

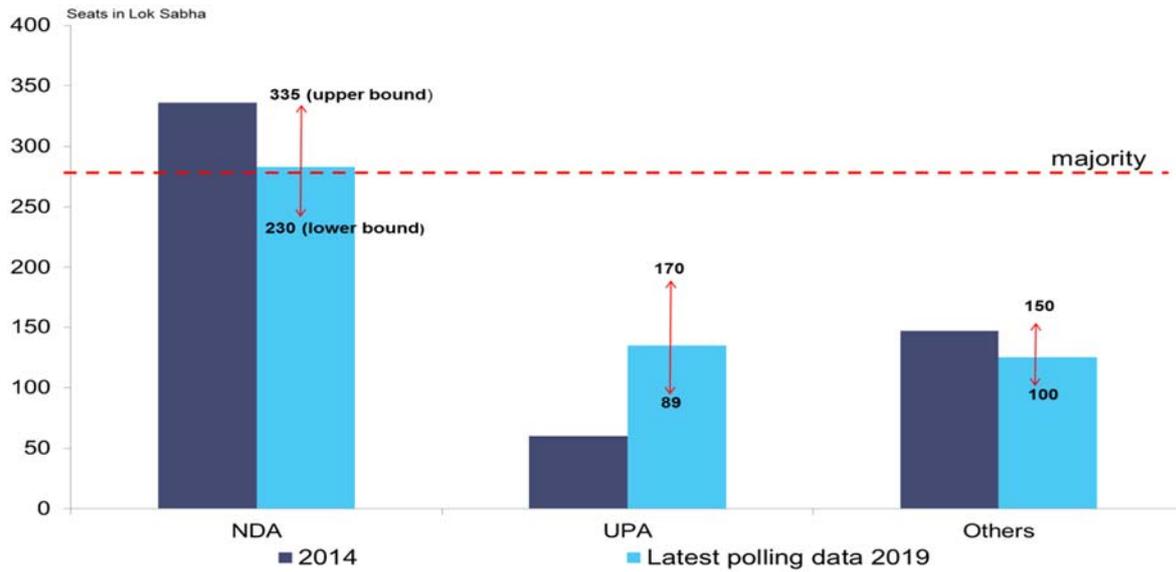
## Indian elections 2019 primer

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India is set to have its lower house elections in seven phases from April 11 to May 19 2019. This note lays out the structure of the Indian electoral system, potential election outcomes and their implications for the policy and reform agenda.

- **Our base case, based on current polling and judgement, is for the National Democratic Alliance (NDA), led by the Bharatiya Janata Party (BJP) with Narendra Modi at the helm, to remain in power** (see Chart 1). This should be positive for markets in the short run as they continue the current reform process.
- However, we expect the **BJP's seat count to fall by at least 40-50 seats** because of regional alliances formed in states with high representation in the lower house. So, even with support of coalition parties, **it is possible that the NDA seat count does not cross the majority mark.**
- The seat count for the Indian National Congress (INC) lead United Progressive Alliance (UPA) should improve from the 2014 levels. **However, it is the smaller regional parties which will hold the balance of power following this election.**
- In the case of a hung parliament, we think the BJP has enough popular appeal and ideological flexibility to acquire support from regional parties to form a working majority. The INC has not shown the same kind of political nimbleness.
- The Modi-led government has made progress on simplifying the **tax code, dealing with corporate insolvencies and non-performing assets in a pre-emptive manner.** Commitment to fiscal discipline and central bank independence has been wavering though. Meanwhile, there has been little progress on reform of **labour laws** that hold back productivity in the manufacturing sector and land acquisition laws, which remain a hurdle for the industrial sector.
- The next edition in this series will provide an update on the campaign and consider India's biggest economic challenges and how the election result could influence them.

**Chart 1 – projected seat counts based on current polling**



Source: Wikipedia, ASIRI (As of March 2019)

**What is the electoral system structure?**

India has a **bicameral parliamentary system**, in which the party or parties who can command a majority (272 or more seats) in the Lower House (Lok Sabha) form the government and the Prime Minister is the leader of the party with an outright majority or largest party in a coalition (see Table 1). Members of the Lok Sabha are directly elected and hold their seats for five years unless the parliament is dissolved earlier.

**Table 1: The Indian electoral system and current composition**

	LOK SABHA (Lower house)		RAJYA SABHA( Upper house)	
Composition	Members	545 (543 elected +2 nominated)	Members	245
	NDA (Majority)	341	NDA	101
	UPA	66	UPA	66
	Others	138	Others	78
Process of election	<ul style="list-style-type: none"> <li>Elected through direct voting in their respective constituencies.</li> <li>First past the post system in place.</li> <li>Hold seats for 5 years.</li> <li>Number of seats for a state is proportional to the population of that state (as of 1971).</li> </ul>		<ul style="list-style-type: none"> <li>Indirectly elected through members of state using single transferable votes.</li> <li>Process tends to be more opaque and has historically been susceptible to corruption and bribery.</li> </ul>	

Representatives of the upper house (Rajya Sabha) are elected indirectly, mostly by members of state and territorial legislatures using single transferable votes. Members of the Rajya Sabha are generally elected for six-year terms, with a third of the membership rotating every two years.

**Of the two chambers the Lok Sabha is the more powerful.** Money bills (supply, budget, tax or appropriate bills in other systems) can only be introduced in the lower house and the upper house has no ability to reject them.

The two houses are on a more equal footing for other types of legislation, with non-money bills having to pass both houses before they can be ratified. Legislation is more likely to be held up in the Rajya Sabha because party and even alliance majorities are less common. Joint sittings of parliament are the main way of resolving persistent impasses. Because the Lok Sabha has twice as many representatives as the Rajya Sabha, it holds more sway in these joint sittings.

### **Who are the major players?**

Currently the **Bharatiya Janata Party (BJP)**, led by the Prime Minister Narendra Modi, holds a small outright majority of seats in the Lok Sabha. However, it governs as part of the broader **NDA alliance**, supported by popular regional parties like the Shiv Sena in Maharashtra. The NDA also has the largest number of seats in the Rajya Sabha but not an outright majority.

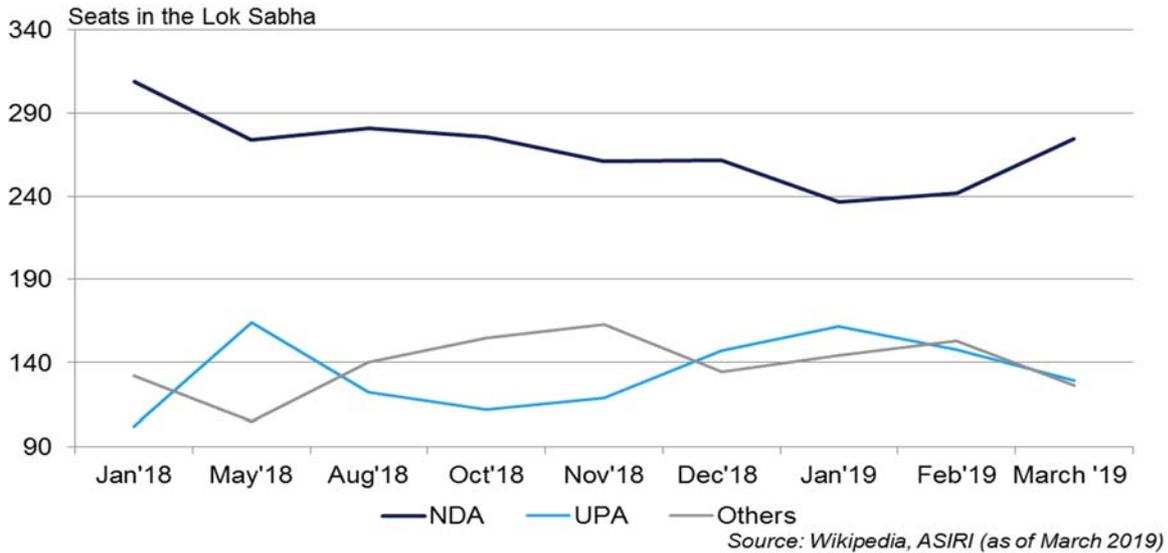
**The main opposition group is the United Progressive Alliance (UPA) led by the Indian National Congress (INC).** The INC has historically been the main governing party, having been led by Mahatma Gandhi through the push for independence, Jawaharlal Nehru the first Prime Minister after independence, and then his Gandhi descendants. But it was decimated in the 2014 elections and with its current leader, Rahul Gandhi, having failed to raise his credibility among voters, the UPA's electoral prospects still look dim.

**The biggest threat to the NDA's majority is therefore not from the UPA but from the Mahagathbandhan (Grand Alliance).** This is an alliance of Samajwadi Party (SP), Bahujan Samaj Party (BSP) and other regional parties with strong influence in the Hindi speaking belt of northern-central India. Indeed, **the NDA could lose up to 30-40 seats (out of 80) in Uttar Pradesh alone.**

There are very wide confidence intervals around polling in India because of the difficulty of getting representative samples and predicting turnout. However, based on the information we do have (see Chart 2), and judgement formed through our reading of the political environment, **the most likely outcome is the maintenance of the current NDA government**, but with a reduced majority.

**The next most likely outcome is a hung parliament** with the NDA remaining in government but requiring the support of variety of regional parties. Neither the UPA nor Grand Alliance would likely support the NDA because of their different caste and ideological bases. While an INC-led coalition with the Grand Alliance cannot be ruled out it would require both groups to significantly outperform their current polling.

**Chart 2: NDA the frontrunner according to polls**

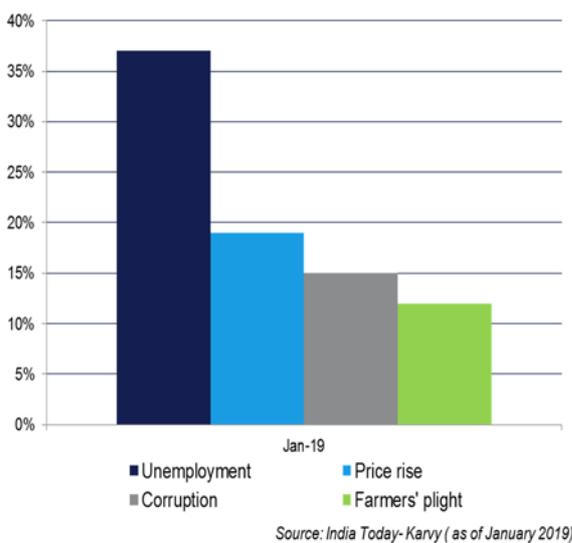


**What are the main issues for voters?**

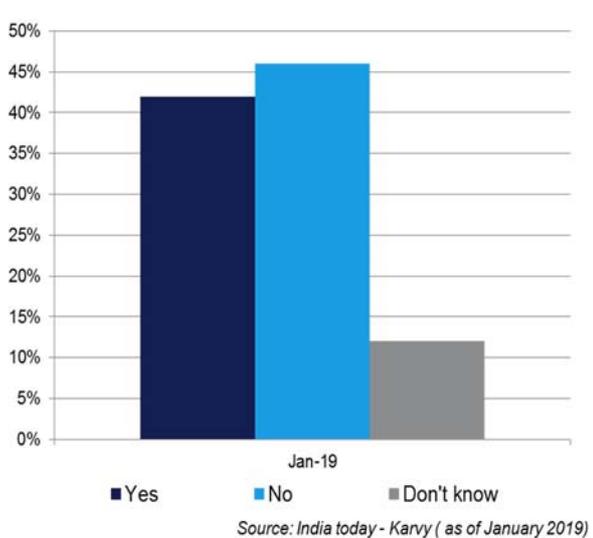
Employment and inflation are the two most important issues for voters. While India's demographics are a tailwind for the economy, the working age population increases by around 12 million each year and the labour market has to absorb at least half of them.

**Unemployment and price rise** are the main concerns for the Indian voter (Chart 3, 4).

**Chart 3: Key issues for voter**



**Chart 4: Enough jobs created?**



The inefficiency of existing labour market institutions makes this difficult. Labour laws are archaic, requiring any firm with more than 100 employees (300 in some states) to get government approval before they can be fired. This also encourages a significant amount of informality, acts as a large weight on productivity in the manufacturing sector, making it

difficult for India to exploit its comparative advantage in utilising cheap labour, like other Asian economies have done.

As a comparatively poor country, food and energy make up a large proportion of the consumer price basket, with food alone accounting for nearly 50%. With nearly 50% of the population also still employed in agriculture, fluctuations in the price of food and energy are highly politicised. Last year was a case in point. When prices rose in the first half of the year they were passed on almost 1-for-1 to consumers. However, when they fell, the decline in retail prices was only partial. Indeed, gross revenue from taxing petroleum more than doubled between FY 2014 and FY 2018.

More recently the unexpected decline in food prices has been a boon for urban consumers, but a bane for farmers as their remuneration has taken a hit. This slump in food prices comes despite the rise in minimum support price ensured by the government. Rural wage growth dropped sharply in 2014 and has been stagnant ever since. The combination of stagnant wages and low food prices are compounding factors in driving Modi's popularity lower in rural areas.

Although there is growing awareness of macroeconomic and policy issues among voters, hip pocket, personality and security issues are more likely to dominate elections. In terms of voter approval, Modi has a clear advantage over other Indian party leaders, with the recent military actions taken against Pakistan boosting his support among more nationalist minded voters.

### **What are the major reform priorities?**

When Modi was elected in 2014 it ushered in a great deal of optimism about structural reforms that would help unlock the country's enormous growth potential.

On this reform front we would give Modi a B grade. Among the signature, high impact reforms delivered by the government have been to open the coal mining and construction sectors to more foreign investment in 2015, upgrade the insolvency and banking code in 2016 and implement a unified goods and services tax regime in 2017 (see Table 2).

Among the key reforms in progress, the **Prompt Corrective Action (PCA) framework is the most important from a macroeconomic stability perspective**. Led by the RBI it is designed to reduce the incidence of non-performing assets (NPAs) in the banking system, particularly in the public sector, and boost their capital adequacy. Twelve public sector banks have already had their lending curtailed while they stabilise their NPAs and **five banks are likely to move out of the PCA process in the year ahead**.

PCA has been necessary to stop financial imbalances related to poor lending practices from becoming systemic. And in time it should help set the scene for a recovery in lending activity. But it has also contributed to the past two RBI governors losing their jobs as politically connected firms and banks have reacted negatively to the more stringent environment.

Of the major reforms in progress, the one **most at risk of stalling in the future is the land reform bill**. The bill originally required industrial firms to obtain approval from at least 80% of

affected residents before acquiring land for commercial purposes. If passed and implemented it would do a great deal to strengthen property rights.

Groups wanting to acquire land have been unhappy about the reform, prompting the BJP to amend the legislation to dilute the impact assessments that have to precede acquisition. However, this has created a backlash the politically important farming constituency and thus the legislation has stalled in parliament.

Meanwhile, modest proposed changes to the labour code are awaiting approval from the lower house and then will move on to the upper house. These include a national minimum wage (differentiated by geographical areas) that would force state minimum wages to be at least as high. We expect this to face opposition in the upper house.

**Table 2: Reforms undertaken and future outlook**

Reform	Impact	Current Status	Future status of reform under possible governments			
			BJP Majority	BJP +NDA coalition parties	UPA coalition	UPA +grand alliance
Allow foreign investment in construction projects (2015)	Medium	Implemented				
Deregulate diesel prices (will lower government subsidies) (2014)	Medium	Implemented				
Fully open the coal mining sector to private/ foreign investment (2015)	High	Implemented				
Remove sectoral investment limits (2015)	Medium	Implemented				
Make it quicker and easier for companies to go through bankruptcy (Insolvency and bankruptcy code- 2016)	High	Implemented				
Pass unified national tax on goods and services(Goods and Services Tax) (2017)	High	Implemented	Will eventually move to a single rate, once revenue collections stabilise.		Instead of 4 GST rates, there might be only 1 rate of 18%	
Prompt Corrective Action Framework (PCA) (Implemented by the RBI)	High	Implemented	Acceleration	Status quo	Status quo	Status quo
Relax government controls over corporate downsizing.	Medium	In progress	At the state level, some legislative progress has been made.	Status quo	Status quo/ Stalling	Stalling
Make it easier for states to use eminent domain to purchase land (Land reform Bill)	Medium	In progress	Would be high priority, but the BJP does not have majority in upper house to pass bill.	Status quo	The INC is against changing the bill in a way which would harm farmers right.	
Simplify and combine existing labour laws into four codes on wages, industrial relations, social security and welfare.	Medium	In progress	Status quo		Status quo	Stalling
Financial Resolution and Deposit Insurance Bill 2017		Withdrawn				

