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## Foreign Loans and Development in the Twentieth Century India: An Over View of Conceptual Issues and Implications

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**Abstract.** The flow of foreign loans occupies a critical position in the economic development of the developing and under developed countries. Some writers view it in terms of the “dependency theory”, which states that foreign economic assistance is a tool through which the “center” exploits the “periphery” and so, the latter continues to remain undeveloped. Here, the center is donor and the periphery is the capital-receiving country. Less income levels, resources, inherited poverty, lack of good governance, political instability are some of the reasons for countries to inter into the trap of foreign loans. The article explains various definitions of foreign loans, its varieties and features. It examines into the needs which compels the countries go for foreign loans and also the donors, their characteristics and nature. Further it looks into the implications of foreign loan on the economy, social sector, agriculture, environment and politics of a country.

**Keywords.** Foreign loans, Debt, Development, Economy, Balance of payments, Donors, Social sector, Agriculture, Environment, Politics.

**JEL.** D02, D69, H81, F63.

### 1. Introduction

Economic development in developing countries is intimately linked to the inflow of foreign capital, which could be private, bilateral or multilateral, and may be broadly described as foreign loans. Economists have agreed that it is a catalytic agent in the process of growth. Rapid and perhaps stable growth is not possible without the steady and continuous inflow of foreign capital (Dalaya, 1990).

The United Nations and its various economic agencies argue that, if world peace and prosperity have to be maintained over a long period, the disparities in the stages of economic development or in the levels of income and standards of living between different countries have to be removed. At the ideological plane, the non-communist countries opine that the disparity has to be removed if communism has to be stalled. On the other hand, the communist countries themselves use the export of capital for enhancing their influence in non-communist countries (Dalaya, 1990).

The gap in income levels and growth rates between the developed and developing economies can be narrowed down by the export of capital to the developing economies through loans. These loans, are termed in other words, as the “foreign debt of the state”.

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### 2. Definitions

Debt is “an obligation to pay money – in a definite amount at a definite time and place. Debt is negative wealth, stated in a unit of account” (Hart, 2000). People value commodities and services gold, reckon up wealth, and calculate debts, using a particular unit of account such as gold. In simple terms, foreign debt refer to a country’s borrowings from the banks of other countries and from international capital markets.

External borrowing or foreign loan is also defined as “the acceptance by a government or a government agency of real or financial resources from an external source with the obligation of repaying such resources in specified amounts to that source at one or several specified future dates” (Kaj, 1969).

The term “foreign debt of the state” includes, all the debts payable to creditors residing outside the country in foreign exchange, goods or services, by the national government or any public autonomous body (like the provincial governments, municipalities, port trusts, public administrations, and so on). The debts, which are guaranteed by the state but repayable by private persons or bodies, are not included here. The creditors can be other state governments and their organizations or international organizations or even private persons or bodies (Dalaya, 1990, p. 3).

In 1988, International Working Group on External Debt Statistics (IWGEDS) provided an exhaustive definition of debt, and an international framework to construct comparable set of data for various countries. India has accepted this definition. The IWGEDS definition of debt states, “gross external debt is the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to non-residents to repay principle, with, or without interest or to pay interest with or without principle.” (Reserve Bank of India, 1998, p.5).

According to the IWGEDS report the definition should be taken in conjunction with the long-standing and authoritative body of definitions continued in the IMF, balance of payments (BOP) manual. Use of the BOP definitional system is of fundamental importance in deciding whether a contractual liability is external or domestic. The existing BOP criteria clearly define the terms “resident” and “non-resident” (Ramachandra, 1990, p.59).

The concepts of residence for individuals are defined in the manual. “The concept of residence adopted for individuals is designed to encompass all persons who may be expected to consume goods and services, participate in production, or engage in other economic activities in the territory of an economy on other than a temporary basis. These are the persons whose general center of interest is considered to rest in a given economy” (Ramachandra, 1990, p.64).

The residents of an economy comprise the government, industrial, private non-profit bodies, serving individuals and enterprises, all defined in terms of their relationship to the territory of that economy. Included with the territory of an economy are, its territorial seas and those international waters beyond, its territorial waters over which the economy has or claims to have exclusive jurisdiction overseas territories and possessions may or may not be regarded as separate economies (Ramachandra, 1990, p. 64). The World Bank has also defined the stock of external debt as “ that debt which is owed to non-residents of the country and repayable in foreign currency” (World Bank, 1998, p.78).

The term ‘debt’ implies a liability, represented by a financial instrument or other formal equivalent. The United Nation’s System of National Accounts (UNSNA) defines financial assets and liabilities as, “ the gold, currency and other claims on other parties owned by an economic agent, or the claims on an economic agent owned by other parties” (Ramachandra, 1990, p. 59).

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The problem of external debt in any country is related to its monetary and fiscal transactions with the rest of the world. When we talk about total debt we are referring to a stock concept. Debt as a stock is measured at a point of time, as an amount of debt outstanding at the end of a period and adds cumulatively all the debt that has not been repaid up the end of that period. The principal is the amount of debt incurred. The interest is the cost of incurring debt, since the debtor must pay the creditor a certain amount over and above the repayment of the principal. As a flow concept, debt is calculated over a period, as the difference between what the country has received and what it has to pay for interest or principal during the same period (Pinto, 2000, p.32).

### 3. Loan: Varieties and other Features

There are various ways of classifying external debt. The World Bank follows a simple procedure. Debt is first distinguished in terms of its maturity. Long-term debt is defined as debt having an original extended maturity of more than one year, while short-term debt refers to debt having a maturity of less than one year. Debt can also be classified by considering the type of guarantee provided by the debtors. Public debt is one implying the external obligation of a national government or one of its agencies to repay it. Publicly guaranteed debt is the external obligation of a private debtor that is guaranteed for repayment by a public body. Private non-guaranteed external debt refers to the obligation of a private debtor and its repayment is not guaranteed by any public entity (World Bank, 1998, pp. 84-85).

Debt is also distinguished by the category of creditors. Official debt refers to credits from various governments or agencies (multilateral) from single governments or agencies (bilateral) and from the World Bank (World Bank, 1998, p. 87).

The Government of India has adopted a similar classification. In the long-term loans, the creditors are multilateral as well as bilateral institutions and countries. The borrowers are the government and non-government agencies with concessional and non-concessional credits. The commercial borrowings, include the loans from International Bank for Reconstruction and Development (IBRD), securities borrowing, and Non Resident Indians (NRI) deposits, up to one year including accrued interest, and other foreign loans with one-year period and including accrued interest (GOI, 1999, p.67).

### 4. Need for Foreign Loans

The two-gap model can explain the need for foreign borrowing by the less developed countries. The Two-gap model is the analysis of saving-investment gap and export-import gap. The savings-investment gap is the difference between the savings and the investment and the difference between imports and exports the export-import gap. The relation between the two gaps implies that an open economy can invest more from its savings only if its exports exceed imports. If this does not happen then the foreign borrowing will cover the difference between imports and exports. In this case, foreign borrowing is necessary to supplement domestic savings and to raise investments beyond the savings permitted by the domestic economy (Awasti, 1995, p.47).

A low level of income reduces the capacity to save. This low level of income is reflection of low productivity, which is largely due to lack of capital. In such a situation, developing activities, whether planned or unplanned are directed towards increasing the Gross National Product (GNP) by boosting the level of investment significantly. Since most of these investments are in the underdeveloped sectors, it also necessitates importation of industrial machinery, raw material, technological

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know how etc. Since payment for most of these imports is done in foreign exchange, export earnings cover a part of such exchange payments. But the narrow industrial bases and under developed sectors will not allow increasing the export earnings. Hence, these limited export earnings leave a trade gap to be filled substantially by foreign loans and capital inflow (Roy, 1986, p.23).

Resources generated through domestic savings and foreign exchange earned through exports of goods and services continue to be scarce in relation to the requirements of finance for development purposes, in most of the developing countries (Awasthi, 1995, p.85).

The capital is an instrument that can enhance economic development and increase productivity. Lack of capital formation is being considered as a prime factor, contributing to the underdevelopment of a country. This capital is also used as investment. In this sense, capital formation and investment both are synonyms and occupy central position in economic development. Underdeveloped countries or developing countries cannot save large part of its income for investments. Therefore, they need more capital and go for foreign borrowings (Tiwari, 1999, p.86).

Developing countries, which are trying to embark on the path of economic development and trying to achieve self-reliance and self-sustained growth, need more financial assistance or loans than they possess to achieve their goals (Saxena, 1982, p.42).

The degree of industrialisation as measured by the share of manufacturing industries in GNP or the percentage of the labour force employed in such industries of these countries is considerably less. In order to achieve the required growth they seek the foreign capital or go for borrowings (Saxena, 1982, p.53).

In some developing countries, the economic structure reveals a dualism, in the form of the coexistence of technology-intensive industrial sector on the one hand, and a backward traditional sector on the other. To bring development to these backward sectors, the countries need huge amount of resources and modern technology (Saxena, 1982, p.55).

Alleviation of poverty pre-supposes increase in national and per capita incomes at a rapid rate, which can be achieved partly with the help of external resources (Tiwari, 1999, p.15). By facilitating additional capital formation and more efficient technique of production, such aid can enable the underdeveloped countries to use their natural as well as human resources. It further helps in effectively removing various constraints thereby increasing the capacity of the economy to produce more.

Foreign borrowings are necessary to fulfill investment and technical gap in developing countries. The broad governing principle is that the foreign investments should be permitted in spheres where new lines of production are to be developed or where special types of experience and technical skills are required or where the volume of production is small in relation to demand. This also should be encouraged when there is no reasonable expectation that the indigenous industry can expand at a sufficient rapid pace on its own (Bhambri, 1980, p.26).

Jawaharlal Nehru in a speech in Parliament of India on April 6, 1949 remarked that, "our national savings will not be enough for the rapid development of the country on the scale we wish" and further suggested that, "in many cases scientific, technical and industrial knowledge and capital equipment can best be secured along with foreign capital" (Bhambri, 1980, p. 29).

Foreign borrowings will help to import the industrial equipment and raw materials (Bhambri, 1980, p.34). The economic development would require under these assumptions, a large import surplus, which would allow capital investment without requiring curtailment of current consumption. The import surplus would be

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financed by a reduction in resource holdings, supplemented by modest amounts of foreign aid (Bhambri, 1980, p.31).

Borrowing increases the financial and real resources currently available, which are used to enhance the availability of resources in the future (Bhambri, 1980, p.32). External factors for borrowing loans include deteriorating income in terms of trade caused by falling growth in the demand for primary products and rising interest rates caused by the stance of economic policies in the industrial countries. For example, excessive domestic inflation, which tends to result in currency overvaluation, may be caused by excessive fiscal deficits and monetary expansion or by an increase in import prices (Bird, 1989, p.1).

### 5. Balance of Payments

The supply of foreign exchange is determined by what the country is earning from its exports or receiving in the form of loans, gifts and investment. If the supply and demand of foreign exchange at the official exchange rate is persistently out of balance, the governments buying or selling operations will encounter serious difficulties. In the case of deficits, the government's holdings of foreign exchange reserves will be exhausted by the perennial necessity to meet the gap created by mismatch between demand and supply of foreign exchange. Then the balance of payments crisis will rise (Payer, 1974, p.2).

When payments for interest and amortization of the foreign debt absorb a large proportion of export earnings, making it impossible to finance the usual level of imports, it tends to become the main cause of the payments crisis (Payer, 1974, p.14).

The growing importance of debt at hard terms in financing the balance of payments has been accompanied by a shift in the role of foreign savings in the Indian context. During the first five years of the 1980s foreign savings averaged around 1.6 percent of GDP and accounted for about seven percent of gross national savings. And during 1986-88, with the ratio of foreign savings to GDP rose about two to three percent, the share of foreign savings in gross national savings was also rose to more than ten percent (CRNIEO, 1991, p.32).

The dependence on debt for financing both the investment –savings gap and the balance of payments gap will result in rise in the debt and GDP ratio. Debt is the principal form of financing the current account deficit, which in turn depends on the deficit on the balance on account of current transfers (CRNIEO, 1991, p.34).

A rising debt and GDP ratio would at any level of the interest rate, raise the interest and GDP ratio on the current account as well. This implies that the net deficit on the trade and current transfer account would have to decline in order to maintain a constant current account deficit and GDP ratio (CRNIEO, 1991, p.33).

### 6. Donors: Character and Nature

Three major donors give foreign loans, the bilateral creditors, multilateral creditors and the commercial creditors. Most of indebted countries, especially the poorest still owe the larger part of their public debt to bilateral creditors. Bilateral creditors are the individual countries. Debt owed to them generally results from aid loans or guaranteed export credits. Bilateral creditors fall into two categories: Paris Club and non-Paris Club creditors. The Paris Club is primarily the developed western countries, which belongs to the Organization of Economic Cooperation and Development (OECD). It gives about seventy percent of bilateral debt. In this Japan is the largest creditor, followed by United States, France, Germany, Britain, Canada and Italy. The non-Paris Club creditors are Eastern Europe and the Arab States (IDRAD, 2000, p.13).



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Two primary sources of official loans from multilateral institutions are the International Monetary Fund (IMF) and World Bank (WB). The regional development banks such as the Inter American Development Bank and Asian Development Bank also come under category. Member countries govern these institutions. If a debtor country does not make payments on its loan on time, it is considered 'off-track' and will not receive loans from other creditors. Until 1996, the International Finance Institutions did not allow rescheduling or cancellation of their loans (Carvonmis, 1984, p.120).

The commercial creditors are the private commercial banks, e.g. Citi Bank, Chase-Manhattan, City Corp., National West Minister. They were the principal lenders in the 1970s with little appreciation of the risk of international lending. In the 1980s, when specific countries did threaten to go bankrupt, much of this commercial creditors debt was transferred to the IMF and the WB. After bilateral and multilateral sources, commercial banks are currently the third largest creditor group for many countries (Pinto, 2000, p.120).

### 7. Repayment: Schedules and Conditions

To determine, whether a debtor nation will be able to service its debt or not, two considerations are important (Bird, 1989, p.27). Firstly, the relationship between the marginal productivity of the resources borrowed and the rate of interest on the loans is of a crucial importance. For as long as the marginal productivity exceeds the rate of interest the loans may be serviced and some contribution made towards repaying the principal. Where, the rate of interest exceeds its marginal productivity, there will be debt-servicing problems and the debtor may be forced to try to take an extra debt to meet existing obligations.

Secondly, borrowing may be viewed as a way of closing a domestic saving gap, which means the gap between the savings required to finance the investment, which is itself needed to achieve a targeted growth rate and the actual amount of domestic savings. Other things remaining the same, a rising savings ratio will offer a better prospect that the debtor will be able to meet its obligations than if the ratio is falling.

Since borrowings are conducted in foreign exchange, excess savings have to be converted or transferred into additional foreign exchange. The foreign borrowing is undertaken to reduce foreign exchange gap, which means the gap between the foreign exchange needed to buy the imports, which are useful to achieve development and the foreign exchange, earned through exporting. For the repayment of these borrowings the country has to reverse this gap and move into a current account surplus (Bird, 1989, p. 4).

The main idea with rescheduling is to allow debtor countries more time to service and repay their debt by spreading out their existing obligations, with a relatively high discount rate in debtor countries. Rescheduling serves to reduce the present value of a given stock of debt obligations. The benefit from rescheduling depends mainly on how the loan provided is used (Bird, 1989, p.27).

External debt-service problems manifest themselves in balance of payments deficits and foreign exchange shortages. There is a tendency on the part of both debtors and creditors to avoid renegotiations of original loan terms. Borrowers are aware that deviations from payment schedules damage their credit standings. If lenders don't go for rescheduling, the debt-service problems can lead to a unilateral moratorium on the payments by the debtor, an outright repudiation of debt by the debtor or declaration of default by the creditor (Carvonmis, 1984, p. 62).

In the case of IMF and World Bank, they give emergency loans for the rescheduling. The disbursement of these funds, being contingent upon the

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borrowers with an agreement on conditions in adjusting its fiscal and monetary policies. This refinancing is also made contingent upon continued conformity to the conditions of the IMF loans. Paris Club rescheduling include an initiative clause under which the debtor promises to enter rescheduling negotiations with commercial lenders, i.e. private banks existing in their respective countries (Carvonmis, 1984, p.63) .

The commercial banks view rescheduling as an extreme event and avoid renegotiations of contracted in full debt until liquidity crises are under way. They call for a case by case approach to restructuring. The commercial banks do not set their own conditions on debtor's policy (Carvonmis, 1984, p.63).

### 8. Impact of Foreign Debt

The impact of debt depends upon three sets of factors. Firstly, what kind of expenditure does debt financed spending spill over into and what are their second and subsequent stage demand generating effects. Secondly, what kind of effect does debt-financed expenditure has on the state of liquidity in the economy. And finally what is the degree of manipulability of the system in general and the state in particular to shape supplies in keeping with demand (Chandrasekhar, 1991, p.23). In the first one, the impact of debt, which generates additional income at different slabs and the distribution of that additional income between the consumption and saving. In the second matter, if the finance improves the gap between the income and the expenditure in favour of income generation, that additional income can be useful to fill the debt repayment and partly some development activities. This finance improves the supply according to the demand, and the consumption will increase thus generating the additional income on the sector, which is financed. On the other side their supply and demand ratio could keep the prices in control. This gives a free hand to government to provide subsequent nutritional levels to the poor.

### 9. Impact on Economy

If the debt service as a percentage of gross external indebtedness increases than the share of new debts used to amortize overall indebtedness and to pay interest the country will fall into serious debt trap (Aman, 1982, p.3).

Indebtedness has been one of the most usual ways of losing important areas of economic autonomy, or even political independence. Sometimes totally lacking in resources or the resources being abundant, but with limited capacity for self financing and, extremely dependent on foreign aid to use the resources, they will have no other alternative to escape from strong external indebtedness to maintain essential imports to ensure basic consumer levels (Aman, 1982, p.5).

Another more common case, relates to those countries, whose indebtedness is strong and they adopt a model of development or the economic and social policy, which is followed by the dominating groups of a certain ideology of development (Aman, 1982, p.5).

The lack of interest to develop indigenous technological processes, which increase the welfare of the population, is another form of indebtedness. Modernisation strategies are said to be reduced to instruments of subordination to industrialised countries. There has been a dangerous acceleration of the technological and financial dependence since the end of the Second World War. Beyond its various forms, the result has been the passive consumption of technology, a fragmented economy, loss of control of the economic system and growing indebtedness (Aman, 1982, p.7). This resulted in an industrialization

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model built on foreign investments leading to massive indebtedness because of import of capital goods and inputs.

The lack of symmetry between the growth of imports which lead to outflows on current account and growth of exports brings a more or less chronic deficit in the balance of payments. This leads to increasing indebtedness (Aman, 1982, p.10).

A considerable social cost is found to be in terms of high unemployment and repressive measures to oblige wageworkers to accept the reduction of their real earnings. The gap in income distribution is a major obstacle to saving and investment. A major diversion of the loans to repay the debt instead of using them for production in many cases has resulted in significant drops in Gross National Product. The liquidation of a considerable part of national industry has also taken place. This is due to the interplay of the reduction in sales due to the competition from imports whose entry is favored by the dismantling of effective protection and by the exchange policies, and the high cost of money, due to the freeing of interest rates (Aman, 1982, p.11).

Due to this the debtor faces deteriorating income terms of trade. It is more likely to encounter debt problems than where its terms of trade are improving.

Where the interest rate is higher than the growth rate, exports favour trade surplus will be required if the debt-export ratio is to be prevented from increasing. With export growth greater than the interest rate, a constant proportionate trade deficit will not raise the debt-export ratio. In these circumstances, a potential borrower will be encouraged to continue to acquire debt (Aman, 1982, p.11).

The Government may, in principle may be able to influence the productivity of investment through domestic economic and social policy, the domestic savings ratio, through taxation and interest rate policy and exports and imports through domestic macro economic policy as well as through exchange rate policy (Aman, 1982, p.4).

The purpose of economic adjustment is to free foreign exchange, which may be used to meet debt obligation. The options are either to expand exports or to contract imports. Although governments may, through appropriate policy, stimulate export growth, the extent to which this will occur will be constrained by the state of the market for the exports of developing countries. If the governments of industrial countries are pursuing anti-inflationary policies, which restrain the growth of demand in their economies and at the same time, also pursue protectionist measures to limit imports and avoid payments deficits, then the environment will not be conducive to export expansion by the debtor nations. In such circumstances, they have to reduce imports either by deflating domestic demand or by imposing their own controls on imports. One possible externality of this is social and political unrest within the debtor countries, which could result in the undermining of democracy. This will result in falling economic growth and declining export prospects due to shortages of required imported goods in developing countries (Aman, 1982, p.8).

On the other hand, external borrowings widen the choices of a government in determining the use of resources over time and create additional opportunities for resource reallocation. The loan reduces the constraints on all types of current domestic expenditure caused by the country's own productive capacity and also reduces the scarcity of foreign exchange (Seiber, 1982, p.8).

The foreign loans or capital supplements the lack of national resources and helps to raise the rate of capital formation. This leads to a higher rate of investment and a higher rate of economic growth (Avramovic, 1962, p.3).

The external borrowing is most often focussed on the increased opportunity for expanding imports of capital goods. This borrowing also influences consumption and trade in consumption goods. To achieve the exports, growth from external



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borrowing, the loans or investment of foreign capital should put in to the production of export goods (Seiber, 1982, p.10).

The benefit of aid or official concessional loan lies in the availability of capital at a lower than market rates to be used for developmental activities. This will decrease the burden of debt repayment problem for the borrowing countries and they can use these loans for social development activities to improve the condition of poor and under developed (Seiber, 1982, p.11).

Borrowed loans also serve to ease the shortage of foreign exchange. In addition filling the foreign exchange gap can help to repay other loans. Borrowing for balance of payments purposes may be done to support payments deficit while making necessary structural adjustments in the economy (as in case of IMF drawings) or simply to tide over a short-term, temporary deficit (Avramovic, 1962, p.13).

### 10. Impact on Social Sector

There are two components of a debt- the first one is size and the second one is the rate of interest combined with the period (Khanna, 1997, p.26). The size of debt needs to be analysed looking at the capacity of the country to repay. A foreign currency loan is required to pay in foreign currency only. The export volume reflects the foreign exchange earnings and out of these foreign exchange earnings the foreign debt is to be serviced. But if a country also borrows from foreign countries or institutions to repay and service its debt, it is ought to fall into debt trap. This phenomenon of borrowing to repay interest is termed by the economists as 'debt trap'.

This debt service, which comes from the internal resources of the indebted country, is made generally by diverting scarce resources from social sector expenditure and additional investments necessary for social and economic development of indebted nations. In many cases, these indebted nations are quite literally in bondage to their creditors. In countries like Peru, in Ecuador, Philippines, Zambia, and Cameroon people live with the consequences of such debt traps. These are indicated by health centers without equipment, drugs or trained staff, schools without basic teaching equipment, with teachers who have not been paid for months, and collapse of agricultural advisory services. For many people life has become a fight for survival due to the debt trap. Many of them have to struggle to maintain health and nutritional standards, to keep their jobs and to keep their children in schools (Pinto, 2000, p.7).

The obligation to meet debt service payments means that aid from countries other than the creditor countries, is often used to refinance debt payments rather than for improving health care, education and other social services (Pinto, 2000, p.8).

### 11. Impact on Agriculture

Because of the World Bank policies in agriculture like encouraging cash crops to benefit farmers and to improve export ratio against imports and to earn hard currency to make debt service payments, there is a large shift from production of basic food for domestic consumption to cash crops for export (Krishnanath, 1964, p.8).

Some farmers are able to start growing the new crops and take advantage of export economy. Their incomes have increased. Many small and subsistence farmers have already lost their farms and occupations. They cannot afford seeds and fertilizers and do not get technical support and also cannot compete with the cheap food imports. The increasing shift to cash crop cultivation has resulted in the

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inadequate domestic production leading to local food shortages and higher prices. This has increased food insecurity for many people living under poverty line. In addition, if many countries try to export these cash crops, their prices tend to fall, and their producers and workers earn less, and suffer a lot in terms of export prices (Krishnanath, 1964, p.9).

### 12. Impact on Environment

International debts generally have to be paid back in hard currency. To earn more of these foreign currency exports have to increase. Most of exports of developing countries are primary commodities obtained through use of the natural resources. To grow cash crops, which are the main exports based products, many countries over use their soils, applying heavy doses of expensive chemical fertilizers that eventually degrade the soil. Vital natural resources are depleted. Fish stocks are damaged through over fishing. Mining companies often dump toxic wastages in local water supplies, destroying nearby lands in the process of exploitation of mineral resources (Krishnanath, 1964, p.9).

Large debt burdens sometimes make it difficult for countries to dedicate sufficient resources to environmental protection. Industrialization to produce more and to earn more through exports increases illegal dumping of pollutants into the air and rivers, endangering existence of various species (Krishnanath, 1964, p.9).

In theory the flow of external loans or capital to the third world is supposed to be invested in productive enterprises, which will eventually produce an export surplus from which they can easily service their foreign debts, but in most debtor countries it's not happening in that way. There are many reasons for this. Social problems like illiteracy, poverty, lack of infrastructure etc. divert the loans towards fulfilling these basic problems (Payer, 1991, p.5).

### 13. Conclusion

Foreign aid and the export of capital have been often used by the United States and other industrial nations as some sort of a bribe with a view to induce compliant behavior from the recipients. This happened in the Cold War era between two ideological groups led by the former Union of Soviet Socialist Republics (USSR) and United States of America (USA). The Marshal Plan initiated by US and the Warsaw Plan implemented by USSR are the examples. The aid or loans to the third world countries under these two plans were extended to compel them to support the donors, their policies and ideologies. On the whole, this use of foreign aid and other capital flow, as a bribe has been one of the most successful and effective tools of foreign economic policy (Payer, 1991, p.8).

Loans have been one of the most critical instruments of international politics for nearly all of recorded history. Donor governments, international institutions, and private banks leverage the political influence and control directly and indirectly. The ability to grant loans depends on overall economic and monetary power and a stock of international reserves. Control of finances therefore can lead to political control, particularly for donor governments, where there is an opportunity to enforce political ideologies or policies. A developed state can use the international lending mechanism to increase control over others and to reward or punish the recipient. The withdrawal or discontinuance of loans would have an adverse effect of recipient. Thus a donor's threat of rejecting assistance can deter the recipient from initiating action that are inimical to donors' interests (Seiber, 1982, p.15).

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