External Aid to India

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1 Insignificant quantum

From the perspective of donors, India is an important recipient country. Both for the multilaterals such as the World Bank and the United Nations Development Programme (UNDP), or the bilaterals such as UK and The Netherlands, the share of aid to India in their total aid basket is quite significant. However, *per capita* assistance and aid as a percentage of India's Gross Domestic Product (GDP) is much less than that of other developing countries, and has declined over the years. The annual disbursement of total aid to India (about US$3.6bn, counting both loans and grants) translates into *per capita* assistance of roughly US$3.5 per year, which is just 5 per cent of what Egypt receives. According to a World Bank study, aid to India was only 0.3 per cent of its Gross National Product (GNP) in 2002–03, whereas the corresponding figures for Uganda, Pakistan, and Vietnam were 11.2, 3.6 and 3.6, respectively. Aid as a percentage of total government expenditure in India is about 2 per cent at the time of writing, and is declining sharply every year.

Most aid is concessional/semi-concessional, i.e. at nominal/lower rates of interest and with longer maturity periods. In addition, civil society received US$1.05bn[1] during 2000–01 from international not-for-profit organisations. This includes a large number of religious trusts, although they may also be spending on rural development, healthcare and relief.

In absolute terms, while external receipts including grants have not been increasing, total repayment has increased. But the external debt to GDP ratio fell from 41 per cent in 1991–2 to 22 per cent in 1999–2000, and to 17.6 per cent by end of March 2004.

1.1 Overall assessment of aid

External assistance, while not very large quantitatively, is of considerable significance in qualitative terms. First, it creates an additionality of resources for social and infrastructure sectors, the two most important areas of concern in India's development policy. Second, international agencies maintain proper documentation of pre-project studies which leads to better design of projects. The donors send a team every six months to the project areas and the lessons learnt are used for mid-course corrections. This is followed by mid-term and final evaluations. They also fund research projects on socioeconomic issues relevant to that sector. Because of the wealth of data generated by the donor promoted consultancies, it becomes possible to identify and pinpoint the shortfalls that occurred, as well as the problems faced in the implementation of various earlier projects. Third, external assistance promotes the interaction of government officers with academicians and professionals from several disciplines such as sociology, anthropology, tribal development, economics, ecology and rural development.

Fourth, there is a great variety in patterns of assistance and also in fund flows (often funds are given to non-governmental organisations (NGOs) with government knowledge or approval, thus promoting government-NGO partnership), showing the flexibility and adaptability of donors to meet specific needs of the line ministries. Fifth, such programmes are comparatively isolated from political interference, and contracts are generally decided on professional rather than patronage considerations.[2] Sixth, it brings with it innovative schemes and projects that make a qualitative difference and add value to development programmes. External assistance enables the recipient to draw upon the best practices which are prevalent in particular sectors worldwide. These best practices, when adapted to local requirements, help in enhancing the impact and effectiveness of the programmes, besides bringing about attitudinal changes. Finally, it is generally felt that the outcomes

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of externally aided projects (EAPs) are much better than the other non-aided schemes. This is not only due to close monitoring, to the greater interest taken by state government officials in donor-assisted programmes.

At the same time, the limitations of external aid should also have to be borne in mind.

- EAPs demand local contributions that often leave the fund-starved states very little money for other activities in that sector. For instance, social forestry on non-forest lands in the 1980s deprived forest lands of resources.[3] Often, once an external project is sanctioned, the state Finance Department reduces the plan allocation for other schemes of that line department – diverting savings to meet ways and means crises and thus, no additionality is created for that sector. This also diminishes incentive for any department to go for external funding. And while the total money does not increase in the development budget, a great deal gets spent on consultancies especially involving foreign experts,[4] leaving less for grassroots activities.
- There is often emphasis under the EAPs on achieving immediate success rather than sustainability.
- State government officers do not take much interest at the time of the formulation of projects, leaving the crucial decisions on priorities to donor-appointed consultants who may not be aware of the field conditions. Sometimes very expensive projects are selected, such as the Sodic Lands in Uttar Pradesh by the World Bank (where the cost of reclamation of land is US$1,578 per hectare), which are hardly replicable, given the resource position of the state government. Such projects, though quite successful, have little learning value.
- Foreign money is seen as easy money and the governments do not undertake close scrutiny of the projects prepared by the consultants, with the result that the projects end up by increasing the dependency syndrome. Such projects have often led to rapid expansion in staff or jeeps or other such non-productive expenditure, such as in the Social Forestry World Bank Projects Phase I and II (1979–92), and in the T&V Scheme in the Agriculture Sector.[5]
- The projects take a great deal of time at the design and sanction level (sometimes more than three years) which exhausts the patience of officers, who unfortunately have a short-term perspective.
- Inter-donor coordination is weak.

Finally, a great deal of international experience is now available about why aid to poor countries has largely failed to spur growth or relieve poverty. It can work only if aid is accompanied by good governance and sound economic policies. For instance, aid has worked in Botswana which had good economic policies soundly administered; but not in Zambia, which had neither. Thus the focus of donors should shift to improving governance, rather than merely providing funds for schemes. Though the donors in India are keen to enter this important but complex arena, governments – especially the national government – are allergic to donors giving advice on governance. Nevertheless, many World Bank and Asian Development Bank (ADB) documents are laden with sermons on governance[6] and macropolicies. This is, however, the prerogative of large donors – smaller donors are not encouraged by national government to "meddle" in policy matters.

Despite these limitations, one can sum up that external assistance brings with it new ideas, new technologies and fresh thinking. The advantages of these spread well beyond the projects to which they are directly applied. They are often replicated (Joint Forest Management and self-help credit groups are good examples) and this replication can trigger a change which spreads over and across projects and sectors.

2 The 2003 guidelines

In June 2003, the Government of India (GoI) announced a new policy for bilateral development assistance. The policy essentially prescribes an end to grant as well as credit assistance from small bilateral donors to the GoI and state governments. It states that instead, small donor agencies are welcome to provide support to the Indian civil society and to channel funds through multilateral organisations. The multilateral partners, who were so far exempt from this restriction, have also been asked to give grants only to the registered organisations. Each bilateral partner will submit the list of organisations it wishes to assist to the concerned Joint Secretary, who would convene a meeting with the bilateral partner, wherein the government's response on the various proposals would be conveyed. The partner is expected to suitably modify the list, in light of these suggestions.

Clearly, the Indian government has tried to signal a change in its status from "aid-taker" to "aid-giver". It would like the world to believe that India is now a prosperous country with burgeoning foreign exchange reserves and no longer needs concessional finance. Affected bilaterals were gratuitously advised that their humanitarian assistance could be better utilised elsewhere for people and countries more in need. It may be recalled that the Planning Commission in its 10th Plan (2002–07) has advocated a greater flow of aid, especially concessional aid, while the Finance Ministry has acted just in the opposite direction.

The new policy of routing funds of small donors to NGOs, universities and other research organisations would have great merit if it leads to the professionalisation of the NGO sector in India. Today they are largely dependent on government funding, but to maintain their independence and autonomy they must have multiple sources of funds. Too much dependence on governments (central and state) which are not able to monitor its grants or which give grants on a patronage basis, has led to the mushrooming of the wrong kind of organisations – which has given a bad name to the entire NGO movement. With the bilateral funds going straight to NGOs, at least the genuine NGO will have a better chance of receiving grants on merit and on the basis of their past work and future potential. A vibrant and confident civil society is the best safeguard in a democracy against the abuse of power by the executive.

The best solution will of course be to give civil society access to foreign funds without any reference to the government. If there is a need to prohibit certain organisations from easy access to funds, government can intervene.

The new guidelines may, however, make it more difficult for NGOs to access donor funds in several ways.

First, smaller NGOs, which could earlier get assistance from UN organisations will now have to seek official clearance, thereby restricting the flow of aid only to older (clearance is issued only to those organisations that have been in operation for more than three years) and larger organisations.

Second, previously many groups without clearance could get bilateral funds if such funds went directly to them after an agreement with a line ministry (since it was presumed that the ministries had applied prudence in the selection of NGOs). Under the new regime, they are deprived of such assistance.

Third, as these guidelines do not apply to certain exempted bilaterals (such as the Department of International Development, DFID), there are two different procedures for an NGO to get grants from the bilaterals. The irony is that the procedure for getting grants from exempted bilaterals is simpler – even though for them, giving funds to NGOs is not a priority. But to receive grants from smaller bilaterals whose main task is now to assist civil society (and who will presumably set up new mechanisms for monitoring and reviewing such grants), added scrutiny is envisaged, which does not seem logical or helpful to the growth of civil society.

Fourth, the procedure for obtaining grants outside India from international donors has not been changed, and an Indian NGO with official clearance can easily obtain grants from them without any scrutiny. This is again anomalous, as donors based *in* India with supposedly better monitoring capability are subject to greater scrutiny, whereas donors with much less scope for eye-to-eye contact with the recipients are left free.

Fifth, earlier most bilaterals could give grants to NGOs holding official clearance without any reference to an organ of government. Now all such cases must obtain official clearance, twice over – from the Ministry of External Affairs (for political clearance) and from the line ministry (for technical approval). Since these ministries are not likely to have information on each applicant, the chances of their referring such cases to state governments cannot be ruled out. It will not only deter civil society from taking up policy advocacy issues (where they oppose government policies) for fear of losing a source of funding, but donors may hesitate to suggest organisations involved in advocacy grants. Uncertainty about approvals will also shift the attention of donors from monitoring outcomes in the field to liaising with the officials of government departments, reminding one of the licence–permit *raj* mentality. It is interesting that the national government justified stopping the flow of "small" aid in the name of reducing transaction costs, but ended up by increasing its involvement in processing individual grant applications to NGOs.

Sixth, the quantum of aid that each country brings to India is decided by their respective parliaments. In some countries (such as The Netherlands) the ratio of bilateral aid to that earmarked for multilaterals is fixed, and therefore funds that were available to the respective embassies in Delhi are more likely to be diverted to other countries rather than to NGOs or multilaterals working in India. It will be hard for the parliaments to vote grants for India which are to be routed through their embassies for the same amounts that were being voted in the past. Thus the policy will certainly reduce the total quantum of aid flowing to India.

Seventh, Indian NGOs will find even the international NGOs will give them lower priority because the Finance Ministry's announcement has created an impression that India does not need external aid. Foreign parliaments and governments often do not make a distinction between the Indian government and Indian civil society. Since a large number of countries are chasing a small amount of aid, it is more likely to flow to those countries where procedures are simpler and not riddled with uncertainty.

And lastly, many of these "smaller donors" such as the Scandinavians are in *per capita* terms, the largest donors to multilaterals like the UN. They also occupy crucial places on the boards of the IMF and World Bank. Once they are told that India is prosperous and no longer needs their assistance, are they likely to support Indian claims for resources from these bodies?

It may be mentioned here that the GoI announced in September 2004 that it has reviewed the existing policy and henceforth bilateral development assistance will be accepted from all G8 countries, as well as the European Commission. Regarding the countries of the European Union outside the G8, bilateral development cooperation from such countries which provide a minimum bilateral aid package (of US$25m per annum) is also welcome. The press note added:

> The other countries not covered by the above policy may consider providing bilateral aid directly to autonomous institutions, universities, NGOs, etc. as before. A simplified policy to facilitate the flow of bilateral assistance to non-governmental organisations and autonomous institutions will be announced shortly.

However, no new procedure has been operationalised on the ground, nor has the policy been communicated to the donors, or the new guidelines revised as of February 2005. Proposals from the NGOs are still subject to bureaucratic scrutiny as last year. So it is business as usual.

2.1 Absorbing greater aid

India uses internally borrowed funds (at market rates) for its expenditure on development, putting great stress on its fiscal deficit. The central government's devolution to the states (including both, through the Planning and Finance Commissions) at US$371bn a year is comparable with its fiscal deficit. Though the World Bank President announced twice (in 2000 and then in 2004) during his visits to India that the Bank would happily increase International Development Agency (IDA) credit to India from US$1–2bn a year, the Government of India took no steps to avail itself of this offer.

2.2 Indifference to foreign aid is explained by several things

1. Dependence on foreign aid is seen as against national interests – a Nehruvian and Gandhian legacy that overstresses self sufficiency. The impression that foreign money is dirty money and is used to "destabilise the nation" is very strong in India. This is the viewpoint not only of politicians but also the press. None of the smaller Indian states which would lose from the withdrawal of bilateral donors made a public announcement about their displeasure with the new policy. The lobby seeking liberalisation of aid flows to the government and NGOs is weak in India.
2. Since most aid is for poverty reduction and social sectors, subjects which are under the domain of state governments, the national government fears that greater aid will mean greater control by the donors of public policy at the state level. Many times in the last five years the central government complained to the World Bank and other donors about dealing with states directly, insisting that they route their communications only through New Delhi. This delays the flow of aid and is against developing a sense of ownership amongst the states.
3. The only way more aid can be absorbed in India is if it is not in project mode, but is direct budget

support with greater flexibility to the recipient states to decide its utilisation. The institutional problems and high transaction costs that accompany multitudes of projects are then avoided. Direct budget support is a form of programme aid: it is used by donors as a modality for supporting a plan or policy programme developed by the recipient government, channelled directly into the financial management, accountability and procurement system of the recipient country. These features are intended to strengthen country-ownership of policy and policy making, to develop government and administrative capacity (especially for financial planning and management), and to improve aid effectiveness. Although the World Bank and the ADB (but not DFID) have been permitted in the past to provide programme loans to the states, the Government of India has never been happy about this initiative and has generally discouraged it.

4. Central government ministries have no incentive to chase aid funds, as their plan allocation does not increase when they receive external funds. The proposal of the Planning Commission that external aid should be over and above the plan (as it is for the states) has never found favour with the Finance Ministry.
5. Though all Indian states in the not-so-distant past had excellent financial systems to absorb aid (both internal and external), administration in the poorer states has lately come under great stress, which affects not only the utilisation of external funds, but also central funds received from the central government. Even IDA assistance remains undisbursed. Fund flows from the central to the state governments, and from state governments to projects, procurement/contractual delays, and conditionalities related to projects are some of the main reasons for the poor utilisation of aid.
6. Poorer states are under great fiscal stress, and are often not in a position to provide matching funds either for donor funds or for central government schemes. Therefore donors should provide matching funds to the states so that they can attract more central funds, especially in schemes that directly benefit the poor. It is understood that such a proposal was made by the Orissa Government to DFID, but it did not find favour with DFID.

Since aid forms only an insignificant part of total state government expenditure (2 per cent in Uttar Pradesh and 4 per cent in Orissa), the issue that needs examination is how one steps up utilisation of central funds and states' own plan funds – rather than merely looking at the absorption of external aid alone. Some of these constraints are as follows:

- State governments seldom get their full annual budget passed by the legislature. Instead, the budget is passed in two instalments, first for four months and later for the full year. This increases paperwork and delays the allotment of funds, keeping implementing agencies waiting.
- Some states, such as Bihar, have concentrated the powers of issuing financial approvals with the Chief Minister or Cabinet. This delays the whole process of issuing approvals by several months.
- A large number of vacancies in field posts implies that the power to approve expenditure is not with the person who has the temporary responsibility for that office.
- Too little decentralisation has occurred, and even senior officials have limited financial powers.
- Some states (e.g. Orissa) cannot find matching funds (because of financial stress) to access central funds, which also has implications for external aid.

In addition to these constraints on maximising expenditure, there are also problems of leakages and inefficient delivery. This in turn requires improving the governance, productivity and accountability of government machinery. Perverse incentives (short tenure, promotions based on seniority and not merit, important posts given on the basis of political clout rather than performance) are not the only factors undermining the effectiveness of the bureaucracy. Its composition is also skewed. For instance, in most states, about 70 per cent of all government employees are support staff unrelated to public service – drivers, peons and clerks. Key public services – education, healthcare, police and the judiciary – are starved of people, whereas many wings are overstaffed. It is not that Indian bureaucrats are bad; in fact many are smart, hard-working, and dedicated professionals. But the perverse incentives that they face explain the government's indifferent performance. Bureaucracy works best where there is strong feedback from beneficiaries, strong incentives for the bureaucracy to respond to such feedback, easily observable outcomes, a high probability that bureaucratic effort will translate into favourable outcomes and competitive pressure from other bureaucracies and agencies. Such conditions do not exist in many poorer states of India.

The concept of good governance needs to be translated into a quantifiable annual index on the basis of certain agreed indicators such as infant mortality rate, extent of immunisation, literacy rate for women, gender ratio, feeding programmes for children, availability of safe drinking water supply, electrification of rural households, rural and urban unemployment, percentage of girls married below 18 years, percentage of villages not connected by all weather roads, number of Class I government officials prosecuted and convicted for corruption and so on. Central transfers should be linked to such an index. Some universally accepted criteria for good budgetary practices may also be included in the index. Once these figures are publicised, states may compete to improve their scores.

3 Summing up

Despite satisfactory economic growth in India in the last two decades, social indicators continue to stagnate and the MDG targets seem difficult to achieve. Fast progress in the livelihood sector would need more foreign aid, especially on soft terms, simplified procedures and institutional reforms towards better governance. Above all, the Ministries of External Affairs and Finance, which decide how much aid India should aspire for, must change their anti-aid posture and act in the interest of millions of the poor and deprived who stand to benefit with greater flow of aid to the country.

Notes

1. 1 crore = 10 million; US$1 = 43.5 Rs in 2005; US$1m = 4.35 crore Rs.
2. Secretary, a State Public Works Department, once told me that many PWD engineers were keen to come back from the World Bank Roads Project to the normal Provincial Division, where supervision is lax and opportunities to take commissions were higher.
3. In hindsight, it would have been more cost effective to regenerate degraded forests than barren wastelands.
4. According to a DFID report (August 1999) the donor produced 160 consultancy reports for the small Himachal Pradesh forestry project of Rs 40 crores, in two districts. Many of these reports have never been read, let alone acted upon by finance department (FD) staff. It caused a tremendous burden to the local staff. The gainers were the British Universities (Mid-term Appraisal of the 9th Plan: 332.
5. A senior official of the FD recently told me that the World Bank had no moral authority to ask the Uttar Pradesh Government to cut down on its staff now, as maximum increase in staff and non-plan expenditure had taken place due to the Bank's projects in the past.
6. Improving governance is the explicit and main plank of the 10th Plan Document for reaching the desired targeted growth. It is difficult to understand why the Ministry of External Affairs officials get upset when the European donors talk about the subject.