

INDIA ELECTION UPDATE:

An Arranged Marriage in Delhi

With over 900 million eligible Indian voters likely to use their voting rights to elect 543 members for the lower house of the India parliament, a certain level of nervousness on the part of the political class seems natural. The central plot is a spending contest between Prime Minister Narendra Modi and Opposition leader Rahul Gandhi, as to who will cobble together a winning coalition to form the next government - a little like an expensive arranged marriage in Delhi (the last election expense bill in 2014 was a little over USD\$5 billion).

Democracy and freedom of choice costs money. With results scheduled to be announced on 23 May 2019, political observers in India have swung from predicting an electoral defeat for PM Modi, after three state governments slipped into the Opposition's fold in December, to a more cautious Bharatiya Janata Party (BJP) led coalition government after a military skirmish with Pakistan prioritised national security in the minds of the electorate over economic concerns on farm distress, low job creation and weak growth. Whatever the election outcome, a return to coalition politics, a stronger Opposition and the re-emergence of regional parties as power centres in a national Government may appear likely. In FTI Consulting's 2017 report¹, we reflected upon anti-incumbency sentiments, which have since strengthened and been responsible for three electoral upsets in December 2018. However, the capital market is betting on a BJP-led coalition government.

Should a coalition-style Government come together in Delhi, what can global investors and corporations expect? FTI Consulting's India policy experts evaluate some likely policy changes and implications in some of the key sectors over the next five years.

Power of the Junior Partner

A BJP-led coalition government will have to accommodate junior coalition partners beyond its existing allies – the Janta Dal United (JDU), All India Anna Dravida Munnetra Kazhagam (AIADMK) and Shiv Sena – who may enjoy strong leverage within the new government if they are able to negotiate key ministerial portfolios. If the election throws up a fractured mandate, both national parties, the BJP and the Congress, will be forced to reach out to smaller regional parties for support, which will come at a price. This should see a new set of political leaders, from outside the

BJP, in Delhi within the new Government. The incumbent BJP Government, led by Modi, saw powers concentrated with the Prime Minister's Office (PMO), and empowered bureaucrats in the ministries. A repeat of such concentration of powers within the PMO seems unlikely. A stronger opposition will be scrutinising Government policies and enforcing greater accountability. More time for consensus building – longer debates, more disruptions and slower decision making – appears inevitable with the new Government. Parliamentary productivity could be sub-par with fewer legislative bills being passed. A case in point is that the new Government is likely to be cautious on introducing legislative

¹ [India Keeps Moving Right: Preparing for a Second Modi Term](#)

bills that allow easier land acquisition and introduction of labour reforms, anticipating Opposition pushback.

If the anti-incumbency trend of the last three years continues – as evident in the electoral upsets in the five state assembly elections in 2015 and continued into 2018 – and economic wins over national security issues with the electorate, then a Congress-led coalition Government could become a tenable option. A BJP-upset in Uttar Pradesh could easily change the national electoral arithmetic, and the alliance between the two largest regional parties there could cause the BJP concern.

Change in State-Centre Dynamics

Ministerial berths and bureaucrats will be shuffled as per the new political dispensation of the new Government. Now that key Hindi-speaking northern states – Punjab, Rajasthan, Madhya Pradesh, Chattisgarh are now under the Congress Party, a change in the state-centre dynamic may well shift. The BJP-led central Government created the NITI Aayog as a central Government think tank that cheer-led the central agenda and aligned state Government programmes with those at the centre, dictated closely by the PMO. The emergence of state-level political power centres and central Government ministries wrestling policy making away from NITI Aayog, could see NITI Aayog's role limited to that of an advisory body. A competitive federalism spirit may continue with global investors and corporations deepening their state-government engagements, as the focus moves from central Government policy making to state-level policy implementation.

GST 2.0 and Benefits of Structural Tax Reforms

The Goods and Services Tax (GST) regime and creation of a single indirect tax code across the country has been a key achievement of the BJP Government, notwithstanding the criticism it faced for its bumpy implementation and unwieldy structure. Businesses have been affected by poorly defined dispute settlement mechanisms and anti-profiteering measures within the GST legislation. A new Government is expected to propose a dual-rate GST regime, replace the current five-tiered model structure, and iron out policy kinks, after the necessary state-level and GST Council consultations.

Expanding the tax base is a strategic policy imperative – and corporations and individuals must expect greater tax scrutiny. Corporations should expect more tax litigation with the Indian tax office and prepare their local compliance teams accordingly.

Protectionist Technology Policies & Taxation Pressures

The hardline stance of Indian security establishment on data policies has upset global digital majors' India plans. Fears of state surveillance of citizen data and increased taxation on global technology companies are some of the concerns that have been expressed. The draft Data Protection Authority (DPA) bill that governs privacy issues and the handling of personal data, is expected to be introduced in Parliament in 2019. Fears of increased taxation on digital majors, on the other hand, will not be easily allayed as Indian tax regulators take a coordinated position with global regulators in Europe and the U.S. regarding taxes on internet and data-driven digital companies. This is part of India's stated intent of expanding the tax basket and securing higher corporate tax collections.

Changing Energy Mix: Renewable Energy and Electric Vehicles

India has been adding significant renewable energy capacity to meet its 175 GW (of which 100 GW is expected to be solar) capacity target by 2022. This policy momentum is expected to continue, even as renewable energy project developers and investors face challenges in collecting bills from financially-weak, state-owned electricity distribution companies. India is rapidly moving towards electric, with the government's Faster Adoption and Manufacture of Electric Vehicles (FAME) scheme entering into its second phase. With its focus on scaled deployment of electric vehicles by state-owned and a mass build-out and deployment of Electric Vehicle (EV) charging infrastructure, significant Government subsidies for buyers and new safety and emissions norms (BS VI) kicking in over the next two years, is set to greatly incentivise the adoption of electric vehicles and alter the Indian urban mobility landscape. The automotive industry is watching this space with caution as it could prove disruptive to the growth plans of automotive majors with knock-down effects on ancillary units. This is a clear source of risk for automotive sector investors that will play out over the next decade.

Social Infrastructure – Nutrition, Health and Education

Social infrastructure – specifically nutrition, health and education – remain under-invested in India. Manifestos of both national political parties, BJP and the Congress, promise raising public expenditure on health to 3 percent of GDP (currently at 1 percent, amongst the lowest in the world) – echoing unfulfilled promises from the manifestos of the previous election cycle from five years back. A lack of trained doctors in primary health centres and teachers in primary schools is a risk to future growth. The launch of two India-specific USD\$1 billion Environmental, Social and Governance (ESG) funds which were launched in the last six months, reiterate the unfulfilled need for better social infrastructure. Investors and global corporations in food, health and higher education sectors have an opportunity to collaborate and commit to co-investments with the government to meet the critical challenges with access in these sectors. This is the latent demand that is being tapped into by local enterprises – non-bank finance companies, medical diagnostic centres and food processing units – creating a new cohort of successful enterprises that are generating jobs and driving prosperity in India's Tier II and Tier III cities. Global corporations that miss these shifts would be closing themselves out of large parts of the Indian consumption and growth story.

Urban Infrastructure

Both the BJP Government and the Congress have focused on strengthening urban infrastructure. While the Congress manifesto makes explicit mention of the 74th Amendment to the Constitution 74 that would give municipal bodies financial independence with rights to issue municipal bonds, and fixed terms of city mayors; the NITI Aayog under the Modi Government mentions the need for a dedicated Metropolitan Transport Authority in all 1 million + cities and a comprehensive city governance framework. Municipal finance and deepening the bond market have remained unfulfilled promises. It will be an achievement for either political party if it is able to strengthen municipal governance and financing. Ironically, they don't need to wait for the national elections, as the real power to affect this lies with state Governments rather than the central Government. On

this issue, stronger voices from the states in the new Government should be able to lead this change. This is another opportunity for global investors and corporations to build deeper local engagement at the state level and participate in some of the economic and social transformation projects in key cities and municipal bodies.

Environmental Activism & Industry Impact

The link between climate change and environmental issues – air quality, water scarcity, plastic use, carbon emissions – and public health is increasingly scrutinised. An active civil society, free media and activist judiciary is exerting pressure on corporations and the executive arm of the Government, to address these issues on priority. The National Green Tribunal (NGT) has emerged as a strong environmental regulator, with a matching bite. It has imposed large penalties on private and public sector players, including a number of state governments for their inability to prevent environmental damage. Though Environmental Impact Assessments (EIAs) for investment projects are now an accepted part of operating in India. Evaluating social risks pertaining to human rights violations, gender and social issues, and local community impact risks have also become important, particularly around big infrastructure projects, and this continues to draw public attention. Whistleblowing incidents that bring violations of environmental and social laws to light are a reality. Corporations must devote adequate attention to their crisis response and management capabilities, to safeguard their reputation and respond quickly to allegations of such violations.

Divestment Season

One should expect a quick assessment and flogging of the family silver in the first two years of the new Government. A few state asset divestments are expected as the new Government seeks to create funds to balance its books and fund its election promises, including the populist farm loan waiver programmes and other welfare schemes announced in the heat of the election trail. Such divestments should offer good opportunities for global investors and corporations seeking an entry into the Indian market through the purchase of mature state-owned assets.

Conclusion: India 2024

India's macro-economic story is very much still intact – domestic consumption is strong and the positive effects of structural tax reforms like the GST, infrastructure investments, Indian Bankruptcy Code (IBC) and allowing banks to clean up Non-Performing Assets (NPAs) are showing positive effects. Kickstarting private investments and large infrastructure spending will require a combination of other factors – starting with a stable Government in Delhi and a strong political will to further administrative reforms.

Geo-politically, Brexit and protectionist tendencies of the Trump Administration, are forcing India eastward – into investing more into Asia-led initiatives like the Asian Development Bank (ADB), BRICs, the Regional Comprehensive Economic Partnership (RCEP) and the ASEAN Economic Community (AEC), as well as re-kindling alliances with Middle Eastern powers. A recognition of China's Belt and Road Initiative by India is clearly not on the cards, though India may want to play a more active role in the immediate neighbourhood (Nepal, Sri Lanka, Bangladesh, Maldives and Myanmar) to neutralise some of the diplomatic gains made by China.

The dampening effects of a global trade war between the U.S. and China, has some impact on India's economic growth but it is muted. India remains a large high growth economy, unhappy with 7 percent GDP growth, driven primarily by a domestic consumption growth story. Investors are flocking to India for precisely this reason – few large economies around the world offer this sort of hedge against a slowdown of global growth. What works for India, should work for investors as well, irrespective of who forms the Government in Delhi on 23 May 2019.



The Indian macro-economic story is intact irrespective of which government comes into power at the centre. This is the real story of India's economic and social growth – it is domestic consumption led growth, powered by demography rather than political leadership. This is the bullish India bet for most global investors and corporations operating in India



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