

## India's elections; what the fuss is all about.

April 2009 - Author: Jamshed Desai, Fund Manager.

**Mumbai and India are going to the polls. The newspapers and television news channels are agog trying to keep pace with the free for all punches and counter-punches traded by candidates and political parties.**

Sadly, politicians haven't changed and continue to seek votes in the name of petty regional issues, caste-bank politics and without sparing a thought for the larger good of the country. Rather, the lure of the lucre of coalition politics is simply irresistible for most of them to form their own little cabal ahead of the elections. By doing so, they stand to land a substantial share of the spoils of power if they win. They can achieve that by aligning themselves so as to be part of the winning combination that forms the next Government.

Most of the regional political parties have no real ideology or manifesto they can call their own. They count on their ability to read the mood of the masses and particularly their vote banks early. This way they can jockey themselves into the best position just ahead of election time and ensure not just their political survival, but even thrive post it.

As always, there is much being said and written about the forthcoming elections in India, so much so that the common refrain I hear from friends, especially outside India is, what's all the fuss really about? It's only an election after all. Indonesia just went to the polls and nobody made such a big deal about it. India is far from being anywhere as important, economically or politically, as the US or China in the larger scheme of the world. And yet, we in India go on and on about our general elections. To the extent that events that are headline news elsewhere in the world, barely get a mention on the front pages, or are at best, tucked away inside under some snippets column during these times. Let me say this unequivocally, that it is a big deal after all. Here's why...

People forget that there are three things that collectively hog a lay Indian's attention for the better part of his life (aside from food, clothing and shelter) and that is cricket, Bollywood movies and politics. Indians, specifically those who make a livelihood from financial markets being more insular than their western counterparts are, think that their world (which is India) will fall apart if they don't have a Government that is led by either the Congress or the BJP.

That's of course far from the truth, but they aren't very wrong either. The history of coalitions in India – not a very long one actually – has borne out that any coalition which doesn't have one or the other National parties as the central anchor has been doomed to fail. But there's a lot more than that. Some of the common fears that people and investors have today are the following:

1. Coalition politics in India is all about compromises, as it probably is elsewhere. However, in India, compromises come at a huge cost of poor governance. This has been demonstrated in the past when government policymaking and commitment to reform have been singularly lacking chiefly because the largest constituent of that coalition didn't have the political will to push ahead with them.

2. A strong Prime Minister from within the ranks of the coalition members is equally important. If a coalition fights and wins an election on a common agenda with a clear leader projected as its Prime Ministerial candidate, it simply takes away the uncertainty of who and what to expect post the elections. However, when a coalition has thrown up a complete surprise candidate, usually a 'compromise' candidate acceptable to all, (but not necessarily the best man for the job) it has never worked.
3. A highly fragmented coalition becomes too loose and unwieldy to manage even if there is one large lead constituent, such as the Congress or BJP at the helm. This makes the dispensation unstable and prone to being toppled by the opposition by effecting defections, or it could simply break down under the weight of its own contradictions.
4. People fear that a 'Third Front' Government led by Mayawati, (who leads a caste-based party in the North), could provide the glue and leadership for disparate regional parties, currently non-aligned to either the Congress or BJP, to come together to form this Third Front. The Left parties will once again play a crucial role in supporting such a volatile cocktail from 'outside', making it even more unstable. The Left's own agenda borders on the xenophobic and is populist at its best.
5. The current state of the economy leaves little room for manoeuvre for the incoming Government. A weak economy inherited by a weak coalition is most likely to see little improvement or could worsen further.

The coalitions of Mr. V.P Singh and Mr. Chandrasekhar, (1989-91), Mr. Deve Gowda and Mr. I.K. Gujral (1996-97) and Mr. Vajpayee (1998-99), all broke down because of one or more of the above factors. In this period, India did muddle forward economically, inching ahead rather than taking strident steps. The stock market too swayed wildly, alternating between rallies and corrections lasting a few months each way. India itself was in the midst of a long-term economic and fiscal correction of the boom of the late 80s and early nineties with over-capacity in industry, high inflation and interest rates and a wide fiscal deficit. It took India the better part of the decade and early part of the next to achieve the sort of fiscal and economic consolidation to set itself up for the next growth phase post 2003.

A very rudimentary assessment of the current economic situation will read somewhat like this; GDP growth has slowed sharply from above 9% in 2008 to possibly between 5-6% next year. The fiscal deficit including off balance sheet items such as the states' deficits and oil subsidies are already at about 11% of GDP. While inflation is bottled up for now, it can go back to 4-5% by the end of the year. Exports have collapsed, but imports have done so faster. Should oil prices tick up a bit more, the current account could again raise its head alarmingly so requiring strong Government intervention. The need to spend more on infrastructure, create more jobs, attract further foreign capital to service the capital deficiency are acute challenges that lie ahead. And the current fiscal situation gives very little elbowroom unless there is a sharp reduction in subsidies, government spending and a further increase in taxes.

Such fiscal consolidation, as desired by the markets, cannot be achieved when we have a motley crowd of politicians hijacking governance. Should we have a Prime Minister who is seen to be weak and coalescing, it will simply bring decision-making to a standstill. Result; the economy will suffer on account of the government's own populist agenda. Capital markets will vote with their feet and foreign investors will be spooked into investing any further into India. India could be stuck in a quagmire for such time as fresh political leadership comes its way and / or global conditions improve perceptibly enough to make a difference for India, in spite of its rulers.

From a pure economic standpoint, the current fiscal situation could elicit a sharp response from the new government in the form of higher taxes, lower fiscal relief for industry, and possibly some populist measures that uses sparse resources unproductively.

The urban elite and folks like us who have a stake in the capital markets have reason to be worried about what could transpire should a 'Third Front' cocktail be served up post elections. The Prime Minister of such a cocktail could be just about anybody, even Ms. Mayawati. She is currently the Chief Minister of the largest state in the country and is likely to have a strong result this time. Her ambition has been to take her party (the Bahujan Samaj Party) to Delhi and herself to be betrothed, Prime Minister of India. While she hasn't driven her state's economy into the ground under her reign, she has done little to suggest that she's a change agent. Very little is known about her larger vision for India, if she has one at all.

The BJP's leadership consists of bickering men and women torn apart by their desire to win votes and appease its own religious bigots within their fold. Its leader, Mr. Advani, is a chip of the old BJP block. Fresh ideas that a young India needs cannot possibly flow with him at the wheel. The BJP has a number of relatively younger leaders, but who lack the political base from where they can challenge the current ageing leadership.

The Congress is better served by a man who is acceptable to all at home and abroad in the erudite Mr. Manmohan Singh. His only flaw lies in his inability to take bold decisions even if it means displeasing his own party colleagues. The biggest positive about the Congress is that Ms Sonia Gandhi has the complete loyalty of all leading Congressmen who refuse to see beyond her as their party leader. This binds the party well. However, in spite of Ms Gandhi's own aura, the party's organisational weakness has failed to convert this advantage into votes due to their poor track record on performance over the last five years and in the states, where the Congress rules. Result; the Congress – led UPA coalition faces a real anti-incumbency threat.

Investors understand all of the above. Their apprehensions are not entirely overstated. Recent history has taught us lessons that haven't been forgotten easily. Hence, the excessive ponderance on the current elections and who will become Prime Minister are not entirely without reason.

At the same time, from an external investors' standpoint, money managers who invest in India from within and abroad, have been primed well ahead of the elections to expect the unexpected. The market is therefore bracing for a negative surprise but which is perhaps not apparent in stock prices at the time of writing. This will become more apparent closer to the results date. There is hope after all that the Congress or BJP will pull off something eventually, there is a numbing pain in the gut of the unknown that could transpire.

*There are three broad results that are possible:*

The **optimistic scenario** has to be one where we have either the BJP or Congress faring much better than expected individually and succeed in forming a coalition around them. Experts attach a very low probability to this scenario.

**Stock market reaction:** Very favourably.

The **base scenario** is of a weak coalition led by the UPA (Congress-led) or NDA (BJP-led) but in which the leading national parties, Congress and the BJP, will have a much smaller than expected share of seats and will hence need to attract many more coalition partners than necessary to make the cut. This will give rise to a fragmented and disjointed coalition tugging and pulling in different directions.

A variation of this form of coalition is a hark back to the 2004 UPA minority coalition supported on the floor of the house by the Left parties and some others. This time too, we could have a similar situation with the Left supporting a Congress-led coalition.

**Stock market reaction:** Neutral to positive. Relief that uncertainty of the event was out of the way coupled with global and regional trends could result in some sort of a rally.

The **worse scenario** is of neither the Congress or BJP faring well and a clutch of regional parties faring better than expected. Result; a Third Front government. But such a Government will need the outside support of the Congress or BJP, making it ideologically dysfunctional. Leadership of such a coalition is still unknown since it doesn't exist per se on paper yet. A Mayawati-led third front with the Left and Congress supporting it could be very volatile and unstable.

**Stock market reaction:** Negative. Markets could sell-off temporarily on fears of continuing political uncertainty.

Regardless of the eventual political result, the medium-term trend could be guided eventually by global and regional trends and the evolving economic conditions within the country. This is going to be high-octane political action at its wily best, with enough twists in the tale and a sting in the story to keep all riveted until the very end. If investors wish to test their trading skills in the short run, try playing India in May. Others may wish to take a ringside view. Either way, enjoy!