Balance of Payment Crisis (1991), India

India faced the Balance of Payment crisis in 1991 due to huge macroeconomic imbalance. Balance of Payment (BoP) Crisis is also called currency crisis. It occurs when a nation is unable to pay for essential imports or service its external debt payments. This article throws light on the many causes behind the Balance of Payment Crisis India faced in 1991.

What were the Causes of the Balance of Payment Crisis 1991?

There was a huge Macroeconomic imbalance of high current account deficit and high fiscal deficit. The crisis did not develop overnight. It was caused by decades of imprudence. There was reliance on populist measures. The causes of Balance of Payment Crisis are listed below.

1. The Government Expenditure was more than the earnings. Hence the Fiscal Deficit was high. The Gross Fiscal deficit rose from 9 % of GDP in 1980-81 to 12.7 % of GDP in 1990-91.
2. The Internal Debt of the Government rose due to the above reason. It rose from 35 % of GDP in 1985-86 to 53 % of GDP in 1990-91.
3. In addition the country was importing more than exporting. Hence the Current Account Deficit was high.
4. The current account deficit was triggered by the rise in crude oil prices because of the Gulf War. Due to this, the Forex Reserves of India depleted massively. Despite substantial borrowings from the International Monetary Fund (IMF) earlier in the year.
5. By June 1991, India had less than $ 1 billion forex reserves, just sufficient to meet import requirements for a period of 3 weeks.
6. India did not have enough Forex reserves to conduct business with the world.
7. India was on the verge of defaulting on its International Debt Obligations.
8. Investors pulled out their money.
9. Short term credit dried up, as exporters were apprehensive that they would not be paid.
10. There was a massive rise in inflation rates.

The **above crisis** was treated as **Balance of Payment Crisis.**

The effects of the Balance of Payment Crisis are mentioned below.

1. Imports were restricted.
2. The price of fuels were raised.
3. Bank rates were raised.
4. Government had to cut its spending.
5. India had to secure an emergency loan of $ 2.2 billion from the International Monetary Fund by pledging 67 tonnes of Gold as collateral security.
6. In May 1991, India sent 20 tonnes of Gold to Union Bank of Switzerland, Zurich and in July, 47 tonnes of Gold was given to Bank of England to raise a total of $ 600 million.

What did Manmohan Singh do in 1991?

The Government of India led by PV Narasimha Rao, with Manmohan Singh as Finance Minister initiated a 4 pronged strategy to put the economy back on track.

Industrial Policy Reforms

1. License Raj and Inspector Raj were removed.
2. Industrial licensing was abolished.
3. Measures were taken to ease domestic supply constraints.
4. Measures were taken to spur investments.

Trade Policy Reforms

1. To make exports competitive Rupee was devalued by 20%.
2. Licensing controls and regulations on exports were eased.

Public Sector Reforms

1. There was liberalisation of Foreign Direct Investment (FDI).
2. Public Sector companies were given more operational freedom to scale up and make bigger contributions to the economy.

Fiscal Correction

1. Subsidies for Exports were abolished.

Read more about the Economic Reforms in India – 1991 at the linked article.

Frequently Asked Questions related to Balance of Payment

What are the Components of Balance of Payment?

The 3 components of Balance of Payment are Current Account, Financial Account, Capital Account.

- The current account records exports and imports in goods and services and transfer payments. These are a record of international transactions that do not create liabilities.
- Financial Account is the measurement of increase or decrease in international ownership of assets.
- The capital account records all international purchases and sales of assets such as money, stocks, bonds, etc.

What is Balance of Payment Surplus?

A Balance of Payment Surplus means the country exports more than it imports. It provides enough capital to pay for all domestic production. The country might even lend outside its borders. Balance of Payment

Surplus helps in boosting economic growth over a short term period.

What is the difference between Balance of Trade and Balance of Payments?

Balance of Trade is the difference that is obtained from the export and import of goods. Balance of Payments is the difference between inflow and outflow of foreign exchange. Net effect of Balance of Payment is always zero. Net effect of Balance of Trade can be zero, positive or negative. Balance of Payment or BoP is a financial statement that keeps track of all the economic transactions by the nation with the rest of the world. Balance of Trade or BoT is a financial statement that captures the nation’s import and export of commodities with the rest of the world.