



## Is momentum with you, or against you?

Rollover to find out how you can tell

TALK TO CHUCK

charles SCHWAB

Print Close

# INVESTORS.com

POWERED BY INVESTOR'S BUSINESS DAILY™

INVESTING

## India's Vote Means Big Reforms, Slowly

By REINHARDT KRAUSE, INVESTOR'S BUSINESS DAILY

Posted 05/21/2009 07:22 PM ET



Indian Prime Minister Manmohan Singh and Congress party President Sonia Gandhi speak outside the presidential palace in New Delhi, India, on Wednesday. Hopes are high that Singh's government will lead an economic recovery following the "massive mandate" he won in India's national election. AP

Can India's dynastic democracy deliver the pro-business reforms and market liberalization the world expects in the wake of surprise national election results?

Hopes run high it will, as evidenced by the huge run-up in Bombay's stock market on May 18 and May 19. But, India's economy and political system still faces many challenges.

The new government, to be led once again over the next five years by Prime Minister Manmohan Singh, will no longer be at the mercy of a coalition that included communists. Singh's heir apparent is Rahul Gandhi, who is expected to be given a Cabinet post for his role in the Congress party victory.

The global recession has almost halved India's economic growth. The new government will stick with rural-friendly policies that require funding from a revived economy. And, a soaring budget deficit threatens to hamper India's recovery when the global recession ends, economists say.

It's widely expected that the government will overhaul labor laws; allow more foreign direct investment in sectors such as insurance, telecom and retail; divest assets in state-owned companies; develop a corporate bond market; and hike spending on woeful transportation infrastructure.

That's a tall order. Though Singh claims a "massive mandate," it's not clear that some pro-business reforms will be on a fast track, observers say.

Still, the election will boost India's economy over the next five years, says Arjun Divecha, who runs the GMO Emerging Markets Fund.

"There's going to be consistent policymaking, that's a huge positive," he said. "Now the government will be able to actually implement some of the policies that they were not able to, because of coalition partners, like the communists.

"But it's evolutionary rather than revolutionary. I don't think there will be huge structural change. There may be reforms in labor laws, in privatizing some government-owned companies, things like that."

After a fiscal crisis in 1991, India embraced economic reforms that lifted it from decades of slow growth under socialist rule. But India's drive to open its economy stalled over the last several years because of a cumbersome coalition government that included communists and also small anti-growth parties.

The national election gave Singh's Congress party more clout to pursue a reformist agenda, but obstacles remain, says Arvind Subramanian, senior fellow at the Peterson Institute for International Economics.

"There is going to be more reform, but things in India happen very slowly," Subramanian said. "Even if the government wants to push through reforms, it's going to be a slow and deliberate process because of the way Indian democracy and politics work."

### **GDP Growth Ahead?**

India's economy expanded more than 9% on average from fiscal 2005 to 2007. Growth slowed to 6% in the year ended in March.

Economists estimate that India's GDP will still muster up 5% to 5.5% growth this year, sustained by the agricultural sector. Its economy relies less on exports than China's.

"Most politicians feel that the economic model that produced 9% GDP growth is more or less sufficiently reformed, and the emphasis should be on continuity rather than radical change," said Swaminathan Aiyar, a research fellow at the Cato Institute.

He says that Singh will be able to push through some reforms within 100 days, others in a year.

"These pertain to pension reform to provide more individual choice; ending the public sector monopoly in coal mining; and raising foreign investment limits in insurance, telecom and civil aviation," Aiyar said.

### **Election May Revive Investment**

Foreign investment in India surged in 2006, 2007 and the first half of 2008.

In February, India's FDI fell to \$1.4 billion, almost one-fourth of the inflows obtained in the year-earlier period. Still, total inflows reached \$25.35 billion from April 2008 to February 2009 — higher than the \$20.13 billion in the year-earlier period, says Jyoti Narasimhan, an analyst at IHS Global Insight.

"With the election, the mandate for reform is more cemented," she said. "There's no question now of a reversal."

Despite the national election results, provincial politics in rural areas will stay the same, says Ravi Ramamurti, director of the center for emerging markets at Northeastern University. He says if some industrial sectors are partly privatized, India's powerful, family-run companies stand to gain more than foreign-based multinationals.

"Just because the government will focus more on growth doesn't automatically mean they are going to open the floodgates to foreign direct investment," Ramamurti said. "In India's case, growth can come from giving a freer hand to the domestic private sector."

He says India's family-controlled conglomerates are adept at "navigating the political environment, which is crucial in infrastructure and other regulated industries."

Analysts say the government may sell stakes in state-owned firms in the oil and electrical power industries as well as heavy manufacturing.

India's economy needs more roads and highways, especially in rural areas; airports; and other forms of improved transportation.

GMO's Divecha says a stable government will boost infrastructure.

"People are more willing to invest in long-term infrastructure projects knowing that tomorrow, government policy isn't going to change," he said.

An infrastructure boom could benefit cement makers and many other Indian companies, say analysts.

But if business reforms trigger foreign fund inflows, India's currency, the rupee, will likely appreciate. That would hurt net dollar earners in India's software and services industry as well as exporters in the auto and drug sectors.

For U.S. investors, Barclays' India ETN ([INP](#)) vaulted 24.2% on Monday. Even after shedding a sliver of those gains, it's still up 48% for the year.

India's Icici Bank ([IBN](#)) jumped 25% on Monday. But Infosys ([INFY](#)), a major IT outsourcing firm, is down for the week despite Monday's 9% jump.

