

# [Thus a financial crisis. there is also a](https://assignbuster.com/thus-a-financial-crisis-there-is-also-a/)

Thus out of our total reserves of $5824 million in 1990-91, foreign currency assets were only $2236 million. The policy of economic liberalisation and globalisation led to a cumulative increase in our rests, first slowly and then rapidly. By January 2005, the total had crossed $ 130 billion.

Dollars are coming from multiple avenues, FIIs, FDI and remittances from NRIs and exporters. World Bank has voiced concern over rising forex reserves in developing countries in its Global Development Finance, 2003. This is because of two things. Dollar reserves are being used by us and other countries to finance current account deficit of the USA.

And secondly, increasing reserves add to inflationary forces within the reserve-holding country. For these two reasons, RBI is also in a tricky situation. Reserves, by themselves, are both necessary for supporting import needs and for meeting emergent developments. However, a part of our reserves are on account of deposits and investments by FIIs.

These components of our liabilities carry the risk of speculative outflow of foreign funds and causing a financial crisis. There is also a limit to which RBI can ‘ sterilise’ these reserves (that is, neutralise their impact on money supply and inflation). And, if RBI stops buying dollars, rupee would appreciate and our export competitiveness would be adversely affected. However, India is not the only country which has accumulated these foreign exchange reserves. Some other Asian countries are far ahead of us and are sitting on huge piles of reserves. Some collective measures are being considered by these countries such that these reserves get invested within Asian economies themselves instead of financing current account deficit of the USA. Investment in US government securities carries a smaller rate of return.

The objective is that the Asian countries should themselves benefit from their reserve accumulations and should also be protected against both potential financial crises and inflation. It is also noteworthy that, in recent years, India has been prepaying some of its more expensive external debt, so as to reduce the total cost of debt servicing. Our indebtedness vis-^-vis other emerging economies has also improved over the years. India had once become the third highest indebted developing country in the world; now it is the ninth.