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469A Bukit Timah Road
#07-01, Tower Block, Singapore 259770
Tel: 6516 6179 / 6516 4239
Fax: 6776 7505 / 6314 5447
Email: isassec@nus.edu.sg
Website: www.isas.nus.edu.sg

Indian Elections 2009: Where are Economic Reforms Headed?

Bibek Debroy*

Preface

India is holding its 15th general elections from 16 April to 13 May 2009. The elections are taking place in challenging circumstances. A variety of cross-cutting political, security, economic and socio-cultural issues are influencing the elections. The exercise is impacted by multiple parties, personalities and positions from India's vast political spectrum.

The Institute of South Asian Studies (ISAS) is bringing out a series of papers analysing different aspects of the elections. These include, among others, analysis of key national and regional parties and their strategies, key political personalities, and issues dominating perceptions of the electorate.

ISAS had earlier prepared seven papers, providing an overview of India's political parties; the role of the youth in India's elections; the economic backdrop to the general elections; the major domestic issues likely to dominate the elections; India's key foreign policy concerns and their impact on the elections; the role of women and importance of women leaders in Indian politics and elections; and the geographical distribution of India's regional parties, their areas of influence and regional electoral outlooks.

The eighth paper in the series critically examines the outlook for economic reforms and the major economic policies that are likely to prevail in India following the elections.

Combinations and Configurations

The Indian political scenario and the shape of the new central government are completely uncertain until May 2009. Conceptually, there can be the following configurations: 1) a Congress government; 2) a BJP government; 3) a Congress-led government; 4) a Bharatiya Janata Party (BJP)-led government; 5) the Third Front, supported by the Congress from the outside; 6) the Third Front, supported by the BJP from the outside; and 7) the Third Front government. One does not need psephology to figure out that the Congress and the BJP will add up to 280 seats or thereabouts. And, clearly, neither the Congress nor the BJP is going to

* Professor Bibek Debroy is a Visiting Senior Research Fellow at the Institute of South Asian Studies, an autonomous research institute at the National University of Singapore. He can be contacted at isasbd@nus.edu.sg or bdebroy@gmail.com.

wither away. Therefore, Options 1, 2 and 7 are extremely improbable though they are logically possible.

We are left with Options 3, 4, 5 and 6. Opinion polls, masquerading as precognition, will not get us any closer to which of the four is most likely, since quite a bit hinges on which is the largest party or the largest alliance, and the subsequent exchange of one kind of portfolio for another.

It is useful to remember the composition of the Indian parliament in 2004, at least for the major political parties – the Congress (145 seats); the BJP (138); the Samajwadi Party [SP] (39); the Nationalist Congress Party [NCP] (9); the Trinamool Congress [TMC] (2); the Rashtriya Janata Dal [RJD] (21); the Lok Janashakti Party [LJP] (3); the Shiv Sena (12); the Asom Gana Parishad [AGP] (2); the Akali Dal (8); the Dravida Munnetra Kazhagam [DMK] (16); the Bahujan Samaj Party [BSP] (17); the All India Anna Dravida Munnetra Kazhagam [AIADMK] (0); and the Left (59).

For the 2009 elections, across psephologists, we have such modal numbers as the Congress (135-150 seats); the BJP (135-145); the SP (23-30); the NCP (13-14); the TMC (13-17); the RJD-LJP (15); the Shiv Sena (12); the AGP (4-5); the Akali Dal (4-5); the DMK and its allies (13-15); the BSP (26-34); the AIADMK and its allies (30); and the Left (35-40). That leaves the field wide open, since some incremental parties will not sleep with the enemy. The SP and the BSP, the TMC and the Left, and the DMK and the AIADMK are instances of such rifts. Consequently, the definitions of the United Progressive Alliance (UPA) and the National Democratic Alliance (NDA) are fungible. All one knows is Options 3 and 5 are a bit more likely than Options 4 and 6.

One also notices stability in the numbers across 2004 and 2009, though there are state-level shifts not discernible in all-India aggregates. That apart, one should mention the relative decline of the SP and the Left, and the relative increase in importance of the BSP, the TMC and the AIADMK. Other than the Congress, these three parties in the ascendance are led by ladies.

The Economic Domain

However, there is greater certainty in the economic domain. The Reserve Bank of India's (RBI) annual review of the monetary policy has just been announced and it has said that the economy will grow by six percent in 2009-10. In an interview, the Chief Economic Adviser at the Ministry of Finance has suggested a band of 5.5 percent to 7.5 percent, which is so wide that it is hardly illuminating. However, to be fair to the Chief Economic Adviser, the upper part of the range is conditional on the United States' economy bottoming out by September 2009, which is an unlikely event. Without this, the Chief Economic Adviser's band is 5.5 percent to 6.5 percent.

Neither the RBI nor the Chief Economic Adviser will vehemently disagree if one breaks up the 2009-10 growth into 5.5 percent for the first half of the year and 6.5 percent for the second half. From October 2009, India will thus settle into a trajectory of 6.5 percent (down from 8.5 percent) and remain there until the world economy and exports perk up. What does one expect the incoming government to do so that the trajectory becomes 7.5 percent rather than 6.5 percent or the recovery occurs before October 2009?

Manifestos and Recovery Prescriptions

Reportedly, the Congress has been working on a 100-day reform blueprint. It is true that the big-bang reforms should occur in the first 100 days. Otherwise, steady-state resistance takes over. On economic reforms, the UPA flaunts the National Rural Employment Guarantee Scheme (NREGS) and the Right to Information (RTI) Act. The RTI Act was pushed through by the UPA government during that window and though the NREGS was formally launched in August 2005, the decision had already been taken during the first 100 days, when the National Advisory Council still possessed some bite. During 1991-1996 too, significant reforms occurred during the first 100 days. However, this 100-day hypothesis is not quite true of either the United Front or the NDA. Does that validate a hypothesis that steady state resistance to reforms is greater under the Congress? With Option 3, 5 or 6, the incremental allies will stonewall enough to jettison all reforms. The first 100 days will not shake India, except that, with Option 3, we might have a Right to Food Bill.

This is simply not a matter of the National Common Minimum Programme (NCMP) or the National Agenda for Governance (NAG), as commentators often suggest. Four political parties have brought out their manifestos so far – the Congress, the BJP, the Communist Party of India (Marxist) [CPM] and the SP. In addition, the BJP has an information-technology vision document. Despite subsequent band-aid attempts, the SP's manifesto is worse than even that of the CPM. It prohibits English, computers, capital markets, agricultural mechanisation and shopping malls. All three markets – labour, land and capital – will be messed up if the SP becomes part of a ruling coalition. One can ignore the SP and turn to the other three. Not only can these three manifestos be contrasted, one can also contrast the 2009 manifestos with the 2004 vintages. In the 2004 versus 2009 manifesto face-off, the CPM is consistent. However, both the Congress and the BJP have moved to the left in five years.

Indeed, there is a blurring of differences across the three 2009 manifestos in economic content. In substance, all three manifestos have similar positions, demonstration of India's version of Gresham's Law – bad policies drive good policies out of circulation.

Take the question of subsidising the poor, this is a good policy. The Congress (2009) manifesto states that, "This will require that all subsidies reach only the truly needy and poor sections of our society. The Indian National Congress will continue its efforts to create and implement a national consensus on this issue." This is excellent and there will be medical insurance for the unorganised sector below the poverty line (BPL), old age pensions for BPL elder citizens, subsidised food grains for BPL families and health insurance for BPL. And what kind of national consensus has the UPA worked out on identifying BPL in the last five years? If we have not been able to do it in five years, what is the guarantee that we will be able to do it in another five years? The consensus implicit in the manifesto is the NREGS (self-identification), single-woman headed households, disabled and elderly, urban homeless, released bonded workers or collective (the Scheduled Castes, the Scheduled Tribes Other Backward Castes and the minorities). There is no quarrel with self-identification, single-woman headed households, disabled and elderly. However, for the rest, we have no consensus at all.

Both the BJP (2004 and 2009) manifestos mention BPL but less than that of the Congress. In 2009, we have subsidised food-grains for BPL (with the good idea of food coupons and private outlets thrown in), subsidised pensions and interest rates for the aged, bank accounts for BPL women, subsidised bicycles for BPL girls, and subsidised school education for girls from "disadvantaged families". As with the Congress, we have not licked the problem of identifying BPL. The BJP (2009) manifesto also has a curious figure. However, before that, the BJP (2004) said, "In the past six years, the number of Indians living below the poverty line has diminished significantly." This is absolutely right and this is based on the National Sample Survey data for 1999-2000 to 2004-05, two points when there were large samples. The next large sample data will not be available till 2011. As such, we do not quite know what has happened to poverty since 2004-05. The BJP (2009) manifesto states, "It is a telling comment on the UPA's performance that a whopping 55 million people have been pushed below the poverty line over the past five years. This is according to a study by the Indian Statistical Institute (ISI)." Beyond this statement in the BJP's manifesto (2009), no one seems to have heard of the ISI-Kolkata study.

Moving on to the CPM, the Left party does not believe in BPL. In 2009, as in the case in 2004, it wants a universal public distribution system, no targeting. The view was stated more strongly in the manifesto in 2004, "BPL cards should be available for all those who are not income-tax payers." It is, thus, a bad idea to pay income taxes, rich farmers included. Since the policies are always based on the lowest common multiple of bad ideas, we can arrive at only one conclusion. India is a poor country and everyone in India must be poor. Everyone must be entitled to subsidies.

Before mentioning the issue of resources, let us flag another odd development. No economist will quite know the answer as to what India's ideal interest rate should be. The CPM (2009) manifesto wants credit at four percent for agriculture and self-help groups. The manifesto does not specify whether this is a real or nominal rate of interest. However, it must be nominal. Since the manifesto also questions the government's figures about an inflation rate of four percent, the CPM clearly wants a negative real rate of interest. The Congress (2009) manifesto does not mention a specific figure. However, small and marginal farmers must have credit at "lower rates" and all farmers will be waived interest if they repay bank loans. Since interest and principal payment will be waived for those who do not (or cannot) repay, we have zero percent interest for farmers. The BJP also wants four percent for agriculture and educational loans, spliced with higher interest rates on deposits by elder citizens. Let us not forget the CPM's insistence on the Employees' Provident Fund rate of more than 8.5 percent, something the other two parties do not mention but would not contest. With small savings and government borrowing thrown in, the banks will borrow at eight percent or more, and lend at four percent or less. Now we know why the public-sector banks cannot be privatised and why loss-making private banks must be nationalised.

The Reform Outlook

Manifestos are not just promises. When in government, the political parties do try to implement them. The period from 2004 to 2009 is evidence enough and the manifestos feed into the NCMP or the NAG. It is true that the 'common minimum' is the highest common factor and not the lowest common multiple, and it is, thus, a common maximum programme that becomes a binding constraint.

However, not all reforms require legislative changes. Even within the NCMP constraints, more reforms were possible. Was it because of the NCMP that the roadways programme collapsed under the UPA? Was it because of the NAG that it took off under the NDA?

Administrative decisions are often determined by ministers and it is here that the collateral damage by incremental parties is the greatest.

With Option 3, a fairly likely scenario in terms of distribution of portfolios is Defence with the SP; Home with the RJD; Mines, Petroleum and Fertilisers with the LJP and the JMM; Commerce and Telecommunications with the DMK; and Agriculture with the NCP. And who knows – perhaps a historic blunder of the Prime Minister with the Left and even Finance with an incremental ally.

That is the reason why the 6.5 percent growth trajectory is independent of any central government action, within and without 100 days. It is a function of monetary policy loosening and fiscal measures already introduced and steam of entrepreneurship. Yes, rural sector reforms are important and can provide endogenous sources of growth. However, these reforms are state subjects. And if one means substantive rural reforms and not just hikes in procurement prices or a Right to Hunger Bill, the experience of the last five years does not suggest that they are likely under Option 3. The likelihood is greater under Option 4.

Nor should one forget the fiscal mess. The RBI's annual review of monetary policy has just stated that the overall (centre + state) fiscal deficit is 10.8 percent of the gross domestic product, excluding off-budget items. As Indian Finance Minister P. Chidambaram said, he was pressing the "pause" button on the Fiscal Responsibility and Budget Management (FRBM) Act. What is happening is much more than a "pause". Given additional public expenditure demands under Options 3, 5 and 6 and existing government borrowing programmes for 2009-2010, the FRBM has been broken in spirit. It will now be broken in law and India will get back to automatic monetisation of deficits.

The cycle of high interest rates cannot be broken. No one will touch rates on small savings and deposit rates will have a floor of eight percent. Priority sector lending will be at four percent. How can one expect prime lending rates to drop below 11 percent, even if the RBI rates are cut more? With Options 3, 5 and 6, we are unlikely to get the privatisation of public sector undertakings too, not just on efficiency grounds, but also to bridge deficits. Privatisation is more likely with Option 4.

This is realism rather than pessimism. Policy responses to a downturn can be fiscal, monetary or structural. On the structural side, there is, thus, a glorious certainty about nothing significant occurring. Public expenditure is not the point, even in infrastructure. The problem is not resources but administrative capacities of the government systems to deliver. One would like to think those reforms are more likely under Option 3 or 4, except that the last five years of a Congress-led government (Option 3) do not inspire confidence.

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