ISAS Insights

No. 51 – Date: 23 February 2009

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:
The Economic Backdrop

Bibek Debroy[1]

Preface

India will hold its 15th general elections in April/May 2009. The elections will take place in challenging circumstances. A variety of cross-cutting political, security, economic and socio-cultural issues will influence the elections. The exercise will be impacted by multiple parties, personalities and positions from India's vast political spectrum.

As India moves into the election mode, the Institute of South Asian Studies (ISAS) is bringing out a series of papers analysing different aspects of the forthcoming elections. These will include, among others, the key national and regional parties, and their strategies, key political personalities, and the issues that are likely to have an impact on the elections.

ISAS had earlier prepared two papers, providing an overview of India's political parties and the role of the youth in India's elections.[2] This third paper in the series examines the economic backdrop to the general elections.

The Economic Backdrop

The Indian economic story is increasingly turning dismal. Till fiscal year 2007-08, there was a nine percent gross domestic product (GDP) growth story, driven by a savings rate of 38 percent and an investment rate of 39 percent, fairly close to East Asian levels. When the external shock hit India in September 2008, there was initial speculation that India might be decoupled. That hypothesis has been buried. India cannot be decoupled with an export to GDP ratio of 14 percent with goods, and 21 percent with goods and services. Export growth has turned negative and this shaves off at least two percent from GDP growth. The slowdown in growth had started before the external shock hit, thanks to a tight monetary policy.

---

1 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.

2 In the second paper in this series (ISAS Insight No 50: "Indian Elections 2009: Why the 'Y' Factor Matters?"), 'one billion first-time voters', as mentioned in the first sentence of the last paragraph on page 1, should be read as 'one hundred million first-time voters'. The error is regretted.

Recent GDP figures from the Central Statistical Organization (CSO) show growth of nine percent in 2007-08 and 7.1 percent in 2008-09. This suggests the baseline growth had already dropped from a trend of around nine percent to around seven percent, thanks to higher interest rates. With the shock of the global slowdown superimposed, growth will drop further. There is near consensus that growth will be even lower in the year 2009-10. Recently, the Prime Minister's Economic Advisory Council submitted a report projecting a seven-percent growth in 2009-10. This is based on the consumption to GDP ratio increasing by four percent, a savings rate of 31 percent and an investment rate of 32 percent. However, there are not too many takers for this optimistic projection.

Non-government growth projections for 2009-10 are more like five percent, certainly for the first half of the financial year. There is some difference of opinion about whether five percent will remain for the entire financial year or whether there will be a mild recovery to six percent in the second half.

Recent increases in savings and/or investments have been across all three groups – households, the private corporate sector and the public sector. While savings may recover, there is no obvious reason why investment should since there is also lumpiness in investments. Consequently, there is also an employment angle, both in terms of jobs that will not be created because of lower growth and slashing of existing jobs, though there is some cushion because the agriculture sector has performed well and large chunks of the rural sector are not integrated into the national and global markets. Having said this, using aggregate employment elasticities, growth reduction from nine percent to five percent means loss of six million jobs.

In the early days of the global shock, the industry chamber, the Associated Chambers of Commerce and Industry of India produced a report that the industry would shed 25 percent of its jobs. Partly under government pressure, this was subsequently withdrawn. There is now a report from the Indian Ministry of Commerce and Industry (MOCI), another from the Labour Ministry and yet a third from the Federation of Indian Exporters' Organization (FIEO) on job losses. For the export sector, MOCI talks of one million jobs lost by March 2009, the FIEO of 10 million and the Labour Ministry of about five million jobs lost across the board. Some of these losses will be in the organised sector, others in the unorganised sector, and others in the contractual or informal segment within the organised sector. Firm employment figures date to 2004-05 since there is a time-lag in data. However, there is a labour market issue, with India adjusting from a nine-percent to a five-percent growth. Towards the end of February 2009, the CSO will disseminate figures for the third quarter of 2008-09 and one will know how bad the slowdown really is.

One reason why the present general elections are important is because the incoming government will have to grapple with this problem and come out with sensible policy measures. There were few structural reforms under the United Progressive Alliance (UPA) government. Had these been introduced, counter-cyclical options would have been available and sources of growth perhaps become more endogenous, less susceptible to external sector developments. There have been monetary policy changes too and the transmission mechanism is not working satisfactorily yet, with no sharp increase in bank lending or a reduction in interest rates. However, with further loosening and with a time-lag, the monetary policy should begin to work.

The more interesting question for the new government will be on fiscal policy. There is a Fiscal Responsibility and Budget Management (FRBM) Act, with terminal goals in 2009-10 of a revenue deficit to GDP ratio of zero percent and fiscal deficit of three percent. The budget estimates for 2008-09 promised a revenue deficit of 0.5 percent and a fiscal deficit of 2.5 percent. However, this was without providing for items such as farmers' debt relief, the 6th Pay Commission and National Rural Employment Guarantee Act that should have been budgeted for. As a result, the revised revenue and fiscal deficits for 2008-09 are at much higher levels of 4.4 percent of GDP and six percent of GDP respectively.

There was little fiscal consolidation and reform under the UPA government. Indeed, reforms are easier when there is growth and buoyant tax revenue. Reforms are difficult when there is a downturn. That growth opportunity was missed. There will be an attempt to find a scapegoat in the external slowdown for the widening in deficits. However, that is not true. The additional fiscal stimulus because of the slowdown does not amount to more than five percent of GDP. The rest of it is due to populist expenditure and so-called flagship programmes of the UPA government. The centre's revised fiscal deficit is at six percent of GDP. With the inclusion of off-budget items, we will be at nine percent. The aggregate state-level deficit is 2.5 percent of GDP. However, this will increase, since it is contingent on tax revenue growth. Therefore, the overall deficit (not just the technical fiscal deficit) will be 12 percent of GDP, a horrendous figure, unparalleled since 1991. The issue is not the inevitable downgrading of India's sovereign credit rating. More importantly, there was a consensus on fiscal rectitude across every government since 1991. That disappeared under the UPA government and the incoming government will find it difficult to reverse the trend. Instead, there will be pressures to dilute and relax the FRBM Act and the states will follow suit. As a corollary, other structural reforms will also be difficult to introduce.

In the 2009 general elections, there is certainty that neither of the two major parties will obtain a majority. There is also certainty that the Congress Party and Bharatiya Janata Party (BJP) together will obtain less than 270 seats. Depending on whom one asks, the range for the BJP is between 100 and 120, while that for the Congress Party is between 110 and 130. In principle, one of three configurations is possible after the elections and in decreasing order of probability, they are Congress-led, the Third Front and BJP-led. Both the alliance of the UPA and the National Democratic Alliance are in tatters, with neither alliance fighting the elections as a coherent pre-poll alliance. Therefore, government-formation will be post-poll.

These elections are also important because they should witness a decline in the importance of the Left. The Communist Party of India (Marxist) [CPI(M)] is in bad shape in Kerala and if there is a Congress Party and Trinamool Congress tie-up in West Bengal, it will be in worse shape there. With a West Bengal tie-up, the Left should be down to 30 seats and without the tie-up, it will be at around 40. Meanwhile, the Bahujan Samaj Party is certain to increase its tally to around 40 seats. These elections are interesting in that sense too, with a certain decline in the importance of many political parties that have hitherto been important – the CPI(M), the Samajwadi Party and the Rashtriya Janata Dal.

The field is, therefore, wide open, both in terms of who will form the government and in terms of who the Prime Minister will be. Perhaps the only thing certain is that Dr Manmohan Singh will no longer be the Prime Minister, since the Left will make that conditional on offering support to a Congress-led government. It is also palpably clear it is too early for either of the two major political parties to transit to a leadership from the next generation.

Interpreted thus, these elections are an inter-regnum, paving the way for a more complete polarisation in 2015, if not earlier. During this inter-regnum, substantive economic reforms seem unlikely. Coinciding with a global recovery, the nine percent-plus growth in India too will have to wait.

These elections only mark time. And looked at in this light, the perennial talk of instability is perhaps unwarranted. What is the point of a stable government in 2009 that does nothing for five years? Is it not preferable to have an unstable government that lasts for a couple of years, before giving way to a more functioning government in 2011? It is tempting to argue the state-level elections in Delhi, Madhya Pradesh and Chhattisgarh demonstrated that people voted for development and governance. In a first-past-the-post system, life is rarely that simple. For similar reasons, 2009 will not be a vote on secularism versus fundamentalism, or on a hard versus soft state, interpreted in the sense of terrorism.

oooOOOooo