D2 - Topic - Balance of Payment crisis
And new economic reforms

What is BOP and how does it lead to crisis

Government runs into deficit when it spends more than it receives alternatively, it runs into surplus when receives more than it spends.

To meet the additional exp. when in deficit, it can resort to 3 options Printing money, drawing money from foreign exchange reserves But it is not that easy as it appears. It influences other economic variables while resorting to these measures. Excessive printing of money can lead to inflation. It can lead to debt crisis if the govt borrows a lot from foreign source.

Excessive borrowings from domestic sources can result in higher interest rates and further the situation of crowding out.

Financial situation before crisis -
In 1950, PC was formed and since then India commenced on the path of planned development. Since 1950 India ran into continuous trade

deficit because of license raj system. The private savings were a mode of catering the public sector investment and consumption. The redistribution of income and wealth through tax and transfers was another goal during the time to reduce inequalities & poverty.

Balance of Payment crisis had its origin from the fiscal year 1979-80 onwards. By the end of 6th plan India's BoP deficit rose to Rs 11384 crore. The second oil shock of 1979 was more severe and value of the Imports of India became almost double between 1978-1982. From 1980 to 1983 there was global recession and India's exports suffered during this time.

The trade deficit was not been offset by the flow of the funds under net invisibles. Apart from the external assistance, India had to meet its colossal deficit in the current account through the withdrawal of SDR & borrowing from IMF under the extended facility arrangement.

The things became worse by the 1990-91 Gulf war which was accompanied by double digit inflation.