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ECONOTE No. 80: India and Brazil: A study in comparative populism — 31/1/2019

Summary

In **India** Modi's administration track record will be put to the test in the April-May elections, with the outlook for the government becoming more and more unfavorable. The administration delivered much less structural changes than it had promised, bar introduction of the GST, while the ill-conceived and irrelevant cash substitution measures did nothing to eradicate tax evasion while subtracted basis points from GDP growth. Bringing the central bank under complete political control did not impress investors nor did the last vote-buying budget. **Brazil's** new administration is promising to unravel years of socialist policies by introducing neo-liberal measures, including reduction in the fiscal deficit, pension reforms, war on crime and on the endemic corruption. This encouraged voters to trade-in state subsidies for promises of a clean, reformed political system as well as war on street crime.

Investment Conclusions

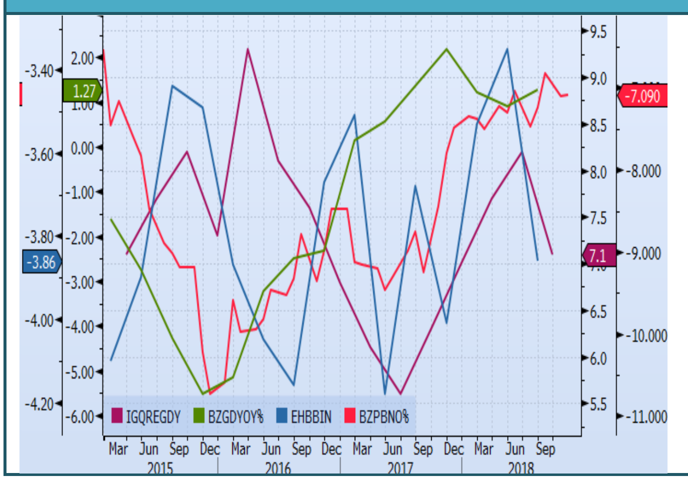
In an equities- bearish global environment, investors may need to rely not so much on growth acceleration or lower interest rates but on rapid structural changes, which could change asset prices. It is here that **Brazil outclasses India** with promises of structural changes and elimination of corruption, especially in the state oil sector, which distorted costs and prices and diverted state resources to private pockets. Brazil's Bolsonaro brings to the table suggestions or policies, on social issues, taxation and the environment, running contrary to global trends or conservative views. Modi's re-election, by no means certain, will add more of the same of the last 4 years, while Congress's victory will very likely depend on a coalition with the attendant limitations. Nothing exciting here either way.

The macro picture: GDP, fiscal deficits, forex rates and equities

As Fig. 1 shows, **India's** GDP growth (mauve) suffered a dip during 2017 as a result of the abrupt withdrawal and substitution in Nov. 2016 of all large denominations banknotes in an effort to "flush out" black money.The idea was that rather than reveal criminal, or at least illegal activities, these cash holdings would have not been redeemed.In fact more than 99.0% of all issued notes were exchanged thereby proving that the black economy in India had found different ways of operation.The result of this nonsensical experiment was accute disruption in the economy and a dip in GDP growth.Tight monetary policy with rising official rates during 2018 in order to control inflation also kept the growth rate down.The February 2019 budget although putatively keeping the fiscal deficit to about 3.4% of GDP (Fig. 1 blue) injected additional spending in the form, among others, of cash handouts to farmers (rural income scheme) and pensions to unorganised workers and, hence, may sustain growth in 2019. **Brazil's** GDP growth (Fig. 1 green) shrank from 2014 till the middle of 2017 as a result of the profound political instability resulting to the impeachment and removal of president Rousseff and the still continuing investigation into two major scandals, one involving the construction company Oderbrecht and the other the state oil company Petrobras.Both scandals involved wide sections of the political class in Brazil, including the ex president Lula, now in jail, and cast the past socialist administrations in the worst possible light.A parallel development was the steep rise of the fiscal deficit (Fig. 1, red) to nearly 9.0% of GDP driven primarily by social spending.The election in Oct.2018 of the right wing president Bolsonaro was the result of profound popular discontent with the corruption of a socialist administration as well as the rise in crime which affected all social classes but especially the poor.

The USD/INR rate weakened continously during 2018 from 64.0 to 74.0 but has since October stabilised to, currently, about 71.0, but with the election threatening to inject undertainty in the market.The USD/BRL did likewise during 2018 falling from 3.2 to 4.2 (Sept) but, since the elections, stabilising now to around 3.7.Equities performance has been variable with Sensex (2018=100) outperforming IBOVESPA till September when Bolsonaro's election led to the latter's outperformance to date.

Fig.1: Brazil, India: GDP growth and fiscal deficit % of GDP, 2015-18



Source: Bloomberg, See text

Poverty, subsidies and populism

Under Lula's administration, **Brazil's** anti-poverty policies became something of a model.One key measure involved families with incomes below a certain level and with school age children, and which were given income subsidies but only on evidence that the children attended regularly school and health check-ups. Under the new president Bolsonaro there is not specific policy indications but only the aim to cut back the large fiscal deficit which will, invariably, involve cuts in social policies spending. **India's** poverty alleviation traditionally involved, and even more so under Modi's adminsitration, a complex system of income payments on the basis of putative work-creating schemes in the countryside , plus corruption -ridden food subsidies and food handouts. There is a great deal of truth in the claim that poor, starving people can not wait for policies which rely on trickle-down effects or on long term structural economic reforms.Hence the argument of giving them cash now.Nonetheless this policy treats only the symptoms but not the causes of poverty and, hence, have no long term impact except to develop dependency and politcal corruption.This is the major error in India's poverty policies, which were given an extra boost in the February 2019 Budget designed to buy votes for the general election in April-May 2019.Additional annual income for small farmers was introduced as well as pensions for certain sectors of the labor market. Although the fiscal deficit for 2019 was set to stabilize to 3.4% of GDP, some of the extra spending would be financed by the central bank transferring to the government surplus capital requirements from its balance sheet! **Brazil's** fiscal policies have not been elucidated yet, but key target will be the radical reform of the state pension system whose unfunded excesses and regressive structure has been for long a taboo under the previous left wing governments but not under Bolsonaro's neo-liberal administration. Privatization of state assets is also high in the new agenda. **India's** progress on privatization has been glacial as has been the elimination of bad debts from state banks, an issue of dispute between the RBI and the government before RBI was "taken over" by political appointments. Whilst appreciating the immense difficulties of introducing major structural reforms in the context of a democratic process, nonetheless the **comparative** outlook is brighter for Brazil than that of India.

Fact Box: Comparative issues of populism

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Issues	India	Brazil
Overall economic policy	Statist, decreasingly liberal	Aggressively liberal, extensive privatization
Open economy, trade	Ambivalent	Selective, pro FDI
"Popular "subsidies	Increases	Reductions
Pensions, poverty alleviation	Actively increasing	Reducing, restructuring
Corruption, crime	Lessening importance	Crucially important
The environment	Major concern, slow action	Negative attitude
Gender issues	Suppressed-ignored	Being suppressed
Foreign policy	Fear of China, otherwise opportunistic	Aggressively anti-left in Latam, pro-US, pro-Trump

Fig.2: Brazil and India: Stock indices and Forex rates

Source: Bloomberg, see text

Conclusions : Populism in name only, but Brazil is preferred

It is clear that the comparison of the two "populist" regimes in India and Brazil ranges from the unfair to the very difficult, starting from the definition as to what is a populiust regime.The current working definition is that of a regime led by a strong personality and with economic and social policies favouring certain social classes or of policies of radical nature either favouring pervasive statism or strong neo-liberalism.**Brazil's** Bolsonaro's policies, such as there are, and they are more statements of intentions rather than actual measures, will try to reverse years of socialist mismanagement.Luckily, if this is the correct word, Latam economic policies are strewn of inept attemts to "milk" the private sector cow, without killing it, and passing on the rewards partially to the "poor" and mostly to the pockets of corrupt politicians.Argentina and Venezuela are excellent examples of this dangerous ineptness in addition to Brazil.We say "luckily" here because the remedies are obvious and it takes a shift in political support to lead to saner policies (Argentina and Brazil again) **India's** case is far more complex, but in the core is the persistent inability to eradicate poverty through policies which treat symptoms but not causes.The added factor here are that any policies which increase competition, either via domestic liberalisation of all markets or imported from abroad through freerer trade and capital movements, are resisted as they may damage the interests of the "poor". The role, size and importance of the state stays, of course, sacrosant, despite the totally obvious contradiction that a strong and inflated state simply leads to corruption and the redistribution of wealth from the poor to the bureaucrats and, via them, to the rich. The chance that Brazil will see more structural reforms, makes its equities markets outlook relatively brighter than that of India, as a simple and "macro" driven investment conclusion.

Andrew Freris (writing conpleted on 31 Jan. 2019)