Commentary

India Votes For Continuity, Not Radical Change

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India's ruling coalition, led by the Congress Party, surged to an unexpected victory in last week's elections. It no longer needs the Left Front (four Marxist parties) for survival, and so can go ahead with economic reforms earlier vetoed by the left. Yet its policy emphasis will be on continuity rather than radical change. A party re-elected after five years of almost 9% annual gross domestic product growth has no pressing reason to change its model.

Congress believes it won the election by focusing on the rural poor--raising support prices for crops, waiving repayment of bank loans by small farmers, guaranteeing 100 days work for rural laborers on government projects, improving rural infrastructure and providing massive subsidies for food and agricultural inputs.

This produced rural prosperity in a country where 70% of the population is still rural, and where trade controls insulate rural India from the gyrations of global markets. This explains why Congress won handsomely: The rural masses were not touched by the global recession. Congress will now aim to strengthen this populist approach.

This will mean a heavy fiscal burden in a country where the combined fiscal deficit of the central and state governments exceeds 10%. But that will easily be defended as a Keynesian stimulus in these recessionary days. The new government will soon come out with a new stimulus package, possibly in its budget in June. This is likely to emphasize expanded credit and low interest rates more than tax giveaways: Manmohan Singh knows he must return to fiscal restraint once the recession ends.

Congress is by instinct a left-of-center party, and wishes to been seen as the savior of rural India, not the business community. Foreign investors think of Congress as the party that initiated the pro-market economic reforms in 1991, but that was sparked by a major balance of payments crisis.

The collapse of the Soviet Union, along with the success of Deng in China, helped gradually change the old socialist mind-set. But most of the heavy lifting on economic reform has already been done in the last two decades. So, when after the inconclusive election of 2004 the Left Front said its support would be conditional on a policy thrust on agriculture and the rural poor, Congress agreed as much out of conviction as compulsion.

However, the Left Front stymied the passage of several Congress-proposed bills as too market-friendly, and these may now go through. They cover areas such as pension reform to provide greater individual choice and facilitate more investment in equities; ending the public sector monopoly in coal mining; and increasing foreign investment limits in insurance, telecom and civil aviation.

The Left Front was opposed to foreign investment in retail, which may now be liberalized. While these reforms will be useful, they will not be game-changing like the reforms of the 1990s. Bills have to be passed by both houses of Parliament, and the Congress-led coalition is well short of a majority in the Upper House, and so will move cautiously on legislation, making sure it can get the support of small parties.

Since Congress sees itself as having won a mandate for continuity rather than change, why has the Indian stock market surged 20%? One reason is sheer relief. Investors had expected a hung parliament and a very unstable ruling coalition, and are greatly relieved at the prospect of a stable government for five years, free of dependence on the Left Front. Yet the economic fundamentals of India have not changed. It remains a country that has long performed below its potential, where poverty and rural neglect have for decades co-existed with world-class skills.

India's export to GDP ratio has risen sharply in the last two decades, yet it remains less dependent than almost any Asian country on exports, and rural India is largely insulated from global winds. So, it can hope to keep growing at 5% to 6% in the coming year despite the global meltdown. It wants to accelerate spending on infrastructure, but is held back by cumbersome procedures and corruption. Foreign analysts legitimately worry that anti-recession measures--tax cuts, higher subsidies and higher infrastructure spending--will send India's public debt soaring, and that politicians will refuse to reverse the current tax cuts.

Will India go back to 9% growth when the global recession ends? Probably not. In 2003-08, India rode the global boom sparked by huge U.S. trade deficits and easy money. That global tide lifted all boats: Even Africa's annual GDP growth soared from 2.4% to 6%. The tide is now falling and is unlikely to return to its earlier highs. When the recession ends, global growth will be more muted, and so will India's. But it can surely aim at 7%-8% GDP growth, enough to qualify as a miracle economy.

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