



June 2009

India: Political and Economic Update

Asian Development Bank

I. POLITICAL DEVELOPMENTS

1. The 15th general elections were held in India over mid-April to mid-May. The Indian National Congress (INC) has emerged as the single largest party with 206 seats as against 145 seats in the previous *Lok Sabha* (2004-2009). The principal opposition party, the *Bharatiya Janata Party*, has come second with 116 seats as compared to 138 in the previous election. The INC-led United Progressive Alliance (UPA) government currently has the support of around 310 Members of Parliament as against the minimum requirement of 272. Given its much stronger position in the current *Lok Sabha*, there is optimism that this UPA coalition government will provide continuity with stability. It will also have greater flexibility to push ahead with several required policy reforms.

2. The election result has therefore, been very well received by the market and India's corporate sector. The new Council of Ministers has been sworn in. Key Ministries such as Finance, Commerce, Human Resources Development, and those related to infrastructure have been assigned to very experienced and senior Ministers. The Government has already stated that its focus will remain on bringing about faster and more inclusive growth as laid down in the 11th Five Year Plan (FYP), 2007–2012. It will continue to enhance public investment in infrastructure and agriculture sectors, promote private sector participation in infrastructure, revamp urban governance, bridge various regional and sectoral divides, and take steps to protect India's natural environment while working towards fulfilling the development aspirations of the people.

II. ECONOMIC DEVELOPMENTS

3. The global financial crisis has resulted in a sharp slow-down in India's growth momentum from 9% in FY2007 to 6.7% in FY2008. However, there are indications that the various fiscal and monetary stimulus measures announced by the previous UPA Government have begun to yield some results. The liquidity situation in India is better today as compared to what it was in the first quarter of this year. With the easing of monetary policy, interest rates have fallen. Nine private sector infrastructure projects close to \$15 billion have achieved financial closure between March and May 2009. With the improving sentiments being reflected in an increase in the bellwether index, the SENSEX, public and private sector companies are reviving their plans of accessing the market for mobilizing funds. The Indian economy is well poised to regain its growth momentum once the global economy revives.

4. The new Government has stated that it will push ahead with various reforms to further strengthen the economy. It will try to facilitate further development of the financial sector, undertake pension reforms, and simplify FDI requirements in various sectors. Recommendations of some of the important Commissions which had been set up by the earlier UPA government – Administrative Reforms Commission, the National Commission on Enterprises in the Unorganized Sector, National Farmers' Commission, National Knowledge Council, and National Manufacturing Competitiveness Council - will also be taken up for implementation.

5. As a result of the various stimulus measures to counter the economic slowdown, the fiscal deficit at the center is expected to increase to around 6% of GDP in FY2008, while the combined deficit including that of the states, is expected to touch 11%. According to the Fiscal Responsibility and Budget Management Act of 2003, the fiscal deficit at the center should have been 3% by FY2008. The current Government has therefore, emphasized that while it will focus on containing the adverse effects of the global crisis, it will also take steps to return to the path

of fiscal prudence. It is expected to announce concrete proposals in the forthcoming Budget in July. The Government is planning to selectively divest some of the Government's stake in key public sector companies. A comprehensive Goods and Services Tax (GST) will be rolled out by 1 April 2010. This will help in creating a seamless national common market by doing away with all other central and state level taxes. By removing tax-related distortions, introduction of GST is expected to increase revenue mobilization.

III. IMPLICATIONS FOR ADB'S INDIA OPERATIONS

6. The new Government will be essentially guided by the 11th FYP's assessment that the Indian economy faces the following key binding constraints: infrastructure bottlenecks and lack of long-term funds for infrastructure investment; systemic weaknesses within the agriculture sector; interstate disparities in economic and social indicators; poor education and health indicators, and balancing of the growth-environment trade-off. The global economic crisis has only reinforced the urgency of addressing these constraints in a fiscally prudent manner.

7. The current and proposed operations program for India, which is closely aligned with the 11th FYP, therefore, remains fully relevant. Its strategic pillars - support for inclusive and environmentally sustainable growth; catalyzing investment through the use of innovative business and financing solutions; strengthening results orientation and emphasizing knowledge solutions (including capacity building); support for regional cooperation – will support the Government's development priorities. In addition to supporting infrastructure development in the transport, energy, urban, water resources management, and agriculture sectors with a focus on the backward states, ADB will scale up assistance for PPPs in infrastructure, climate change adaptation and mitigation, capacity building, knowledge creation, and regional cooperation. The proposed operations program also emphasizes the need to enhance support for non-sovereign operations and private sector development in line with Strategy 2020. ADB is also currently discussing with the Government additional and targeted assistance to address the impact of the financial crisis.

8. To mirror the Government of India's increasing orientation towards results, the proposed operations program has been designed within a results-based framework. Detailed country and sector results frameworks have been prepared in line with the 11th FYP and discussions with the Government. Close monitoring of the operations program and continued focus on portfolio performance will help to ensure that ADB assistance is being used effectively in support of the Government's development priorities.

9. The relevance of the proposed India's operations program has, if anything, been reinforced by the political and economic developments of the past two months.