



INTERNATIONAL LAW  
JOURNAL

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**WHITE BLACK  
LEGAL LAW  
JOURNAL  
ISSN: 2581-  
8503**

*Peer - Reviewed & Refereed Journal*

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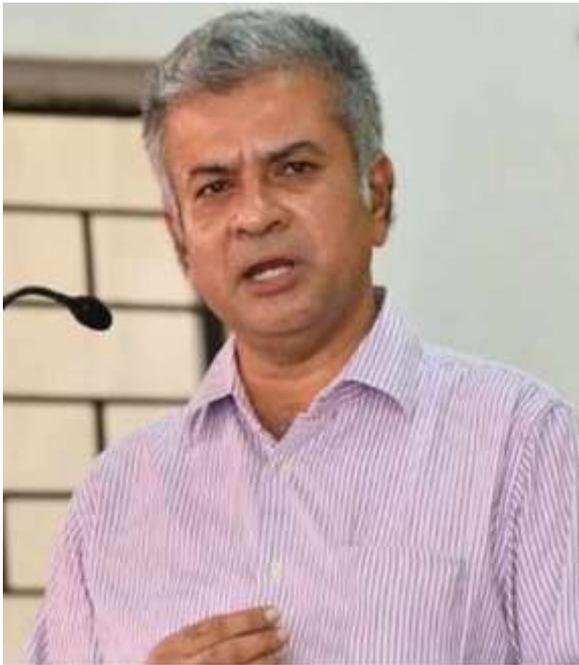
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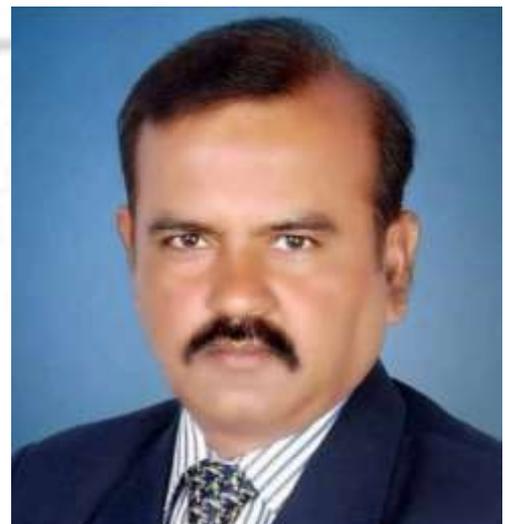
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E.MBA, LL.M, Ph.D, PGDSAPM

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BBA. LL.B. (Hons.) (Amity University, Rajasthan); LL. M. (UPES, Dehradun) (Nottingham Trent University, UK); Ph.D. Candidate (G.D. Goenka University)

Subhrajit did his LL.M. in Sports Law, from Nottingham Trent University of United Kingdoms, with international scholarship provided by university; he has also completed another LL.M. in Energy Law from University of Petroleum and Energy Studies, India. He did his B.B.A.LL.B. (Hons.) focussing on International Trade Law.

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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

# **BALANCING GROWTH AND RISK: INDIA'S APPROACH TO EXTERNAL COMMERCIAL BORROWINGS**

AUTHORED BY - DANISH HUSAIN & SONALI SINGH

## **INTRODUCTION**

As competition increases and the complexity of the international financial structure advances, ECBs have emerged as an effective way to fund business operations and governmental projects, especially in developing countries such as India. Coordinated through the ECB system, Indian corporations, public sector firms, and other qualifying parties can obtain financing from global capital markets at possibly reduced interest expense as compared to domestic funding. This mechanism is most effective in the large end-use sectors like infrastructure, manufacturing, and energy that need a large initial outlay. ECBs have been most useful for countries like India for meeting financing needs where infrastructure creation is necessary for long-term sustainable growth. Besides, if the interest rates suggest so, ECBs also contribute to increasing the integration of India into the global economy by attracting foreign investments<sup>1</sup>.

However, as this paper demonstrates, ECBs bear certain vulnerabilities to India's financial sector, especially vis-à-vis the fluctuations in foreign currency and the issues of dealing with external liabilities. India over time has put in place a legal structure to contain this risk while encouraging capital inflows. Key regulatory authorities embracing ECBs include the Reserve Bank of India (RBI) and the Securities Exchange Board of India (SEBI) have played an important role in policy making on ECBs. With the country still relying on external borrowings, there is a need to balance the search for foreign investments and economic security.

## **EVOLUTION**

External Commercial borrowing has been well associated with the liberalization of the Indian economy and globalization process. Before 1991, India's economy has been more of a reserved

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<sup>1</sup> Ashis Kumar Pradhan, *External Commercial Borrowings by the Corporate Sector in India*, 20 *J. Public Aff.* 1 (2019), [https://www.researchgate.net/publication/334511641\\_External\\_commercial\\_borrowings\\_by\\_the\\_corporate\\_sector\\_in\\_India](https://www.researchgate.net/publication/334511641_External_commercial_borrowings_by_the_corporate_sector_in_India)

economy with stringent control measures on foreign funds. There was concern about external borrowing burdens labeled by high external debts, fluctuating exchange rates, and difficulties in Forex. Hence, facilities for drawing global funds and credit from overseas markets were severely limited under strict regulatory measures<sup>2</sup>. The early 1991 is considered the landmark period when the country initiated the process of liberalizing the economy. The formation of liberalization policies was related to the Balance of payments (BOP) situation in India and became an important component of these policies. The government saw that borrowings from different international markets are useful in financing infrastructures and broadening the industrial structure<sup>3</sup>. This change of stance was conducive to the successive changes in the regulatory framework of the ECB over time.

## PHASES OF EVOLUTION

### 1. Post-War Era and the Bretton Woods System (1940s-1970s):

After World War II, the world's financial system was reconstructed with the system of Bretton Woods, in accordance with which the International Monetary Fund and World Bank were created. This framework laid the foundation for borrowing and lending across the borders activities.

Application: Emerging markets started borrowing from foreigners to rebuild their economies and investment funds; globally, most funds were borrowed from international financial institutions as against borrowing from individuals. For developing countries such as India, the opportunity to get foreign capital was considerably scarce. Earlier, only a handful of the large public sector enterprises or government agencies could borrow from international markets<sup>4</sup>. An emphasis was placed on official development assistance and bilateral or multilateral financing.

Regulatory controls: Due to issues to do with foreign exchange reserves and sustainability of debt, there were strict limitations to foreign borrowings. Since the 1990s, the Indian companies involved in corporate borrowings from global sources of funds have gotten a boost due to the policy liberalization on external borrowings, moving towards capital accounting and more

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<sup>2</sup> Ashima Obhan & Akanksha Dua, *Evolution of the Indian ECB Framework*, Mondaq (Apr. 22, 2019), <https://www.mondaq.com/india/contracts-and-commercial-law/799160/evolution-of-the-indian-ecb-framework>

<sup>3</sup> Balance of Payment Crisis, 1991 – History, Causes, Effects, Government Measures & Role of Manmohan Singh, *Textbook* (Aug. 28, 2023), <https://testbook.com/ias-preparation/balance-payment-crisis-1991>

<sup>4</sup> Bretton Woods and the Birth of the World Bank, *World Bank*, <https://www.worldbank.org/en/archive/history/exhibits/Bretton-Woods-and-the-Birth-of-the-World-Bank> (last visited sep.5, 2024)

enhanced credit ratings. During this particular period, a country's problem was the balance of payments (BOP), especially in the deterioration of non-oil import payments, capital inflow through external aid, and private borrowings for commercial purposes. The Total Financial requirements of the country in 1985 were fulfilled by ECBs to the extent of one-fourth<sup>5</sup>. However, since 1991 for different reasons of a shift in government policy from debt to non-debt financial flows, the prominence of ECBs gradually declined.

## **2. Liberalization and growth (1990s to early 2000s)**

During the period in the early decade, particularly the 1990, the economies of the world especially of developing nations such as India expanded immensely with the liberalization of their economy. During this period, there was increased usage of ECBs occasioned by the need to tap new opportunities in business.

**Deregulations:** It also became easier for businesses to source funds internationally due to the changes in the regulatory framework. Over the years all the countries slowly began to ease general restrictions on the volume, the maturity, and the utilization of ECBs.

**Diverse Borrowing Sources:** Firms started searching for various mechanisms for ECBs such as syndicated loans, bonds, and so forth. On one side liberalization, privatization, and globalization since 1991 have sapped Developmental Financial Institutions (DFIs) on the other side it compelled corporate houses to go for huge External Commercial Borrowers (ECBs). In this method Developmental Finance institutions which were formed to help industries were given authority to give loans to long-term industries at subsidized rates of IFCI, IDBI, ICIC, and SFCs. However, with the liberalization of ECB policy, a new low-cost financing opportunity was made available to firms. Due to this corporate sector borrows from global institutions who were willing to take risks and offer cheaper funds than costly domestic funds available<sup>6</sup>.

## **3. Global Financial Crisis and Regulation (2008-2010)**

Considering the global financial crisis there was, therefore, a change in credit markets. That

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<sup>5</sup> The Indian Economy: A Review (Part - I), *Drishti IAS*, Feb. 28, 2024, <https://www.drishtiiias.com/summary-of-important-reports/the-indian-economy-a-review-part-i>

<sup>6</sup> Arvind Panagariya, *India in the 1980s and 1990s: A Triumph of Reforms*, IMF Working Paper WP/04/43, at 1 (Mar. 2004), <https://www.imf.org/external/pubs/ft/wp/2004/wp0443.pdf>

affected the supply and the price of ECBs to business entities most of which were operating in the emergent markets. Banks especially those in government-setting countries stepped up supervision as a means of controlling risks emanating from ECBs<sup>7</sup>. To achieve this, it entails checking the level of external debt and the amount of borrowing from the outside world. The trends of ECBs depict that for the years 1991-92 and 1992-93 the gross ECB inflow has reduced and has a negative figure in the later year. Business in emerging markets. Regulatory Responses: Governments and central banks increased oversight to manage risks associated with ECBs. This included monitoring the levels of external debt and implementing stricter borrowing guidelines.<sup>8</sup>

The shift of ECBs clearly shows that the size of total ECB inflows in India reduced mainly in the years 1991 to 1992 and 1992 to 1993 and became negative in the later years. It then increased at a rapid pace until 1996 and 1997 as a result of policy liberalization, such as expanding business borrowing options abroad. Bank borrowings, trade-related credits, and the flow through convertible bond placements in the offshore market all increased during this time. India's capital account saw a sharp decline from 1997 to 2001 due to several factors, these factors included the East Asian currency crisis, Argentina's default on its international bond obligations, the Iraq war, high credit market volatility, low investor confidence, and extreme risk aversion.

#### **4. Post-crisis period and market maturity (2010 present)**

More effectively, the global financial process makes emerging markets more integrated into the financing process; companies can use more Broder range of financing techniques, green bonds, and masala bonds (rupee-denominated bonds issued outside India). Greater attention was paid to managing currency risks Risk Management associated with ECBs and increased hedging with the help of derivatives. International institutions such as the Reserve Bank of India from time to time were updating their ECB frameworks due to the tension between capital demand and the stability of the financial system. These measures included limiting the uses of the funds for productivity only and promoting longer-term borrowing over short-term borrowing. It can be seen from the trends of the ECB that the amount of gross ECB inflows

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<sup>7</sup> Reserve Bank of Australia, *The Global Financial Crisis*, <https://www.rba.gov.au/education/resources/explainers/the-global-financial-crisis.html> ,(last visited oct. 25, 2024).

<sup>8</sup> Arunperumal, A., *External Commercial Borrowings in India - An Overview*, 4 INT'L J. Recent & Innovation Trends Computing & comm. 208 (2016), <https://ijritcc.org/index.php/ijritcc/article/download/2631/2631/2606>

into India for 1991–92, 1992–93, and 1993–94 formed the trough as they turned negative in the latter year-end bonds and masala bond (rupee-denominated bonds issued outside India). There was a stronger focus on managing currency risks Risk Management associated with ECBs, leading to more hedging and use of derivatives. Central banks such as the Reserve Bank of India periodically updated their ECB frameworks to balance the need for capital inflows with the need to maintain financial stability.<sup>9</sup> This included measures like restricting end uses to productive purposes and encouraging long-term borrowing over short-term loans, The trends of ECBs show that the amount of gross ECB inflows in India declined during the years 1991-92 and 1992-93 and became negative in the later years. It has been growing at a steady rate till 1996-97 it is partly because of liberalization policies such as raising the ambit for overseas borrowings by corporates. There was a marked rise in the trade-related credits, bank loans, and convertible bonds floated in the Euro market.

### **Current trends**

With increasing focus on sustainability, more and more businesses are issuing ECBs through green bonds and other securities that are related to environment, social, and governance. ESGs Fintech and Different digital platforms have enhanced the ease of companies in tapping the credit markets internationally to environments linked to environmental, social, and governance (ESGs) criteria.<sup>10</sup> Advances in fintech and digital platforms have made it easier for companies to access international credit markets. The outbreak of the COVID-19 pandemic and geopolitical tension have an influence on global financial products including the ECBS.

The historical background of ECBs in India can be obtained from the Sahoo Committee Report tabled in the Indian Parliament in 2015.<sup>11</sup> First, until the early 1980s, India's utilization of the global capital markets was relatively small, so more domestically owned companies relied on a bilateral and multilateral approach for external financing. Nonetheless, with the liberalizations of the 1990s onwards, India adopted more open policies to cover external finance which led to a sharp rise in ECBs as Indian firms looked forward to international capital markets for expansion. The Sahoo Committee pointed out the imperative to establish an

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<sup>9</sup> Swami Prasad Saxena, *Dynamics of External Commercial Borrowings in India*, 41 Bus. Analyst 137, 137–54 (2012), [https://www.src.edu/system/files/6\\_0.pdf](https://www.src.edu/system/files/6_0.pdf)

<sup>10</sup> S. Gupta, *External Commercial Borrowing: Quest in India*, 1 INT'L J. Multidisciplinary approach & stud. 4 (2014), <http://ijmas.com/upcomingissue/26.04.2014.pdf>

<sup>11</sup> Sahoo, MS, *Report of the Committee to Review the Framework of Access to Domestic and Overseas Capital Markets* (Ministry of Finance, Government of India 2015), Phase II, Part II: Foreign Currency Borrowing, Report III

effective framework to govern the risks that are tied to ECBs including currency risk. They noted that there should be changes to financial regulation that correct market inefficiencies but not developmental ones.

With the emergence of liberalization policy in the 1990s, India began allowing foreign capital to fund its expanding financial needs. Nonetheless, open-outcry ECBs posed threats to India's external debt profile, foreign exchange, and the country's soundness of financial systems. Measures have been taken to mitigate these risks and to regulate these FDI flows more effectively, RBI used a route system for ECB. One is the Automatic route and the other one is the approval route. The Automatic Route allowed Indian businesses to access ECBs without prior government or RBI clearance if they complied with certain regulatory parameters that included borrowing Limits, End-Use Restrictions, and Borrower Eligibility. This route was to gain more foreign capital in the country, particularly for some companies by doing away with many formalities. In aim, the Approval Route insisted on prior RBI approval before companies could access ECBs. This route was for situations where companies required ECBs beyond the normative prescribed framework, and particularly where the sector or the borrowing conditions are relatively high risk. Although the procedure required RBI's supervision, it was easier to monitor loans in sensitive sectors or beyond the normative levels of borrowing, thereby implying a higher level of financial stability.

### **Process of raising ECB**

The concept of raising foreign resources involves the steps through which Indian companies can obtain ECBs from foreign lenders. This process includes meeting regulatory standards set by the Reserve Bank of India (RBI) under two distinct categories<sup>12</sup>: There are two types of routes: The Automatic Route, and the Approval Route. They also have their eligibility, procedural, and compliance steps with a view to regulating the admission of foreign capital in India while protecting the country's financial opening.

### **Approval Route**

As per the Approval Route for the ECBs, the companies belonging to some sectors or fulfilling some qualitative criteria need prior approval of the government or RBI each time to raise

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<sup>12</sup> Reserve Bank of India, *Master Circular on External Commercial Borrowings and Trade Credits*, RBI/2007-2008/23, Master Circular No. /02/2007-08 (July 2, 2007), <https://www.rbi.org.in/Commonperson/english/scripts/Notification.aspx?Id=300>

money. These are imposed on companies to regulate higher-risk industries or conditions that need more control in attaining economic objectives and under the regulation of the business government. Qualifying parties under this approach are the EXIM bank for on-balance funding; and the banking and financial sectors that are participating in implementing sector-focused receivables restructuring for industry, such as textile and steel, with government of India and RBI approval. Non-Banking Financial Companies (NBFCs) also fall into this route when taking funds from multilateral financial institutions with a minimum five-year tenor if classified as Infrastructure Finance Companies by the RBI. Further, housing finance companies can raise ECBs through Foreign Currency Convertible Bonds (FCCBs) if they meet stringent conditions: the financial intermediary raising funds should have a net worth of INR 500 crores and more and it should be a listed company in NSE or BSE and FCCB up to USD 100 million should be issued by the company where the purpose of fund utilization should be pre-approved. Also, SEZ developers who primarily concentrate on infrastructure facilities and various corporates involved in the service sector like hotels, hospitals, and software companies needed to deal with the ECBs of more than USD 200 million in terms of Approval Route.<sup>13</sup>

Where ECBs are raised from indirect equity holders, the Approval Route is required where the lender has more than 51% indirect equity in the Indian company. Those Corporates involved in ECB-related violations with the RBI, or the Enforcement Directorate (ED) also require the Approval Route. This route is all-encompassing of any ECB proposals that do not fall in the Automatic Route while guaranteeing their assessment to ensure they meet all the regulatory requirements.

### **Automatic Route**

According to the automatic route, no governmental prior approval is needed by the entities that intend to raise borrowings. Instead, they have to follow certain laid down conditions like maximum allowable borrows, industry categories, and uses of the funds. Those companies that satisfy these conditions are free to launch funds on their own through the automatic route without the government's approval.

The type of borrowers allowed to obtain ECBs in India are companies incorporated under the

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<sup>13</sup> Abhinav Harlalka & Karan Karla, *External Commercial Borrowings: Regulatory Framework Substantially Relaxed*, Nishith Desai Associates (Feb. 1, 2019), <https://www.nishithdesai.com/SectionCategory/33/Regulatory-Hotline/12/49/RegulatoryHotline/4572/3.html>

Indian Companies Act of 1956, including banks and other financial institutions, hotels, hospitals, infrastructure companies, micro-finance institutions (MFIs), and units in Special Economic Zones (SEZs) through the automatic route. However, ECBs cannot be raised through this route by individuals, trusts, and nonprofit organizations. Identified lenders consist of multilateral development banks, international commercial banks, official export credit agencies, overseas equity investors, international capital markets, and overseas partners. For foreign equity holders, specific requirements apply they must have at least 25 % of the paid-up capital in the borrowing company for loans that do not exceed USD 5 million, and the same condition applies for loans that exceed this amount. Additionally, the debt-to-equity ratio should not exceed 4:1. All these criteria are useful in making the ECB more effective while at the same time maintaining a good balance of foreign borrowing.<sup>14</sup>

According to ECB guidelines in India, other industries can borrow up to \$750 million a year while the hotel industries, healthcare industries, and software industries can borrow up to \$200 million which cannot be used for land purchases. Concerning the above sources microfinance-focused NGOs and other microfinance institutions can mobilize up to \$10 million a year. Additionally, ECBs have a minimum maturity period requirement based on the loan amount: for loans not exceeding \$20 million, the minimum tenor is three years for loans not exceeding \$750 million the minimum tenor is five years. This rule enables assured foreign funds management by various companies and, inclusive, time frames for repayments.<sup>15</sup>

## **GOVERNING ACTS AND REGULATION OF ECBs**

External Commercial Borrowings (ECBs) are credit funds raised by an Indian Company, in a foreign currency from a non-Indian source. The intent of such borrowings could be to finance different corporate and infrastructure programs, and so on. The guidelines and rules to control ECBs are at large determined by the Reserve Bank of India (RBI) and are intended to avoid the adverse consequences of these borrowings on the Indian economy.

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<sup>14</sup> Reserve Bank of India, *Master Circular on External Commercial Borrowings and Trade Credits*, RBI/2007-2008/23, Master Circular No. /02/2007-08 (Feb. 7, 2007), [https://www.rbi.org.in/Commonperson/english/scripts/Notification.aspx?Id=300#:~:text=\(i\)%20For%20ECB%20up%20to,the%20direct%20foreign%20equity%20holding](https://www.rbi.org.in/Commonperson/english/scripts/Notification.aspx?Id=300#:~:text=(i)%20For%20ECB%20up%20to,the%20direct%20foreign%20equity%20holding).

<sup>15</sup> Reserve Bank of India, *Master Circular on External Commercial Borrowings and Trade Credits*, RBI/2014-15/3, Master Circular No. 12/2014-15 (July 1, 2014, updated through June 11, 2015), <https://www.rbi.org.in/commonman/english/Scripts/Notification.aspx?Id=1388>

## **Transition from FERA to FEMA**

The earlier legal architecture of the FERA was substituted with FEMA which brought about a change from the earlier control-based approach post-liberalization to a more positive growth-friendly regulatory regime prevalent in India. This transformation was required to achieve a more efficient foreign exchange control that would be suitable for the liberalized economy, especially after the 1991 crisis. FEMA planned to encourage exports and investment while at the same time promoting structured growth of the foreign exchange market. As India began liberalizing its economy there emerged a requirement to have FDI, especially through External Commercial Borrowings (ECBs) in large projects. However, such borrowing practices put organisations in perilous situations such as fluctuations in currency prices meaning that they require a proper framework to regulate these risks to avoid financial imbalance. The various measures enumerated under FEMA were aimed at maintaining the finest balance between economic liberalization and monetary stability where quantity and employment of borrowings from foreign territories were capped and the eventual usage was directed to be most productive and in sync with Indian economic goals. Further, the regulations were intended for the preservation of India's foreign exchange reserves and for the growth of the financial markets where the domestic markets are linked with the global markets.<sup>16</sup> These regulations also promoted investment in other strategic areas and nurtured export-oriented industries which in the long run boosted economic growth, by providing access to foreign capital.

## **Regulatory Acts Governing External Commercial Borrowings in India Foreign Exchange Management Act (FEMA), 1999**

FEMA is the primary law that regulates external financial business in India and comprises ECBs. In FEMA, the power to control the inflows as well as outflows of foreign exchange has been vested with the RBI. ECBs are regulated through FEMA, particularly to the rules regulations, and guidelines notified by the RBI under the FEMA Act. Section 6(2) of FEMA, 1999<sup>17</sup> is very important to regulate ECBs in India because it acts as a framework to regulate ECBs. Section 6(2) FEMA<sup>18</sup> therefore bestows on the RBI the appellate jurisdiction about borrowing or lending in foreign exchange, transfer of foreign exchange, or making any payment to or receipt of payment for import, from any person who is a resident outside India.

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<sup>16</sup> R. Vimal Kumar, *Transition from FERA to FEMA Significant: RBI Official*, The Hindu (June 13, 2015, 5:38 AM IST), <https://www.thehindu.com/news/national/tamil-nadu/transition-from-fera-to-fema-significant-rbi-official/article7311654.ece>

<sup>17</sup> Foreign Exchange Management Act, § 6(2), No. 42 of 1999, India Code (1999)

<sup>18</sup> § 6(2), Foreign Exchange Management Act, No. 42 of 1999, India Code (1999)

This section provides the RBI with the authority to impose precautionary measures regarding the kinds of transactions and how they must be done.

Under section 6(2), the RBI is further empowered to develop the regulation relative to the ECB. These consist of conditions such as eligible borrowers, recognized lenders, the permissible end use, all-in cost ceilings, and other special features that borrowers must meet. For example, under the powers conferred by this section, the RBI has issued Master Directions or circulars on ECBs laying down guidelines and rules for such borrowings to ensure their conformity with India's macroeconomic policies and management of forex affairs.

According to Section 6(2)(c)<sup>19</sup>, the RBI has power over the borrowing of funds in foreign exchange and hence directly imparts to ECBs. ECBs are thus loans availed of by entities in India from party foreign creditors and hence come under this section.

In conclusion to this section, Section 6(2) FEMA, 1999 is a key provision needed to enable the Reserve Bank of India to regulate ECBs. It offers the legal mechanisms that RBI can use to oversee the borrowing and lending in foreign exchange in a way that is productive and secure for India's economy.

### **Foreign Exchange Management (Guarantees) Regulations, 2000**

The Foreign Exchange Management (Guarantees) Regulations, 2000<sup>20</sup> stated the various guidelines in respect of guarantees for Indian as well as foreign persons. These rules are broader than one might think, covering any case where a guarantee might extend to the financial assets or liabilities of a person or an entity in a foreign country. As prescribed by FEMA, most trading transactions that are normal in any economy are permitted, but capital transactions are allowed only if they are out of the FEMA purview. This is so because capital transactions can influence the balance character of individuals and units within India and outside India.

Hence, all such transactions which are made by an Indian resident or non-resident resulting in a change (enhancement or reduction) of his/her assets or liabilities shall fall within this section.

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<sup>19</sup> § 6(2)(c), Foreign Exchange Management Act, No. 42 of 1999, India Code (1999).

<sup>20</sup> Foreign Exchange Management (Guarantees) Regulations, 2000, Notification No. FEMA 3/RB-2000, Gazette of India (2000)

Notwithstanding the provisions contained in Section 6 (1)<sup>21</sup> and under such permissible class of transactions and limit of forex, as may be notified by the RBI, the Act contains general permission that any person may sell or draw foreign exchange to or from an authorized person for any capital account transaction.

According to Section 6 (3)(j)<sup>22</sup> read with Section 47 of the FEMA<sup>23</sup>, the powers of the Reserve Bank of India to issue the Foreign Exchange Management (Guarantees) Regulations 2000 and the Foreign Exchange Management (Permissible capital account transactions) Regulations 2000 to regulate giving of guarantee.

The provision of Regulation 3 of the Foreign Exchange Management (Guarantees) Regulation 2000<sup>24</sup> lays down the conditions under which an Indian resident may give a guarantee in favor of a non-resident in as much as he is permitted and notified or only in so far as it is covered by the general or special permission of the RBI.

Prohibition in the Regulations: Foreign Exchange Management (Guarantees) Regulation, 2000, Regulation 3, provides a blanket prohibition on the granting of the following in terms of part sponsoring of guarantee save for general or special permission of the RBI.

- Giving of any guarantee
- Provision of any surety
- Any other transaction that has the same impact as guaranteeing a debt, obligation, or any other liability of an individual who is resident in India or of an individual who has borrowed, such sum from an individual residing outside India. The above are prohibited when provided by a resident, to a non-resident. If the guarantor is personally a resident of India and the debtor is a non-resident, then the Regulations apply. In other words, the same Regulations will apply irrespective of whether the person in respect of whom the guarantee is given is a resident or not.

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<sup>21</sup> The Foreign Exchange Management (Guarantees) Regulations, 2000, § 6(1), Notification No. FEMA 3/RB-2000, Gazette of India (2000)

<sup>22</sup> The Foreign Exchange Management (Guarantees) Regulations, 2000, § 6(3)(j), Notification No. FEMA 3/RB-2000, Gazette of India (2000)

<sup>23</sup> Foreign Exchange Management Act, § 47, No. 42 of 1999, India Code (1999)

<sup>24</sup> Foreign Exchange Management (Guarantees) Regulations, 2000, Regulation 3, Notification No. FEMA 3/RB-2000, Gazette of India (2000)

## IMPACT OF ECB ON THE INDIAN ECONOMY

ECBs play an important role in the Indian economy as an external source of funds for many sectors resembling as important sources of foreign capital. The above borrowings assist in fulfilling the financial needs of Indian companies especially in infrastructure, manufacturing, and other capital-intensive industries. ECBs help mobilize foreign investments to boost the economic level, increase the competence of a country in the world, and aid the flow of funds to be available at reasonable interest rates. Also, they enable the overcoming of the domestic savings-investment gap, thus contributing to development. Nonetheless, the high usage of ECBs may surprisingly lead to issues on foreign debt indicators as well as apprehension over the resilience to foreign economic disturbances calling for effective regulation and supervision of such facilities.

Advantages of External Commercial Borrowings (ECBs) include lower interest rates compared to the cost of domestic sources of financing, which therefore makes it cheaper for corporations. They are financed in foreign currency so that helps organizations for instance to import machinery or pay international suppliers. They also enable businesses to issue large funds for long-term requirements such as infrastructure, from internationally accredited places like the capital markets and banks.

Indian companies' registrations for external commercial borrowings (ECBs) surged nearly twofold at \$49. Meanwhile, the overall cost of ECB loans rose in FY24 to USD 72 billion from USD 62.3 billion last fiscal year owing to high global benchmark interest rates, but net inflow saw an improvement at \$9.5 billion. FY23 net ECBs to India flew in at under \$1 billion. Last year, the EC continued financing for US\$ 23.8 billion while in FY24 ECB disbursements jumped to US\$ 38.4 billion.<sup>25</sup>

Although External Commercial Borrowings (ECBs) have their advantage such as lower rates of interest they also have their disadvantages. The equity of a company may decline because of a careless borrowing culture; there will be increased debt levels which are reflected in the financial ratios. Firms may face a downgrade of their ratings meaning that they are risky hence a low market value. This means that when companies borrow in foreign currencies, they stand

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<sup>25</sup> Business Standard, Friday, December 6, 2024, 09:28 AM IST, [https://www.business-standard.com/economy/news/ecb-registrations-double-to-49-2-bn-in-fy24-net-inflows-touch-9-5-bn-124052301462\\_1.html](https://www.business-standard.com/economy/news/ecb-registrations-double-to-49-2-bn-in-fy24-net-inflows-touch-9-5-bn-124052301462_1.html)

to cut their costs through hedging by experiencing exchange rate risks. There are also borrowing constraints and standard durations; long maturities are characteristic of large borrowings. These are some of the risks that companies need to be careful of when conducting ECBs.

## CONCLUSION

In conclusion, External Commercial Borrowings (ECBs) have added an important source of financing options to assist the development of India's economy. ECBs have thus facilitated access to global capital and bolstered domestic savings investments, especially in infrastructure, manufacturing, and Energy. While using ECBs, some benefits which include lower interest costs and sourcing of funds in foreign currency are obvious, the negatives which include exchange risk and ballooning of external liabilities are also not far from observation. To guard against these risks India has put in place the legal framework in the provision of ECBs under FEMA. Here, the Reserve Bank of India (RBI) stands as the central supervisory authority and monitors ECB inflows to ensure that they are properly utilized for productive purposes and Total Macro Economic Impact Analysis of the Indian Economy and Consistent with the macroeconomic objectives of Reserve Bank of India. It is therefore clear that as India becomes more and more integrated into the international economy the appropriate use of ECBs will be necessary. This means that, while foreign capital will need to be tapped for its advantage, measures that can neutralize the risks will be required to ensure continued sustainable economic growth and a sound financial system.