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1991 Currency Crisis and Structural Adjustment in Indian Economy: A Study

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ABSTRACT *In the early 1980s it was a situation of mass poverty, unemployment, low agricultural and industrial output and very bad situation in international trade. This was a time for adopting a microscopic view rather than a telescopic view on Indian economy. So, for the first time India knocked the doors of IMF and the funds in the form of SDRs entered the country with conditions attached. But, the comprehensive adjustments of 1980s could not that successfully implemented and a gradual deterioration in macroeconomic environment led to a severe currency crisis in 1991. The present study has been conducted with the objective to identify and explain the factors responsible for 1991 currency crisis in India and to explore the inherent needs to implement structural adjustments in Indian economy. The findings of the study have been derived through a review of extant literature.*

KEYWORDS : International Monetary Fund (IMF), Structural Adjustment Program (SAP), Indian Economy, 1991 Currency Crisis

1. Introduction

It is only after the year 1991 that India's reputation started gaining momentum, not only as the world's largest democracy but also as a rising economic power. In the year 2011, India became the third largest economy in the world in terms of 'purchasing power parity. India achieved this position because it has established a framework for long-term sustainable development of the economy by reducing barriers to trade, lowering government spending and making the financial markets efficient, consequently the economy becoming more attractive for global investments. But it was not at all an easy task to implement various economic policies so that the nation will be on an onward march. It is the result of conditions imposed jointly by International Monetary Fund (IMF) and World Bank (WB) under the optimistic Structural Adjustment Programs (SAP) of 1991 that evolved the Indian economic model of today.

2. Research Objectives

The present study has been conducted with the following objectives:

1. To briefly describe the history of Indian economy before 1991 currency crisis.
2. To identify and explain the forces responsible to adopt structural adjustments in Indian economy in 1991-92.

3. Research Methodology:

In the present study, the method of literature review has been adopted to fulfill the objectives of research. Here, first of all a few scholarly articles on Indian economy has been collected. The sources from which these are collected include www.jstor.com, www.proquest.com, and www.ebscohost.com. Additionally the latest text and reference books on Indian economy were also collected. After a phase of extensive readings, the substantive findings have been summarized below in a sequential manner.

4. Indian Economy in Colonial Period (Before 1947)

The honorable Member of Parliament M J Akbar once said very rightly: "the Britishers did not come to India because India was a poor country, nobody conquers a poor country, the return on investment is not sufficient, they came to India because we were a rich country". But the question is how the state of Indian economy became so malnourished under the British rule from 1757 till 1947. This can be better verified from Figure 2.1 that shows the comparative per-capital levels of industrialization from 1750 to 1980. Here, it can be seen that the index of comparative industrialization is at 7 and 8 for India and developed countries respectively in the year 1750. This index has fallen below its usual level, started rising after independence and finally reached up to 16 for India in 1980. But there seems an unprecedented growth of this index up to 344 for the developed countries by year 1980.

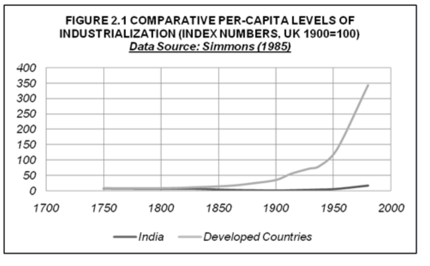
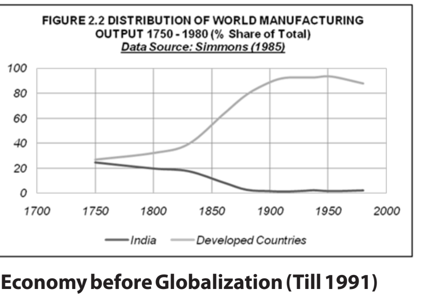


Figure 2.2 reveals the picture on distribution of world manufacturing output during the period 1750 – 1980. In the graph below we can see that the manufacturing output of India as percent share of total i.e. world aggregate was 24.5% for India in 1750 and that of developed countries was 27.0% in the same year. In other words, the Indian share of manufacturing was almost equal to the share of all developed countries taken in aggregate in the year 1750. Then after it the Indian share of manufacturing started consistently declining and became 2.4% in 1938 and further declined to 1.7% in 1953. The shift of figures in 1938 to the figures in 1953 might be because India did not remain an undivided continent after 1938. Initially the Myanmar and then Pakistan got departed from the country because of which the share of manufacturing to the total may have declined. But still, if we will take into account this shift over the period of hundred years it can be said that the industrial growth in Indian economy in real sense collapsed like anyhting.



5. Indian Economy before Globalization (Till 1991)

At the time of independence agriculture was the main economic activity in the country and industrialization was almost limited to a few jute mills, one or two steel plants in operation and a seek power generation system. Additionally the literacy rate was at its all time low. So, in such a situation the Government of India in the mode of practicing a mixed economic model decided to bring balanced economic development not only in the social level but also regional level through a series of five year plans. A fully fledged organization called the Planning Commission of India (Currently renamed as Niti Ayog) was established to initiate planned development in Indian economy. A deep respect towards the Gandhian philosophy on self reliance made the Indian economy an inward-looking one in the post independence era. Additionally, adoption of a mixed economy model made itself a highly interventionist one. Due to the inward-looking character of the economy protection on imports were levied through tariff and non-tariff barriers. And due to the heavy Government intervention in heavy industries, the private sector could not develop up to the required level since private entrepreneurs were facing a complex structure of licensing requirements in order to start business. These two in an aggregate caused a state of economic suppression in the country. India neither could develop a good international market for its products nor could it build an industrial economy in the home ground. Additionally, since the economy experienced a severe drought for two consecutive years in 1979 and 1980, not only the agricultural but also the industrial output got disrupted. Though the balance of payments situation of India was in a surplus especially because of foreign aids during 1970s, a deficit current account was not a new thing for the country. But a high current account deficit became a concern around early 1980s since the country was required to finance on a regular basis the imports of at least the basic commodities including petroleum, medicines, defense materials for the military etc. The stagnation of Indian economy compelled the Government to take Special Drawing Rights (SDRs) from International Monetary Fund (IMF) and allow the prescribed Comprehensive Adjustment Program (CAP) to be implemented in the country. India gone for an Extended Arrangement (EA) instead of a Standby Arrangement (SBA) for a worth of SDR 5000 Million on 09/11/1981 that was supposed to expire on 08/11/1984. Hence the program years thus were 1982, 1983 and 1984 during which a balance of SDRs 1100 Million was left as balance. There were three basic objectives of the 1982 – 1984 adjustment programs: promotion of domestic financial stability, mobilization of domestic savings and liberalization of restrictions on trade.

6. 1991 Currency Crisis in India: The Causes

As part of the CAP the first series of liberalization was introduced in 1982 and within two years of its launching many policy changes were done. First of all investment limits in different industries was relaxed, expansions and diversifications were allowed. Secondly, the price controls that was existing on some of the key industries like cement, aluminium, paper etc. got removed by the Government. Thirdly, in order to promote exports to income elastic products, deregulation was introduced in industries like computers, electronics, leathers, gems and jewellery etc. In addition to it, traditionally there were sectors in which only public sectors were allowed to enter out of which a few were chosen and keeping the national interest in mind they were opened up for private investments also. This brought a sense of optimism in the industrialists' community of the country. Apart from IMF intervention through its SAP, the substitution of petroleum imports by domestic production of it put the current account deficit position of the country in a shape and till the mid 1980s it remained even below 1 ½ % of GDP. But, IMF led SAP not only concentrated on export promotion but also it fuelled liberalization of imports. In some sectors licensing requirements were eased while in others non-tariff trade barriers were replaced by tariff barriers. Hence, the rapid export growth in the country got witnessed by large volume of imports. This led to an increased current account deficit and the situation started became vulnerable when the global growth rate slowed down in the late 1980s. All the major trading partners including USA reduced their imports from India due to decline trend in their growth rates and it hampered Indian exports adversely. One more thing that worsened the situation was the increased demand for oil in the country and the outbreak of the Gulf Crisis in the mean time. During these years, due to rapid industrialization the transport sector also developed and consequently the demand for petroleum increased that forced the Government to become dependent more and more on imports of oil.

Apart from the above discussed external shocks on Indian economy, there were some internal reasons that caused 1991 crisis and the most important out of them was the emergence of a highly uncertain political environment in the country from 1989 to 1991. After the assassination of the then Prime Minister of India Mrs. Indira Gandhi, her son Rajiv Gandhi came into power with a historic majority in parliament in 1984. Rajiv Gandhi implemented the left out reforms those were supposed to be implemented in Indian economy and besides a strong resistance from the opposition the liberalization process was continued. But a decline in economic growth rate during the last part of his tenure supported by low exports, increased oil prices and unemployment; the Congress party headed by him could not perform well in 1989 general elections. Since the previous ruling party could not prove majority, the only option left with them was to form a coalition Government in the country which Rajiv Gandhi totally refused to do. Hence, the next largest party was given a chance to form a coalition Government and V. P. Singh became the Prime Minister of India in 1989. The country was already in sick condition and due to lack of expertise of this Government a lot of social evils cropped up including caste disputes and religious riots. After the forced resignation of V. P. Singh in 1990 three caretaker minority Governments were formed in quick succession by different Prime Ministers till 1991 and finally a general election was scheduled to be conducted in the country so that all political woos can be erased. During these two years the Indian voters saw the national level politics resting upon unacceptable issues like reservation on the basis of caste, building Ayodhya Ram Temple, Bofors Scandal etc. and considered the ongoing political instability of the country responsible for it. Hence the whole of the nation was expecting Rajiv Gandhi to come as the next Prime Minister of India in 1991 so that no more inter-party rivalries would be there. But Rajiv Gandhi was assassinated during a campaign just before the elections. However, after everything else the Congress Government came into power in 1991 with P. V. Narasimha Rao as the Prime Minister and Dr. Manmohan Singh as the Finance Minister of the country. These two people became the pioneers of globalization in Indian economy after coming to the picture but till they joined their positions the most of the investors have had lost their confidence on India as an investment destination. A wide current account deficit and a lowered investor confidence because of political instabilities in last couple of years insisted the credit rating agencies to downgrade India's position. A lot of outflow in foreign capital including those of Non Resident Indians (NRIs) took place during this period which put even the capital account into a deficit position. Now, it was a situation when not only the current account but also the capital account was in a deficit position and the balance of payment in aggregate was obvious to be in deficit. The foreign exchange reserves in the country was even less to finance a fortnight's imports. So, this was the second time when India knocked the doors of IMF for assistance. This time it was SBA instead of EA that secured SDRs 552 Million on 08/01/1991 and again SDRs 1656 Millions on 31/10/1991 was procured leaving no more balance for utilization. The detail of lending arrangements of India with the IMF till date is given in Table 2.3. Since SDRs are sanctioned from IMF with conditions, this time also India implemented the so called Structural Adjustment Programs (SAP) as prescribed by the Fund.

Table 2.3: LENDING ARRANGEMENTS OF INDIA WITH IMF (Amounts Expressed in Millions of SDRs)

Facility	Date of Arrangement	Date of Expiration	Amount Approved	Balance not Drawn	Program Years
EA	09/11/1981	08/11/1984	5000	1100	1982,1983,1984

SBA	08/01/1991	07/04/1991	552	0	1992
SBA	31/10/1991	30/06/1993	1656	0	1992,1993
Source: O. S. Deol, IMF Adjustment Programmes and Developing Economies (New Delhi: New Century Publications, 2005), pp. 163.					

7. Conclusion

The SAP was drafted for India jointly by IMF and the WB with the objectives to bring macro-economic stabilization in the country. There were various gears those were required to be stepped up for satisfying this objective which includes: cutting down of government expenditures, tightening of monetary policy, easing economic policies to bring foreign capital and technology, tax reforms, a flexible trade policy etc. In order to suffice these purposes, a series of reforms were introduced in the country in the form of New Economic Policy (NEP) of 1991. And because of this bold decision taken around two and a half decades ago that Indian economy has taken the shape of today.

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