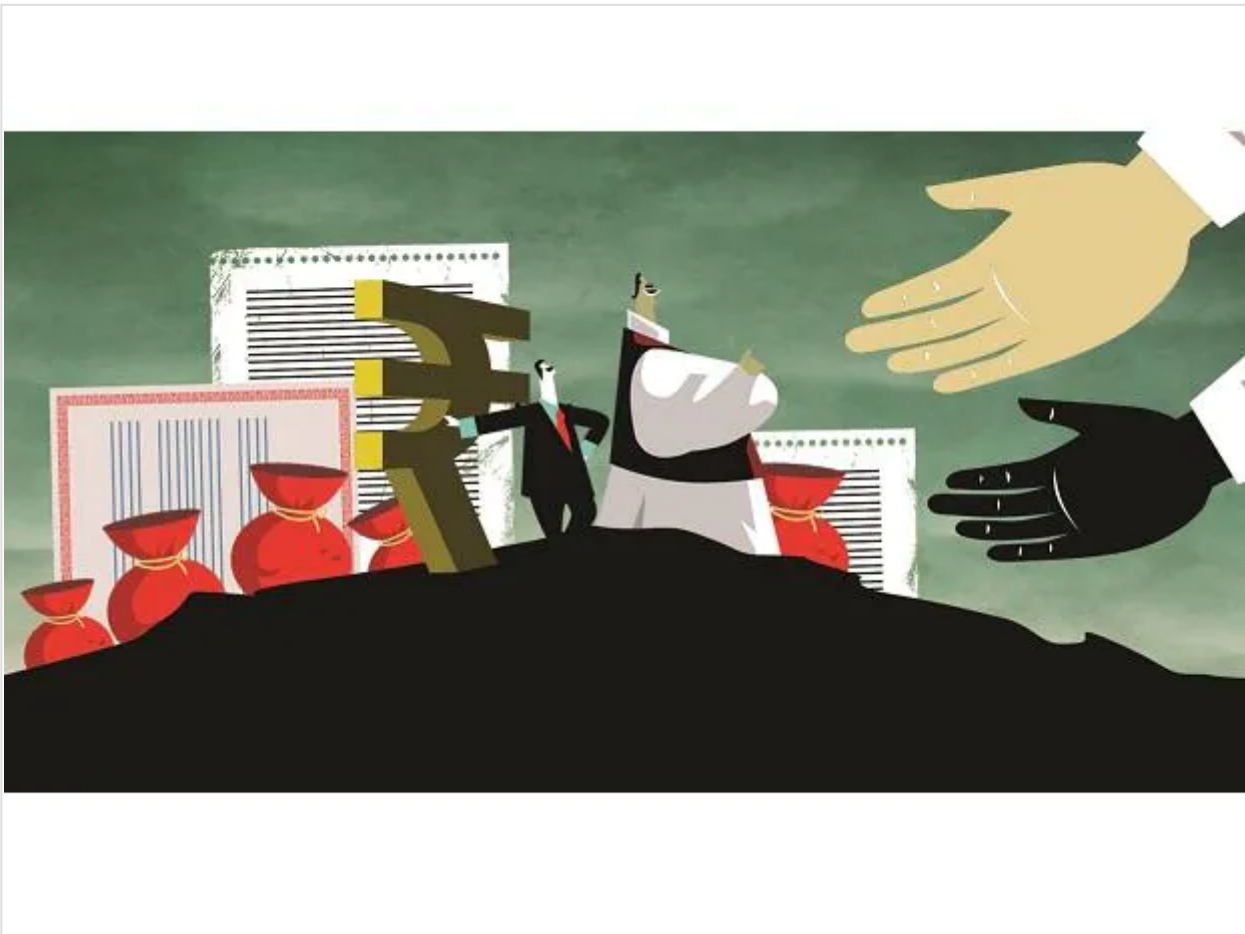


Govt plans to offload some of interest cost on aid given to partner nations

The central government plans to tweak letters-of-credit rule

Subhomoy Bhattacharjee | New Delhi June 06, 2022 Last Updated at 06:06 IST



The last time India made any change to its international loan portfolio was in 2004. Illustration: Binay Sinha

The central government plans to offload some of the interest cost on aid given to partner countries. This will allow it to make greater intensive use of the letters of credit (LOC) it offers as development aid to countries.

At a time when India's neighbours are requesting more aid, the government reckons this will expand the use of the rupee loans it offers. India's Exim Bank has a portfolio of 310 LOCs, with credit commitments aggregating \$31.96 billion to 66 countries. The sum is substantial, considering India's fiscal breadth.

Under the new deal, countries will be encouraged to finance the interest equalisation portion of the LOC, but as bilateral transactions with India. "It will marginally raise the cost of these for recipient countries, but only in the long term," said a government official privy to the discussions.

In the initial period of the LOC, when there is usually a moratorium on repayment and the needs are the highest, the countries will not need to pay interest charges. India will also continue to bear the exchange risks in the LOCs opened. The changes have to be cleared by the Union Cabinet before implementation.

The last time India made any change to its international loan portfolio was in 2004. Until then, the LOC used to be implemented directly by the finance ministry. The responsibility was taken over by Exim Bank on behalf of the government through its India Development & Economic Assistance Section.

In this fiscal year (2022-23, or FY23), the government has already made one change to its aid structure, bringing State Bank of India (SBI) into the scheme. The government signed an agreement with Sri Lanka under which SBI would provide a \$1 billion of 'short-term concessional loan facility'. While this is not the same as Exim Bank's LOCs, the potential has expanded since SBI can offer a much larger balance sheet.

But the flip side is that as a commercial lender, SBI or other Indian banks will want the recipient to put up some money under the arrangement. While there are plans to expand the Exim Bank equity, it is still short of what India's development partner countries would like. In 2021-22, the Government of India ploughed Rs 750 crore capital into Exim Bank. A further capital infusion of Rs 1,500 crore in FY23 was announced by the government in the Budget this year. This is where the plan to offload some of the interest cost will come in handy.

An LOC offers comfort to sellers from, say India, if its foreign buyer is unable to pay for the goods exported to them, the foreign buyer's bank will pay for the business instead.

Commenting on the proposal, Sachin Chaturvedi, director-general of Research and Information System for Developing Countries (RIS), a Delhi -based think tank for international trade, said, "India has a very transparent development cooperation relation with its partner countries. Recipients will be keen to use the LOC once they sign the contract instead of leaving those unused, at times". A publication titled '75 years of development partnership' brought out by RIS shows India has been offering support since Independence, but the volume, especially based on LOC, has increased significantly in recent years.

The Reserve Bank of India has worked with the US Federal Reserve, the Bank of England and others on a World Bank led programme to develop general principles for credit reporting applicable to all countries. It addresses the fundamental problem of information asymmetry between lenders and borrowers, in the use of LOCs.

In the aftermath of the Covid-19 pandemic, the challenge is to ensure countries continue to receive them, even if they slip up on payment schedules.