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Political Upheaval in India May Reignite the Economy

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India's elections in May produced historic political upheaval. The Baharatiya Janata Party (BJP; Indian People's Party) won an absolute majority in parliament (282 or 52% of the available seats). Its defeated rival – the Indian National Congress (Congress Party) – not only led the government for the past decade, but for 50 of India's 67 years as a sovereign nation. The Congress Party enjoyed immense prestige for leading the independence movement from Great Britain. Jawaharlal Nehru, India's first Prime Minister from 1947 to 1964, was paramount leader of the Indian National Congress as well as Mahatma Gandhi's protégé. Nehru's daughter Indira Gandhi (no relation to Mahatma Gandhi) was a Congress Party Prime Minister for 16 years. She was succeeded by her son Rajiv Gandhi until his assassination in 1989. His widow, Sonia Gandhi, is the current Congress Party President and her son Rahul was the Congress Party's candidate for Prime Minister. The election results, therefore, were a stunning rebuke to the Congress Party and the Gandhi dynasty since they won a paltry 44 seats in parliament or 8% of the available 545 seats.

The BJP is pro-business, but also potentially divisive

The Congress Party rhetoric stresses secular themes intended to ameliorate India's sharp divisions according to religion, caste, and wealth. The BJP, on the other hand, stresses Hindu nationalism and sometimes pursues divisive politics. The new Prime Minister – Narendra Modi - is a particularly controversial leader. He is a long-time member and former professional activist for the extremist Hindu paramilitary group called the Rashtriya Swayamsevak Sangh (National Patriotic Organization or RSS).

During his first term as Chief Minister of Gujarat, Mr. Modi was accused of instigating, or at least tolerating, violent anti-Muslim riots. He used anti-Muslim rhetoric during his campaign for a second term in 2002 to win a landslide victory. Following the election campaign, however, Mr. Modi abruptly shifted focus to pro-business economic development.

By contrast the Congress Party pursued socialist economic policies until a financial crisis in 1991 forced it to revise its ideology. Prior to 1991, successive Congress Party governments imposed high protectionist barriers to impede imports and foreign investment. Private companies operated within a complex regulatory system designed to limit business expansion, investment and competition. The government nationalized what it called the “commanding heights” of the economy including heavy industry, foreign owned companies, banking, infrastructure or other capital intensive industries.

By 1991, the economy was stagnant, inflation was approaching 14% and the government was nearly bankrupt. India requested a bailout package from the International Monetary Fund. Adhering to the IMF’s guidelines, the Congress Party installed Narasimha Rao as Prime Minister and Manmohan Singh as Finance Minister to liberalize the Indian economy by dismantling elements of the socialist system.

The new leadership opened the Indian economy to greater international trade and investment, eliminated many onerous licensing regulations, tackled inflation and initiated privatization. Indian economic growth accelerated to an average of 6% between 1992 and 1998. Despite this success, the Congress Party lost the 1996 and 1998 general elections due to corruption scandals and ideological incoherence. The BJP exploited Congress’ weakness to become a major national party, but neither the BJP nor Congress was strong enough to govern without coalition partners. The BJP led a coalition government with several regional parties from 1998 to 2004. The BJP Prime Minister - Atal Bihari Vajpayee – enhanced the pro-market economic reforms of his Congress predecessors. Perhaps his most significant reform was introducing competition in the telecommunications sector, thereby launching India as a premier destination for software and call center outsourcing.

Economic reform momentum stalled under Congress Party rule from 2004 - 2014

Even though economic growth maintained its 6% pace and inflation fell to a record low average of 4.4% under the BJP’s tenure, the Congress Party won a surprise victory in the 2004 general elections. Congress ran on a “share the wealth” platform that resonated with India’s vast underclass. As economic growth accelerated to an average of 9% during its first four years back in power, the Congress Party enacted generous social welfare programs and halted further economic liberalization. Predictably growth slowed to 4.6% in 2012 and 2013 while inflation spiked to 8.5%.

The BJP has a clear pro-market mandate

During the 2014 election campaign the economy was the central issue. Voters overwhelmingly rejected the lack of reform momentum during the Congress Party’s decade in power and provided a clear mandate for the BJP to pursue its pro-market agenda. While voters remain wary of the BJP’s tendency toward divisiveness, they seem ready for a clean sweep of the dynastic and corrupt politics of the

Congress led government. For the first time since independence in 1947 an opposition party can form a majority government, and, perhaps even more importantly, the Congress Party cannot block legislation.

If Narendra Modi can successfully implement the BJP's pro-business agenda while avoiding pressure from his Hindu nationalist base to harass religious minorities he could reignite the Indian economy. India's potential is enormous, boasting a population of 1.2 billion including 150 million fluent English speakers, and 1.5 million engineering graduates each year (vs. 140,000 in the United States). The Indian population remains predominantly rural and agricultural, with only 31% living in cities. Only 25% of GDP comes from manufacturing vs. 44% in China. India's GDP per capita is a mere \$1,350 while China's GDP per capita is approaching \$7,000 (\$52,800 in the U.S.). With appropriate policies in place India is ripe for more rapid industrialization and urbanization.

The BJP victory upended the Indian political system. As foreign investors, we tend to focus primarily on economic policies and performance. From this point of view, a BJP dominated government offers significant hope for faster growth, moderating inflation, more stable government finances and higher returns. As human beings, however, we hope the BJP's and Mr. Modi's darker tendencies remain in abeyance during their tenure in power. In his first month in office, Mr. Modi struck a conciliatory and inclusive tone in his speeches, but we are now awaiting more specific policy proposals.