CALACS Policy Brief Series: Beyond Aid and the Future of Development Cooperation
Issue 3, August 2017

IMPACT OF LINES OF CREDIT ON THE FUTURE OF INDIA'S DEVELOPMENT COOPERATION: CAUSES AND IMPLICATIONS OF THE GAP BETWEEN ALLOCATION AND DISBURSEMENT OF CREDIT

By Vyshali Kottam

EXECUTIVE SUMMARY

As Lines of Credit (LoCs) gain importance in India's development cooperation (IDC), it becomes necessary to reflect on their implementation. This paper examines some of the causes behind the increasing gap between India's commitment in providing LoCs to other developing countries and the actual disbursement of these funds. It also attempts at identifying some of the causes for this gap on both India's as well as the partner country's end and possible implications that it could have on the future of IDC. As the use of LoCs grow, they have the potential to change the face of IDC for the better or for the worse.

Keywords: India, IDC, Lines of Credit, Development Cooperation

Credits: This CALACS Policy Brief was written by Vyshali Kottam and edited by Karin Costa Vazquez. It was an initiative by the Center for African, Latin American and Caribbean Studies at O.P. Jindal Global University School of International Affairs with the support of the Asia Foundation. The opinions expressed are those of the author and do not necessarily reflect the views of CALACS.

INTRODUCTION

India has become an emerging power in the international development cooperation landscape, particularly in South-South Cooperation. The first two phases of Indian Development Cooperation (IDC) largely focused on extending grants, technical assistance and training to civil servants and military personnel. In the third phase from the early 1990s, economic diplomacy became a primary policy thrust to the broader framework of India's international cooperation. With India's economic growth, the volume of cooperation also grew substantially, not only to help other developing countries but also to provide fuel for India's own growth. It is in such a context the Line of Credit (LoC) became an important instrument of India's international cooperation (Samuel & George, 2016). Of the existing modalities, LoCs have now come to constitute a major proportion of the overall development cooperation provided by India.

LoCs in India, now under the purview of the Development Partnership Administration in the Ministry of External Affairs (MEA), are routed through the EXIM Bank. As LoCs begin to play a major role in the provision of IDC, it is necessary to reflect on their implementation. This paper examines some of the causes behind the increasing gap between India's commitment in providing LoCs to partner countries and the disbursement of these funds in a timely manner, both from India's as well as the partner country's end. It also attempts at identifying possible implications that such an increasing gap could have on the future of IDC.

GROWING VOLUME OF INDIA'S DEVELOPMENT COOPERATION (IDC)

It has been predicted that IDC is likely to increase over the next years, continuing the trend observed in the past decade. Between 2000 and 2015, IDC increased seven-fold reaching volumes comparable to that of several OECD countries. Differently from OECD countries, however, one dollar of India's development cooperation has greater purchasing power than one dollar in foreign assistance provided by any rich country. As the value IDC is recognized, demand for Indian development cooperation grows (Mullen, 2014).

LINES OF CREDIT

A Line of Credit (LoC) is a long-term loan provided at a concessional rate where the money is disbursed as well as repaid. LoCs are also referred to sometimes as Development Finance and are coordinated by the Division – I of the Development Partnership Administration (DPA-I).

According to the EXIM Bank of India, that has been handling India's LoCs since 2004, LoCs are extended to overseas financial institutions, regional development banks, sovereign governments and other entities overseas to enable buyers in those countries to import developmental and infrastructure projects, equipment, goods and services from India on deferred credit terms (Exim Bank of India, 2016). The interest rate differential on these concessional loans are borne by the Government of India.

In 2004, India saw a policy shift that lead to a stop in direct budgetary assistance by the Ministry of Finance (MoF). In that same year the Government of India launched the Indian Development and Economic Assistance Scheme (IDEAS) as the need for an independent, full-fledged financial program with a supporting institution was felt. A probable reason for this shift could have been the expanding economy and foreign engagement which would require increasing the volume of LoCs. It was under this scheme that India offered a newly restructured channel for development assistance, the LoCs. These LoCs are Government of India-backed and Export Import Bank of India-managed credit lines. By 2014, India had approximately 10 billion USD as open LoCs (Mullen, 2014).

ADVANTAGES AND GROWING PROPORTION AND VOLUME OF LoC IN IDC

LoCs are increasingly recognized as beneficial to both the Indian economy as well as the partner countries. The development financing instrument has a conditionality that requires the borrowing country to finance 75% of the required goods and services from India. This not only boosts Indian exports but also provides goods and services to the borrowing country at a much cheaper rate. The purchasing power of each U.S. dollar spent in India is greater than the purchasing power of the same dollar spent in the United States, a 1,000 USD grant from the Indian government would, for example, cover the full cost of training an Afghan bureaucrat in India for three weeks, while it would cost several times that amount to train the same bureaucrat at any institution in the United States (Mullen, 2014).

Figure 1: Indian Development Cooperation (grants and loans) at Current Prices vs. Purchasing Power Parity terms, 1997/98 – 2014/15 in USD million (Mullen, 2014).

Thus, the very structure of LoCs facilitates the promotion of Indian exports to partner countries. Grants, in comparison, are untied forms of development cooperation and do not foster a market for Indian goods and services (Taraporevala & Mullen, 2014). LoCs have been utilised as a financing mechanism for technology transfer and capacity development in partnering countries. They serve as a market entry tool for Indian exporters in other countries. They help them expand their business in existing export markets without any payment risk from overseas importers and serve as a means of market diversification (Exim Bank of India, 2016). Although in some cases, Indian investment has been criticised, the fact that they have helped build goodwill and support for India, among the developing and underdeveloped countries and in international institutions cannot be ignored. LoCs also built on India's comparative advantage in sectors such as energy exploration and development, agricultural training, and developing of the transport sector (Prasad, et al., 2015).

India views its LoCs as an integral part of engaging in "mutually beneficial" development partnerships, which include increased trade. The value of India's operational LoCs in May 2014 was about 10 billion USD, over 60% of which went to African countries. This trend is likely to continue, since the new government's foreign policy will have an increased focus on trade, including with the African continent (Mullen, 2014). Evidence of this has been found in the Indo-African engagement where there has been an increase in the overall volume of development cooperation and a more defined focus on LoCs. They complement aid from OECD donors and are helping India to re-establish closer bilateral relationships with many African countries (Taraporevala & Mullen, 2014). Provision of LoCs for initiatives like TEAM-9 and NEPAD indicates India's intentions at establishing good relationships with African countries.

GAP BETWEEN COMMITMENT AND DISBURSEMENT

LoCs have numerous advantages and have been lauded for fostering mutually beneficial relationships, yet they are plagued with significant problems too. One among these problems has been the widening gap in the promises and commitments made to the borrowing partner country for the amount of credit, and the fulfillment of those promises and commitments by India. While a large number of LoC agreements have been signed, there are increasing questions about the widening gap between promises, performance and actual delivery of the projects (Samuel & George, 2016). This gap between commitments made for a particular amount of credit and disbursement of that credit has been increasing and is now wider than ever before, to the tune of over 50%.

India first extended a LoC of 1 billion USD to Bangladesh in 2010. Of this, 200 million USD were later converted into grant and the LoC was enhanced from 800 million USD to $862 million USD in 2015 by means of an amendment to the agreement. Only 7 of the total 15 projects have been completed (Loiwal, 2016). India announced 2 LoCs to Bangladesh, each worth 2 billion USD in June 2015 and in March 2016. In the latter case, 14 projects were planned to be implemented. As of July 2016, the EXIM Bank of India had approved only four out of the eight projects sent by the Bangladesh's Economic Relations Division (ERD). India further announced a 5 billion USD LoC – the biggest offered to any country at one go by India – in April, 2017. This took India's total LoC to Bangladesh to 8 billion USD in the past six years (Jacob, 2017).

This can also be seen in the dismal disbursal amount of Indian LoC committed in 2010 i.e. of the 1 million USD LoC that was later trimmed to 800 million USD, only 169 million USD was disbursed by September 2014. More importantly, as reported by the Bangladesh Railway in July 2016, the performance of railway projects being implemented under this LoC had been poor with around half of the projects involving around 690 million USD not being completed and with performance of some other projects being insignificant even six years after signing of the credit agreement. Though five projects amounting to 120 million USD and related to procurement were completed, status of development projects including construction of railway tracks and bridges is not satisfactory (Sultana, 2016).

The extent of Africa's importance in the IDC stratagem is demonstrated by the promise of LoCs worth over 8 billion USD made by the Indian government to African countries between 2008 and 2011. However, a substantial disparity between the promised amount and the operative LoCs pesists as only 4.3 billion USD were available as LOCs to African countries between 2004-05 and 2011-12 (Taraporevala & Mullen, 2014).

Although the amount of credit promised to the African Region is close to 9,133 mn USD, only 3,843 mn USD has been disbursed so far, indicating that only a meager proportion of 42% disbursal has taken place. This picture is worse in the case of the Asia, where 8,948 mn USD was allocated to be provided but only 2,078 mn USD has been disbursed. This indicates a disbursal of only 23.2% of the promised credit. This dismal picture is also reflected in the gap between the amount of credit allocated and the amount of credit disbursed in the Latin American and Caribbean and the Oceania regions, although the proportion of LoCs is almost negligible compared to the allocations to the continents of Asia and Africa.

Figure 2: Graph depicting the Amount of Credit allocated and the Disbursement of credit so far by the Exim Bank

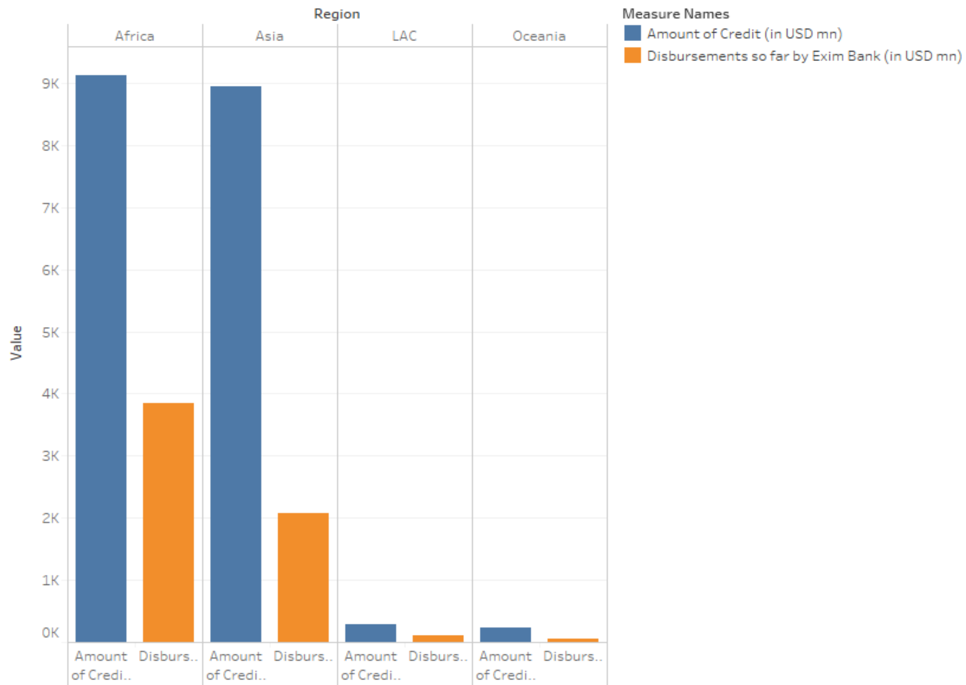
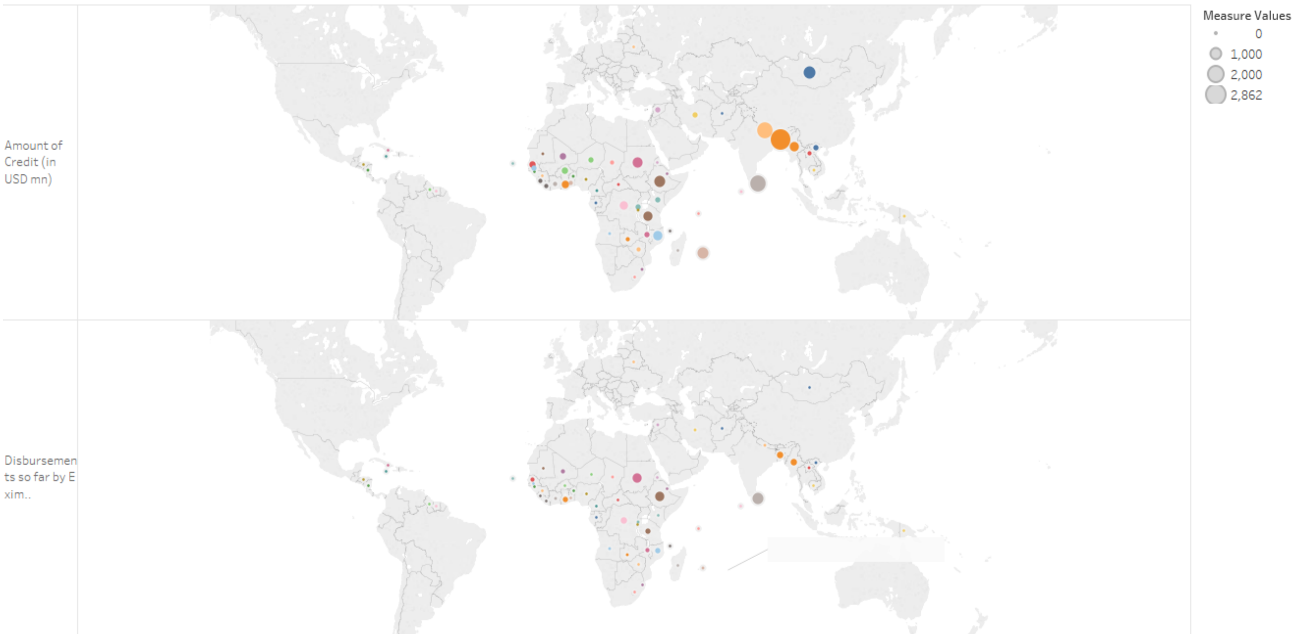


Figure 3.0: Map depicting the Amount of Credit allocated and the Disbursement of credit so far by the Exim Bank LoCs to various countries (size of the bubble corresponds to the amount of credit)

Figure 3.1: Map depicting the Amount of Credit allocated and the Disbursement of credit so far by the Exim Bank LoCs to various countries



CAUSES

The reasons for this gap is a result of several factors on both India's end as well as on the borrowing country's end, some of which are the following.

On India's End

The primary reason for the stark difference in these committed percentages is the fact that they are **tied loans** thus requiring that 75% of goods and services for projects be sourced from India (Taraporevala & Mullen, 2014). Even though it is negotiable and numerous countries have requested for a relaxation, this has not been seen to go beyond less than 60%. Although Bangladesh had requested for bringing down the ceiling to 50%, as per conditions negotiated 65% raw materials required had to be bought from India or the major proportion of work on most projects were to be given to Indian Companies (Aman, 2016). The **debt forgiveness** either in full or partial in LoCs provided to the borrowing country at their request also places more pressure on and constrains India's ability to finance existing and future LoCs.

India has disregarded the risks associated with investing in non-democratic countries. 60% of India's operative LoCs are currently routed to countries governed by 'authoritarian regimes' with limited access to electoral processes, civil liberties, political participation, and other associated processes. The potential scope for uprisings and indeed regime change within these countries is high and yet IDC does not account for these risks that could lead to potential loan defaulting (Taraporevala & Mullen, 2014).

India's **attempts to compete with China's LoCs**, particularly in Africa, and in countries like Bangladesh has also contributed to this rise in disparity. China's growing economic influence in Bangladesh can be noticed by the recent credit line worth 24 billion USD signed by Chinese President Xi Jinping during his visit to Dhaka in October, 2016, which is also the first by a Chinese head of state in the past three decades (Blanchard, 2016). Even though the moral of such a move might be considered noble by many, however, given China's disagreements with India, its closeness with Pakistan and historically big brother image in the South Asian region such a move is bound to make India uncomfortable (Mullen, 2017). Bangladesh backing of Xi's "One Belt, One Road" initiative to boost trade and transport links across Asia and into Europe has only worsened its discomfort. India has reservations about the plan, amid worries that it is an attempt to build a vast zone of Chinese influence (Blanchard, 2016). The 5 billion USD LoC to Bangladesh underlined New Delhi's efforts to wean away Dhaka from China, the biggest supplier of defence equipment to Bangladesh for many years (Jacob, 2017).

The **administrative and procedural delays** in various stages in the process, such as in approvals, verification, conflict etc., from line ministries and the Indian Exim Bank has been another reason, as can be seen from the example of Bangladesh. Bangladesh Railway officials reported a delay in getting clearances from the EXIM Bank, such as in the case of construction of Khulna-Mongla port rail line. Some of the projects to be implemented under the 2 billion

USD LoC also didn't get the initial nod from the EXIM Bank in July 2016. Further, the projects implemented under the initial LOC agreed upon in 2010 have said to be plagued by problems including cumbersome tendering process, escalation of material costs and lack of adequate competitive bidders in the Indian market (Mullen, 2017). Some Bangladesh's Economic Relations Division (ERD) officials alleged that India has given priority to the projects that serve their interest, while the project that could better serve Bangladesh interest have been side-lined (Aman, 2016).

India has extended a 640 million USD LoC on the Ethiopian sugar industry namely Wonji /Shoa, Fincha and Tendaho plants where the Exim Bank had halted the credit supply for a minor problem. Postponement in release of funds by the Exim Bank to the Ethiopian Government also reflects problem of communication between the partner and the implementing agency (Kumar, 2015).

LoCs have also been plagued with structural supply issues, such as a **lack of capacity and/or sectoral competence in companies**, both public and private to take up project. Senior officials from Bangladesh Railways indicated that the price offered by the Indian companies led to the rise of project costs of LoC, resulting in a two-year delay of the project implementation. The 800 USD millions of LoC was for upgrading the rail system. Since the Indian company didn't have appropriate expertise to manufacture meter-gauge carriages or engines, Bangladesh had to seek additional assistance from the Asian Development Bank to implement the plan as envisaged in the LoC. This example clearly shows the gap between promises, performance and eventual implementation, often escalating the cost and eventually compromising on the expected 'development' outcome (Samuel & George, 2016).

Preliminary exploration also indicates that some Indian firms that have taken up LoCs have very little visibility in India and no specific core competence to deliver on their bid under the LoC. As a result, they largely outsource most of the work, a process that creates delays and inevitably, higher overhead costs (Kumar, 2015).

The sugar industry in Ethiopia has also been a victim to this problem. The Wonji/Shoa plant awarded to the Uttar Pradesh based company Uttam Sucrotech International Ltd, should have been finished by June 2012, but was not completed until December 2013. The contract for the Fincha plant that received around 132 million USD of the 640 million USD LoC, went to a Mumbai based company, Overseas Infrastructure Alliance (OIA) where the project closure was delayed, by more than two years. The first phase of the Tendaho plant should have been completed by August 2011 but once again has been subject to delay (Phase II is not expected to begin before 2017) (Kumar, 2015).

The above structural issues coupled with a **lack of commitment** in companies to serve in the interest of the borrowing country becomes a recipe for disaster. Field interactions reveal that India needs to review its approach to LoCs. They should not be viewed as one-time projects under which the company picks up the job and walks out once the project is over. In such a case, the company has no long-term commitment nor does it have an interest in delivering turnkey projects on time or ensuring their long-term sustainability. It is this limitation that delays almost all LoC projects (Kumar, 2015).

On Borrowing Country's End

The **administrative and procedural problems** in providing Detailed Project Reports (DPRs), feasibility reports etc., causes delays and widens the disparity. In some cases, borrowers submit low-quality reports based on minimal evidence and conduct investigations designed to support the desired outcome. Often, the project request will include an outdated, rehashed report prepared by some aid consultant without relevant experience. In others, allegations have arisen that agencies hoping to receive the finalized contract have prepared the DPR themselves (Saxena, 2016).

Some borrowing countries may also be plagued with severe structural supply issues where their **companies lack capacity and competence** to serve the project. Under the mutually agreed terms of the agreement, while the project implementing firm should be from India selected by the Ethiopian side, the sub-contracting firms can be local to be selected by the implementing partner. The choice of these sub-contractors becomes extremely difficult given serious information asymmetries. In the case of the Ethiopian Sugar Industry, more than 18 companies participated, which in itself presented a major challenge for the Ethiopian Government. The selection involved division of tasks across several companies with one appointed as EPC. This kind of 'clubbing' of two companies led by one EPC poses multiple challenges. In one case, the successful engineering, procurement and construction (EPC) bidder was so at odds with the subcontractor that the matter escalated and ended up before an Indian court. In the process, the responsible Ethiopian government department was compelled to visit Exim Bank headquarters, because the Bank had stopped releasing money against LoC commitments (Kumar, 2015).

Any form of **internal turmoil**, particularly those that are political nature, severely constrain the ability of some of the borrowing countries to repay the loan. Since the oil-rich South Sudan seceded in 2011, Sudan has been unable to honor payments due and has defaulted. This in turn has triggered interest penalties and caused setbacks to the financial health of the portfolio.

Some of the borrowing countries are also increasingly resorting to **excessive bargaining** in conditionalities. Resource-rich ones, in particular, often play India and China against each other, sometimes even after the end of documentation and negotiations. They insist on relaxing terms ad waiving conditions and such cases have only been on the rise (Saxena, 2016). Also, an absence of robust mechanisms for monitoring and verification that come in the way of project implementation (Kumar, 2015).

IMPLICATIONS

The causes mentioned above have widespread implications and could potentially affect the future of IDC. Reasons such a debt forgiveness, defaulting, excessive bargaining, India overreaching its commitments to compete with China etc. Excessive bargaining for relaxations, besides severe financial implications, threaten the guidelines' universality and predictability (Saxena, 2016). Lack of capacity and competence in companies on both ends and administrative and procedural hurdles, along with the above factors, results in delays and time-lag which further escalate the costs of the project, feeding into the difficulty faced by the borrowing country to repay and the difficulty faced by India to finance. All these factors severely threaten the health of LoC portfolio and consequently, the future of all ongoing and upcoming projects, with the possibility even, of spiraling into a crisis.

Ethiopia imported raw centrifugal sugar and refined sugar worth 175.85 million USD in 2011, making raw centrifugal the country's third largest import in dollar terms. Ethiopia's domestic demand for sugar has been rising sharply over the past five years, forcing the government to spend substantially higher amount on imports and the delays in project implementation have only worsened this.

Above mentioned causes resulting in the poor implementation of projects may lead to the loss of goodwill and trust of India on the world stage. This can have adverse impacts on its ties with countries and may result in loss of supporters for its initiatives in international organisations. These not only pose a threat of internal political imbalance but also of severely affecting Indian exports and exporters, which may further lead to a fall in our internal economic growth.

All the factors have a grave effect, particularly on the sustainable development of the borrowing country and its people. In the absence of robust project guidelines or poor implementation and delays by the private sector actors, development gains are often compromised (Samuel & George, 2016).

CONCLUSION

A sustained increase has been observed in the volume of IDC. A large part of this increase is fueled by the rising proportion of LoCs that are now being offered to a large base of countries for sustainable development. LoCs have not only provided a large market for Indian exports and minimized their risks, but also have also provided flexible financing for the development activities of the partner countries. For partner countries, this development finance in the form of concessional loans over an extended period has facilitated the access to cheaper technologies that suit their contexts and requirements to a greater extent. LoCs have helped increase India's presence in the global international development cooperation arena as a provider and has earned it a lot of goodwill along with some criticism. LoCs, thus exhibit potential as a favorable modality to facilitate sustainable development and build sustainable partnerships for IDC in the future.

They have the potential to change the face of many under-developed and developing countries for the better. India's LoCs could help Ethiopia become self- reliant in sugar production and even become a net exporter. The total economic gain would be US$ 966.65 million per year (Kumar, 2015). The time is thus ripe to reflect on the drawbacks that have lagged the disbursal of credit and make efforts to comprehend possible implications in order to devise possible policies for resolution. LoCs have immense potential to shape the future of IDC and therefore, it is of paramount importance for India to make constant efforts to reflect and learn from the feedback.

REFERENCES

Aman, H., 2016. *Four projects approved under $2b Indian LoC.* [Online] Available at: http://www.daily-sun.com/arcprint/details/150357/Four-projects-approved-under-2b-Indian-LoC/2016-07-12 [Accessed 21 May 2017].

Blanchard, R. P. a. B., 2016. *China to sign some $24 bln in loans to Bangladesh as Xi visits.* [Online] Available at: http://www.reuters.com/article/bangladesh-china-idUSL4N1CJ3BS [Accessed 20 May 2017].

Chowdhury, I. S., 2015. *BD to buy rly carriages, engines with ADB finance.* [Online] Available at: http://www.observerbd.com/2015/08/03/102745.php [Accessed 20 May 2017].

Exim Bank of India, 2016. *Lines of Credit.* [Online] Available at: https://www.eximbankindia.in/lines-of-credit [Accessed 20 May 2017].

Jacob, J., 2017. *India announces $5-billion line of credit to Bangladesh, 22 pacts signed.* [Online] Available at: http://www.hindustantimes.com/india-news/india-announces-4-5bn-line-of-credit-to-bangladesh-22-pacts-signed/story-qExR2itHj3fAKsisPI3P7J.html [Accessed 21 May 2017].

Kumar, S., 2015. *India's Development Cooperation with Ethiopia in Sugar Production: An Assessment,* New Delhi: Research and Information System for Developing Countries (RIS).

Loiwal, M., 2016. *Bangladesh, India sign $2 billion new line of credit.* [Online] Available at: http://indiatoday.intoday.in/story/bangladesh-india-sign-2-billion-new-line-of-credit/1/616214.html [Accessed 21 May 2017].

Mullen, K. A. a. D. R. D., 2017. *India's development cooperation with Bangladesh: Lines of credit (LOCs).* [Online] Available at: http://cprindia.org/sites/default/files/op-eds/India's%20development%20cooperation%20with%20Bangladesh%20Lines%20of%20credit%20%28LOCs%29%20%281%29.pdf [Accessed 21 May 2017].

Mullen, R. D., 2014. *5 Predictions for India's Development Cooperation Under New Government.* [Online] Available at: http://asiafoundation.org/2014/05/28/5-predictions-for-indias-development-cooperation-under-new-government/ [Accessed 20 May 2017].

Mullen, R. D., 2014. *The State of Indian Development Cooperation,* New Delhi: Indian Development Cooperation Research (IDCR), Centre for Policy Research, .

Prasad, K., Shivakumar, H. & Mullen, R. D., 2015. *Trends in Indian Development Assistance in the Energy Sector.* [Online] Available at: http://cprindia.org/sites/default/files/op-eds/Trends%20in%20Indian%20Development%20Assistance%20in%20the%20Energy%20Sector.pdf [Accessed 20 May 2017].

Qadri, A. & Singhal, R., 2014. *Development and Diplomacy through Line of Credit,* New Delhi: Observer Research Foundation (ORF).

Samuel, J. & George, A., 2016. *Future of Development Cooperation (Policy Priorities for an Emerging India),* New Delhi: Oxfam India.

Saxena, P., 2016. India's Credit Lines. In: S. Chaturvedi & A. Mulakala, eds. *India's Approach to Development Cooperation.* New York: Routledge, pp. 60-76

Sultana, M., 2016. *Indian LoC projects limping.* [Online] Available at: http://print.thefinancialexpress-bd.com/2016/07/30/147705 [Accessed 20 May 2017].

Taraporevala, P. & Mullen, R. D., 2014. *India-Africa Brief,* New Delhi: Indian Development Cooperation Research (IDCR), Centre for Policy Research (CPR).

¡CALACS!

Center for African, Latin American and Caribbean Studies
at O. P. Jindal Global University

The Center for African, Latin American and Caribbean Studies (CALACS) combines interdisciplinary research, policy dialogue, and capacity development to understand the changing dynamics of South-South relations, deepen partnerships between African, Latin American and Caribbean (ALAC) countries and India, and support ALAC countries and India, as part of the Global South, in reshaping global governance. Hosted by Jindal School of International Affairs, CALACS serves as a hub for academics, policymakers, and businessmen to connect, exchange, and develop initiatives related to:

- ALAC countries relations with India
- ALAC countries, India & the Global South: policy coalitions & institutions (BRICS, IBSA, New Development Bank)
- Trade, investment and other issues affecting ALAC countries

CALACS Team:

Prof. Karin Costa Vazquez - CALACS Director and Assistant Dean for Global Engagement
Prof. Mohammad Jilani, Aakanksha Lohia, Sanjana Medipally, Amika Bawa, Aparna Raman, Hima Bindu, Prachi Dang, Paloma Matusse, Rushil Anand, Nitin Arya

João Bosco Monte - Senior International Associate
Caio Borges - Senior International Associate
Supriya Rouchoudhury - Senior Associate

Contact us:
Email: calacs@jgu.edu.in
Facebook: https://www.facebook.com/JGUCALACS/
Flickr: http://www.flickr.com/calacs
Website: http://www.jgu.edu.in/researchcentre/Centre-For-African-Latin-American-and-Caribbean-Studies/