

Research Article

# The Compulsion of 1991: How a Balance of Payments Crisis Forced India's Economic Liberalisation

Partha Majumdar\* 

Department of Computer Science, Swiss School of Business and Management, Geneva, Switzerland

## Abstract

This report analyses the 1991 Indian economic liberalisation, arguing that it was a reactive response to a severe balance of payments crisis, rather than a proactive ideological shift. The analysis first details the structural weaknesses of the pre-1991 "Licence Raj" economy, highlighting its inefficiencies stemming from state control, import substitution industrialisation policies, and unsustainable debt-fuelled growth during the 1980s. The confluence of external shocks (the Gulf War and the collapse of the Soviet Union) and internal vulnerabilities precipitated a catastrophic depletion of foreign exchange reserves, pushing the nation to the brink of sovereign default. The government's desperate measures, including pledging gold reserves, underscore the lack of viable alternatives. The report emphasises the direct causal link between the stringent conditionalities imposed by the International Monetary Fund (IMF) and World Bank bailout package and the specific reforms implemented under the New Economic Policy (NEP). The NEP's key features—devaluation, trade liberalisation, industrial deregulation, foreign investment liberalisation, and public sector reform—directly correspond to the IMF/World Bank's Structural Adjustment Program. While acknowledging the existence of prior reformist ideas and the growth of the 1980s, the report concludes that the crisis was the indispensable catalyst that transformed desirable but politically impossible reforms into a necessary reality, demonstrating that India's liberalisation was fundamentally a paradigm shift by decree driven by economic necessity.

## Keywords

1991 Indian Economic Crisis, Balance of Payments Crisis, Licence Raj, IMF/World Bank Bailout, Structural Adjustment Program

## 1. Introduction

The economic reforms initiated in India in July 1991 represent a watershed moment in the nation's post-independence history, fundamentally altering its economic trajectory. For four decades, India's development strategy had been anchored in a state-led, inward-looking model of import-substituting industrialisation. The New Economic Policy (NEP) of 1991 marked a radical departure from this paradigm, dismantling the intricate web of controls and opening the economy to

domestic and international competition. However, this transformation was not a proactive ideological shift born of political consensus or intellectual evolution. The central thesis of this report is that the economic reforms of 1991 were a reactive, non-negotiable response to an acute balance of payments (BoP) crisis that brought India to the brink of sovereign default. The nature, scope, and timing of the reforms were dictated not by choice, but by the immediate compulsion of se-

\*Corresponding author: [partha.majumdar@hotmail.com](mailto:partha.majumdar@hotmail.com) (Partha Majumdar)

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curing emergency financial assistance from the International Monetary Fund (IMF) and the World Bank. Liberalisation was, therefore, a matter of national economic survival.

This report will construct this argument by systematically examining the evidence. It will first establish the deep-seated structural vulnerabilities of the pre-1991 "Licence Raj" economy, demonstrating how its foundational principles created a fragile and inefficient system. It will then provide a data-intensive analysis of the confluence of external shocks and internal weaknesses that triggered the 1991 crisis, leading to a catastrophic depletion of foreign exchange reserves. The analysis will detail the desperate measures taken by the government, including the politically fraught decision to pledge the nation's gold reserves, which underscores the complete exhaustion of policy alternatives. Finally, the report will demonstrate the direct and undeniable causal link between the stringent conditionalities of the international bailout package and the specific reforms enacted under the New Economic Policy, thereby proving that India's celebrated liberalisation was, at its inception, a paradigm shift by decree.

## 2. The Anatomy of a Controlled Economy: India's Structural Vulnerabilities (1950-1990)

The 1991 crisis was not a sudden event but the culmination of four decades of economic policies that, while rooted in the post-colonial ambition of self-reliance, engendered deep structural weaknesses. The state-dominated economic architecture, popularly known as the "Licence Raj," created a high-cost, low-efficiency system that was ill-equipped to handle the pressures of a globalising world. The seemingly robust growth of the 1980s, rather than being a sign of strength, was a debt-fuelled expansion that masked a rapidly deteriorating fiscal and external position, making the eventual collapse both more severe and inevitable. [24]

### 2.1. The "Licence Raj": A Framework for Inefficiency

From the 1950s until 1991, the Indian economy was governed by a system of comprehensive state control and regulation termed the "Licence Raj". [36] This framework, a form of state capitalism rather than pure socialism, was institutionalised through legislation like the Industrial Development Regulation Act of 1951 and the Industrial Policy Resolution of 1956. [36] Under this regime, the private sector was required to obtain government licenses for nearly every aspect of business operation, including establishing a new firm, expanding production capacity, or diversifying product lines. [36] Satisfying up to 80 different government agencies could be necessary before a private enterprise could commence production, creating a bureaucratic labyrinth that stifled entrepreneurship, suppressed competition, and fostered a culture

of rent-seeking and corruption. [12]

This system inherently favoured large, incumbent corporations that possessed the resources and connections to navigate the complex bureaucracy. [36] Consequently, economic power became concentrated in the hands of a few established business houses, while small and medium enterprises found it exceedingly difficult to compete or grow. The result was a stagnant industrial landscape characterised by low productivity, technological obsolescence, and a severe lack of consumer choice. For decades, the Indian automobile market, for instance, was dominated by just two models—the Ambassador and the Premier Padmini—a stark illustration of the system's failure to foster innovation and dynamism. [5]

### 2.2. The Ideology of Import Substitution and Its Consequences

The philosophical underpinning of the Licence Raj was the policy of import substitution industrialisation (ISI), a strategy born from the post-colonial imperative of achieving economic self-reliance and reducing dependence on foreign powers. [36] This approach led to the creation of a virtually closed economy, insulated from global markets by a formidable wall of protectionist measures. These included comprehensive quantitative restrictions (QRs) on imports and some of the highest tariff rates in the world, with peak duties reaching as high as 300 to 355 per cent. [13] This protection ensured that domestic producers controlled approximately 95 per cent of the market for manufactured goods and nearly 100 per cent of the consumer goods market. [13]

A critical and debilitating consequence of this inward-looking strategy was the chronic overvaluation of the Indian rupee. The government maintained a fixed exchange rate system, pegging the rupee to a basket of currencies of major trading partners. [34] This policy, combined with a domestic inflation rate that was consistently higher than that of its trading partners, meant that the real effective exchange rate was persistently overvalued. [13] This structural misalignment had two profound effects. First, it rendered Indian exports uncompetitive on world markets, causing merchandise exports to stagnate at a meagre 3-4 per cent of GDP for decades. [13] Second, it made foreign goods artificially inexpensive in rupee terms, creating a large and persistent demand for imports.

The confluence of meagre export earnings and high import demand resulted in a structural shortage of foreign exchange. The government's response was not to devalue the currency or liberalise trade, but rather to ration the scarce foreign exchange through the elaborate system of import licenses. [36] This created a pernicious feedback loop: the policy of ISI led to an overvalued currency, which caused a foreign exchange shortage, which in turn was used to justify the very import controls and licensing regime that defined the closed economy. The Licence Raj thus became a self-perpetuating system for managing a problem of its own creation.

### 2.3. The Unsustainable Growth of the 1980s: A Debt-Fuelled Expansion

The 1980s are often cited as a decade of economic awakening, with GDP growth accelerating to an average of 5.6 per cent, well above the so-called "Hindu rate of growth" of around 3.5 per cent that had characterised previous decades. [26] However, this growth was not a harbinger of sustainable reform but rather the final, feverish stage of a failing economic model. It was fundamentally unsustainable, financed not by productivity gains or export growth, but by a massive and reckless expansion of government borrowing. [26]

Throughout the decade, the government's non-development expenditure mounted, leading to a ballooning fiscal deficit. The gross fiscal deficit of the central government surged from 5.4 per cent of GDP in 1981-82 to 8.4 per cent by 1990-91. [29] The combined fiscal deficit of the central and state governments reached an alarming 12.7 per cent of GDP in 1990-91. [6] This fiscal profligacy was financed by debt. The internal debt of the government swelled from 35 per cent of GDP in 1985-86 to 53 per cent by 1990-91. [6]

Crucially, the government's fiscal imbalances spilt over into the external sector, giving rise to a perilous "twin deficit". [33] The widening current account deficit was increasingly financed not by concessional aid, but by high-cost commercial borrowings from international lenders and deposits from Non-Resident Indians (NRIs). [1] India's external debt nearly doubled in the latter half of the decade, rising from approximately \$35 billion in 1984-85 to \$69 billion by 1990-91. [7] This accumulation of foreign debt, much of it short-term, created a highly fragile situation. The growth of the 1980s was a credit-fuelled bubble, leaving the economy acutely vulnerable to any external shock that could trigger a crisis of confidence and disrupt the flow of foreign capital. The stage was set for a catastrophic collapse.

## 3. The Perfect Storm: The Unravelling of the Indian Economy (1990-1991)

The deep-seated structural vulnerabilities of the Indian economy were brought to a breaking point in 1990-91 by a confluence of severe external shocks and escalating domestic instability. This "perfect storm" triggered a rapid and catastrophic loss of international confidence, leading to capital flight and the complete evaporation of foreign exchange reserves. Within months, India was pushed from a position of chronic economic difficulty to an acute crisis, facing the real prospect of a sovereign default for the first time in its history.

### 3.1. Proximate Trigger 1: The Gulf War (1990-91)

The Iraqi invasion of Kuwait in August 1990 delivered a powerful and multi-pronged blow to India's fragile balance of payments. [13] The immediate consequence was a sharp spike

in global oil prices. As a nation heavily reliant on imported crude, India's import bill soared. The cost of petroleum, oil, and lubricants (POL) imports for 1990-91 escalated from an initial estimate of Rs. 6,400 crores to Rs. 10,820 crores, single-handedly inflating the trade deficit to unsustainable levels. [7]

The crisis in the Gulf had two other direct impacts. First, a crucial source of foreign exchange—remittances from the large population of Indian expatriate workers in Iraq and Kuwait—abruptly collapsed. [21] Second, the conflict disrupted trade, leading to a slump in India's exports to the Middle East. [13] The Gulf War thus simultaneously increased India's foreign exchange expenditure while constricting two of its key sources of foreign exchange earnings, placing immense pressure on its already dwindling reserves. [27]

### 3.2. Proximate Trigger 2: Geopolitical Shifts and Domestic Instability

Compounding the shock of the Gulf War was the concurrent turmoil within the Soviet Union, which had been India's largest trading partner. [33] Trade with the USSR and Eastern Bloc countries was conducted through a rupee-payment system, which provided a valuable cushion for India's external accounts by not requiring hard currency payments. The political and economic disintegration of the Soviet Union led to a collapse in this bilateral trade, eliminating a significant export market and further exposing India's foreign exchange vulnerabilities. [12]

This period of external turmoil coincided with acute political instability within India. A succession of weak and short-lived coalition governments paralysed the policy-making process, preventing any decisive action to address the escalating economic crisis. [1] The inability of the Chandra Shekhar government to pass the annual budget in February 1991 served as a clear signal to the international community of a state of political gridlock, further eroding confidence in the government's ability to manage the economy. [33]

### 3.3. The Collapse of Confidence and Capital Flight

The combination of deteriorating economic fundamentals, severe external shocks, and political paralysis precipitated a catastrophic loss of confidence among international creditors and investors. [1] This psychological shift transformed a serious economic problem into an unmanageable crisis.

International credit rating agencies, including Moody's and Standard & Poor's, sharply downgraded India's sovereign debt rating. [13] This downgrade acted as a red flag to global financial markets, effectively cutting off India's access to new commercial borrowings. It became prohibitively expensive, and ultimately impossible, for India to raise funds to service its existing external debt. [33]

The crisis of confidence became a self-fulfilling prophecy.

As credit lines dried up, Non-Resident Indian (NRI) depositors, who had previously been a stable source of foreign currency, began to withdraw their funds en masse. Net inflows of NRI deposits turned negative in September 1990, accelerating into a torrent of capital flight through the first half of 1991. [29] This capital outflow directly drained the country's foreign exchange reserves at the moment they were most needed. In a final blow, the IMF and the World Bank, citing the lack of a credible adjustment program, suspended their ongoing assistance to India, signalling a complete loss of faith from the international financial community. [33]

### 3.4. The Bottom Falls Out: Foreign Exchange Reserves Hit Rock Bottom

The cumulative effect of these pressures was a precipitous decline in India's foreign exchange reserves. From a level of

\$3.1 billion in August 1990, reserves plummeted to just \$896 million by mid-January 1991. [13] By June 1991, the reserves stood at a perilous \$1.1 billion, an amount barely sufficient to finance essential imports. [33]

The most alarming metric was the import cover—the number of weeks of imports that the available reserves could finance. [23] By June 1991, India's import cover had dwindled to just two to three weeks. [36] This meant the country was days away from being unable to pay for critical imports such as oil, industrial raw materials, and fertilisers. This scenario would have brought the entire economy to a grinding halt. The government was on the verge of defaulting on its international debt obligations, a move that would have shattered the nation's financial credibility for years to come. The crisis had reached its zenith; a sovereign default was now a "serious possibility". [1, 30]

**Table 1.** India's Economic Indicators on the Brink of Crisis (1985-1991). Note: Figures are compiled and approximated from multiple sources for illustrative purposes. Fiscal Deficit includes the Centre and the States. Import cover estimates vary slightly by sources but reflect the sharp downward trend.

| Year      | Fiscal Deficit (% of GDP) | Current Account Deficit (% of GDP) | External Debt (USD Billion) | Foreign Exchange Reserves (USD Billion) | Import Cover (Weeks) |
|-----------|---------------------------|------------------------------------|-----------------------------|-----------------------------------------|----------------------|
| 1985-86   | 9.0 (approx.)             | -2.5                               | 35.0 (approx.)              | 6.8                                     | 16-20 (approx.)      |
| 1988-89   | 10.0 (approx.)            | -2.9                               | N/A                         | 5.9                                     | 12-14 (approx.)      |
| 1989-90   | 10.0 (approx.)            | -2.5                               | N/A                         | 6.2                                     | 10-12 (approx.)      |
| 1990-91   | 12.7                      | -2.6                               | 69.0                        | 2.2                                     | 8-10 (approx.)       |
| June 1991 | N/A                       | N/A                                | N/A                         | 1.1 - 1.2                               | 2 - 3                |

## 4. A Nation's Sovereignty Pledged: The Gold Airlift and the IMF Imperative

By mid-1991, the Indian government had exhausted all conventional means of managing the economic crisis. With foreign exchange reserves at a critical low and international credit markets firmly closed, policymakers were forced to take extraordinary and politically perilous measures to avert an imminent default. The decision to physically airlift and pledge the nation's gold reserves was the ultimate act of desperation, a clear signal that India had no other options. This act of last resort paved the way for the only remaining course of action: approaching the IMF and the World Bank for a bailout, a process in which India held no bargaining power and was compelled to accept a pre-packaged set of radical economic reforms.

### 4.1. The Last Resort: Pledging the Nation's Gold

In an act that underscored the sheer gravity of the crisis, the Government of India authorised the pledging of its gold reserves to secure emergency foreign exchange loans. [33] This was a measure of absolute last resort, a move that is only contemplated when a nation is on the verge of complete financial collapse. The act itself serves as the most powerful evidence that the government was not choosing a new policy direction but was desperately trying to keep the country solvent on a week-to-week basis. [11]

A total of 67 tonnes of gold from the Reserve Bank of India's holdings were used as collateral. [33] The operation was conducted in two highly secretive tranches to avoid public panic and political backlash. In May 1991, 20 tonnes of gold were airlifted to the Union Bank of Switzerland (UBS) in Zurich. This was followed by a larger airlift of 47 tonnes to the Bank of England in London, which took place between May 21 and May 31, 1991, while the country was in the midst

of a general election. [33] Together, these pledges raised approximately \$600 million in foreign currency. [6] While this amount was insufficient to resolve the crisis, it provided just enough liquidity to meet immediate payment obligations and stave off default for a few more weeks.

When news of the gold shipments eventually became public, it caused a national outcry and was widely perceived as a moment of national humiliation, symbolising a surrender of economic sovereignty. [33] The intense political fallout, which contributed to the collapse of the Chandra Shekhar government, highlighted the extreme desperation that had forced such a drastic measure.

## 4.2. Cornered into Negotiations: Approaching the IMF and World Bank

The funds raised by pledging gold were merely a reprieve. The only viable path to securing the substantial financing required to stabilise the economy—an initial emergency loan of \$2.2 billion, with more to follow—was to formally request a bailout package from the International Monetary Fund and the World Bank. [36]

India approached these international financial institutions (IFIs) from a position of extreme weakness. As a supplicant nation on the verge of bankruptcy, its bargaining power was virtually non-existent. [34] The IFIs held all the leverage and were in a position to dictate the terms of any assistance. The resulting negotiations were not a collaborative policy-making exercise but a process of accepting a set of predetermined conditions. The loans were explicitly granted in exchange for India's agreement to a comprehensive and non-negotiable set of structural reforms. The evidence is clear that these conditionalities were not mere recommendations but prerequisites that India was "forced to agree to". [34]

## 4.3. The Blueprint for Reform: The Structural Adjustment Program (SAP)

The core conditionality attached to the IMF and World Bank loans was the swift and comprehensive implementation of a Structural Adjustment Program (SAP). [33, 37] This was a standard policy prescription applied by the IFIs to crisis-hit developing countries during this era, reflecting the prevailing "Washington Consensus" ideology, which favoured fiscal discipline, deregulation, and market-oriented policies. [33] The crisis effectively stripped India of its policy autonomy, subjecting it to a standardised playbook for economic restructuring.

The SAP laid out a detailed blueprint of reforms, which would soon be packaged and announced in India as the New Economic Policy. The key conditions, collectively known as the LPG (Liberalisation, Privatisation, Globalisation) framework, included [5, 15, 18, 19]:

- a) *Macroeconomic Stabilisation*: This involved immediate measures to control the twin deficits. The primary re-

quirement was a sharp reduction in the fiscal deficit through cuts in government spending, particularly subsidies, and a tighter monetary policy. [6]

- b) *Trade Liberalisation*: The program mandated the dismantling of the protectionist trade regime. This included the abolition of the import licensing system for most goods and a phased but significant reduction in customs tariffs. [8]
- c) *Industrial Deregulation*: A central condition was the abolition of the "Licence Raj" to remove barriers to entry for private firms and foster competition. [6]
- d) *Exchange Rate Reform*: The SAP required a sharp devaluation of the overvalued rupee to improve export competitiveness, followed by a transition towards a more flexible, market-determined exchange rate system. [36]
- e) *Encouragement of Foreign Investment*: The program called for the removal of long-standing restrictions on Foreign Direct Investment (FDI) to attract foreign capital, technology, and management expertise. [32]
- f) *Public Sector Reform*: The IFIs mandated reforms to improve the efficiency of the public sector, which included initiating a program of disinvestment (privatisation) of state-owned enterprises (SOEs). [32]

This set of conditionalities was not a menu of options from which India could choose. It was a comprehensive, integrated, and mandatory package that formed the basis of the bailout agreement. The subsequent reforms were, therefore, a direct execution of this externally imposed agenda.

## 5. The New Economic Policy: A Paradigm Shift by Decree

The New Economic Policy (NEP), unveiled by the newly formed government of Prime Minister P. V. Narasimha Rao and Finance Minister Dr. Manmohan Singh in July 1991, was a direct and systematic implementation of the conditionalities laid out in the Structural Adjustment Program. The speed, scope, and specific content of the reforms announced demonstrate a clear one-to-one correspondence with the mandates of the IMF and the World Bank. The NEP was not an indigenously developed policy evolution; it was the domestic execution of a bailout agreement, a paradigm shift enacted by decree.

### 5.1. Devaluation and Trade Liberalisation

In immediate fulfilment of a key IMF condition, the government acted swiftly to correct the chronic overvaluation of the currency. The Indian rupee was devalued in two sharp, successive steps on July 1 and July 3, 1991, resulting in a cumulative depreciation of approximately 18-20 per cent against major currencies. [33, 35] This measure was aimed squarely at making Indian exports more competitive on the global market and curbing import demand, a classic stabili-

sation measure prescribed by the IMF. [6]

Simultaneously, the government began to dismantle the four-decade-old protectionist trade regime. The complex and restrictive system of import licensing was virtually abolished for most capital goods, raw materials, and intermediate components. [32] A radical reform of the tariff structure accompanied this. Peak customs duties, which had stood at over 300 per cent, were slashed, with a clear roadmap for further phased reductions towards a target of 50 per cent. [32] These actions directly mirrored the trade liberalisation mandate of the SAP. [32]

## 5.2. Dismantling the Licence Raj

The centrepiece of the domestic reforms was the abolition of the "Licence Raj," the system of industrial licensing that had stifled private enterprise for decades. With a single stroke, the new industrial policy eliminated the need for government licenses for all but 18 specified industries related to strategic, social, or environmental concerns (a list that was later pruned further). [13, 32] Furthermore, provisions of the Monopolies and Restrictive Trade Practices (MRTP) Act, which had prevented large firms from expanding, were removed, allowing businesses to make investment and production decisions based on market signals rather than bureaucratic approvals. [22] This sweeping deregulation was the cornerstone of the liberalisation agenda pushed by the IMF and World Bank to unleash the private sector and foster a more competitive economic environment. [8]

## 5.3. Opening the Floodgates: Foreign Direct Investment (FDI)

To address the chronic shortage of foreign exchange and attract much-needed capital and technology, the NEP dramatically liberalised the regime for foreign investment. The new policy provided for automatic approval of Foreign Direct Investment (FDI) up to 51 per cent equity in a wide range of high-priority industries. [32] For other proposals, a new Foreign Investment Promotion Board (FIPB) was established to provide a single-window clearance mechanism and actively solicit foreign investment. [32] This policy reversal was a direct response to the SAP's objective of integrating India into the global economy and bolstering its foreign exchange reserves. [6] The impact was immediate and profound: foreign investment, which stood at a mere \$132 million in 1991-92, surged to \$5.3 billion by 1995-96. [12]

## 5.4. Public Sector Reform and Privatisation

In line with the privatisation component of the LPG model, the NEP initiated a significant reform of the public sector. The number of industries reserved exclusively for public sector enterprises was drastically reduced from 17 to 8, and subsequently to just three (defence, atomic energy, and railways),

opening up vast swathes of the economy, including telecommunications and civil aviation, to private participation. [32] The government also launched a program of disinvestment, which involved selling minority stakes in select Public Sector Undertakings (PSUs) to the public and financial institutions. [32] While full-scale privatisation was a gradual process, these initial steps were a clear fulfilment of the IMF and World Bank's mandate to improve the efficiency of state-owned enterprises and reduce their drain on the government's budget. [8]

The direct, unambiguous mapping of each pillar of the New Economic Policy to a specific conditionality of the bailout package leaves little room for interpretation. The NEP of 1991 was the practical manifestation of the terms of the financial rescue, a comprehensive reform program that India was compelled to adopt in its moment of greatest economic vulnerability.

## 6. Deconstructing the Debate: Compulsion, Not Choice

The evidence of the economic collapse and the nature of the subsequent bailout overwhelmingly supports the narrative that India's 1991 reforms were a product of compulsion. However, a nuanced academic debate exists regarding the role of pre-existing reformist ideas and the growth trajectory of the 1980s. While acknowledging these alternative perspectives, a thorough analysis reveals that the crisis was the indispensable catalyst that transformed economically desirable but politically impossible reforms into an unavoidable reality.

### 6.1. The "Crisis as Opportunity" Argument

It is accurate to note that by 1991, a cohort of reform-minded technocrats and economists existed within and outside the Indian government. [13] These individuals had long recognised the inefficiencies of the Licence Raj and advocated for a more market-oriented approach. For them, the crisis of 1991 presented a unique "opportunity" to implement a policy agenda that had been politically unviable for decades. [2]

However, their influence prior to the crisis was marginal. The political economy of the Licence Raj was deeply entrenched, supported by powerful vested interests—including protected domestic industries, license-holders, and a vast bureaucracy—that benefited from the status quo. [13, 20] This powerful coalition had successfully thwarted previous, more modest attempts at liberalisation. A reform effort in 1966 was quickly rolled back following political backlash, and the piecemeal liberalisation of the 1980s under Rajiv Gandhi also stalled in the face of political opposition. [36] For four decades, the political consensus remained firmly in favour of the state-led model, making any radical departure "politically untouchable". [13] The crisis did not create the ideas for reform, but it was essential in creating the political space for

their implementation.

## 6.2. The Indisputable Role of the Crisis

The 1991 crisis was the necessary and sufficient condition that shattered the long-standing political equilibrium. Its sheer severity—the spectre of a sovereign default and the halt of essential imports—created a national emergency that transcended normal politics. This allowed the new government of P. V. Narasimha Rao to frame the reforms not as an ideological choice, but as a rescue package essential for national survival. [33] The gravity of the situation effectively silenced or marginalised much of the opposition that would have otherwise derailed such a radical program. [10]

This perspective is strongly supported by scholarly analysis. The reforms were "precipitated by" the crisis, "forced" upon the government, and undertaken "under pressure" from the IMF and the World Bank. [34] The nature of the liberalisation is described as "sudden, comprehensive and largely externally imposed," highlighting the lack of domestic agency in the process. [31] The crisis created a "there is no other alternative" (TINOA) consensus, not out of ideological conversion, but out of the stark reality of having no other options. [28] It was the crisis that acted as a political sledgehammer, breaking the power of vested interests and overriding the ideological opposition that had blocked meaningful reform for decades.

## 6.3. Countering the "1980s Growth" Narrative

Some scholars, notably Atul Kohli, have argued that India's growth acceleration began in the 1980s, a full decade before the 1991 reforms, suggesting that the reforms were not the primary driver of India's economic turnaround. [16] This view posits that a shift to a more "pro-business" stance in the 1980s, which favoured established capital, was the real inflexion point. [14]

However, this argument is convincingly countered by other economists, such as Arvind Panagariya and Jagdish Bhagwati, who characterise the growth of the 1980s as "fragile and unsustainable". [17, 25] As detailed earlier, this growth was not driven by improvements in productivity or competitiveness but was financed by an unsustainable accumulation of public and external debt. [1, 3] This debt-fuelled expansion is what led directly to the balance of payments crisis.

The critical distinction lies between the "pro-business" policies of the 1980s and the "pro-market" reforms of 1991. [4] The former involved easing some controls for existing large firms, essentially a more lenient form of the old system. The latter, however, represented a fundamental reorientation of the economy towards competition, efficiency, and integration with the global market. [2] The 1991 reforms were a structural break, not a mere continuation of the policies of the 1980s. The fact that the 1980s model culminated in a near-default is the strongest evidence of its unsustainability and the necessity of the drastic, crisis-induced changes that followed.

## 7. Conclusion: The Enduring Legacy of a Forced Transformation

The evidence examined in this report leads to an unequivocal conclusion: India's economic liberalisation in 1991 was a paradigm shift born of compulsion, not choice. The narrative is clear and causally linked. A four-decade-long adherence to a state-led, inward-looking economic model created deep structural vulnerabilities, including a chronic foreign exchange shortage and pervasive industrial inefficiency. The unsustainable, debt-financed growth of the 1980s stretched this fragile system to its breaking point. When a perfect storm of external shocks—the Gulf War and the collapse of the Soviet Union—hit in 1990-91, the system shattered.

The ensuing balance of payments crisis was catastrophic, marked by a collapse of international confidence, a sovereign credit downgrade, and the flight of capital. With foreign exchange reserves dwindling to cover a mere two to three weeks of essential imports, India stood at the precipice of a sovereign default. The desperate and politically humiliating act of airlifting the nation's gold reserves to foreign banks to serve as collateral for emergency loans was the definitive proof that all other options had been exhausted.

This position of extreme vulnerability left India with no leverage in its negotiations with the International Monetary Fund and the World Bank. The country was forced to accept a bailout package that came with a stringent and non-negotiable set of conditionalities. The New Economic Policy of 1991 was a direct and faithful implementation of this externally mandated Structural Adjustment Program. The devaluation of the rupee, the dismantling of the Licence Raj, the liberalisation of trade and foreign investment, and the initiation of public sector reform were not elements of a homegrown strategy but the fulfilment of the terms of a financial rescue. [9]

While it is true that reformist ideas had existed in India for years, they lacked the political traction to overcome entrenched interests. The crisis of 1991 acted as the catalyst that made the politically impossible, economically unavoidable. The long-term consequences of these reforms—the subsequent decades of high growth, the rise of a new service-based economy, and the persistent challenges of inequality—continue to be debated. However, the origins of this transformation are not in dispute. The 1991 reforms were a product of a crisis that necessitated the surrender of policy autonomy in exchange for national economic survival. This moment remains a powerful lesson in how decades of flawed economic policy can culminate in a crisis so severe that it forces a nation to change its course under duress fundamentally.

## Abbreviations

|     |                           |
|-----|---------------------------|
| BoP | Balance of Payment        |
| FDI | Foreign Direct Investment |

|       |                                              |
|-------|----------------------------------------------|
| FIPB  | Foreign Investment Promotion Board           |
| GDP   | Gross Domestic Product                       |
| IFI   | International Financial Institution          |
| IMF   | International Monetary Fund                  |
| ISI   | Import Substitution Industrialization        |
| LPG   | Liberalisation, Privatisation, Globalisation |
| M RTP | Monopolies and Restrictive Trade Practices   |
| NEP   | New Economic Policy                          |
| NRI   | Non-Resident Indian                          |
| POL   | Petroleum, Oil, Lubricant                    |
| PSU   | Public Sector Undertaking                    |
| QR    | Quantitative Restrictions                    |
| SAP   | Structural Adjustment Program                |
| SOE   | State-Owner Enterprise                       |
| TINOA | There Is No Other Alternative                |
| UBS   | United Bank of Switzerland                   |
| US    | United States (of America)                   |
| USD   | US Dollar                                    |
| USSR  | Union of Soviet Socialist Republics          |
| WB    | World Bank                                   |

## Author Contributions

Partha Majumdar is the sole author. The author read and approved the final manuscript.

## Conflicts of Interest

The author declares no conflicts of interest.

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