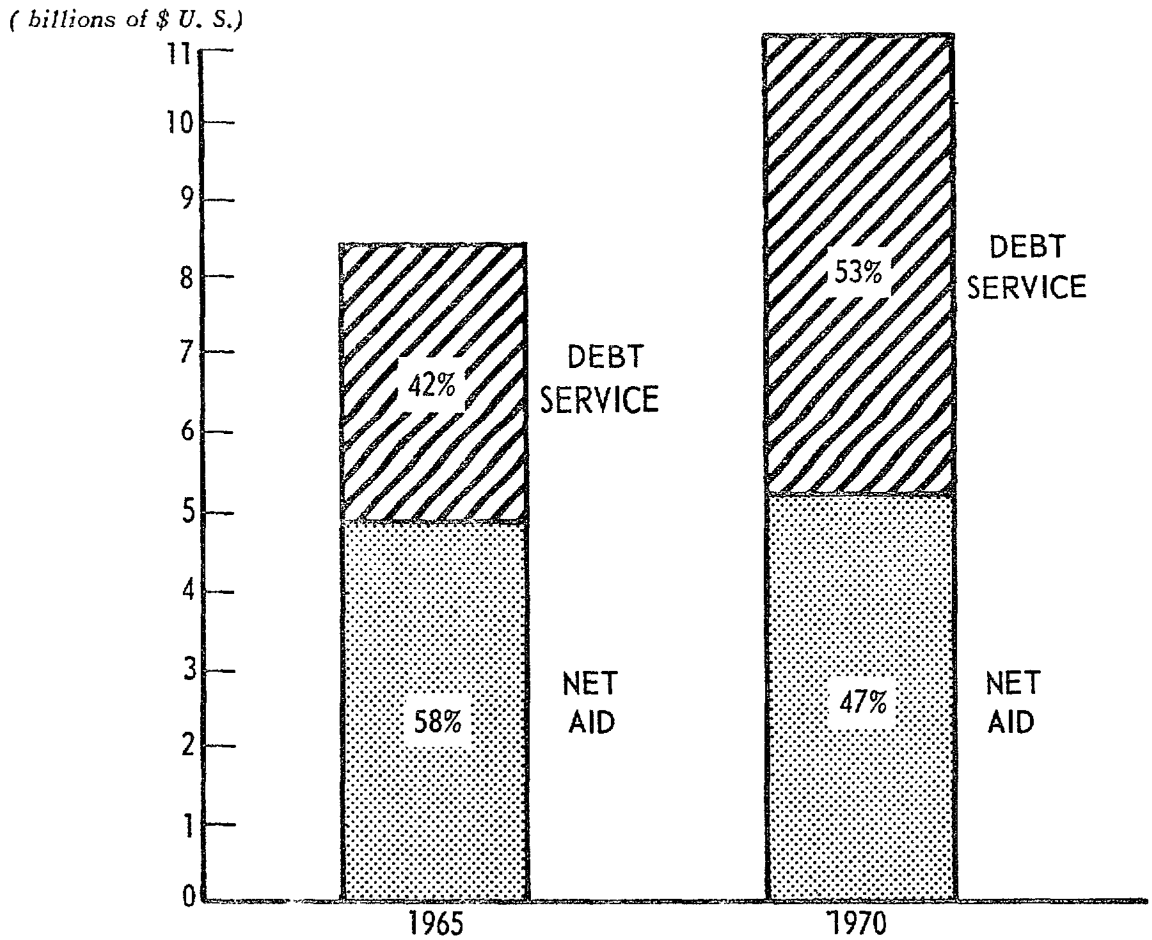
[1]Disbursements on loans, grants, and grant-like contributions.



	(Billions)	
Total external resource flows	$8.4	$11.2
Less debt service	3.5	5.9
Net aid transfer	$4.9	$ 5.3

Sources: World Bank Annual Report, 1972, and GAO.

MAJOR DEBTORS

Ten debtor nations accounted for 57 percent of the outstanding debt of 80 developing countries as of December 31, 1970. India, the largest debtor, accounted for about 14 percent of the 80 countries' total debt.

Selected statistics, for 10 major debtor countries

Country	External public debt as of 12-31-70 (note a)	Exports (f.o.b.) in 1970	Percent of average annual debt growth 1960-70	Percent of average annual export growth 1960-70
	(millions)			
India (note b)	$ 9,235	$2,026	18.4	4.3
Pakistan	4,302	723	26.0	6.3
Brazil (note b)	3,809	2,739	7.6	8.0
Mexico	3,791	1,402	13.8	6.2
Indonesia (note b)	3,463	1,009	(c)	(c)
Iran	3,022	2,354	19.0	10.8
Argentina (note b)	2,457	1,773	5.2	5.1
Chile (note b)	2,503	1,247	16.4	9.8
Turkey (note b)	2,626	589	13.2	11.9
Korea	2,637	835	(c)	38.1
Total	$37,845			

[a]Including undisbursed amounts.

[b]Had debt renegotiations during the 1960s.

[c]Not readily available.

Sources: World Bank Annual Report, 1972, and IMF publications.

During the 1960s most major debtors accumulated debt faster than their exports grew. This imbalance is important to realize because export earnings are the principal source of foreign exchange for debt repayment.

We noted the rising external debt and debt burden of the developing countries, especially the major debtors listed above, but limited our review and analysis of individual debt-servicing problems to India. As a case study, India--although unique in many particulars--is a notable example of accelerating debt burden and affords considerable insight into the dimensions and significance of the developing world's debt-servicing problems. We selected India to serve as an illustration of the total problem, as reflected in India's circumstances. Moreover, India's case illustrates many of the causes of rising debt burden, as well as efforts by the United States and other free-world creditors to provide debt relief.

DEBT RELIEF

Debt relief exercises, involving many developing countries, are occuring more frequently and are increasingly an important form of economic resource transfer. After 1956 eight developing countries--Argentina, Brazil, Chile, Ghana, India, Indonesia, Peru, and Turkey--went through multilateral debt renegotiations; most of these were triggered by actual or imminent default of the debtors. Among these countries, most of which required more than one renegotiation, are some of the largest debtors in the developing world. At least 12 other developing countries bilaterally renegotiated their debt. Pakistan suspended its foreign exchange debt service payments in 1971.

The underlying reasons for each of the multilateral debt reschedulings were different, but most were due primarily to

- --too many medium- and short-term credits used to finance imports without providing for restructuring the economy by channeling investment to export sectors whose expansion would have enabled the developing country to earn the foreign exchange necessary to service the incurred debt,

- --unexpected shortfalls in commodity exports resulting from reliance on a few commodity exports whose prices and volumes were subject to significant fluctuations, or

- --overreliance on external short- and medium-term credits as opposed to domestic savings to finance domestic investment, coupled with inward-looking commercial policies and overvalued exchange rates which inhibited export expansion.

India's debt renegotiation was preceded by a very significant increase in the debt-service-to-exports ratio and was not undertaken because of imminent default. The relatively hard terms of some past aid, combined with stagnant exports during IFYs 1965-68, raised India's debt service payments to over 27 percent of export earnings in IFY 1968. The Aid

India Consortium[1] decided that this burden was hindering India's economic development and originally agreed to provide debt relief of about $100 million for the first year of the proposed debt relief exercise for India, which began April 1, 1968.

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[1]Consists of the following donors: Austria; Belgium; Canada; Denmark; France; West Germany; Italy; Japan; the Netherlands; Norway; Sweden; the United Kingdom; the United States; and the World Bank and its soft-term affiliate, the International Development Association (IDA). Members attend periodic meetings during which they usually pledge specific amounts of aid for India.

CHAPTER 2

CONSORTIUM GIVES INDIA MORE TIME TO REPAY SOME OF ITS DEBTS

As early as 1964 India requested discussions with Consortium members about possible relief from debt repayments. The tempo of the discussions increased in 1966 and 1967, because of India's increasing burden of debt service payments. At that time such payments were expected to claim about 27 percent of India's export earnings during the 3-year period which began with IFY 1969. By mid-1967 the Chairman of the Consortium, the World Bank, still had not found a suitable way for the members to share debt relief for India.

The World Bank then asked an international financial expert to report on the problems of giving India debt relief. The Bank received the expert's report and plan in January 1968 and placed them before the Consortium for consideration in March of the same year. The report suggested that the members reduce to 20 percent India's ratio of debt service to export earnings. To do this scheduled repayments totaling $300 million over the 3 years which began with IFY 1969 should be deferred for 10 years at no interest. The Bank's original 1967 suggestion was that $80 million per year of debt payments be deferred for 8 years.

Each member's suggested share of the debt relief was to be decided by a formula which took into account the loan terms of its prior credits to India. Members who had loaned to India on easy terms were not asked to reschedule as large a proportion of their debt service due. During IFY 1967 the United States, for example, held about 36 percent of the outstanding debt and about 19 percent of debt service due Consortium members; its proposed share of debt relief was about 9 percent. Japan, a much smaller creditor whose past lending was on harder terms, held about 7 percent of the outstanding debt and about 9 percent of debt service due Consortium members. Japan was asked to supply 21 percent of the debt relief.

Recognizing the importance of lending terms, the expert also recommended that more attention be given to the terms of future aid. The Chairman of the Consortium proposed that new lending to India should have average maturity terms of 30 years, including 10 years' grace; be interest free for the first 2 years; and bear no more than 3-percent interest thereafter. Not all Consortium members have adhered to this proposal.

Because the United States did not fully achieve all its own objectives in negotiations during the debt relief exercise, it did not make a 3-year commitment. U.S. officials reasoned that a full 3-year commitment was not required and that further improvements in terms could be pressed for annually. As a result, a firm commitment was made for only the first year (IFY 1969); debt relief was subsequently granted for IFYs 1970 and 1971 and later extended through IFY 1972.

Although accepting the expert's plan, not all Consortium members met the agreed terms of the debt relief exercise. Also, as shown in the following table, the Consortium as a group provided about $5 million less in debt relief over the 4 years than called for.

Consortium's IFYs 1969-72
Debt Relief Exercise (note a)

	Debt relief proposed (note b)	Debt relief given	Grant element (note c)
	(millions)		
West Germany	$109.3	$117.5	52.0%
Japan	82.4	82.4	31.2
United Kingdom	72.3	72.0	76.6
World Bank	39.1	45.0	28.0
United States	34.9	34.9	62.0
Italy	26.9	5.5	31.2
France	20.8	19.9	33.8
Sweden	-	-	-
Austria	3.9	6.0	62.5
Norway	-	-	-
Belgium	3.7	4.4	58.0
Denmark	-	-	-
Canada	3.3	4.4	61.0
Netherlands	3.3	2.6	100.0
	$399.9	$394.6	

[a]See appendix V for these donors' cumulative debt, including suppliers' credits, as of April 1, 1970.

[b]According to AID, $300 million in debt relief was originally requested for IFYs 1969-71. The debt relief exercise was extended for IFY 1972 at the same level as in each of the preceding 3 years.

[c]Grant element denotes the quality of debt relief and depends on terms. The lower the interest and the longer the repayment period, the better the quality. (See footnote, p. 38.) Debt relief was supposed to have a minimum quality rating of 60 percent, whereas a grant would be rated at 100 percent. The U.S. annual contribution to the Consortium's debt relief exercise, rescheduling $8.7 million of the 1951 Wheat Loan for 10 years with no interest, is rated at 62 percent.

Sources: AID; IBRD; and Department of Economic Affairs, Government of India (GOI).

In 1967 the World Bank expected that India would experience rapid economic growth, based mainly on more available foreign exchange. However, only about 75 percent of the expected foreign exchange--from external aid and export proceeds--materialized during IFYs 1969-71, due largely to a decrease in foreign aid. Public investment was much restrained, and the Indian industrial sector grew slowly. As a result, by April 1971, the Consortium still faced the same economic problems that existed before the debt relief exercise. One consolation was that India's low growth rate during IFYs 1969-71 undoubtedly would have been worse without the Consortium's debt relief.

The Consortium discussed more extensive debt relief for India during 1970, but members did not agree to provide relief beyond IFY 1971. The World Bank then proposed that the IFYs 1969-71 exercise be extended through IFY 1972 at the same annual level. The Consortium generally accepted this in 1971, although expressing reservations about a long-term debt relief program.

From a ratio of about 14 percent in IFY 1962, the ratio of debt service to export earnings would have risen to an average of 29.2 percent during IFYs 1969-72 without debt relief. Even with about $395 million of debt relief, debt service absorbed an average of 24.1 percent of export earnings during the 4 years.

The World Bank agreed to make an aid and debt study to meet the Consortium's request for reconsideration of India's long-term debt-servicing prospects. The Bank's three-volume report was issued in May 1972 and gave the members a better sense of the level of external assistance needed, of how aid could best be transferred to India, and on what terms.

CONSIDERATIONS FOR CONTINUED DEBT RELIEF

In agreeing to extend debt relief for 1 more year, the Consortium noted several points to be improved before additional long-term debt relief would be considered. These points include the net aid contribution of the East European and Russian donors, World Bank participation in further debt relief to India, and India's export promotion efforts. The United States and the World Bank believe that all Consortium members must provide significant net aid for India. All these factors, except World Bank participation (see p. 19), were specifically included in the World Bank's aid and debt study for India.

The general problem is that net aid for India is declining, as illustrated by the chart on page 17, which projects the cumulative effect of new annual lending at current levels and terms, less annual debt service payments on outstanding and new loans. According to these projections, the United States and IDA[1] will continue to be India's principal sources of net aid. In reality IDA disbursements to India are expected to rise in the near future and to provide a higher level of net aid than shown in the chart.

As projected, other donors collectively will be receiving more in repayments than they disburse in new loans. The net transfer to India from all non-Consortium countries as a group was negative in IFYs 1971 and 1972 as the result of a sharp drop in their disbursements. The Communist Bloc already withdraws more in repayments than it extends in credits and is discussed in the section following the chart.

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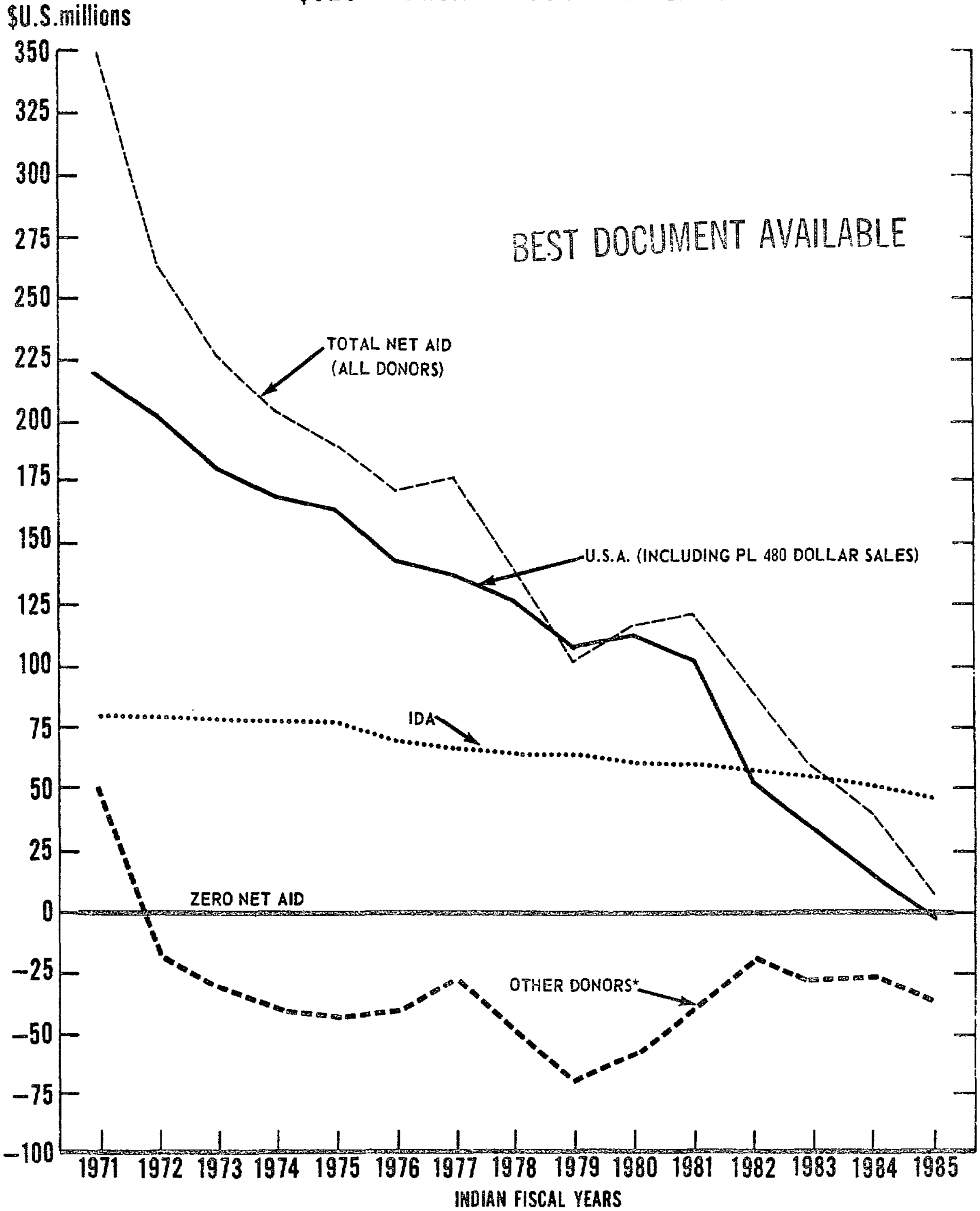
[1]The U.S. share of contributions provided by the 19 developed member countries of IDA was approximately 35 percent as of June 30, 1972.

NET AID RESULTING FROM CONSTANT LENDING OF $925 MILLION AT CURRENT TERMS



*Including Some Donors, Such As Canada, Whose Net Aid Would Remain Positive.

COMMUNIST BLOC NET AID POSITION

Consortium members and especially the United States have been pressing for parallel debt relief from the non-Consortium creditors--primarily East European and Russian--since the start of the debt relief exercise. During the negotiations GOI was reportedly reluctant to seek debt relief on the grounds that much of the debt service to these nations was not paid in foreign exchange but in Indian export goods valued in rupees. India claimed that its exports to non-Consortium nations in repayment of credits were not a substantial burden and were not comparable to free exchange repayments to Consortium members.

Some Consortium members did not accept India's argument and contended that exports to the non-Consortium nations reflected costs in materials, labor, power, and transportation. Moreover, the members observed that they would have political difficulties giving debt relief which could--in theory or fact--allow India to continue its debt repayments to the non-Consortium nations. It was also requested that India agree to try to secure parallel relief from the non-Consortium creditors.

During the negotiations for the Indian debt relief exercise, it was noted that India had talked to the U.S.S.R. about the rupee-valued debt. Consortium members expected at that time to continue discussions with GOI on the issue of obtaining parallel debt relief from non-Consortium creditors.

The United States, in its justification for continuing the debt relief exercise for the second year (IFY 1970) said:

> We, and the Consortium, have wished India to secure parallel debt relief from non-Consortium creditors, including the Bloc * * *. Previously India had argued that rupee repayment aid from the Bloc and Consortium aid could not be compared directly. In extensive interchanges at the May 22-23 [1969] Consortium meeting, the difficulty of simple comparison was noted, but the Indian representative acknowledged the need for equity in Consortium and non-Consortium debt relations * * *.

India had tried to obtain formal debt relief from the U.S.S.R. and claimed that it was receiving an overall net flow from the Bloc. The published statistics shown below, however, indicate a negative aid flow from the Bloc.

Communist Bloc Contribution to Net Aid

	Aid disbursements		Debt service		Net aid	
	IFY 1971	IFY 1972	IFY 1971	IFY 1972	IFY 1971	IFY 1972
	(millions)					
U.S.S.R.	$49.00	$22.50	$ 93.46	$54.73	-$44.46	-$32.23
Czechoslovakia	1.78	2.75	11.98	12.28	- 10.20	- 9.53
Poland	3.72	3.99	5.13	5.28	- 1.41	- 1.29
Yugoslavia	16.41	-	8.83	9.70	7.58	- 9.70
Hungary	-	.50	.36	.44	- .36	.06
Bulgaria	-	.50	.05	.05	- .05	.45
Total	$70.91	$30.24	$119.81	$82.48	-$48.90	-$52.24

Sources: World Bank and Department of Economic Affairs, Ministry of Finance, GOI.

In the meetings leading to the IFY 1972 extension of the original debt relief exercise, the United States noted that it would be extremely difficult to participate in further debt relief unless parallel relief was provided by non-Consortium nations, particularly those not providing positive net aid. The United States, the United Kingdom, and other Consortium members expressed interest in including this point in the Bank's aid and debt study, which the Bank agreed to do.

The United States is concerned that some Consortium and non-Consortium nations--primarily the Communist Bloc--will withdraw resources from India in the future because of their harder lending terms (7- to 12-year repayment periods at 2-1/2-percent interest), while easier lenders, such as AID, continue to provide net resources. Unfortunately, India has not yet received debt relief from the U.S.S.R. or other Bloc countries.

WORLD BANK PARTICIPATION IN FURTHER DEBT RELIEF FOR INDIA

In 1968 the World Bank and IDA held about 25 percent of India's outstanding debt to Consortium members. The consultant for the proposed debt relief exercise and the Consortium emphasized the importance of the Bank's participation. AID observed that, even though the Bank had avoided prior debt-rescheduling operations in other countries for fear its own credit rating would be impaired and would invite similar demands from its other debtor nations, the Indian debt relief exercise would have little effect on the Bank's credit standing. The U.S. representative reasoned that the Bank should participate in some way in the debt relief exercise to insure a successful result. The United States also believed that improvement in foreign-aid terms might improve India's ability to service its total debt, and thus enhance over the long run the quality of its obligations to the Bank.

The World Bank realized the importance which other members placed on its participation in this exercise and agreed to provide some sort of debt relief to India. A Bank spokesman commented in 1968 that, because interest must be charged and cancellation was not possible, the Bank would provide about 50 percent more relief than its scheduled share under the formula adopted, to partly compensate for its need to charge interest on the rescheduled amount. In the 1971 discussions leading up to an extension of the 3-year debt relief exercise, however, the Bank said that it would be unable to repeat its annual $15 million rescheduling. The members voiced concern about this lack of participation. The United States, for example, hoped that the Bank would be able to participate in some way--if not by adjustment of payments, then by some other measure, such as additional industrial credits. The Bank, however, did not participate in the 1972 extension of the Indian debt relief exercise.

EXPORT PROMOTION BY INDIA

In his report of January 1968 to the Bank, the expert stated that if Consortium members made a positive decision, it would be founded on the assumption that GOI would take the actions it had implied, especially in export promotion. During the discussions about the debt relief exercise, Consortium members echoed the need for maximum GOI export efforts.

In 1971 the U.S. AID Mission noted that the Indian export effort was beginning to show real progress because of the improvement shown in nontraditional exports. However, the Consortium again said that India must continue to increase its export efforts.

India's Recent Export Growth

IFYs	Value	Average annual growth	Increase over previous year
	(millions)		
1962-68	$ -	2.4%	-
1969	1,810	-	13.3%
1970	1,884	-	4.1
1971	1,950	-	3.5
1972 (estimate)	2,150	-	10.3
1962-72	-	4.5	

Sources: World Bank and GOI.

CONSORTIUM MEMBERS' NET AID POSITIONS

In 1968 AID made it clear that some brake must be placed on the worsening trend of net aid. In that same year, the United States noted that two Consortium members were already in a net negative aid position and that repayments to two others were more than half of their gross aid. At the Consortium meeting in 1971, Canada noted that continuation of the situation wherein only a few member nations provided significant net resources to India could have serious implications for the future of Canada's development assistance to India. The United States reviewed its position and noted it was a significant net aid donor to India. The following table shows the relative net aid positions of the Consortium members.

Net Aid Provided to India by Consortium Members

Consortium members (note a)	Net aid transfers (note b) IFY 1971		IFY 1972	
		(millions)		
Small:				
Austria	$ 0.1		$ -2.4	
Belgium	2.5		2.9	
Denmark	1.5		8.3	
Norway	1.7		1.6	
Sweden	3.3	$ 9.1	8.9	$ 19.3
Medium:				
France	28.5		25.0	
Italy	-7.7		-6.3	
Netherlands	18.1	38.9	5.3	24.0
Large:				
Canada	100.8		103.1	
West Germany	-14.4		2.6	
Japan	-25.3		-28.3	
United Kingdom	59.7		84.4	
United States	354.6		271.4	
IDA	52.9		118.3	
IBRD	-22.4	505.9	-36.2	515.3
		$553.9		$558.6

[a]Small--$0 to $10 million gross annual assistance; medium--$10 million to $50 million; large--over $50 million.

[b]Excludes such other forms of aid as technical assistance and U.S. Public Law 480, title II.

Sources: World Bank and Department of Economic Affairs, Ministry of Finance, GOI.

The reason for U.S. concern over relative net aid positions of Consortium members can be seen from the tables above and on page 30. The United States supplied about 36 percent of the Consortium's gross aid disbursements in IFY 1972, which represented about 49 percent of the Consortium's net aid. This situation occurred because some Consortium members were withdrawing more funds than they were providing. In other words, some members were, in effect, financing the withdrawal of funds by other members.

CHAPTER 3

INDIA'S DEBT-SERVICING PROSPECTS

The amount of outstanding external debt and debt service payments are not of themselves causes for alarm. But it is alarming when a country's debt service exceeds its ability to repay. Unfortunately, there is no precise measure of repayment capacity, as discussed in appendix I. The ability to repay ultimately depends on a country's ability to earn, save, or otherwise accumulate foreign exchange.

The development problem associated with India's increasing debt service is simply that scarce foreign exchange, either earned or borrowed, is being used increasingly to repay the principal and interest on external debt, rather than to finance needed imports.

Two simple methods of measuring the shift of foreign exchange from financing imports to paying interest and principal on external debt are:

--The debt-service-to-exports ratio. This measure concentrates on foreign exchange earnings by comparing debt service to export receipts. The ratio of India's debt service (excluding debt relief) to exports climbed from 13.8 percent in IFY 1962 to 29.1 percent in IFY 1971. The Consortium-recommended ratio is 20 percent.

--Net aid. This measure focuses on external borrowings, by subtracting interest and amortization payments from total external development assistance. The resulting amount is called net aid. India's net aid has steadily declined from an average of $1.2 billion during the drought of IFYs 1966 and 1967 to an average of about $496 million for IFYs 1971 and 1972, because India's gross foreign aid receipts have been declining while debt service has been rising.

A useful way to combine components of both measures is to show India's external receipts and their uses. This presentation avoids concentrating on just one part of the balance of payments.

Balance of Payments Summary

	Average IFYs 1963-65	Average IFYs 1966-68	Average IFYs 1969-71	IFY 1972
	(millions)			
Receipts:				
Exports	$1,606	$1,611	$1,881	$2,150
Gross aid disbursements	1,237	1,575	1,181	1,123[a]
Total available	$2,843	$3,186	$3,062	$3,273
Uses:				
Imports	$2,592	$2,802	$2,293	$2,370[a]
Debt service (including supplier credit)	215[b]	375[b]	550[c]	626[c]
Other net uses (note d)	36	9	219	277
Total use	$2,843	$3,186	$3,062	$3,273

[a]Excludes refugee assistance which amounted to $230 million.

[b]Includes only part of service on supplier credits.

[c]Excludes $394.6 million debt relief provided during IFYs 1969-72.

[d]This is a balancing account which includes changes in reserves, IBRD special deposits, IMF transactions, other capital movements, and errors and omissions.

Sources: World Bank and Department of Economic Affairs, Ministry of Finance, GOI.

In IFY 1971, as net aid decreased, India paid for more of its imports with receipts from exports. If the declining import trend had continued and, assuming ideal conditions, had not impaired industrial development, India's rising exports would soon have exceeded imports. With a trade surplus, there would have been no question of debt service consuming too much foreign exchange. Imports, however, started to rise in IFY 1971 as India continued to recover from its industrial recession. Both AID and the World Bank now estimate that imports will continue to rise. According to AID, India's low level of imports has led to substantial shortages which must be alleviated if industrial growth is not to be hampered.

A continuing trade deficit must be financed in some way--India's deficit has been essentially financed with net foreign aid. India's import level depends on export earnings plus net aid; therefore, only continuing external assistance greater than annual debt service will sustain its trade deficit.

The important question that India and its aid-givers must answer is how long will India need more imports than it can finance by exports to maintain development growth. India publicly states in its development plans that it foresees an end of net aid by IFY 1981, implying no trade gap at that time. Commenting on this goal, the Consortium stated:

> * * * we do not feel that a country whose per capita annual income is still not much above the daily pay of a skilled laborer in the United States should plan on dispensing, in the foreseeable future, with some net capital inflow on concessionary terms.

Although the U.S. aid relationship with India has changed, the United States has not estimated a date for terminating its net aid.

In an attempt to view with a longer perspective India's need for external assistance, we made six projections showing a range of possible future debt, debt service, and net aid inflows for IFYs 1971-85. These projections and our underlying assumptions concerning alternative net aid flows and India's export performance are in appendix II.

EXPORT GROWTH REQUIRED TO LOWER INDIA'S DEBT-SERVICE-TO-EXPORTS RATIO

The Consortium advocated lowering to 20 percent India's ratio of debt service to exports. India must increase its export earnings substantially to reduce this ratio from the current level of about 29 percent.

Some idea of the export growth required may be obtained from the annual debt service payments India faces under the assumed levels and terms of new lending described in appendix II. For a 20-percent debt-service-to-exports ratio, export earnings would have to be 5 times the annual debt service payments.

During IFYs 1972-85 India's export earnings would have to grow at an annual average of between 5.6 percent and

10.7 percent to lower the ratio from 29.1 to 20 percent in IFY 1985. (See app. II.) The higher the debt service levels, the higher the growth rate needed. Such rates of export growth, especially the lower percentages, are not unattainable for a developing country, even though all the required export growth rates are above India's IFYs 1962-72 average of 4.5 percent, as shown on page 21.

The short-term implications are more difficult for India. If the debt service reaches only the lowest level we projected for IFY 1974, annual export growth between IFYs 1971 and 1974 would have to be 18.4 percent to lower the ratio to 20 percent. Such growth is probably not possible.

If India were to achieve its planned annual export growth of 7 percent, a target which the World Bank thinks is too high but which AID does not, the debt service to exports ratios for all our six projections would range from 27 percent to almost 34 percent in IFY 1974.

FUTURE PROSPECTS

India has received debt relief for the last 4 years in response to the development problems associated with the foreign exchange squeeze that increasing debt service payments were causing.

India has, and is going to have, such a large debt service on existing debt that the Consortium believes the debt service will restrict India's flexibility in allocating free foreign exchange between uses and will severely tax free foreign exchange earnings and thereby obstruct the rate of growth. The debt service burden is such that it not only preempts foreign exchange from development uses but also creates the need to incur substantial additional debt.

When repayments on estimated new debt are calculated, it becomes apparent that, no matter how much or how little new assistance is made available, the terms of that new assistance are of utmost importance in abating or adding to India's future debt burden. The Development Assistance Committee of the Organization for Economic Cooperation and Development has suggested that India is "structurally over-indebted," which means that it owes so much over a long period that the prospects of foreign exchange earnings are not great enough for its needs. Other analyses indicate that India is so heavily burdened by large service payments on debt already outstanding that it cannot reduce the burden very much by decreasing new external borrowing.

CHAPTER 4

SIGNIFICANT FACTORS IN THE FUTURE ROLE OF U.S. ASSISTANCE TO INDIA

The problem of India's rising debt service should be looked at in the broader context of future economic assistance to India. In a September 1971 statement to the Subcommittee of the Senate's Committee on Appropriations, AID said: "* * * India's aid requirements are expected to rise in the face of a growing debt burden and the need for faster growth if employment and other problems are to be met." Both gross and net assistance to India, however, have plunged significantly since 1968, except for a slight rise in IFY 1972.

Four significant factors are intertwined in future U.S. aid policy toward India:

1. Dependence of India on U.S. assistance.

2. Prospects for repayment of U.S. loans.

3. Effect of India's creditors on one another.

4. Probability and advantages of coordinated debt relief for India.

DEPENDENCE OF INDIA ON U.S. ASSISTANCE

A substantial decrease in the U.S. share of total net aid over the long run would seriously impair India's prospects for sustained economic development, unless other donors increased their net aid proportionately or unless India improved its economic performance markedly. Compensating for a large decrease in U.S. aid would represent for most donors a significant increase in their recent levels of aid and for some a more liberal set of lending terms than customarily granted.

Following the Indian-Pakistan war in December 1971, the U.S. aid relationship with India changed. Part of the development loan pipeline--about $87.6 million--was suspended, and this suspension remained in effect until March 1973. No development loans were made in fiscal year 1972 and no new loans or Public Law 480, title I, agricultural commodity sales[1] have been made in fiscal year 1973.

Since the war India's leadership has placed increasing emphasis on self-reliance and has questioned the desirability--at least in the present context--of external assistance of the type and magnitude received in past years. Thus, in addition to awaiting a clarification of the nature of its future economic relationship with India, the United States will have to consider the effect of India's emerging concepts of political and economic relationships with the outside world.

Past U.S. assistance has been provided on relatively soft terms. The combination of high assistance levels and soft terms has made the United States the predominant supplier of net aid to India. In IFY 1972, as shown below, the United States supplied about 55 percent of India's net aid, a decline from the 72 percent provided the previous year.

Total Net Aid Provided to India in IFY 1972

Donor group	Aid disbursements (note a)	Debt service	Net aid	Percent of total net aid
	(millions)			
Consortium	$1086.35	$ 527.81	$ 558.54	112.3
(United States)	(393.72)	(122.33)	(271.39)[a]	(54.6)[a]
Communist Bloc	30.24	82.48	-52.24	-10.5
Other	6.90	15.93	-9.03	-1.8
Total	$1123.49	$ 626.22	$ 497.27	100.0

[a]U.S. aid such as technical assistance and Public Law 480, title II, is excluded.

Source: Department of Economic Affairs, Ministry of Finance, GOI.

[1]Title I of the Agricultural Trade Development and Assistance Act of 1954 (Public Law 480, as amended, 7 U.S.C. 1691) provided for the sale of U.S. agricultural commodities abroad for foreign currencies.

This table also shows that if U.S. assistance had not been available in IFY 1972, other donors would have had to increase their net aid by about 120 percent[1] to compensate for U.S. net aid furnished to India. Other donors would have had to increase their share by $394 million (disbursements of U.S. aid), or about 54 percent[2] above their actual level of disbursements.

A substantial reduction of U.S. loans to India would have a serious impact on the inflow of external resources. Unless the reduction was offset by increased assistance from other donors and/or the trade gap was rapidly closed, India's economic development would undoubtedly suffer.

PROSPECTS FOR REPAYMENT OF U.S. LOANS

At December 31, 1971, India owed the United States $3.3 billion repayable in dollars, or about 20 percent of the total dollar-repayable debt owed the United States by 80 developing countries. (See app. VI.)

Although India's recent export growth is higher than in the past, it appears that the large annual payments on India's debt to the United States and others will be met principally by (1) curtailment of imports at the risk of retarding economic development, (2) continued U.S. assistance, or (3) increased assistance from other donors. On the other hand, there is the less realistic possibility of default.

An important consideration in the U.S. economic assistance policy is the amount of debt service payments due from India. As of April 1, 1971, India was scheduled to pay between $100 million and $154 million each year into the 1990s on existing debt to the United States. If its present expectations hold, India may not require net aid beyond IFY 1981, although it would have to continue borrowing to bridge the gap between export earnings on the one hand and the cost of imports and debt service on the other.

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[1]From about $226 million ($497 million-$271 million) to about $497 million. ($271 million ÷ $226 million = 120 percent.)

[2]$394 million ÷ $729 million ($1,123 million - $394 million) = 54 percent.

It seems that a sudden and sharp reduction of U.S. net aid would force India to limit imports even with continued good export growth. Whether this would result in a lower rate of growth, based on lower imports, or whether other donors would provide larger amounts of assistance cannot be answered at this time. The estimated compensating amounts--just to insure zero net aid--which other donors would have to provide, if the United States terminated lending, are shown in the following table.

BEST DOCUMENT AVAILABLE

	Average		
	IFYs 1973 and 1974	IFYs 1975 and 1976	IFYs 1977 and 1978
	(millions)		
Debt service to the United States	$121	$129	$139
Debt service to others	555	553	553
Total debt service payments	676	682	692
Assumed new lending (without United States)	615[a]	615[a]	615[a]
Negative net aid	-61	-67	-77
Compensatory assistance needed from other donors	61	67	77
Zero net aid	-	-	-

[a]Assumes new lending at the current level and terms.

Sources: World Bank and our assumptions.

Without U.S. assistance, other donors would have to increase their assistance by about 10 to 13 percent[1] to offset debt service payments to the United States and to provide

[1]$61 million ÷ $615 million = 10 percent; $77 million ÷ $615 million = 13 percent.

a zero net aid flow. Even higher lending levels would be required to insure a positive net aid flow to India. The total net aid required would be determined by India's import needs and export growth.

The preceding assumes that India would, as always in the past, continue the flow of debt service payments to the United States. India's ability to continue such payments under the present condition of suspended U.S. assistance depends on its economic performance and the amounts and terms of assistance from other countries.

EFFECT OF INDIA'S CREDITORS ON ONE ANOTHER

India's growing debt burden places each of its major creditors in the position of not only affecting India directly by its aid policy but also affecting each of the other creditors indirectly. A net aid source indirectly assists India to repay those creditors currently receiving more in repay ments than they are extending in new assistance.

As our projections in appendix II show, the terms of assistance significantly affect the gross levels of lending needed to support a given level of net assistance. Harder loan terms simply require more gross lending to support a given net aid position and contribute heavily to the borrower's debt burden.

Differences in lending terms affect not only the borrower but also the lenders. All lending involves some risk. Development lending has the particular risk of whether a developing country over the long run will reach the stage of relative self-sufficiency required to repay its debt. Those creditors extending loans on relatively hard terms shift some of their risk to the softer lenders. When harder term creditors reach the stage of receiving more in repayments than they disburse in loans, they also reduce the value of assistance by other lenders which are in a net aid position.

India's debts have matured to the point where there are a number of creditors in a deficit aid position and others in very small net aid positions. The remaining lenders not only carry the principal burden of net aid to India but assist indirectly in repayments to those in a deficit position.

This principle was recognized in India's prior debt relief exercise. Consortium members whose past lending was on harder terms provided a larger share of debt relief than softer lenders like the United States. The effect of the exercise was to partially harmonize the terms of past lending. The Chairman of the Consortium proposed uniform terms for members' new loans to India.

The major effect of India's creditors on one another, therefore, stems from the differences in lending terms which affect the creditors' shares of net aid to India.

During the Indian debt relief exercise, the United States pointed out that it was the main supplier of net aid to India and called for a more equitable sharing among Consortium members of net aid. The United States also noted that most non-Consortium countries were receiving resources from India in the form of debt payments, while the Consortium was providing net aid. The United States felt that there was a need for parallel debt relief from the non-Consortium countries.

PROBABILITY AND ADVANTAGES OF COORDINATED DEBT RELIEF FOR INDIA

A monograph published in 1970 states:

> * * * a liberal approach to debt rollovers should be confined to obvious long-haul cases. Such countries will be heavily burdened by larger service payments on debt already outstanding so that they cannot reduce the burden very much by reducing new lending. They have little hope of escaping a high debt service [to exports] ratio even if their export proceeds grow at a rapid rate. These countries have little room to maneuver * * *. Extensive and liberal debt relief is the only policy alternative left. Certainly India and Indonesia fit into this category.[1]

The principal forms of economic assistance are development lending and grants. Debt relief, although normally reserved for balance-of-payments crises, can also be a form of economic assistance. In its September 1969 report on economic assistance and development, the Pearson Commission on International Development recommended that aid-giving countries consider debt relief a legitimate form of aid. Because debt relief releases free foreign exchange which is not tied to any particular project or imports, it is more valuable to the recipient country than new loans, which are usually tied.

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[1] Charles R. Frank, Jr., Debt and Terms of Aid, Overseas Development Council, Monograph Series #1, 1970, p. 45.

The World Bank is currently studying India's long-term debt servicing prospects. Our projections in appendix II indicate that India probably will need additional debt relief, at least in the short run, if debt service payments are to be held to the Consortium-recommended 20 percent of export earnings.

Debt relief can be given in several ways:

1. Moratorium--temporary suspension of debt service payments.

2. Refinancing--new loans from creditor countries which enable the debtor to make debt service payments.

3. Rescheduling--rephasing payments of interest and principal on outstanding loans.

4. Cancellation--elimination of debt service payments.

While donors may find one or more of these methods impossible because of legal or regulatory obstacles, the effect is basically the same for the first three methods; i.e., India would have more time to repay its debt. The amount of time and the terms determine the value of the debt relief to the recipient. (See note c, p. 14.)

The Indian debt relief exercise was the first multilateral debt renegotiation in which participating countries adopted a burden-sharing formula which was not directly proportional to their shares of debt service payments but which made the individual share also dependent on past lending terms. In the final agreement countries whose past lending to India was on harder terms contributed larger amounts of debt relief than did the softer lenders, like the United States. As the negotiations for and execution of the Indian debt relief exercise show, agreement on this principle was difficult to achieve. The creditor countries have different assistance policies and past lending practices and restrictive laws or regulations. The forum for discussion, however, does now exist and the problems have been well researched; hence this principle may apply in future debt relief exercises.

The burden-sharing principle was evident in late October 1972, when the United States agreed to participate for 1 year in a multilateral debt-rescheduling exercise involving $200 million of India's debt to the Consortium. U.S. participation is based upon an IBRD-proposed formula which provides for deferment of one-third of total relief in proportion to debt service due and two-thirds on the basis of past lending terms. The formula requires the United States to provide $29.12 million in debt relief in IFY 1973. Many details of U.S. participation in this rescheduling exercise had not been settled at mid-December 1972.

EFFECT OF DEBT RELIEF ON CREDITORS AND DONORS

India has received the type of debt relief that has definite advantages. It received more time to repay external debt; the foreign exchange released by debt relief was not tied to specific projects or imports; and the terms of the debt relief added little to India's existing debt.

In most cases of debt relief, the creditors granting relief realize both disadvantages and advantages which depend on the form and terms of debt relief, the original terms of loans being renegotiated, and the actions of other creditors.

The principal disadvantages to a creditor are: forgoing or delaying repayments, inability to tie the released foreign exchange to procurements in the creditor country, and a retroactive softening of terms on the affected loans.

Because the United States has consistently been a soft-term lender, its benefits from granting debt relief stem primarily from equalizing the differences in past lending terms. Debt relief which allocates burden sharing among creditors on the basis of their past aid terms serves to retroactively harmonize or equalize the difference in terms between hard and soft lenders. Thus creditors whose past aid was on the hardest terms would assume the largest share of debt relief.

Not only should debt relief be considered a legitimate form of aid but it offers certain advantages, for both lenders and borrowers, over aid:

--It is simpler to administer.

--It is frequently additional to normal aid flows.

--It has an immediate effect on recipients' balance of payments.

--It provides untied resources for recipients.

--It offers, in cases of long-term relief, the potential for multiyear planning.

A useful concept which can be regarded as a measure of donors' sacrifices and which provides a basis on which donors' aid performance can be compared is referred to as the "grant element"[1] in a loan. Softer or more concessional loans have a higher grant element. Although actual terms vary widely, the following table illustrates the grant element in loans having different terms.

Type of assistance	Interest rate (percent)	Maturity (years)	Grace period (years)	Grant element (percent)
Private suppliers' credits	6.0	9	2	16.1
Multilateral loans	5.6	25	5	32.0
Official development loans	2.0	34	8	66.6
Grants	-	-	-	100.0

In terms of grant element, a softer lender makes a larger concession on new loans than does a harder lender. If those loans are subsequently renegotiated, with burden sharing based on past aid terms as was done in the Indian debt relief exercise, the harder lender generally makes a larger concession in the renegotiation. Thus the differences in donors' terms tend to be equalized.

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[1]Calculated by discounting the value of interest and amortization payments to the present and stating this value as a percentage of the loan's face value. According to World Bank publications, 10 percent is the conventional discount rate.

SPECIAL DRAWING RIGHTS AS A FORM OF ASSISTANCE

In addition to the conventional methods of debt relief listed on page 36, an external aid concept now under consideration, involving the use of Special Drawing Rights (SDRs), could indirectly afford debt relief by halting the growth of debt service requirements. The developing nations would use additional allocations of SDRs to procure the real resources needed to sustain their present rates of economic growth. Under the simplest approach, one of several under consideration, an increased supply of SDRs would be redistributed to favor the developing nations, which would incur no present, deferred, or future debt in the process. Consequently, no debt-servicing obligations would be assumed and the developing nations could apply their scarce foreign exchange reserves to the repayment of existing debt.

Linking SDRs with development aid is one of several proposals under consideration which could affect economic relations between developed and developing nations.

Background

SDRs were established in 1969 by IMF to help meet the liquidity needs of international trade. SDRs, created under an international agreement, primarily were to provide an orderly means of adjusting the growth of world reserves to the expansion of production and trade. Sometimes called paper gold, SDRs are now internationally accepted and used as reserve assets by as many as 113 countries.

SDRs were initially allocated to participating countries in 1970 on the basis of participants' quotas[1] in IMF. This system of distribution rations the newly created assets among participating countries, virtually as a gift, in predetermined proportions. According to an executive agency study

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[1]The amount of money each country originally provided in 1945 or under subsequent amendments to help establish IMF.

prepared in early 1972, this method was chosen because it minimized disagreements at the time SDR articles of agreement were being formulated.

The present system entitles the 25 so-called developed countries to receive about 75 percent of the total SDR allocation, amounting to $9,315 million equivalent as of April 30, 1972, leaving the 88 developing countries that participate in the exercise with the remaining 25 percent.

This distribution, which gives the largest share of SDRs to a few rich countries, is not defended on equity grounds but rather on the economic grounds that the developed countries are the principal participants in international trade, hold the bulk of foreign exchange reserves, and require increases in liquidity to support expanding trade.

The purchasing power derived from internationally agreed SDR creation and distribution should serve international objectives. It would be desirable if SDRs could effectively serve more than one objective. Besides fulfilling their primary function of meeting international liquidity needs, SDRs could offer a substantial source of funds for financing foreign assistance and thereby augment the flow of development aid transfers. Developing nations are usually willing to incur debts but not able to finance them. Revising the SDR distribution scheme could help these nations, by placing more liquidity at their disposal, to finance their deficits during critical stages of growth when foreign assistance is essential.

The SDRs could be allocated to developing countries in a number of ways, such as directly by IMF or indirectly by one or more of the international development institutions. The expected result of an SDR-aid link would be increases in the developed nations' foreign exchange reserves and a transfer of real resources to the developing nations. The latter would, of course, be expected and encouraged to spend most of their SDRs on needed development-oriented resources rather than hold them in their reserves. In essence, an SDR-aid link is a potential mechanism for significantly increasing untied development aid within a concerted multilateral framework.

Views of the Congress and others

Congressional interest in an SDR-aid link has been mixed. In August 1969 the Subcommittee on International Exchange and Payments of the Joint Economic Committee submitted a report supporting a proposal to link reserve creation and development assistance, but some Subcommittee members opposed it. The House Committee on Appropriations has expressed concern over increasing amounts of aid being directed through multilateral organizations. The Senate Foreign Relations Committee, however, has called for new forms of development aid and has shown an interest in channeling a greater share of U.S. assistance through the multilateral organizations. As a form of development aid, SDRs could be effectively distributed to developing countries through appropriate international organizations.

Proponents contend that an SDR-aid link would not circumvent legislative overviews. All forms of the proposed link would be subject to congressional sanction and review. Congressional consent would be required to ratify any link necessitating an amendment to the IMF Articles of Agreement. Moreover, the Congress could at any time rescind U.S. participation in the link.

One argument against the SDR-aid link is that premature establishment of the link could disrupt additional SDR allocations and their acceptance as a monetary instrument. It has also been suggested, however, that the link may be a necessary feature of any monetary reform in order to obtain sufficient support in IMF.

The developing countries strongly support the establishment of an SDR-aid link, and a number of developed countries have indicated a willingness to consider it. Also, both the World Bank and IMF are undertaking preliminary and general studies, respectively, concerning the proposed link.

The executive agency study also concluded that linking SDRs to aid would enable the United States to obtain the level and nature of transfers necessary to attain at least three U.S. foreign policy objectives. First, aid provided by SDRs would be multilateral. This would be consistent with U.S. attempts to channel increasingly more of its foreign aid through multilateral institutions or within a multilateral framework. Second, an SDR-aid link could be used to obtain an agreement from other donors to share a greater part of the foreign assistance burden. Again, this is consistent with U.S. intent to share these financial responsibilities with other nations. Third, U.S. officials contend that a link would help win the developing nations' support for other issues concerning international monetary reform and could stem their growing discontent over the stagnation of foreign assistance flows. SDRs could provide an additional $2 billion a year or more in external financial resources for developing nations. This possibility is currently under discussion among the executive agencies.

IMF proposals for SDR-aid linkage

On September 6, 1972, IMF issued a report on reform of the world monetary system. The report outlined a variety of ways in which a new SDR-based monetary system could also be used as a link to force a more generous volume of aid and financing to developing countries. A number of possibilities were proposed for making additional SDRs available to developing countries, including

- --stipulating that a given percentage of SDRs be turned over to international development agencies,
- --obtaining agreement from the developed nations to transfer some of their own SDRs, or currency equivalents, to the international agencies,
- --giving the developing nations a greater share of SDRs than they are entitled to by their IMF quotas, or
- --enlarging the developing countries' quotas in IMF, which would give them additional benefits.

IMF is now studying these proposals and related questions associated with linking SDRs and development aid.

Prospects

Because rising debt service obligations tend to absorb new aid and because developing countries increasingly need assistance at concessional terms, the proposed SDR-aid link will almost certainly be explored further by the United States, the multilateral agencies, and the developed nations.

CONCLUSIONS

As long as external factors in the Consortium and international lending practices remain constant, it would be preferable for the United States to continue providing debt relief by reschedulings for India rather than by providing new lending at rates which could be inequitable vis-a-vis harder term creditors. Moreover, the harmonizing of retrospective lending terms benefits the United States, consistently a softer lender, because harder lenders have usually had to reschedule a larger portion of the total outstanding debt due them. Thus, debt relief can effect more equitable burden sharing among donors.

CHAPTER 5

EXECUTIVE AND LEGISLATIVE PARTICIPATION IN DEBT RENEGOTIATIONS

According to the Attorney General of the United States, the executive branch has authority to renegotiate terms of loans to countries without congressional review or approval. This is in contrast to the restrictions on executive branch authority to negotiate new loans, including statutory limitations on minimum lending terms, sources of procurement, and loans to countries in default.

EXECUTIVE AUTHORITY

The President's authority to renegotiate the terms of loans and credits to foreign governments varies with the enabling legislation. The principal ongoing programs under which foreign debts to the United States are concentrated include:[1]

1. Loans to countries under the Foreign Assistance Act of 1961, as amended.

2. Long-term dollar sales of agricultural commodities under Public Law 480.

3. Export credits under the Export-Import Bank Act of 1945, as amended.

In 1970 the United States participated with other creditors in a massive rescheduling of Indonesia's external debt. In response to a request from the Secretary of the Treasury, the Attorney General issued an opinion on December 24, 1970, stating that the executive branch had the authority to renegotiate the terms of loans and credits under the above programs.

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[1]Debt renegotiations may also include debts incurred under current or defunct programs; hence this list is not intended to be exhaustive.

For loans to countries made under the Foreign Assistance Act of 1961, as amended, this authority is provided under section 635(g)(2), which states that "in making loans under this Act, the President * * * may collect or compromise any obligations assigned to, or held by * * * him." The authority to compromise is limited by section 620(r) of the same act, which provides that:

> No recipient of a loan made under the authority of this Act, any part of which is outstanding on or after the date of enactment of this subsection [Sept. 19, 1966], shall be relieved of liability for the repayment of any part of the principal of or interest on such loan.

The purpose of this restriction, known as the Dirksen Amendment, was to prevent the conversion of loans into grants by subsequently relieving the recipient country of its liability for repayment of interest or principal.

Similarly, in his opinion on the Indonesian debt rescheduling, the Attorney General found adequate legal authority for rescheduling Public Law 480 debt and Export-Import Bank credits under the circumstances presented there.

Within the executive branch, foreign loan and credit programs are administered by several agencies, such as AID and the Export-Import Bank. These agencies are responsible for the granting of loans and credits and the actual negotiations involved in making collections.

General coordination of U.S. loan policy is a function of the National Advisory Council on International Monetary and Financial Policies. This interagency council, chaired by the Secretary of the Treasury, considers the overall debt burden in a recipient country as part of its consideration of proposed loans. The Council also considers debt renegotiations in its meetings.

Renegotiation of loan terms can release a developing country's foreign exchange which may then be used for development imports. In some instances, however, renegotiation may reduce or defer a lending nation's available resources until repayment is made. Under the AID-administered development loan program, for example, interest and principal collections are recycled into the program. Recycling of collections also reduces AID's new funding requirements in its budgetary requests to the Congress.

CONGRESSIONAL INTEREST

Although legislative restrictions on executive branch authority to renegotiate loans are few, the Congress has shown considerable interest in the ability of developing countries to repay existing debts to the United States. The Congress also has shown interest in debt relief. In the specific case of the 1970 Indonesian debt rescheduling, the executive branch informally discussed the matter with several congressional committees and later submitted a special report to them. The Congress was also consulted in the case of the Egyptian debt rescheduling in 1971.

The importance of keeping the Congress well informed with respect to debt relief matters cannot be overemphasized. The United States is the largest single creditor to the developing countries and--together with other creditor nations--is under increasing pressure to reschedule, refinance, or cancel outstanding debt. Any form of debt relief provided is comparable to new aid. And as the need for relief becomes more frequent, debt relief is increasingly an important form of economic assistance.

In our opinion, debt rescheduling--as an example of debt relief--provides additional resources to assisted countries because the foreign exchange that would have been used to repay their debts remains available to pay for needed imports.

The assistance which the United States provides developing countries through debt relief is not now included in the President's proposals to the Congress for new economic assistance. Nor is it shown in a meaningful manner in subsequent reports summarizing the actual assistance provided. We believe this assistance should be systematically and comprehensively reported to the Congress with the President's annual proposals for foreign assistance.

CONCLUSION

Although the problem of external debt varies significantly among developing countries, it is generally agreed that there is an increasing need for debt relief. Historically, debt relief has been granted most commonly in cases of default, to maximize the repayment potential of the debtor country. Most instances of consultation with the Congress have, in fact, involved cases of default where the repayment objective was paramount. Also, where debt relief has been used in nondefault cases, such as India, the Congress has generally been informed during the hearings on the AID program, although not as a part of the formal presentation.

The Congress may wish to consider the desirability of requiring the executive branch to submit more specific information on the funds released to debtor countries via debt relief, as compared to proposed development lending, grants, and other forms of economic assistance.

RECOMMENDATIONS

Because of the growing importance of the developing countries' debt burden and the increasing frequency of debt relief exercises, the executive agencies should insure that the Congress is well informed with respect to the relationship of debt-servicing problems, debt relief, and economic assistance.

Although the executive agencies furnish the Congress with certain information on U.S.-provided debt relief, we recommend that the Secretary of State report systematically and comprehensively to the Congress concerning:

--Individual countries' debt-servicing problems.

--The rescheduling of loans, which affects the availability of development loan repayment proceeds for recycling.

--Total U.S. resource transfers, including debt relief, together with analyses clearly presenting net aid flows to developing countries. The analyses should include all types and forms of debt relief--whether for development assistance or for maximizing the repayment potential--granted by the United States.

AGENCY COMMENTS

In a joint letter dated December 6, 1972, which commented on our report, the Department of State and AID said:

> The research reflected in this document is impressive both in scope and balance. The debt service problems facing the Indian Government and the process followed by its Western creditors to assist in solving these problems are accurately reported.

Both the Department of State and AID agreed generally with the recommendations presented for their review and comment. With respect to our recommendation that the Congress be informed concerning the rescheduling of loans, they commented that:

> While these [rescheduling] negotiations are conducted by executive agencies, in all cases the Congress was fully informed. In a number of significant negotiations--notably the Indonesian and Egyptian cases in 1970 and 1971--the guidance of key Congressional Committees was sought before concluding agreements.

Concerning our recommendation that executive agencies' economic assistance programs presented to the Congress identify net aid flows, the agencies said:

> A.I.D. has in the past, for those countries in which net aid flows were of major importance, presented to the Congress information on net aid, debt, and related balance of payments problems. This practice will be continued. With the onset of significant repayments on long-term development loans, as in the case of India, net aid flows will become an increasingly important measure of the usefulness of development assistance programs. (See app. VII.)

GAO COMMENTS ON THE AGENCY LETTER

AID and the Department of State agreed, in general, with our recommendations. (See app. VII.)

We still feel, however, that the Congress should be more fully and systematically informed about all debt reschedulings--in nondefault as well as crisis situations, whether the reschedulings are highly significant or relatively routine in the eyes of the executive agencies. Although reschedulings and related negotiations have generally been identified during congressional hearings on foreign assistance programs or during formal presentations, we found no indication that the Congress or its committees were subsequently and fully informed with respect to all rescheduling agreements ultimately reached, especially in routine and nondefault cases. In view of the growing importance of developing countries' debt problems to the U.S. global economic policy, all agency efforts and agreements reached to relieve debt service burdens should be communicated to the Congress.

We also believe that the importance of net aid to the developing countries cannot be overemphasized in information furnished to the Congress. The net aid concept is a useful and meaningful indicator of the real level of available resources provided by U.S. assistance programs.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Debt relief will be of growing importance in the immediate future, as developing countries experience difficulties maintaining their development programs under conditions of large and rising external debt burdens. The Congress, therefore, may wish to:

--Consider the need for it to play a larger role in determining U.S. policy concerning debt relief to developing nations and in related program oversight concerning the terms and conditions under which assistance in the form of debt relief may be granted.

--As a prerequisite in order to have essential information, consider legislation to require comprehensive annual reporting by the Secretary of State, to be submitted in January of each year and thus be available to the committees of the Congress in their considerations of authorization and appropriation proposals. Such reporting might make available for the Congress current summary perspectives of the worldwide dimensions of the debt burden problem, as well as the specifics of debt relief granted or proposed.

CHAPTER 6

SCOPE OF REVIEW

We made this review at the Department of State and AID in Washington, D.C., and at the Embassy and AID Mission in New Delhi, India. Limited work was also done at the Department of the Treasury in Washington.

We reviewed agency files and records and testimony of agency officials appearing before the congressional committees. We talked with officials of the Departments of State and the Treasury and AID in Washington and New Delhi. We also extensively used a number of general studies of the debt burden of developing countries and specific analyses of India's external debt problem.

Statistics in this report are primarily those summarized by the World Bank from data published by GOI. Other sources include AID, GOI, and IMF.

The assumptions and conclusions in this report were based on circumstances prevailing up to fiscal year 1972 and do not reflect the suspension of U.S. aid in December 1971. In focusing on India's external debt and economic assistance, we have excluded military assistance from our assumptions of future foreign assistance to that country. As far as we can determine, most military assistance is excluded from statistics on existing debt and past foreign assistance.

In his Annual Foreign Policy Report to the Congress of February 9, 1972, the President stated that the U.S.S.R. and its East European Allies had supplied India with over $730 million in military equipment since 1965. A U.S. official estimated, in testimony before the 91st Congress, that the total foreign exchange component of India's recent defense spending was about $240 million a year during 1968, 1969, and 1970. To the extent that these and other military purchases are made on credit, India's total foreign repayment obligations may be understated in this report. Similarly, estimated future debt repayments would be higher. Because military assistance estimates are incomplete and classified, we have not attempted to include them in our data on past foreign assistance, existing debt, and future debt service payments.

DEBT-SERVICING CAPACITY

> To the best of our knowledge, no one has yet succeeded in developing a set of rules which will determine, in a generally acceptable manner, the permissible limit of indebtedness of individuals or of business firms even in the domestic economy * * *. The appraisal of creditworthiness of anybody - be it an individual, a business firm or a country - is a mixture of facts and judgments.

These comments from a 1964 World Bank staff study on economic growth and external debt emphasize the difficulty of determining debt-servicing capacity. None of the studies consulted about the external debt of developing countries and specifically of India's debt claimed a precise measure of repayment capacity.

Unless the rate of return on an investment of borrowed funds is above the cost of such funds, it is impossible to meet interest and principal repayments. Also, to repay external loans, a borrower, such as India, must be able to transform the output of projects or general imports financed by foreign capital into foreign exchange for repayment. As noted in the study quoted above:

> The government of the borrowing country cannot print international money in order to pay its debts; the solution to which the debtor governments have occasionally resorted in the past with respect to their internal debts cannot be of help in meeting international financial obligations. If anything, domestic inflationary financing makes the fulfillment of external debt obligations more difficult, certainly over the short run and possibly over the long run. The borrowing country must lay its hands on international currency in order to pay its debts.

The ability of a country to service its external debt is related not only to the productive use of domestic and borrowed resources but also to its ability to earn or save foreign exchange by increasing exports and/or reducing imports.

SHORT- AND MEDIUM-TERM DEBT-SERVICING CAPACITY

In discussions of debt-servicing capacity, the distinction is sometimes made between the long-term and short- or medium-term capacity. Analysis of capacity in the short or medium term concentrates on the variables which affect the balance of payments. These variables can be classified as:

1. Fluctuating.

   a. Exports.
   b. Capital flows.
   c. Emergency and inflation-induced imports.

2. Offsetting.

   a. Reserves.
   b. Compensatory finance.
   c. Compressible imports.

3. Rigid.

   a. Minimum tolerable imports.
   b. Debt service--interest and amortization.

The basic methodology is to compare countries on the historic fluctuations in their trade and capital flows, the amount of their foreign exchange reserves to their minimum import needs, and the ratio of their debt service obligations to their export earnings and the concentration of these obligations in the near future.

An analysis involving this many variables is difficult, and there are no precise values for such variables as the minimum tolerable level of imports. Therefore simpler measures are sometimes used to indicate the likelihood of debt-servicing difficulties.

Debt service ratio

The simplest indicator used to compare countries is the ratio of interest and amortization payments to foreign exchange earnings, called the debt service ratio. Athough this is only an indicator, it is easy to understand and compute accurately. The debt service ratio has some value in indicating the potential shortrun pressures which a country may face if foreign exchange earnings fall.

No critical value for the debt service ratio has been established. However, the 1971 World Bank Annual Report noted in a comparison of debt service ratios for 79 developing countries that:

> * * * only 19 had an average debt service ratio of over 10% in the years 1965-69. It is noteworthy that among these 19 are all the countries which have had multilateral debt renegotiations except Indonesia, where the average debt service ratio over the period was 8%.

In the instance of the Indian debt relief exercise, Consortium members agreed that a 20-percent ratio should be the desirable maximum for India.

<u>Debt service and debt structure indicators</u>

Some studies used the debt service ratio in combination with the time structure of repayments. One study concluded that an index which combined the debt service ratio with the average maturity of all loans was a good predictor of debt-servicing capacity. The authors found a high correlation between this composite index and previous debt renegotiations in various countries. They stated that:

> * * * if the average maturity of debt is long, say 30 years (typical of a country like India), the critical level of debt servicing capacity is reached when the debt service ratio is 18.3 percent. If, however, the average maturity of debt is short, say 8 years (typical of a country like Mexico), the critical debt service ratio is 25.1 percent.

Applying this index to country projections of debt service and debt service ratios between 1967 and 1992, they found that the likelihood of future debt renegotiations was high for such countries as India, Indonesia, Pakistan, and Tunisia.

The Secretariat of the Development Assistance Committee, Organization for Economic Cooperation and Development (OECD), has devised another measure of debt-servicing capacity, called the 1-15 year debt burden ratio. Expressed as a percentage, this ratio is essentially a convenient summary measure of adjusted debt structure. The ratio consists of debt service due in the next 15 years to the current year's exports of goods and services. Debt service due is adjusted by subtracting from outstanding debt any foreign exchange reserves exceeding a 2-month supply of imports. A high 1- to 15-year ratio clearly indicates that the borrower has little room in which to maneuver its debt and that service payments on new debt or adjustments in the pattern of old debt need to shift beyond the 15-year period.

An OECD study observed in 1969 that such countries as India and Pakistan had very high ratios during the 15-year period and also had higher burdens falling in the first 5 years than most developing countries. Such a profile was characterized as structurally overindebted because there is no breathing period during which excess short-term debt can be shifted to a future period when debt would decrease substantially.

LONG-TERM CAPACITY

Analysis of a country's long-term debt capacity involves projections of macroeconomic variables, such as savings, investment, income, exports, and imports. The general economic considerations are: (1) a country's dependence on foreign capital to supplement its own resources, (2) the rate at which this dependence changes, and (3) the existing debt burden. If a country's resource gap is large, if this gap is expected to be closed slowly, and if existing debt service payments are already large relative to its ability to pay, the country has little capacity to service additional debt except on the softest of terms.

GROWTH AND DEBT CYCLE

The stages of economic development are sometimes described in terms of a growth-debt cycle. In the first stage of this cycle a developing country borrows abroad to finance the gap between its domestic investment and savings and the interest and amortization charges on the external debt accumulated during this stage. The second stage of development begins when the volume of gross domestic savings equals the volume of gross domestic investment. The country no longer borrows abroad to finance its investments. It must continue to borrow, however, to make service payments on the external debt accumulated in the first stage. In the third stage domestic savings are sufficient to finance all domestic investment and pay off its debt. Additional external borrowing is not required. The length of the full cycle depends on a country's absolute need for external capital, the rates of growth of income, savings and exports, and the terms of foreign borrowing.

There is nothing automatic about progressing from one development stage to another. Some countries may never advance beyond the first stage but face a continuously rising debt because their growth rates are below the cost of borrowed capital. Other countries may be so successful that they attract private foreign capital and their external debt will grow after they have reached self-sufficiency because foreign investors are eager to employ their funds in countries in which returns are large and secure.

DEBT SERVICE ASSUMPTIONS AND PROJECTIONS

The lack of firm estimates as to when India will no longer require foreign assistance and the uncertainty about the aid levels that donors will be willing to make available seriously impair the reliability of long-range estimates of future foreign aid to India. As an illustration only, we have projected a range of possible net foreign aid levels based on assumptions about new lending and possible terms of that lending. Our various assumptions, including India's long-term debt service and export growth, are explained on pages 66 to 68 but consist essentially of two lending levels and three levels of terms, as follows:

Lending levels

A. Current ($925 million annually).

B. Higher than current, yielding an amount of net aid that would cover an assumed trade gap.

Terms

1. Current (about 2.75 percent interest, 30-year maturity, and 7-year grace period on the principal).

2. Slightly softer than current. (Recommended by the Consortium for members now lending.)

3. Harder than current.

We limited our projections to 15 years, or to IFY 1985. Following are discussions about each of the six possible projections regarding net aid and debt service.[1]

A. 1. Net aid resulting from constant lending of $925 million at current terms
(See chart on p. 17.)

This projection shows that net aid would decrease from $350 million in IFY 1971 to $8 million in

[1]Debt service from each projections was added to the Indian Ministry of Finance's estimate of repayments on debt existing as of April 1, 1970, to arrive at the future levels of debt service.

IFY 1985. The debt service payments would climb from \$575 million in IFY 1971 to \$917 million in IFY 1985. If India were to receive economic assistance at these terms and at this level, it would then receive positive net aid, even though declining, at least until IFY 1985. New lending at current levels and current terms would yield about \$2.3 billion of net aid over the 15-years, while debt service would total about \$11.6 billion.

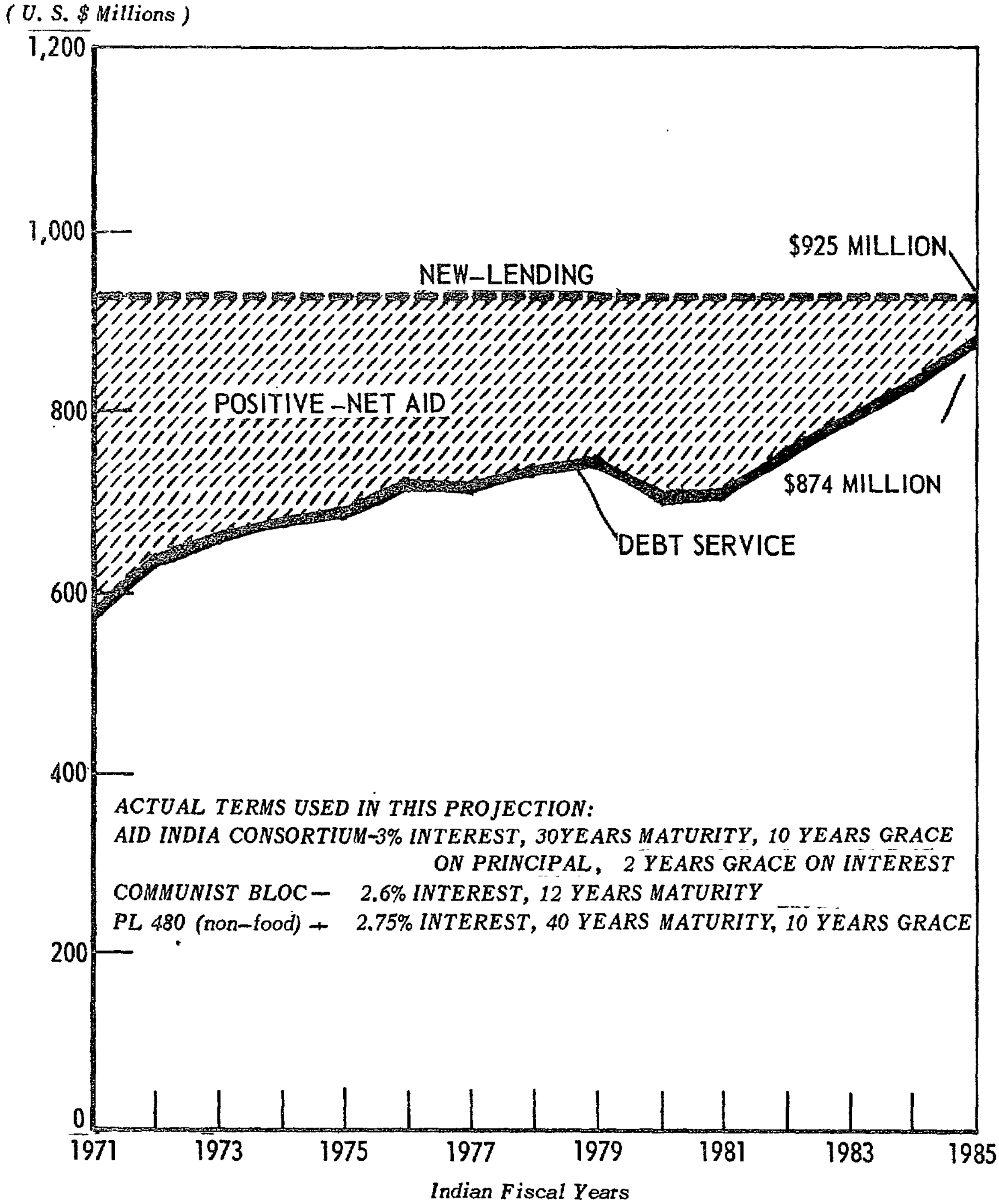
A. 2. <u>Net aid and debt service resulting from constant lending of \$925 million at slightly softer terms</u>
(See chart A, p. 60.)

This projection shows that slightly easier terms would yield about \$800 million more net aid over the 15 years. Annual net aid would fall from \$350 million in IFY 1971 to \$51 million in IFY 1985, which is a less rapid decline than when computed on current terms. Debt service would increase from \$575 million in IFY 1971 to \$874 million in IFY 1985. The 15-year net aid total would be about \$3.1 billion, while cumulative debt service would total almost \$11 billion.

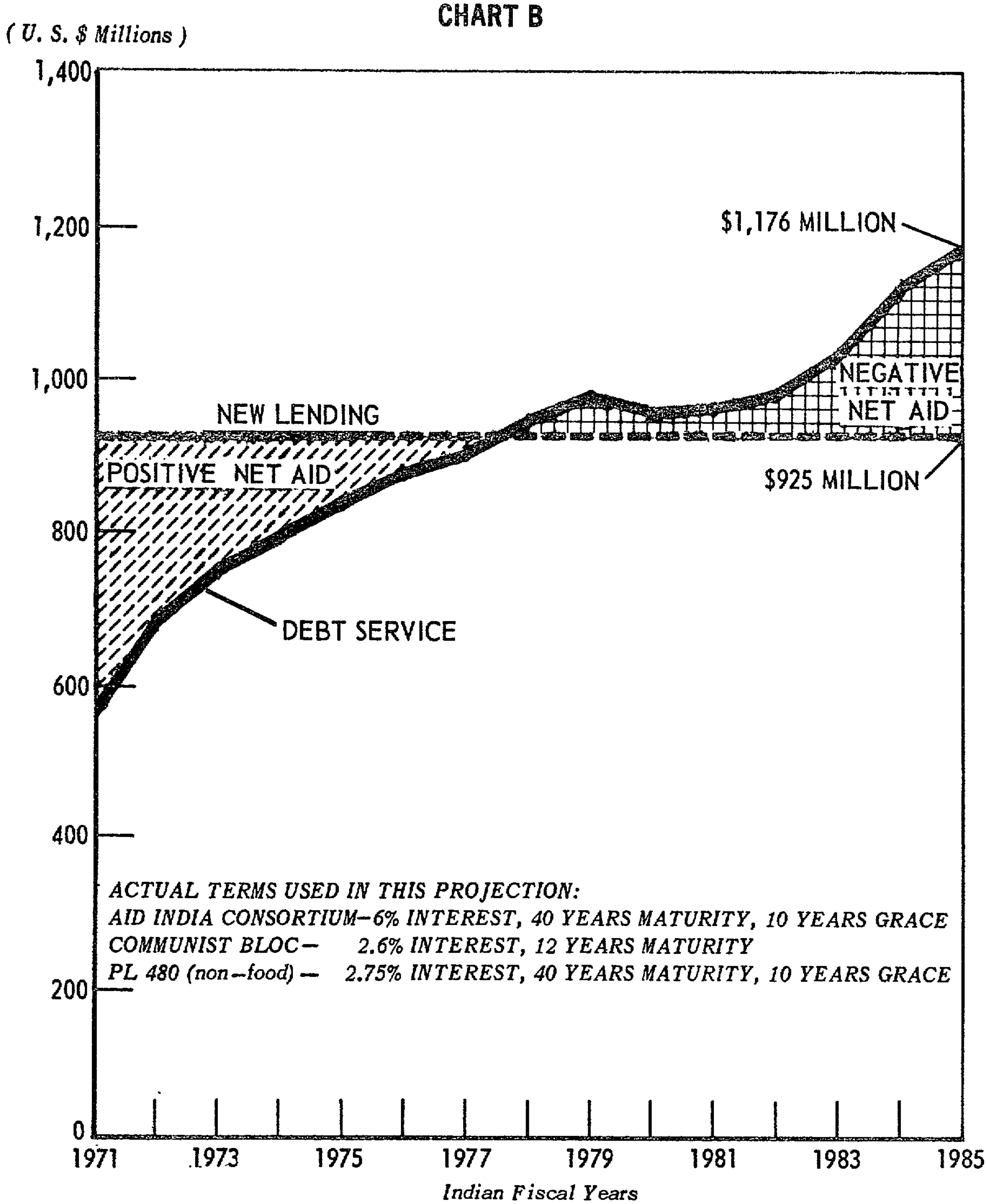
A. 3. <u>Net aid and debt service resulting from constant lending of \$925 million at harder terms</u>
(See chart B, p. 61.)

The results of these terms are not good from India's standpoint. Cumulative debt service over the 15 years would be nearly as great as cumulative current levels of new lending. Annual net aid would become negative in IFY 1978 and would decline to -\$251 million by IFY 1985. With the small, declining amounts of net aid available before IFY 1978, there is some doubt whether sufficient imports could be financed to support India's planned growth. It is also doubtful that it would continue to borrow at these harder terms when it became obvious that the net aid flow would so quickly become negative.

NET AID AND DEBT SERVICE RESULTING FROM CONSTANT LENDING OF $925 MILLION AT SLIGHTLY SOFTER TERMS
CHART A



NET AID AND DEBT SERVICE RESULTING FROM CONSTANT LENDING OF $925 MILLION AT HARDER TERMS
CHART B



B. 1. <u>Net aid and debt service resulting from higher levels of lending at current terms</u>
(not charted)

At current terms of lending, to obtain total net aid of $5.5 billion for the 15 years, India would require $18.4 billion of new borrowing. Its debt service payments would rise from $575 million in IFY 1971 to almost $1.2 billion in IFY 1985. New lending would reach $1.33 billion in IFY 1979 and drop off to $1.15 billion by IFY 1985.

To insure India significant amounts of net aid, even at the concessionary terms it now receives on development loans, would require very large amounts of new lending. Its debt service levels would also rise steadily, implying a continuing burden even after net aid was no longer required.

B. 2. <u>Net aid and debt service resulting from higher levels of lending at slightly softer terms</u>
(See chart C, p. 63.)

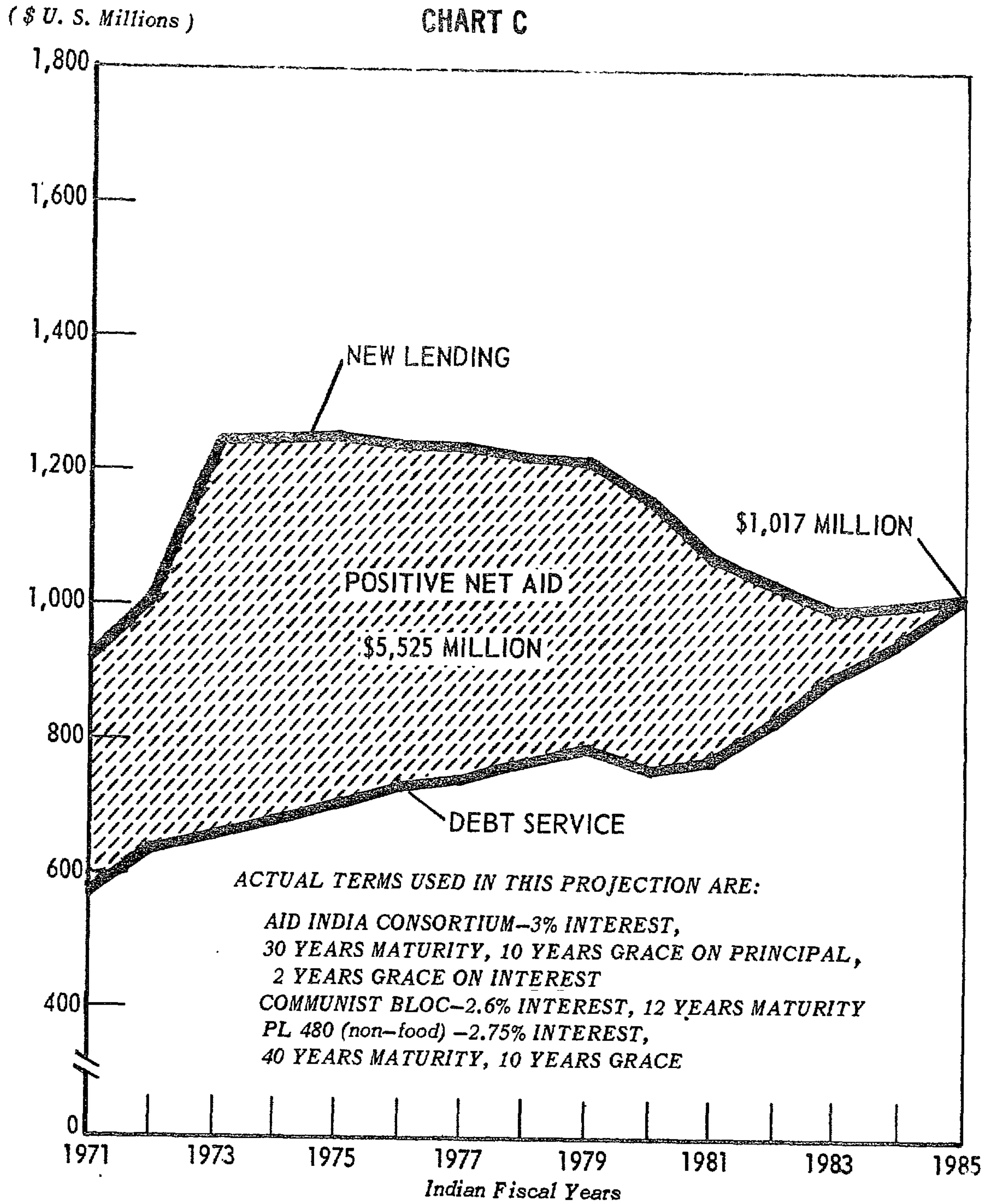
At slightly softer terms of lending, $5.5 billion of total net aid over the 15 years can be obtained from about $17 billion of new lending. Debt service payments would gradually climb to over $1 billion in IFY 1985, while new lending would quickly rise to about $1.3 billion in IFY 1973. This projection shows that the same amount of net aid as in B.1 and B.3 can be supported with less new lending because the terms are easier. Also the debt service level would be lower at the end of the 15-year projection period. (See p. 64.)

B. 3. <u>Net aid and debt service resulting from higher levels of lending at harder terms</u>
(See chart D, p. 65.)

At harder terms the new lending required to support the same $5.5 billion of net aid over the 15 years is very large--about $22.3 billion. The highest annual level of new lending would reach $1.7 billion in the projection's last year, IFY 1985. Such high levels of new lending on a

NET AID AND DEBT SERVICE RESULTING FROM HIGHER LEVELS OF LENDING AT SLIGHTLY SOFTER TERMS

CHART C



continuous basis are unprecedented in India's history. The legacy of debt that would be accumulated by IFY 1985 would imperil India's balance of payments, because of the very high debt service payments which would continue far beyond the 15 years.

RESULTS OF PROJECTIONS

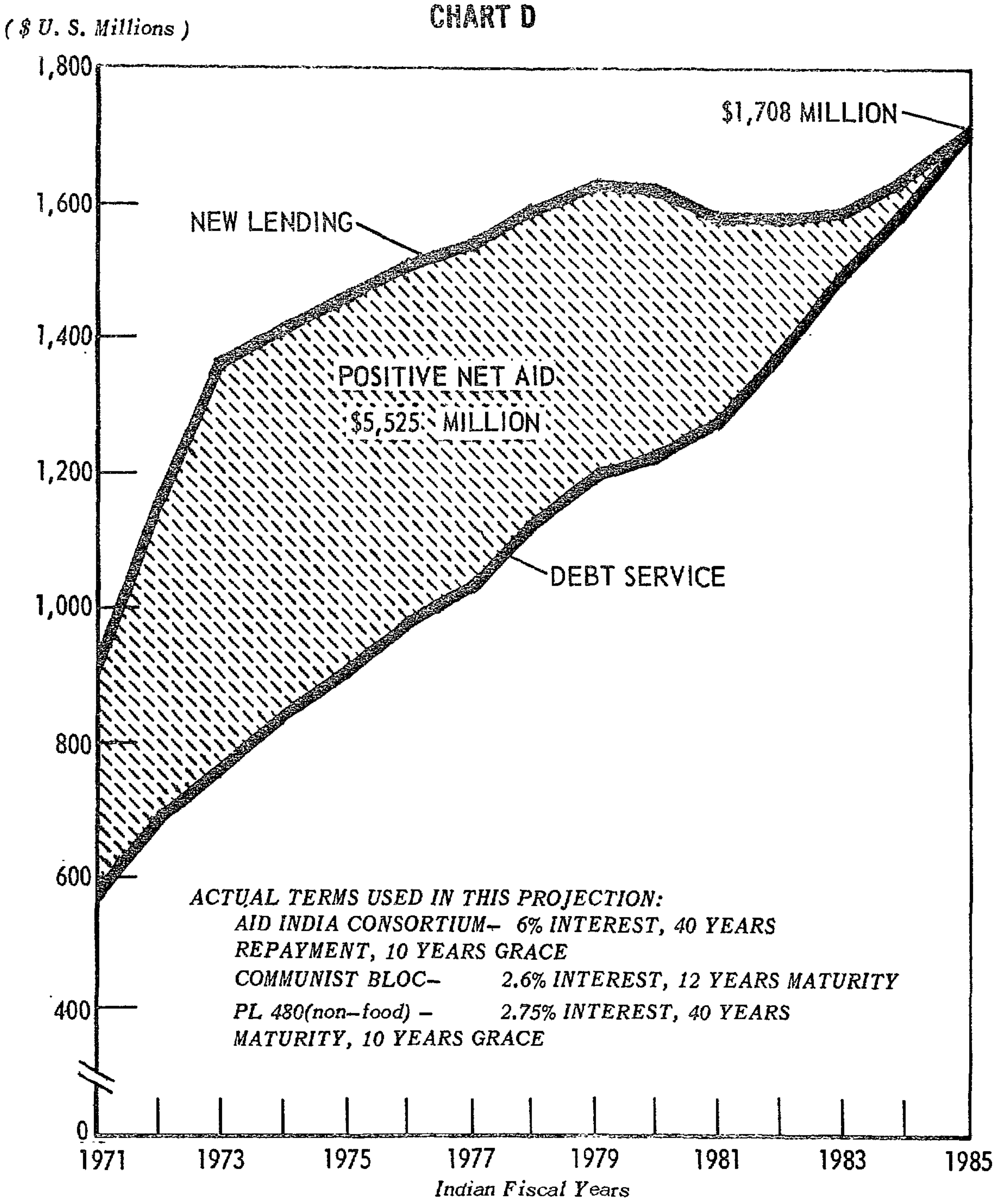
As seen from the projections, easier terms assure the borrower either more net aid if new lending is constant or a fixed amount of net aid with less new lending. The results of our six projections may be compared in the following summary table.

Results Of GAO's Six Projections
IFYs 1971-85

	Annual levels of borrowing	Projected IFY 1985 levels: New lending	Projected IFY 1985 levels: Debt service	Projected IFY 1985 levels: Net aid	Cumulative totals for IFYs 1971-85: New lending	Cumulative totals for IFYs 1971-85: Debt service	Cumulative totals for IFYs 1971-85: Net aid	Cumulative totals for IFYs 1971-85: Debt outstanding in IFY 1985
	(millions)							
Current levels of lending at:								
Current terms (A.1)	$925	$ 925	$ 917	$ 8	$13,875	$11,613	$2,262	$15,843
Slightly easier terms (A.2)	925	925	874	51	13,875	10,791	3,084	16,287
Harder terms (A.3)	925	925	1,176	-251	13,875	13,728	147	16,487
Higher levels of lending at:								
Current terms (B.1)	925 to 1,330	1,153	1,153	-	18,406	12,881	5,525	20,036
Slightly easier terms (B.2)	925 to 1,255	1,017	1,017	-	17,018	11,493	5,525	19,294
Harder terms (B.3)	925 to 1,708	1,708	1,708	-	22,307	16,782	5,525	24,792

Sources: World Bank Annual Report on India, 1971; and our assumptions.

NET AID AND DEBT SERVICE RESULTING FROM HIGHER LEVELS OF LENDING AT HARDER TERMS
CHART D



GAO ASSUMPTIONS

The assumptions which shaped our projections of future net aid and debt service are:

Levels of new lending

A. Maintaining the current level of gross lending

This figure of $925 million is made up of three segments: the Aid India Consortium's loans, the Communist Bloc credits, and nonfood Public Law 480 assistance.

For the Consortium the figure used is $800 million a year based on recent disbursements. The Communist Bloc figure is assumed to be $75 million a year. Nonfood Public Law 480 assistance, such as inedible tallow, is assumed to be $50 million annually.

None of these figures provide for grants, suppliers' credits, or food aid.

We did not include grants because recently they have been such a small part of the assistance extended to India. Food assistance was not included because of India's diminishing need for food assistance. Suppliers' credits were not included because we did not have adequate information on the rate of disbursements.

B. Lending at higher than current levels which would yield a fixed amount of net aid

We based our fixed amount of net aid on a 1970 AID study which forecast annual foreign trade gaps. We made a simplifying assumption by equating the foreign trade gap with net aid. The projection selected from the AID study estimates that the trade gap would trail off to $400 million by IFY 1980. We then arbitrarily and systematically reduced the positive net aid to zero by IFY 1985.

To achieve this fixed total amount of net aid for the 15 years, but with a varying annual net aid gap, we estimated Communist Bloc and nonfood

Public Law 480 assistance through the projection at the current levels (see assumption A) and manipulated the Consortium lending to come up with the desired net aid level for that year. Annual new lending required to support the 15-year cumulative net aid total of $5.5 billion ranges from $925 million to $1.7 billion.

Terms of lending

1. Current

Each segment of the new levels of lending (i.e., Consortium, Communist Bloc, and Public Law 480) has its own set of current terms. They are:

a. Consortium: 2.75-percent interest, 32 years' maturity, and 7.5 years' grace period on the principal.

b. Communist Bloc: 2.6-percent interest and 12 years' maturity.

c. Public Law 480: 2.75-percent interest, 40 years' maturity, and 10 years' grace on the principal.

The current terms are based on weighted averages for two segments of current lending--Consortium and Communist Bloc donors. The weights come from actual disbursements on loans during IFYs 1970 and 1971. The terms came from commitments during IFY 1971, or, when some donor had not signed any agreement during that IFY, we used the most recent loan terms.

The Public Law 480 (nonfood) terms are those of the dollar sales agreements to India.

2. Lending at slightly easier terms than current

These easier terms are: 3-percent interest and 30 years' maturity, with grace periods of 2 years on the interest and 10 years on the principal. The Consortium has suggested these terms as the minimum that members should apply to their assistance to India. When we projected the new lending at these terms, we made another simplifying assumption and kept Communist Bloc and Public Law 480 terms the same as they were for current terms assumption. (See 1.) This means that only Consortium new lending has the slightly easier terms applied to it.

3. Lending at harder than current terms

As in assumption 2 above, we used current terms for the Communist Bloc and Public Law 480 levels; the harder terms were applied only to the Consortium amounts. These assumed terms are: 6-percent interest and 40 years' maturity, with 10 years' grace on the principal.

LONG-TERM DEBT SERVICE AND EXPORT GROWTH

We assumed that the import-export gap equals the available net aid; therefore, the six projections implicitly contain export and import growth rates. Imports in IFY 1972 were estimated to be $220 million[1] greater than exports; to have imports and exports equal or exports greater than imports in IFY 1985, exports would need to grow at a faster rate than imports. Rather than attempting to estimate a rate of export growth that India might be expected to achieve over such a long period, 15 years, the following schedule shows the average annual export growth that would be necessary to have a 20-percent debt-service-to-exports ratio[2] in IFY 1985 for the six projections.

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[1]Excludes $230 million in refugee assistance.

[2]The Consortium has accepted that a 20-percent ratio of debt service to exports is the level of debt service that India can manage without crimping her development plans.

Export Growth Required for a 20-Percent Debt-Service-to-Exports Ratio

	In IFY 1985		
	Debt service	Implicit export level	Percent of annual export growth required (note a)
	(millions)		
A.1	$ 917	$4,585	5.9
A.2	874	4,370	5.6
A.3	1,176	5,880	7.8
B.1	1,153	5,765	7.7
B.2	1,017	5,085	6.7
B.3	1,708	8,540	10.7

[a]Base year IFY 1971 exports of $2,047 million were used for the projection.

For our projections of debt service in IFY 1985, India would have to maintain an annual average growth rate in exports of 5.6 percent to 10.7 percent. These growth rates are not unattainable for a developing country but are above India's annual average of 4.5 percent from IFY 1962 through IFY 1972.

DEBT SERVICE IN THE SHORT-TERM

Considering only the average rate of export growth required for a 20-percent ratio of debt service to exports in IFY 1985 does not reveal India's interim debt-servicing problems. If debt service falls within the range we have projected for IFY 1974, the annual export growth for IFYs 1971-74 would need to be 18.4 percent to achieve a 20-percent debt-service-to-exports ratio for even the lowest level of estimated debt service.

If exports grow from about $2.0 billion to about $2.5 billion at the GOI's planned annual rate of 7 percent, the debt-service-to-exports ratio will be as follows:

Projections with 7-Percent
Export Growth

	Debt service in IFY 1974	Debt-service-to-exports ratio
	(millions)	
A.1	$721	28.7%
A.2	679	27.1
A.3	799	31.9
B.1	737	29.4
B.2	679	27.1
B.3	840	33.5

The World Bank does not believe that India can achieve the planned 7-percent annual export growth by IFY 1974. The Bank says that the Fourth Plan export target will be reached only with exceptional difficulty and that extraordinary efforts would be required to meet the target. It estimates an average growth rate over the 5 years of about 4.5 percent. AID agrees that extraordinary efforts are called for but believes that 7-percent growth could be achieved.

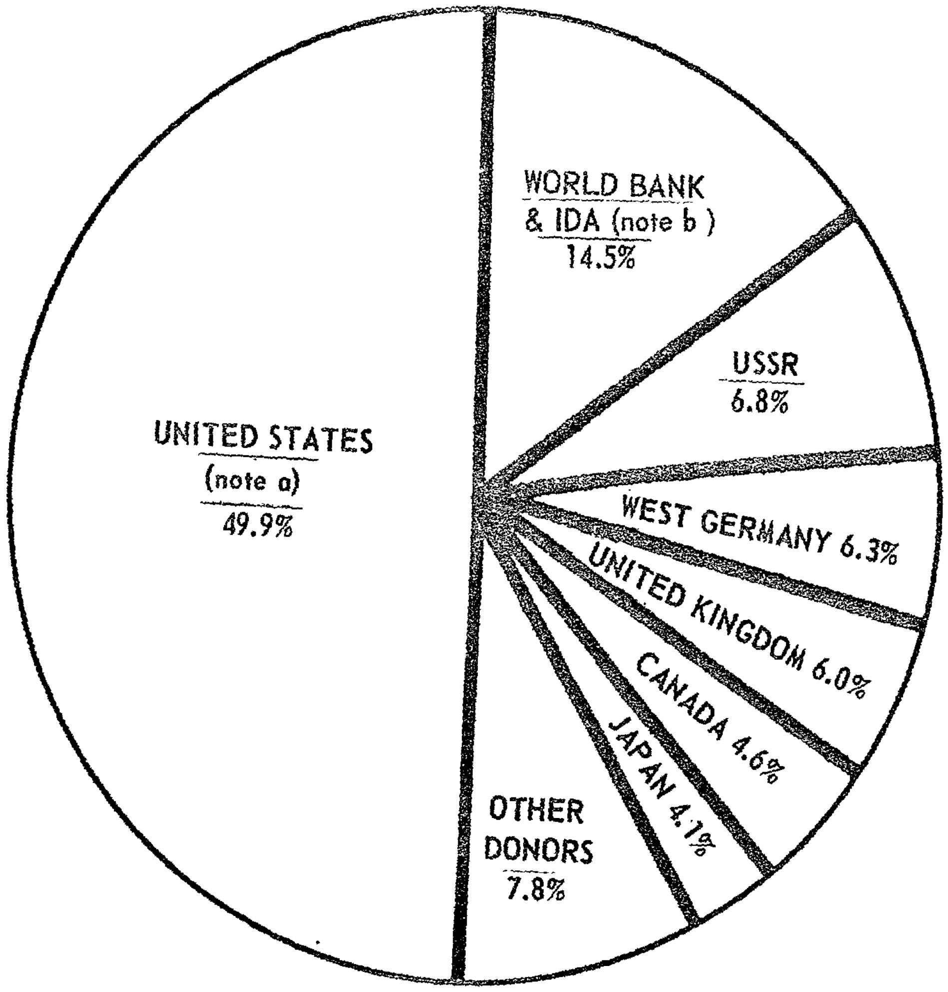
At the World Bank's estimated annual export growth rate of 4.5 percent, the value of exports would exceed $2.3 billion in IFY 1974 and the debt-service-to-exports ratio would be as follows:

Projections with 4.5-Percent
Export Growth

	Debt service in IFY 1974	Debt-service-to-exports ratio
	(millions)	
A.1	$721	30.9%
A.2	679	29.1
A.3	799	34.2
B.1	737	31.5
B.2	679	29.1
B.3	840	36.0

DONORS' NET COMMITMENTS OF ASSISTANCE TO INDIA FROM AUGUST 1949--MARCH 1972

(Percent)



[a] Includes P.L. 480

[b] The U. S. share in the World Bank and IDA is 26.7% as of June 30, 1972

Source: World Bank; Government of India- Ministry of Finance, Department of Economic Affairs.

EXTERNAL ASSISTANCE TO INDIA

Summary by Donor Groups
Cumulative Total August 1949 to March 1972

Donor group	Grants	Type of repayment provision: Exports	Rupees	Hard foreign currency (note a)	Total net commitments
	(thousands of U.S. dollars)				
The Consortium	$1,583,000	$ -	$4,981,800	$11,133,760	$17,698,560
Communist Bloc donors	16,500	1,692,200	-	-41,600	1,667,100
Non-Consortium, Non-Communist donors	341,600	-	-	48,820	390,420
Total	$1,941,100	$1,692,200	$4,981,800	$11,140,980	$19,756,080

[a]Includes IFYs 1971 and 1972 net commitments, totaling about $1.88 billion not broken out by repayment provision.

Sources: World Bank and Department of Economic Affairs, Ministry of Finance, GOI.

EXTERNAL ASSISTANCE TO INDIA

The Aid India Consortium August 1949 to March 1972

Donor	Grants	Type of repayment provision: Rupees	Type of repayment provision: Hard foreign currency (note a)	Total net commitments	Percent of total from all donors
	(thousands of U.S. dollars)				
United States	$1,025,700	$4,979,800	$ 3,855,640	$ 9,861,140	49.9
World Bank and IDA	-	-	2,867,930	2,867,930	14.5
West Germany	8,000	-	1,224,610	1,232,610	6.3
United Kingdom	1,900	-	1,176,300	1,178,200	6.0
Canada	503,200	-	405,830	909,030	4.6
Japan	1,900	-	807,500	809,400	4.1
Italy	17,800	-	225,800	243,600	1.2
France	4,500	-	299,100	303,600	1.5
Netherlands	6,000	-	116,440	122,440	.6
Belgium	-	-	49,100	49,100	.3
Sweden	13,000	-	52,860	65,860	.3
Austria	1,000	-	29,960	30,960	.2
Denmark	-	2,000	22,690	24,690	.1
Total	$1,583,000	$4,981,800	$11,133,760	$17,698,560	89.6

[a]Includes all IFYs 1971 and 1972 net commitments, totaling about $1.92 billion, not broken out by repayment provision.

Sources: GOI official statistics, the World Bank, and U.S. publications.

EXTERNAL ASSISTANCE TO INDIA

Communist Bloc Donors, August 1949 to March 1972

Donor	Grants	Type of repayment provision: Exports	Type of repayment provision: Hard foreign currency (note a)	Total net commitments	Percent of total from all donors
	(thousands of U.S. dollars)				
U.S.S.R.	$14,600	$1,361,300	-$39,600	$1,336,300	6.8
Czechoslovakia	800	128,200	-	129,000	.6
Yugoslavia	1,000	87,700	-	88,700	.4
Poland	-	75,800	-	75,800	.4
Hungary	100	17,100	-	17,200	.1
Bulgaria	-	15,000	-2,000	13,000	.1
Rumania	-	7,100	-	7,100	-
Total	$16,500	$1,692,200	$41,600	$1,667,100	8.4

[a]Includes all of IFYs 1971 and 1972 net new commitments (net of deobligations), not broken out by repayment provisions.

Sources: GOI official statistics, World Bank, and U.S. publications.

EXTERNAL ASSISTANCE TO INDIA

Non-Consortium, Non-Communist Donors, August 1949 to March 1972

Donor	Grants	Type of repayment provision: Rupees	Type of repayment provision: Hard foreign currency (note a)	Total net commitments	Percent of total from all donors
	(thousands of U.S. dollars)				
Australia	$ 83,100	-	-	$ 83,100	0.4
Switzerland	2,200	-	$48,000	50,200	.3
Norway (note b)	14,900	-	2,100	17,000	.1
New Zealand	7,300	-	-	7,300	-
United Nations	121,700	-	-	121,700	.6
Ford Foundation	87,300	-	-	87,300	.5
Rockefeller Foundation	18,900	-	-	18,900	.1
Other	-	-	-1,280	-1,280	-
Various food donors during 1966-67 drought	6,200	-	-	6,200	-
Total	$341,600	-	$48,820	$390,420	2.0

[a] Includes all of IFYs 1971 and 1972 net commitments totaling about $1.2 million, not broken out by repayment provision.

[b] Norway's project grant was made in 1952 and extended by supplemental agreement until 1972; its loan was made in 1968. Norway joined the Consortium in 1970 and therefore appears also with other Consortium donors listed in appendix V.

Sources: GOI official statistics, World Bank, and U.S. publications.

SUMMARY OF INDIA'S EXTERNAL DEBT

Donors	Outstanding debt 4-1-70 (thousands)	Percent Public debt	Percent Suppliers' credits	Percent of debt to be repaid by 1984	IFY of repayment
Consortium:					
Norway	$ 2,869	73.2	26.8	64.3	(a)
Denmark	22,151	72.2	27.8	75.4	(a)
Austria	23,780	95.8	4.2	90.7	(a)
Belgium	25,463	36.1	63.9	83.2	(a)
Sweden	33,754	70.4	29.6	71.9	(a)
Netherlands	85,992	75.7	24.3	62.9	(a)
France	146,047	37.0	63.0	92.7	(a)
Italy	158,068	4.7	95.3	100.0	1983
Canada	269,626	100.0	-	45.1	(a)
Japan	499,768	79.0	21.0	96.2	1988
World Bank	629,091	100.0	-	87.5	(a)
United Kingdom	833,334	98.0	2.0	66.7	(a)
West Germany	864,206	91.9	8.1	81.8	(a)
IDA	1,127,367	100.0	-	9.3	(a)
United States	3,072,898	99.6	.4	38.1	(a)
Total	$7,794,414				
Communist:					
Bulgaria	816	-	100.0	100.0	1982
Hungary	3,350	-	100.0	100.0	1980
Rumania	29,376	-	100.0	97.3	1985
Poland	40,338	90.2	9.8	100.0	1983
Yugoslavia	48,541	-	100.0	100.0	1982
East Germany	53,251	-	100.0	95.0	1986
Czechoslovakia	76,347	96.2	3.8	100.0	1984
U.S.S.R.	640,374	98.5	1.5	100.0	1984
Total	$ 892,393				
Other:					
Switzerland	7,379	98.7	1.3	100.0	1981
Other donors	155,764	(b)	(b)	100.0	(b)
Total	$ 163,143				
Total	$8,849,950	92.6	7.4	58.5	(b)

[a]Beyond IFY 1991.

[b]Not readily available.

Sources: World Bank and Department of Economic Affairs, Ministry of Finance, GOI.

BEST DOCUMENT AVAILABLE

INDIA'S OFFICIAL DEBT TO THE UNITED STATES AS OF DECEMBER 31, 1971, DOLLAR REPAYABLE LOANS

Loan source	Principal outstanding on utilized credits	Interest rates
	(thousands)	
Foreign Assistance Act and related acts	$2,665,683	0.75 to 3%
Public Law 480 long-term dollar sales	417,779	2.5 to 3
Commodity Credit Corporation	3,475	6.375
Export-Import Bank	231,871	5.25 to 6
Atomic Energy Commission	16,668	(a)
Total principal outstanding on utilized credits	$3,335,476	
Total authorized but not utilized	246,297	
Total authorized, less repayments	$3,581,773	

[a]Has a user's charge, presently 7.5 percent, which varies by billing period.

Source: Department of the Treasury, Foreign Credits by the United States Government. Washington: U.S. Government Printing Office, 1972.

DEPARTMENT OF STATE

Washington, D.C. 20520

December 6, 1972

Mr. Oye V. Stovall
Director, International Division
U.S. General Accounting Office
Washington, D.C.

Dear Mr. Stovall:

The Department of State and the Agency for International Development are pleased to comment on the draft General Accounting Office Report to Congress on India's external debt. The research reflected in this document is impressive both in scope and balance. The debt service problems facing the Indian Government and the process followed by its Western creditors to assist in solving these problems are accurately reported. The report also seeks to project the Indian debt and resource transfer problems under a set of alternative aid flows and Indian performance assumptions. This is an admirable attempt to view with a longer perspective the problems of development finance in terms of net resource transfers. Our comments are primarily designed to clarify the United States approach to less developed country debt problems in a broader context, since it is difficult to generalize from the particular circumstances of the Indian case.

USG agencies extend credits to developing countries with the reasonable expectation that they will be repaid in accordance with agreed schedules. In the past, however, changed economic conditions or expectations have prompted some less developed countries to request a rearrangement of the terms of the original contracts. The US response takes into account financial aspects of the case as well as United States interests in the country.

There is no set formula for the conclusion of rescheduling agreements, as negotiations frequently take place in a multilateral setting in which a number of creditor countries are seeking to maximize diverse objectives. A wide range of terms and conditions of rescheduling are the result. While these negotiations are conducted by executive agencies, in all cases the Congress was fully informed. In a number of significant negotiations--notably the Indonesian and Egyptian cases in 1970 and 1971--the guidance of key Congressional Committees was sought before concluding agreements.

Concerning the General Accounting Office recommendation that the analysis of country programs presented to the Congress include a discussion of net aid flows, A.I.D. has in the past, for those countries in which net aid flows were of major importance, presented to the Congress information on net aid, debt, and related balance of payments problems. This practice will be continued. With the onset of significant repayments on long-term development loans, as in the case of India, net aid flows will become an increasingly important measure of the usefulness of development assistance programs. Some less developed countries may, in fact, soon face the problem of debt service exceeding disbursements on new credits, thus generating a reverse resource transfer to developed countries. It seems clear that most developing countries can ill afford to make such transfers.

Both the Department of State and A.I.D. recognize the importance of debt problems to future US international economic policy. The extent of the problems will depend, among other things, on the debt management policies of the less developed countries, the rate of growth of export earnings, and the availability of resource transfers, in particular new concessional lending. In seeking constructive solutions to these problems, the United States will continue to cooperate with other creditors in developing policies designed to avoid debt service crises in borrowing countries.

Sincerely,

Michael M. Conlin, Acting
Deputy Assistant Secretary
for Budget and Finance

PRINCIPAL OFFICIALS RESPONSIBLE

FOR THE ACTIVITIES DISCUSSED IN THIS REPORT

	Appointed
DEPARTMENT OF STATE	
SECRETARY OF STATE:	
Dean Rusk	Jan. 1961
William R. Rogers	Jan. 1969
AMBASSADOR TO INDIA:	
John Kenneth Galbraith	Mar. 1961
Chester E. Bowles	June 1963
Kenneth B. Keating	June 1969
Daniel P. Moynihan	Feb. 1973
AGENCY FOR INTERNATIONAL DEVELOPMENT	
ADMINISTRATOR:	
Fowler Hamilton	Sept. 1961
David Bell	Dec. 1962
William S. Gaud	Aug. 1966
John A. Hannah	Mar. 1969
DIRECTOR, MISSION TO INDIA:	
C. Tyler Wood	Nov. 1959
John P. Lewis	Sept. 1964
Leonard J. Saccio	Oct. 1969
L. Paul Oechsli (acting)	Dec. 1970
Howard E. Houston	May 1971

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