Business Standard

From scarce dollars to global buffers: Can India avoid 1991-like crisis?

Thirty-five years after the 1991 crisis, India's external sector is far stronger. But have larger reserves, stronger exports, and reforms eliminated the risk of another balance-of-payments crisis?

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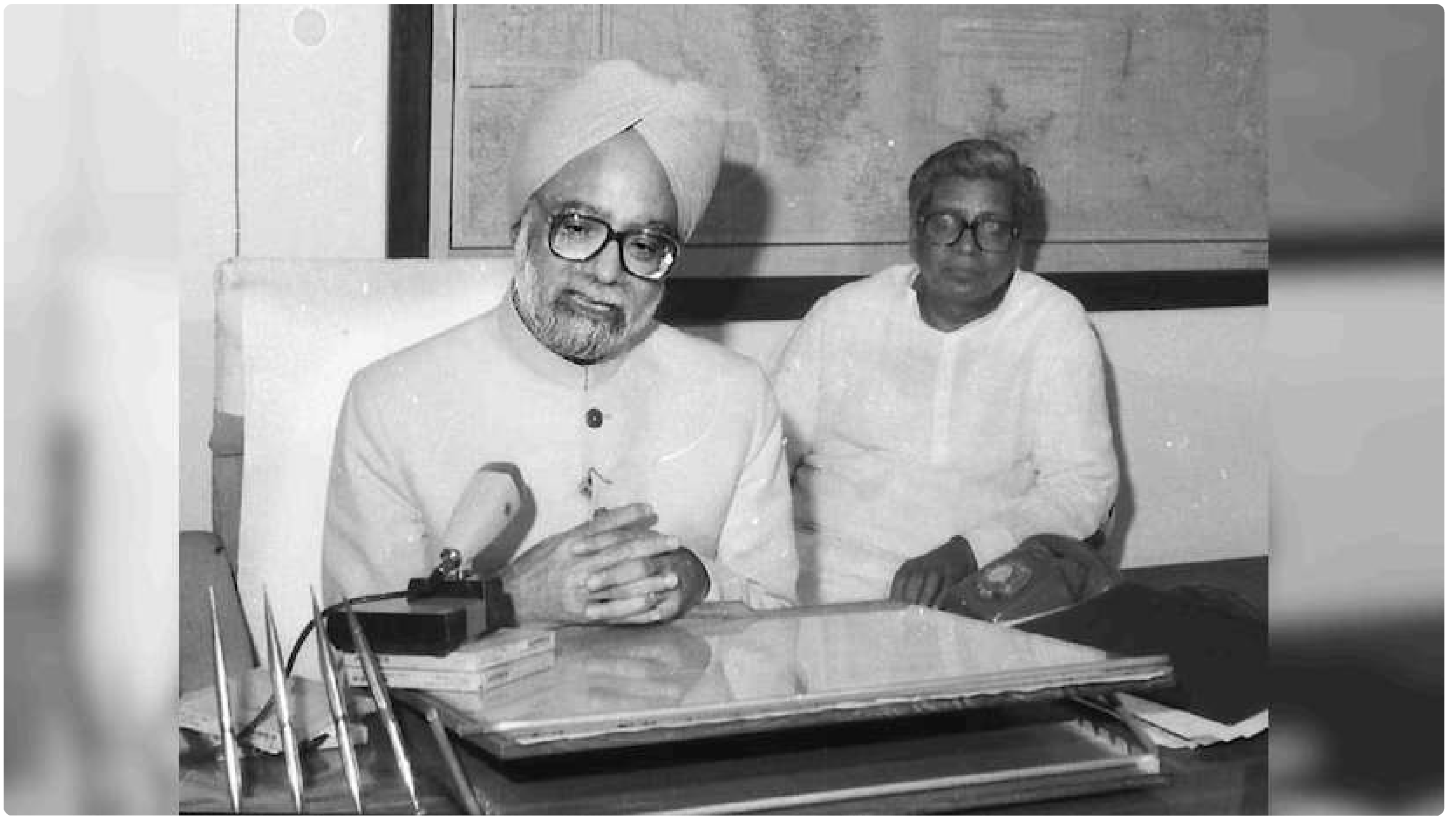

File photo: Then-Finance Minister Manmohan Singh giving a TV interview soon after presenting the Union Budget for 1991-92 (Source: PIB)

In 1991, India was on the brink of an external payments crisis. Foreign exchange reserves had fallen to levels sufficient to finance only a few weeks of imports, which compelled the government to pledge gold to secure emergency funding. The crisis exposed deep weaknesses in the economy and triggered sweeping reforms that opened up trade, liberalised finance and changed the way India managed its external sector.

Thirty-five years later, the picture is markedly different. Merchandise and services exports have expanded, external debt has declined relative to the size of the economy, and foreign exchange reserves now give policymakers far greater room to respond to external shocks.

But the transformation raises a more nuanced question: How much has India's resilience improved, what vulnerabilities remain, and what combination of shocks could place its external buffers under severe strain?

What changed after 1991?

The BoP crisis was the result of a convergence of internal and external pressures. India entered the 1990s with large fiscal and current-account deficits, a tightly managed exchange rate, limited foreign exchange reserves and an economy that remained relatively closed to global trade.

The response went beyond securing emergency financing. According to an RBI assessment of the reform period, the government adopted a combination of macroeconomic stabilisation and structural adjustment measures covering trade policy, industrial licensing, exchange-rate management and the financial sector.

"Trade liberalisation and the accompanying external-account opening appear to have had the biggest long-run impact on India's resilience. Over time, they broadened export participation, reduced import bottlenecks, and made the external sector more flexible and less vulnerable to a sudden stop in foreign exchange inflows," said Nilanjan Banik, professor of economics and finance at Mahindra University's School of Management.

He added that financial-sector and capital-market reforms improved credit allocation and reduced the cost of raising capital.

The reforms also fundamentally changed the way India managed the rupee. Following the 1991 devaluation, India introduced a dual exchange-rate system in 1992 before moving to a unified, market-determined exchange rate under a managed float in March 1993. Unlike the pre-1991 regime, where the RBI had to defend a fixed exchange rate by drawing down reserves, the current framework allows the rupee to absorb part of an external shock through market adjustment, reducing pressure on foreign exchange reserves.

However, the exchange rate is not left entirely to the market. The RBI continues to intervene to contain excessive volatility and disorderly market conditions.

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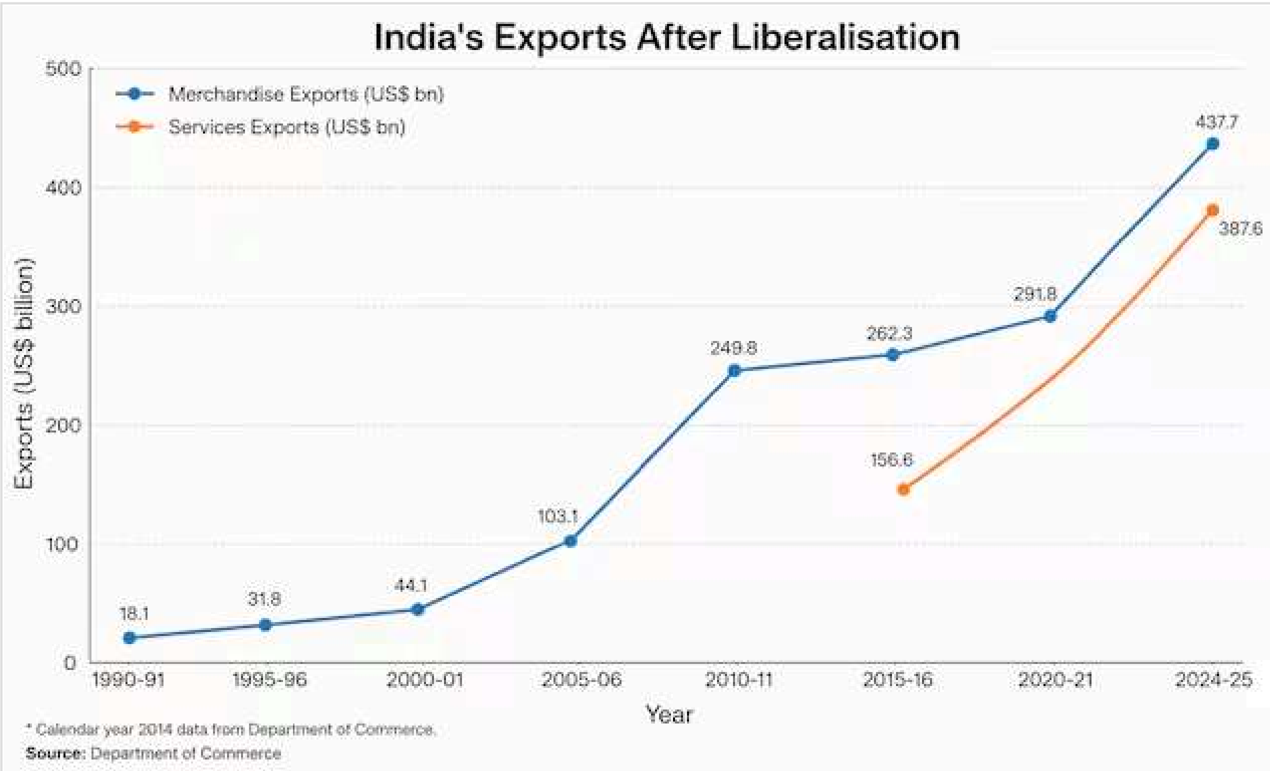
The numbers tell the story

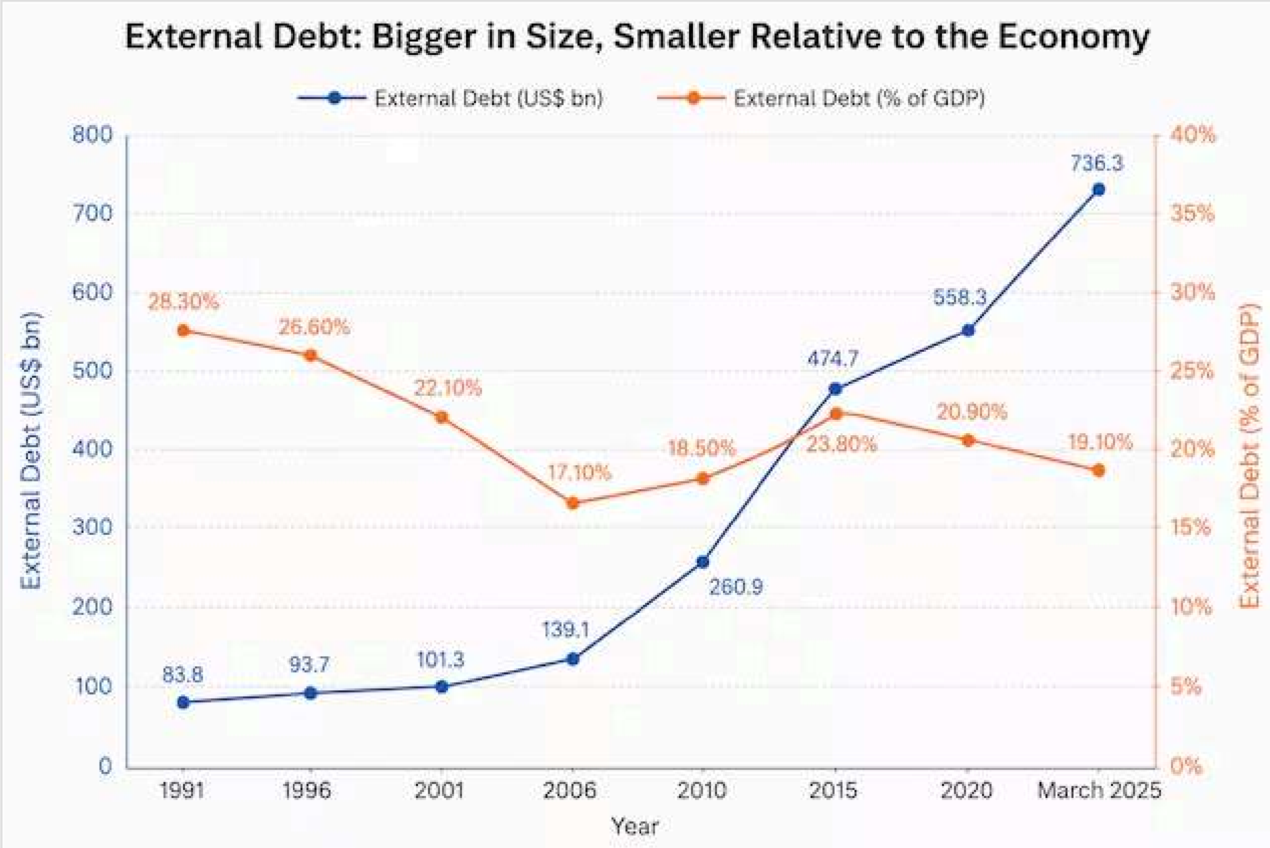
The biggest change since 1991 is visible in India's ability to earn and manage foreign exchange.

Merchandise exports have expanded more than twentyfold over the past three-and-a-half decades. While exports stood at $18.1 billion in 1990-91, they crossed $437.7 billion in 2024-25. Services have emerged as an equally important source of foreign exchange earnings, with exports reaching $387.6 billion in 2024-25.



India's export trends after liberalisation (AI-generated)

External debt has also increased substantially from $83.8 billion in 1991 to $736.3 billion in March 2025. However, the economy has grown much faster over the same period, bringing the external debt-to-GDP ratio down from 28.3 per cent to 19.1 per cent.



India's external debt trends over time (AI-generated)

Foreign exchange reserves have grown sharply as well, which created a much larger buffer than what existed in 1991. Import cover has correspondingly improved, which has reduced the risk of a sudden shortage of foreign currency.

Together, these indicators point to an external sector that is significantly stronger than it was at the start of the reform era.

India's external sector: Then and now		
Indicator	1990-91	2024-25*
Merchandise exports (US$ bn)	18.1	437.7
Services exports (US$ bn)	—	387.6
External debt (US$ bn)	83.8	736.3 (approx)
External debt (% of GDP)	28.30%	19.10%
Foreign exchange reserves	₹11,416 crore	Reached an all-time high of $704.885 billion

Services emerged as the biggest buffer

While merchandise exports expanded steadily after liberalisation, Banik said services exports have contributed the most to strengthening India's balance of payments.

"They generate a persistent surplus in invisibles, and recent RBI commentary says they remain a major source of external-sector strength and a key buffer for the current account," he said.

Does a large reserve buffer guarantee safety?

Economists caution against judging India's resilience solely by the size of its foreign exchange reserves.

Aditya Agarwala, chief investment officer at InvestValue Capital, said reserves provide confidence, but they do not by themselves determine external stability.
"The headline reserve figure is a comfort blanket, not a verdict on external stability," he told Business Standard.

Investors also assessed the current account, the composition of capital inflows, external debt obligations and the credibility of fiscal and monetary policy.
According to Agarwala, stable sources of foreign exchange, such as foreign direct investment, services exports and remittances, offer greater resilience than portfolio investments or short-term borrowing, which can reverse quickly during periods of global uncertainty.

He added that the composition of reserves and the structure of external liabilities are equally important because they determine how much flexibility policymakers have during periods of stress.

The risks have changed

The nature of India's external vulnerability has also evolved.

In 1991, the concern was an acute shortage of foreign exchange. Today, economists see the greater risk in a combination of global developments rather than a single domestic weakness. Agarwala said the most challenging scenario would be a prolonged oil-price shock accompanied by a stronger US dollar and sustained capital outflows.

India imports close to 89 per cent of its crude oil requirements. Higher oil prices increase the import bill, widen the trade deficit, raise inflation and increase demand for dollars. A stronger dollar makes imports and foreign-currency debt more expensive, while geopolitical tensions can disrupt energy supplies, shipping routes and trade.

He said portfolio outflows become particularly problematic when they coincide with a widening current-account deficit, weak foreign direct investment and difficulties in refinancing external debt.

Is another 1991-style crisis likely?

The experts said India enters periods of global stress from a much stronger position than it did three decades ago.

Banik said that compared with 1991, India now has larger reserves, a flexible exchange rate, stronger services exports and a more credible policy framework.

"That means a shock would be handled more through buffering and adjustment than through emergency rescue measures like the gold-pledge episode of 1991," he said.

Ritik Bhandari, team lead at the Centre for Law, Policy & Governance, NFPRC Foundation, said many of the structural weaknesses that triggered the 1991 crisis have been addressed. According to him, the exchange rate is now flexible, inflation targeting has strengthened monetary policy, the current-account deficit has remained relatively contained in recent years and foreign exchange reserves provide a substantially larger cushion than they did in 1991.

The current data support part of this assessment: The current-account deficit was 0.6 per cent of GDP in both 2024-25 and 2025-26, while reserves and import cover were substantially higher than in 1991.

While India has not eliminated external-sector risk, it has significantly reduced the risk of a 1991-style sovereign liquidity crisis. The buffers are large enough to absorb individual shocks, but the harder test is whether they can withstand a sustained oil shock, dollar appreciation, capital outflows and external-debt refinancing pressures simultaneously.

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