A Non DAC Donor Case Study: India's Lines of Credit Programme[1]

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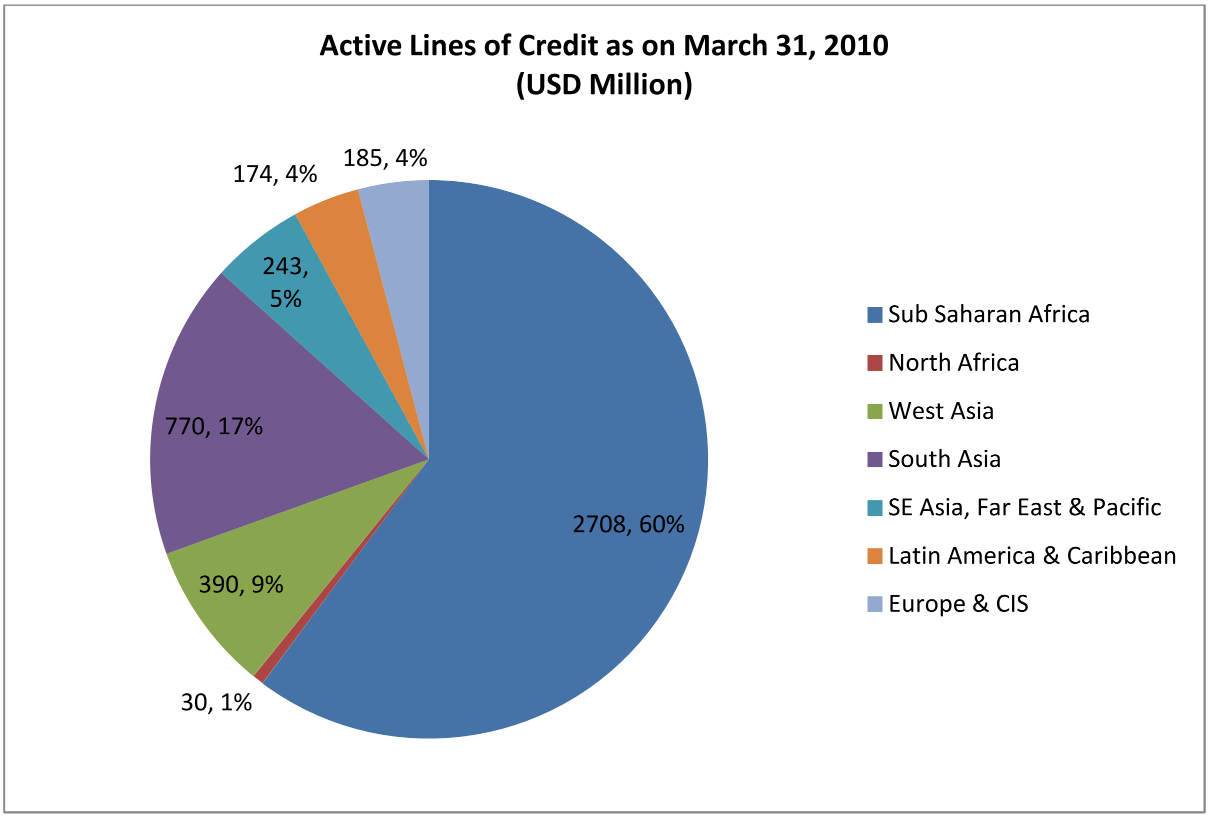
Another important but growing component of India's development cooperation programme is the lines of credit (LOCs) extended by the Export-Import Bank of India. LOCs are generally extended to overseas financial institutions, regional development banks, sovereign governments and other entities overseas, to enable buyers in those countries to import goods and services from India on deferred credit terms. A line of credit is not a foreign aid instrument, but rather an instrument for promoting international trade. It is used as a tool not only to enhance market diversification but also as an effective market entry mechanism for small and medium Indian enterprises. Indian LOCs are tied to the 'project exports' to the tune of 85% of goods and services to be procured from Indian firms. In order to participate in the promotion of economic growth of these developing countries, Indian companies tend to participate in the execution of many projects such as railways, information technology, power generation and transmission, buses, sugar mills and agricultural projects. It is important to mention that extension of LOCs is considered to be an effective market entry mechanism especially for small and medium Indian enterprises.

Figure 1 Indian Lines of Credit Outlay



Source: EXIM Bank Annual Report 2009-10

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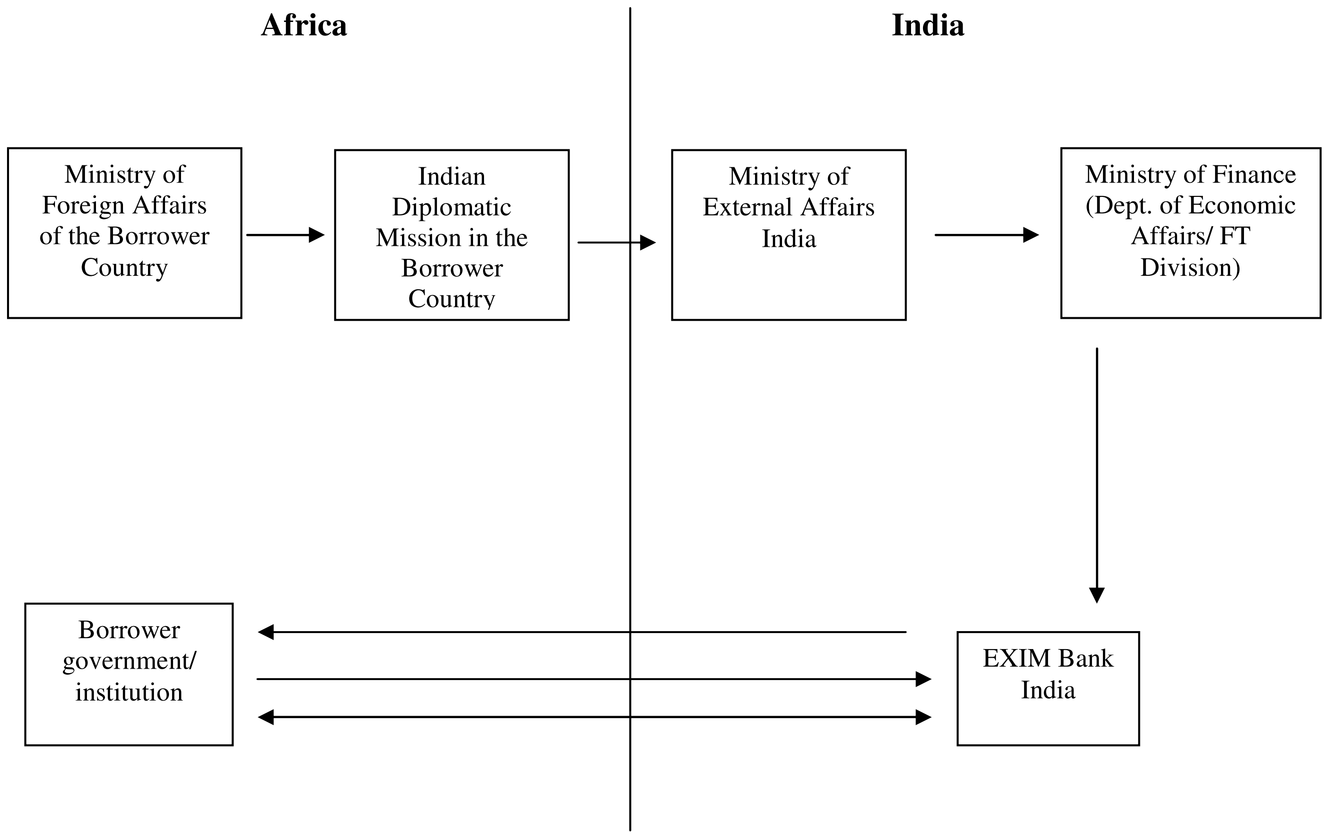
As of 31 March 2010, US$ 2.708 billion or 60% of total EXIM Bank's operative portfolio of US$ 4.5 billion was operational in sub-Saharan Africa. During 200-10, the EXIM Bank extended 22 LOCs aggregating US$ 753.21 million (EXIM Bank 2010). 136 LOCs covering 94 countries are currently available. New initiatives to double the existing levels of lines of credit to Africa to US$ 5.4 billion over the next five years, and a fresh grant of US$ 500 million in the area of capacity building and human resource development, will only strengthen and enhance this development cooperation.

Institutional arrangement for approving LOCs

The Ministry of Finance and the EXIM Bank are the two institutions responsible for the execution of the LOC programme. This section describes the approval process.

Figure 2: Institutions and activity flow chart for approval of an LOC



Source: Based on EXIM Bank of India guidelines for LOC

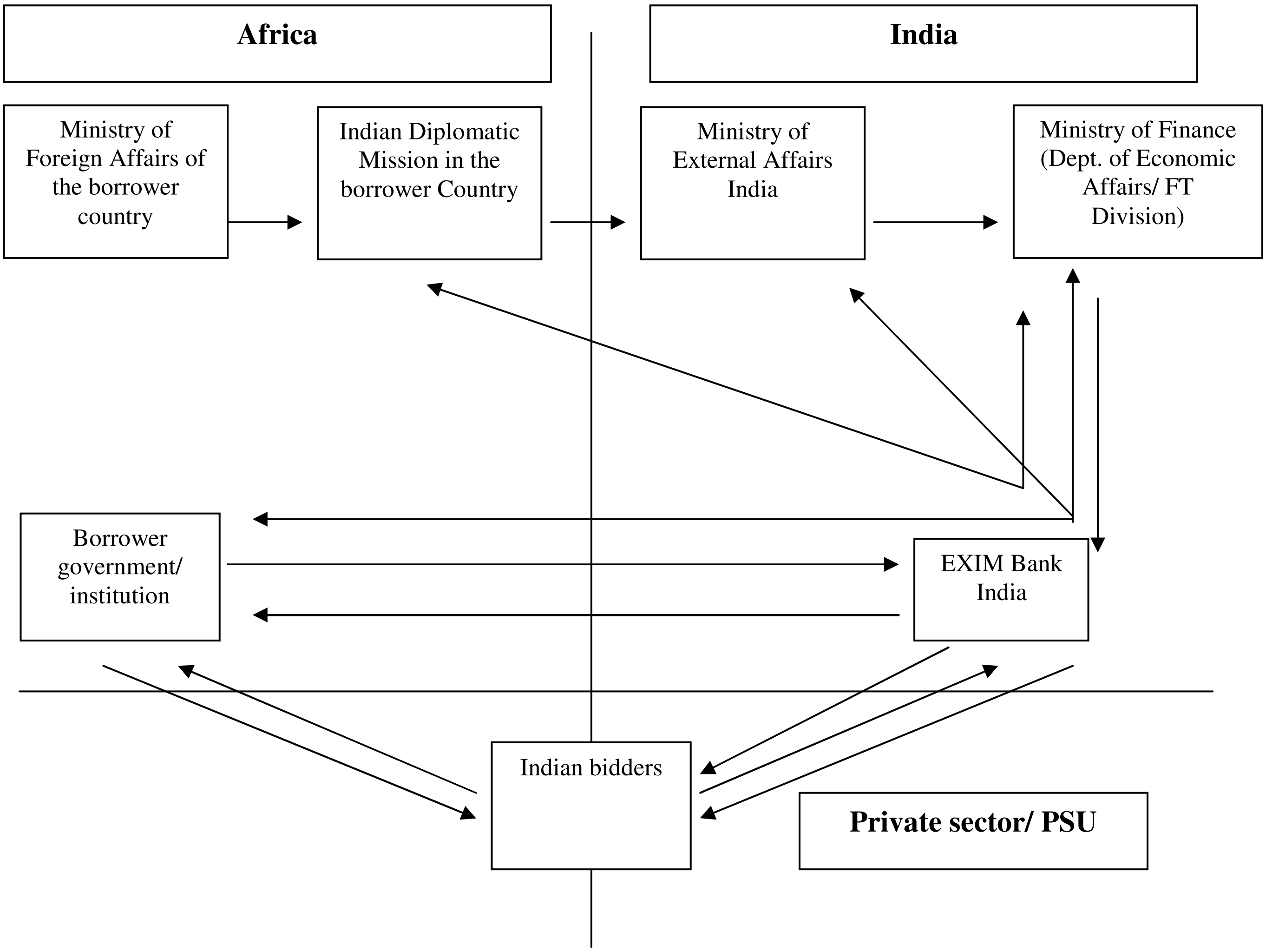
Figure 2 outlines the institutions involved for the approval of LOC and the steps in the approval process. This includes the following:

1. The Ministry of Foreign Affairs of the borrower country requests for an LOC which is accompanied by a pre- feasibility report of the proposed project, estimated cost of project, its justification and proposed repayment arrangement.
2. Indian diplomatic mission in borrower country forwards proposal with its recommendations/ comments to the head quarter in New Delhi.
3. The Ministry of External Affairs, New Delhi recommends the proposal to the Foreign Trade Division in the Department of Economic Affairs, Ministry of Finance for appraisal

4. The Foreign Trade Division in the Department of Economic Affairs, Ministry of Finance examines the proposal, obtains internal approval and conveys approval of LOC and terms (interest rate, credit period) to EXIM Bank
5. The EXIM Bank, after seeking internal approval, conveys offer of LOC, the terms, and sends draft of LOC Agreement to borrower government/ institution
6. The borrower government/ institution accept the terms of the LOC. It can accept the draft of the agreement or suggest changes and/ or amendments to the EXIM Bank and thus the draft of agreement is finalized

Finally the LOC agreement is signed between the EXIM Bank and the Borrower government or institution. The Borrower government/ institution makes available the documents precedent to make the agreement effective and EXIM Bank announces the approval of the agreement. Once the agreement for LOC is signed by the EXIM Bank and the Borrower government, the next stage is the implementation of such LOC which includes the approval of contracts/ projects approved under the LOC. There are two scenarios during this stage. First, the projects/contracts are identified prior to approval of LOC/signing of the LOC agreement. The MOF-DEA approval letter will state these projects. In the second scenario, projects or contracts are not identified prior to approval of LOC or signing of LOC Agreement.

Figure 3: Institutions and activity flow chart after signing of an LOC



Source: Based on EXIM Bank of India guidelines for LOC

Under such circumstances, procedures for approval of contracts (Figure 3) are as follows:

1. The borrower government/institution proposes a project concept/proposal to the Ministry of External Affairs, New Delhi.
2. The Ministry of External Affairs, New Delhi, recommends project proposals to the Foreign Trade Division in the Department of Economic Affairs (DEA), Ministry of Finance, which forwards it to the EXIM Bank.
3. The EXIM Bank examines GOI-recommended proposals in the light of provisions of the LOC agreement. If found in line with all the requirements, it conveys approval for specific contracts/projects to the borrower government/ institution, MEA and DEA.
4. After receiving the approval from the EXIM Bank, the borrower government/ institution invites bids from Indian bidders.
5. After an evaluation of the awards and bids, the borrower government/ institution refers the awarded contract for approval to the EXIM Bank.
6. The EXIM Bank examines the contract in the context of provisions of the LOC agreement and may seek the following clarifications from the Indian exporter: (i) a list of sub-suppliers and their scope of work, (ii) delivery schedule and (iii) any other information considered necessary.
7. Finally, the EXIM Bank approves the contract and conveys this to the borrower government/ institution, MEA, DEA and Indian exporter.

Are Indian lines of credit concessional enough to qualify as ODA?

Indian lines of credit are granted on the basis of the Paris Club initiative and the World Bank classification. Except for countries with middle level income and medium to high levels of debt (MILD), all other countries access these lines of credit on concessional terms. The grant element is 41.25% for the highly indebted poor countries (HIPC) group, 35.11% for countries having a low income and high levels of debt (LIHD) and 28.75% for countries having a middle level income and high levels of debt (MIHD).

Table 1 Terms and conditions of Indian lines of credit

Group	Interest	Period	Grace	Grant Element
HIPC declared under the Paris Club Initiative	1.75% (fixed)	20	5	41.25%
LIHD*	LIBOR+0.5%(floating)	15	5	35.11%
MIHD	LIBOR+0.5% (floating)	12	4	28.75%
MILD *	LIBOR+0.5% (floating)	8-10	2-3	17.11% - 24.56%

*According to the World Bank Statistical Appendix 2003

Source: Ministry of Commerce (2011), India

As OECD defines them, the concessional loans are 'extended on terms substantially more generous than market loans' and 'the concessionality is achieved either through interest rates below those available on the market or by grace periods, or a combination of these. Concessional loans typically have longer grace period' (OECD 2003). In the case of HIPC, the interest rate charged under the Indian LOC is 1.75% at the fixed rate, with 20 years' repayment and a five-year grace period. The grant element constitute 41.25% of the loan, making it highly concessional (EXIM Bank 2010; Rao 2006). Thus, on the basis of the concessionality of loans, Indian LOCs targeted towards heavily indebted African countries definitely qualify as overseas development assistance (ODA) because they carry a grant element of at least 25%.

But can Indian LOCs be technically considered as ODA?

As India does not adhere to OECD/DAC guidelines and extends LOCs as one of its development cooperation tools, it is important to understand what definition of development assistance it would fall under and whether it can technically qualify as ODA or not. Looking into the OECD's wider definitions of official development finance, it seems that it could either fall into the classification of ODA or officially supported exported credits (OSEC), depending on the purpose and concessionality element of the financial flows (OECD 2003).

As discussed above, Indian LOCs have qualified as ODA on the basis of their concessionality element as they carry a grant element of more than 25%. Nevertheless, since the purpose of LOCs extended by India is to promote international trade through financing the export of goods and services, it is likely that they would fall into the category of OSEC and not ODA. It is important to explore how OECD/DAC segregates the issue of LOCs vis-a-vis grant element/concessionality. It is interesting to note that OECD guidelines on ODA state that any 'lending by ECAs – with the pure purpose of export promotion – is excluded' from the category of ODA. Therefore, based on this guideline, Indian LOCs do not qualify to be termed as ODA.

What's the Issue of Tied Aid vis-a-vis Export Credit?

The issue of tied aid in Indian lines of credits originates from the blurred line drawn between the way official development aid and officially supported export credit is defined by the OECD. It is important to mention that on the one hand, development cooperation directorate of OECD excludes export credits to be termed as an ODA and on the other hand, trade and agriculture directorate of OECD agrees that officially supported export credits cannot be considered as tied aid as long as it is in conformity with their agreed arrangement. Thus OECD DAC members are agreeing to have complimentary policies for export credits and tied aid where export credit policies should be based on open competition and the free play of market forces. At the same time, tied aid policies should provide needed external resources to countries, sectors or projects with little or no access to market financing (OECD, 2009a: 17). At the moment it seems that India like other southern donors is not interested to locate whether its lines of credit falls under the category of ODA/ tied aid or not because extending such lines of credits is primarily considered as promotion of trade and investment under South-South cooperation rather than as foreign aid.

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