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Is the Economy Headed Back to 1991?

By Shefali Anand

Is Manmohan Singh, who brought India out of a financial tailspin in 1991, now leading the country back into another crisis?

Raveendran/Agence France-Presse/Getty Images

A BJP supporter displayed a fake Indian currency note during a protest against price rise, New Delhi, Sept. 16.

Twenty years ago, the current Prime Minister and then-finance minister, explained the urgency of implementing economic reforms in a historic budget speech.

At the time, India was nearly bankrupt and on the verge of defaulting on its sovereign debt. The fault lay largely with India's high current account deficit, which can increase levels of foreign debt, and a steep fiscal deficit, or the gap between the government's expenditure and its earnings, Mr. Singh explained. Meanwhile, the country's foreign exchange reserves were not enough to pay its debt.

Reforms proposed by Mr. Singh and the government in 1991 got India out of that mess and eventually on to a path of 8%-plus growth in gross domestic product.

But in recent months, India's economic picture is again looking grim.

Growth has slowed sharply, down from the government's original target of 9% to around 6.5% for the year ending March 31, 2012, according to some estimates. The reform process has all but stalled. India's current and fiscal deficit are both high, and a recent government bill to provide food security to India's masses, will likely worsen India's financial burden.

"It is fiscally irresponsible to propose undertaking spending without explaining where the funds will come from," Gita Gopinath, an economics professor at Harvard University, told Economic Times newspaper.

Some say things have changed sufficiently that today's troubles don't amount to an

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impending catastrophe.

"We're not on the verge of a crisis," says Sachchidanand Shukla, chief economist at Enam Securities Pvt in Mumbai. This time around, India has enough foreign exchange reserves to meet its debt obligations, he says.

But "in terms of the policy-making, we're basically entering a regressive phase," says Mr. Shukla. "Sentiment-wise there's been a huge downgrade" for India's economy, he says.

Here's a look at how key pieces of current economic data compare to where India stood in 1991:

Current Account Deficit (The difference between a nation's total exports of goods, services and transfers, and its total imports of them)

THEN: The current account deficit was estimated to be "more than 2.5% of gross domestic product in 1990-91," said Mr. Singh in his speech. He described India's balance of payments situation as "exceedingly difficult."

NOW: For years after the 1991 crises, the Indian government contained the current account deficit to less than 2% of GDP. But in recent years, the deficit has ballooned to 1991-like levels, thanks partly to higher imports and more recently lower exports. For the year through March 2012, economists expect the deficit to come at around 3% of GDP.

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Fiscal Deficit (The difference between the government's total revenue and its expenditure)

THEN: The fiscal deficit is "estimated at more than 8% of GDP in 1990-91," said Mr. Singh in his speech, calling it "a cause for serious concern." He said "It should be our objective to progressively reduce the fiscal deficit of the Central Government…and to reduce the current account deficit in the balance of payments."

NOW: The fiscal deficit for the year-ended March 2012 is expected to come in at 5.5% or 6% of GDP, much higher than the government's targeted 4.6%. The food subsidy bill will add to this burden, say economists, unless the government cuts back on its expenditure proportionately.

Inflation

THEN: India's wholesale price index, a leading benchmark for inflation, increased 12.1% in the year ended March 31, 1991. Mr. Singh had called it a "serious problem". He said: "Inflation hurts everybody, more so the poorer segments of our population."

NOW: Since early last year, the Reserve Bank of India has been battling 9% to 10% inflation, by increasing benchmark interest rates 13 times. The central bank, and economists, expect that for the year ending March 31, inflation will be around 7%.

Foreign Exchange Reserves

THEN: In early 1991, India's foreign exchange reserves, comprising foreign currency, bonds and other assets, was around $1.2 billion. "The current level of foreign exchange reserves…would suffice to finance imports for a mere fortnight," said Mr. Singh.

NOW: After the opening up of the economy, foreign direct investment and foreign institutional investment into India's capital markets helped boost India's foreign exchange reserves. They now stand at $307 billion, according to the Reserve Bank. Economists say this can cover eight to nine months of India's imports.

External Debt

THEN: External debt was 29% of GDP in March 1991, according to a recent research from Morgan Stanley. "Persistent deficits, which were inevitably financed by borrowings from abroad, have led to a continuous increase in external debt," said Mr. Singh in his 1991 speech.

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NOW: According to Morgan Stanley data, external debt was just 18% of GDP as of June 2011.

Over the years, the composition of borrowing has changed. Mr. Shukla, the economist at Enam Securities, says that while in the nineties it was mostly government borrowing, in recent years Indian companies have been the major borrowers of foreign money, to grow their businesses or fund their short-term cash needs.

Indian Rupee

THEN: In a bid to improve India's financial situation and attract a loan from the International Monetary Fund, Mr. Singh had instructed the central bank to devalue the rupee. This was done in two steps – first by 9.5% against the U.S. dollar on July 1, 1991, and by another 11% two days later.

NOW: In recent months, given India's high current account deficit and muted foreign investment, market forces have pushed the Indian rupee sharply lower against the U.S. dollar. It's down nearly 18% since the beginning of the year to trade at around 52.70 rupees for one U.S. dollar.

To resuscitate India's economy in 1991, Mr. Singh had said: "We must act fast and act boldly."

The same holds true today, to bring India back to a 9% growth track.

Write to Shefali Anand at shefali.anand@wsj.com, or follow her on Twitter @shefalianand.

Current Account Deficit, External Debt, Foreign Exchange Reserves, inflation, Manmohan Singh, rupee

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6:25 pm December 26, 2011

shrikant sharma wrote:

this seems to be a tirade against DR Singh he only can bring out india from this low.the rupee devaluation will boost indias exprt vis a vis usa and europe.

1:13 pm December 26, 2011

Anonymous wrote:

he was a good finance minister he took good decisions to grow our economy bt now he is doing nothing

1:06 pm December 26, 2011

Rishi wrote:

Economic refugees to US like Miss Gopinath need to re-think their expertise in development before running their mouth about what is or is not irresponsible. Having voted with her two feet and found employment with the world's largest pharmaceutical company that no one appears to have heard about, she ought to question where the funds to pay Harvard's coddled economic faculty come from. Hint check your endowment allocations.

Perhaps her umbrage might be better deflected to consider the corporate welfare, transfer pricing thieving and tax shelter used by our Bollygarchs' to launder their income from India to the West.

12:37 pm December 26, 2011

Shakti wrote:

the PM of india is taking the country on the road to make it the new GREECE . the leaders are behaving like a toddler who is confused about exactly what to do? .It has been rightly said by Gita gopinath that we are moving on a spending spree without knowing where the funds will come from. Hope that the Growth rate doesnt fall below 5 %