A review on industrial policies of the first and second UPA regimes

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The first coalition government formed by the United Progressive Alliance (UPA) in 2004 has continued to maintain the New Economic Policy introduced in 1991 and accelerated reform and opening up of the Indian economy. One leading example of the continuing policy direction was the appointment of former Finance Minister Manmohan Singh who had played a key role in handling the 1991 currency as the new prime minister. Even though his appointment was driven by political factors, the appointment of the country's chief financial officer as the prime minister nevertheless announced an emphasis on economic development. Unfortunately, the UPA government has failed to live up to the expectations in many ways.

Relatively high economic growth before the rise of UPA

Since the independence in 1947, India has adopted various industrial policies aimed at economic development. The policies of the different periods

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clearly reflect the policy direction of the government in power at the time.

The first period from 1947 to 1965 was a time when India pursued the development of heavy and chemical industries. Upon considering ways to develop the economy of his country which faced a shortage of capital, Prime Minister Jawaharlal Nehru (1947-64) decided to adopt the USSR model of economic development. According to this model, increasing the production of capital goods—at the expense of present consumption—is necessary to accelerate economic growth. As a result, India focused on investing in heavy and chemical industries rather than consumer goods production during this period. Nehru's government also restricted imports to protect domestic manufacturers. However, these policies could not be continued for a number of reasons, including political instability, droughts and uncertainty of U.S. aid, following Nehru's death in 1964.

Starting in 1965, India invested its efforts in the Green Revolution which focused on increasing agricultural productivity to solve the food shortage problem. The government also began to adopt industrial policies that protected small businesses—a shift from the policies under Nehru which had been criticized for the excessive focus on large companies and heavy chemical industries. These efforts achieved some success. However, excessive government regulation of industry and economy continued, resulting in the decline of the overall competitiveness of the domestic economy.

In the 1980s India faced a foreign currency crisis. As the Indian government received the bailout packages from IMF, the industrial policy shifted from direct physical control to indirect financial control. It appeared that regulations were being relaxed to increase national industrial competitiveness. However, the limited relaxation had only a limited effect, and the increasing inefficiency of the state-owned companies resulted in another foreign exchange crisis in 1991. Under the IMF system, India implemented the New Economic Policy, which dramatically eased regulations and pursued an open-economy policy which included the privatization of poorly run state enterprises and preferential treatment for foreign investors. As a result, there was a rapid increase in the volume of economic activity in the private sector, which led to remarkable economic growth.

Unsatisfactory execution of the infrastructure investment policy

When the UPA government was formed in 2004, it inherited numerous infrastructure projects from the previous administration under the National Democratic Alliance (NDA). Most of them, however, have been either delayed or discontinued for a number of reasons by 2012. India's leading road construction project, the Golden Quadrilateral Highway which connects Delhi, Mumbai, Kolkata and Chennai, had been already 75% complete under the NDA government. However the UPA government failed to complete it while they were in power for five years.

During the first period of the UPA regime, various committees were formed to mediate the interests of different departments and oversee the execution of the many projects, but in many cases, the projects were left unexecuted. According to the progress status report published by the government in December 2011, out of a total of 590 projects that cost over INR 1.5 billion, 283 had been delayed, and only 138 were underway as planned. Of the projects carried out over 18 years from 1991 to 2007, the percentage of delayed projects increased from 34% in 2007 to 47% in March 2010. The delay percentage was 48% as of June 2011, indicating that it had not improved. In contrast to the UPA government's proclaimed determination to establish infrastructure, the actual progress has been unsatisfactory.

○ ● Uncertain Tax Reform

To reform India's complicated tax structure, the Finance Minister P. Chidambaram proposed a uniform Goods and Service Tax (GST) in 2007. Once it was announced, it drew great attention and expectations from the business community. Through the GST, which subsumes indirect taxes like excise duties and service tax, the policy is intended to stimulate interstate commerce, by unifying the tax system which varies from state to state, and to increase tax revenue as a result. However, the government has not been able to implement it due to its failure to accommodate the divergent interests of all the states. During the second period of UPA regime, a commission was formed to review the GST policy, but the actual implementation schedule remains to be seen.

○ ● Large-scale projects delayed by constantly changing industrial policy

The Indian government drew up and announced a national steel industry development policy to ensure a smooth supply of steel products necessary for industrial development. However, the proclaimed goals have not been reached repeatedly. According to the most recent version of the policy announced in 2012, India plans to produce 145 million tons of steel products by 2015, but the recent global economic slowdown casts doubt on whether the goal can be achieved. The reason the steel production plans keep going awry is the insufficient land for steel plants and inadequate supply of iron ore used in steel production. Even just in the case of the plant POSCO is trying to build in Orissa, the progress has been slowed by the complicated interests of different interest groups: local residents who oppose the sale of land and their instigators have obstructed the acquisition of land for steel plant. Other integrated mill projects have faced similar difficulties. Furthermore, the constantly shifting government policy poses a huge obstruction. Projects are thus often obstructed, as one side promotes the steel industry while the other side tries to stop the project citing environmental or tribal reasons.

○ ● Foreigners losing faith in the Indian foreign investment policy vs. outstanding foreign trade policy

The opening of FDI in multi-brand retail was the most appropriate case of chaos caused by the inconsistent foreign investment policy under the UPI government. After the Lehmann collapse, India announced that it would open up the entire multi-brand distribution to foreign investors, but soon withdrew the plan as a result of strong objection from the opposition party and small business owners. It is customary in India to announce a bill in the media and then gradually revise the bill according to the reaction. Nonetheless, the government was criticized as reckless for announcing then withdrawing a very controversial bill. This incident, together with the Vodafone retroactive tax case, was responsible for the country being seen in a negative light.

Foreign trade has been relatively high-rated area of performance under the UPA government. The government succeeded at signing the ASEAN-India Comprehensive Economic Partnership Agreement (CEPA), immediately followed by the Korea-India CEPA and Japan-India CEPA. Trade with the Korea, Japan and ASEAN countries has increased in volume since then. This can be understood as the result of the foreign educational policy of the UPA government.

○ ● UPA government incompetence—not the sole blame

The first period of the UPA regime was marked by the presence of a clear opposition. As a result, any poor policy performance could be blamed

India's industrial policies by period

Period	Features	Details
1947~1965	Emphasis on heavy and chemical industries	• Promoting rapid industrialization aimed at the development of basic industries • Focusing investment on steel, machinery, heavy-chemical and fertilizer industries. • The oversized public sector, import control and import substitution industrialization
1965-1980	Agricultural development and the rise of populism	• Emphasis on agriculture resulting from political instability, droughts and uncertainty of U.S. aid • Adoption of new agricultural strategy (Green Revolution) • Economic concentration control, protection for small businesses and nationalization policies • Competitiveness of domestic industries reduced by excessive regulations and protectionism
1980-1990	Economic liberalization	• Relaxation of regulations to increase industrial competitiveness • Shift from physical control to financial control • Implemented import liberalization under IMF assistance in 1981 • Increased efficiency of state-owned companies; limited effects of relaxed regulations
1991-Present	New economic era	• Second foreign currency crisis in 1991; IMF assistance • Drastic relaxation of regulations; sales of shares of state-owned companies • Sharp easing of regulations on foreign investors

Source: *India's Economic Policy Strategy after Independence* by Kwon Ki-cheol

on the leftist forces. However, there are largely two reasons for the policy failures in the second period of the UPA regime without a leftist opposition.

The first reason was the rampant corruption within the government. It would not be an exaggeration to say that the media headlines during the second period of the UPA regime were dominated by the articles on government corruption. Powerful people blinded by their ambition for success were more focused on sharing the fruits of corruption than implementing new reforms. In the process, the reform bills were relatively neglected.

The second reason was the inclusive growth policy which served as the basis of government policy during the second period of the UPA regime. In response to the growing concern over the social classes marginalized in the course of economic development, many policies were changed or the budget was revised accordingly. Given the long time it typically takes to mediate the different interest groups, the Indian government often ended up looking incompetent. What is clear is that India is still negotiating various policies and reflecting the voices of opposition in the revised policies. Even if this practice takes a long time, it is understandable from the standpoint that it minimizes the harmful effects that could incur in the process of pushing through reforms without support.

Since the domestic economy slowed down and the global economy grew uncertain, the UPA government is once again accelerating reform efforts in the second period of its rule. Even from a historical perspective, many of India's major policies were drawn up or revised in response to the changing external environment. Given its history of turning crises into opportunities for greater growth, India's future policy changes are worthy of our attention. C

Aggressive foreign investment policy—an inevitable choice

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Last year, on September 14, the Indian government relaxed the restriction limiting foreign investment share to up to 51%. In addition to this change, which had been retracted once in November 2011 due to political opposition from the opposition party and some members of the coalition government forces, the government surprised participants in the market by announcing economic reforms for the distribution industry and the liberalization of the airline market. Opening the general merchandising retail sector to foreign investors had long been a policy issue to be resolved, since it could improve the inefficient distribution system to reduce the structural inflationary pressure on food and beverages. Thus, the recent opening up of the market to foreign distribution companies can be considered an opportunity to shift the outlook on India from pessimistic to optimistic.

Of course the liberalization plan could once again meet opposition from the opposition party and small business owners. This time around, however, the proposed measure has notable differences: it leaves the implementation to each state government, and it sets the implementation decision for immediately after the parliamentary session is over. These differences, which were added with meticulous attention to detail, aim at resolving the issues of foreign investment policy in the past. It seems very unlikely that the plan will disappoint market participants with a complete retraction as it had in 2011.

Government struggling to carry out a foreign investment policy

A coalition government formed by the Indian National Congress (INC) and the left in 2004, United Progressive Alliance (UPA) appointed Manmohan Singh, the architect of Indian economic opening, as the first prime minister, and has continued to express its determination to expand foreign direct investment. The UPA government has long recognized the necessity of supplementing the limited domestic sources of investment and attracting foreign investors who can aid the acquisition of advanced technology and management practices for sustained economic growth and job creation. Its continuous efforts to liberalize investment and improve the investment environment reflect this recognition.

However, FDI expansion has run into serious limitations imposed by the left. In November 2011, the foreign distribution companies' failure to secure the long-anticipated exclusive entry into the Indian market is a major example of such opposition. Due to strong objections from the opposition party and regional distribution companies, the Indian government's proposed bill to open up the distribution sector was withdrawn even before it was introduced in the parliament. The government faced public criticism that opening up to multi-brand distributors like Walmart and Carrefour would inflict huge losses on small businesses. As a result, the uncertainty of India's open economy policy has left foreign investors skeptical about entering the Indian market.

Furthermore, domestic and foreign economic conditions and system development have resulted in an inconsistent foreign investment policy. The UPA government strictly enforces environmental regulations for foreign invested companies. Faced with lukewarm government response to opposition from local residents, the companies had no choice but to shrink the foreign direct investment. On the other hand, the new roadmap of the financial sector, which attracted many foreign investors, was supposed to permit mergers and acquisitions between foreign and domestic banks beginning in 2009; however, it has been delayed due to the global financial crisis.

Unfavorable environments for foreign investment

The recent uncertainty of India's foreign investment policy has prompted foreign investors who had been interested in investing in India to withdraw their capital or delay their plans. The inflow of FDI since March 2012 has remained low at below USD 2 billion per month.

The reason FDI in India has been sluggish is that foreign capital regulations have not been relaxed sufficiently. India's economic opening including its opening policy took effect in late 1991—later than other Asian countries like China and ASEAN countries. Moreover, India only gradually eased regulations on foreign capital. The second UPA administration, which came into power in 2009, set the relaxation of regulations as one of its major policies in order to attract foreign capital. Foreign investors welcomed the new policy with great expectations, but when foreign capital regulations were not relaxed as had been promised, the expected increase in foreign investment did not happen either.

In India, companies belonging to sectors that do not impose restrictions on foreign investment can receive foreign investment up to 100% ownership. Apart from a few exceptions, manufacturing is one of the sectors

Indian regulations on foreign capital (investment limits)

Category	Details
License requirement	Aviation, space, defense-related parts, industrial catalysts, etc.
Restrictions on investment in small businesses*	Investment exceeding 24% ownership in 21 small businesses requires pre-approval.
Location restrictions	For locations within 25㎞ of the city center of 23 cities with a population of 10 mil. or more (e.g. Mumbai, Delhi, etc.), foreign companies have to obtain permission.
Ban on foreign investment	7 sectors including gambling, lottery, nuclear power, railway, retail goods (except single brand retailing) and tobacco

* Small businesses refer to companies whose total assets excluding land and buildings amount to less than INR 10 mil.

in which 100% foreign investment is permitted. Many service industries, such as insurance and communications, which set their own foreign investment caps, are subject to strict regulations.

India's tax system, which discriminates against foreign companies, is one of the contributing causes of sluggish FDI. The retroactive taxation in March 2012 imposed on a foreign company that acquired Indian assets raised serious concerns among foreign investors, since such tax policy creates unfavorable investment conditions for them. In response to the retrogressive tax, a few foreign portfolio investors even withdrew their investments.

There are also many barriers to entry into the Indian market. For example, problems of land expropriation at the stage of investment implementation are one such barrier hindering FDI. Frequently, foreign investors have given up at this stage due to the opposition of local residents. Moreover, the protectionist labor laws—like the regulations on termination of employment—complex tax system, and inadequate infrastructure such as roads and electricity, all render India a less attractive investment outlet, Issues with land expropriation for foreign companies

Date	State	Company	Details
June 2005	Orissa	POSCO	Agreed to INR 12 bil. with the Orissa state govt. but land expropriation delayed
Oct. 2008	West Bengal	Tata Motors	Gave up the search and acquisition of suitable plant location for the super compact Nano; breakdown of negotiations with the state govt. and orgs. opposing land expropriation.
Feb. 2011	Maharashtra	Reliance	Abandoned the construction plans for the Mumbai Special Economic Zone (SEZ)
May 2011	Uttar Pradesh	Yamuna Expressway	Clash between policemen and farmers refuting the low sale price of the land for the construction site resulted in 4 deaths.

Source: compiled by the author

compared with other Asian countries. Indirect taxes in India include federal sales taxes (excise duty, service tax, education tax, import duties, etc.) and state sales tax (e.g. VAT). In particular, central sales tax (CST), which is levied every year, is a high cost burden.

India still attractive for its high growth potential

For the Indian economy, FDI is not only a source of growth but also a very important means (long-term capital) to offset the current account deficit. Thus, the UPA government, which perceived a crisis in the declining trend in FDI, has shown itself to be actively pursuing an open door policy to foreign capital, for instance, announcing the easing of regulations every six months since April 2010. The regulation relaxation announced in April 2011 put an end to the NOC (No Objection Certificate), which had long been a source of discontent among foreign companies. Until then, a foreign company, which had invested in a joint venture or formed a technology

> The implementation of realistic and effective policies of opening up to foreign capital is the key to sustaining investment growth.

alliance with an Indian company, had been required to submit a NOC from the Indian company to the government, in order to expand its investment or found a subsidiary company in the same sector.

Against the backdrop of economic slowdown, twin deficit, and inflationary pressures in 2012, without suitable measures to stimulate the economy, the Indian government had no choice but to announce an aggressive foreign investment policy last September. The 12th Five-Year Plan (2012-2017), as a result, emphasizes the need for stable FDI expansion to relieve the current account deficit.

Nevertheless, foreign companies have responded cautiously to the Indian government's announcements of plans to open up the distribution industry and relax foreign investment regulations. The British distribution company Tesco, for instance, made known that it would not announce any new business plans until concrete details of the Indian government's plan materialized. If the current administration delivers on its promise to ease foreign capital restrictions, there is a chance that Indian economy could recover from the recent growth slowdown. At the same time, there are many who are skeptical about whether the promise would be fulfilled with actual government policy, given the widespread opposition of political forces. From this perspective, India's liberalization of the distribution sector, will serve as a test of India's commitment to economic opening.

The Indian government's view of FDI also makes it difficult to resolve the uncertainty of investment conditions in the short term. The view holds that opening up to foreign investment is beneficial for the country, but that there is no need to provide additional incentives to foreign companies entering the Indian market. In addition, certain factions of the opposition party have a negative view on FDI.

Notwithstanding the slight deceleration since 2011, the Indian economy is expected to grow rapidly in the medium to long term at over 7%. Unlike China, which is likely to start seeing a decrease in the workforce population, India has high growth potential—comparable to China—as its workforce population will continue to grow until 2050. India is thus an attractive investment outlet for foreign investors. Therefore, in addition to easing foreign capital restrictions, the Indian government has to remove the impediments to FDI, namely the inadequate infrastructure, facilitation of the land expropriation process, reform of the complex tax system, and solutions to the problematic labor laws and tax system. Furthermore, the implementation of realistic and effective policies of opening up to foreign capital is the key to sustaining investment growth.

India spurs industrial development for increasing income and creating jobs

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Since the reelection of Prime Minister Manmohan Singh in 2009, India has carried out its industrial policies more actively than ever before. The key goals of industrial policies under the United Progressive Alliance (UPA)'s second term are to build infrastructure and to nurture the manufacturing industry.

Infrastructure development with private capital

The second UPA regime's determination to refurbish the inferior infrastructure, the biggest stumbling block to India's industrial development, is clearly demonstrated in the 12th Five-Year Plan (2012-2017). According to the plan, India will construct USD 1 trillion worth of infrastructure from April 2012 to March 2017. The first UPA government, by comparison, had invested approximately USD 500 billion in infrastructure construction under the 11th Five-Year Plan (2007-2012).

The Indian government is focused heavily on infrastructure construction

In the run-up to the general elections in 2014, industrial policies will be implemented more actively for more visible outcomes by 2013.

because it clearly understands that infrastructure, such as power generation and transportation, is key to successful industrialization. Currently, India's per capita GDP is less than USD 2,000. From the perspective of economic development, proper infrastructure plays a pivotal role in boosting the per capita GDP to USD 5,000. Increased productivity triggered by infrastructure construction is a prerequisite for an economy of self-sufficiency to transform itself into an economy of division of labor through industrialization.

Despite India's chronic fiscal deficits, private capital makes it possible for the second UPA regime to realize its bold plans. Before the UPA government was formed in 2004, private capital accounted for only 5% of funds in infrastructure construction. Since 2004, however, the share of private capital has increased, accounting for 33% in 2009. Private funding will be expanded in the future. Half of the funds for the trillion-dollar construction under the 12th Five-Year Plan will be financed by private capital.

Private capital includes foreign capital. The Delhi-Mumbai Industrial Corridor (DMIC) is a good example. The DMIC is a USD 90 billion project to build an industrial railway between Delhi and Mumbai, four smart cities, and various industrial cities for high economic growth, which was heavily financed by the Japanese government from an early stage of the project. The Indian government is actively attracting investment from abroad, including South Korean companies. Prime Minister Singh and other high-ranking Indian officials, on their recent visits to Korea, asked for Korean companies' sustained interest and investment in India. Although slightly delayed, bids for land purchase and other individual projects for industrial railways have already been initiated. It is the right time for Korean companies to pay more attention to the DMIC. Overall, supply for India's infrastructure falls far short of demand. Thanks to the Indian government's active policies, infrastructure construction will continue to offer more business opportunities.

The second UPA regime's policies in the infrastructure industry show two major characteristics. First, the government allows the private sector to construct infrastructure, and at the same time, to own and directly manage the infrastructure. For example, Ideal Road Builders (IRB), India's largest private road construction company, has made profits from building and operating over 6,000 kilometers of roads, including the Mumbai-Pune Expressway.

Second, the second UPA regime is turning major infrastructure, such as ports and airports, over to the private sector. Mundra Port, located on the Gulf of Kutch in the state of Gujarat, is a large-scale port with a capacity of 50 million tons a year, and was developed by Adani Group in 2000. Together with the nearby power plant with an annual capacity of 10 GW, Mundra Port is accelerating industrialization and urbanization in the region. GMR Group, on the other hand, has built and operated the New Delhi Airport since 2006, in addition to the Hyderabad airport completed earlier.

As a result of India's policy of looking to private companies to take the lead in infrastructure construction, the supply of infrastructure tends to be concentrated in the regions with higher demand and in the sectors with more business opportunities. In other words, there is a low supply of basic infrastructure, which does not lend itself easily to fee collection and offers few business opportunities. Water supply and drainage, public toilets, elementary schools, and other basic infrastructure are in short supply due to disproportionate development. Realistically, private capital alone cannot address the problem of public urination due to paid public toilets or insufficient water supply and drainage facilities, which lead to problematic issues in urban areas.

Creation of 100 million more jobs in manufacturing

Let us now examine the second UPA is nurturing the manufacturing industry, which is one of its high priorities. Like its other priority of infrastructure improvements, the second UPA regime's determination to develop the manufacturing industry is also clearly shown in the 12th Five-Year Plan. Under the Five-Year Plan, which started in April 2012, the growth target for the manufacturing industry is 9%, a 2.3% point increase from the 6.7% under the previous Five-Year Plan. The same plan has lowered the growth target for the service industry from 9.9% to 9.5%, while setting the target for manufacturing 34% higher than the 11th Five-Year Plan. It has also raised the agricultural growth target 0.7% point higher than before, but it is still much lower than the target for manufacturing. These changes and differences reflect the UPA government's determination to accelerate GDP growth by fueling the growth engines in the manufacturing industry.

The Indian government aims to increase the share of manufacturing in the GDP from less than 20% in 2012 to 25% in 2020 by nurturing manufacturing, and to create 100 million new manufacturing jobs. To this end, the Indian government is making continuous efforts in opening the

Growth targets of the Five-Year Plans by industry

Five-Year Plan	Government	Agriculture	Industry (manufacturing, mining, electricity)	Service industry	GDP
11th (Apr. 2007-Mar. 2012)	First UPA	3.3%	6.7%	9.9%	7.9%
12th (Apr. 2012-Mar. 2017)	Second UPA	4.0%	9.0%	9.5%	8.5%

Source: Planning Commission and Central Statistics Office door wider to foreign direct investment (FDI), expanding the mandatory procurement policy, implementing the National Manufacturing Policy (NMP), and promoting the Special Economic Zones (SEZ).

The FDI expansion policy is what the UPA government continues to promote while overcoming objections from domestic interested parties. Through this policy, India is turning the macroeconomic difficulties into an opportunity for further opening up of the economy. The mandatory procurement policy requires not only the government but also multi-brand distributors, such as Walmart, to procure a minimum percentage of products manufactured in India.

Industrial complex—the key to NMP

The NMP of the second UPA regime was announced in 2011. The core aim of the policy is to designate National Manufacturing Investment Zones (NMIZ). NMIZ, which is similar to Korea's industrial complex policy, is aimed at solving land acquisition and labor flexibility problems, which pose the biggest stumbling blocks to India's manufacturing industry. However, even at the writing of this article at the end of 2012, the official announcement for the NMIZ is still being delayed due to disagreements between the Ministry of Labor and Employment and the Ministry of Environment and Forests.

Even though the central government's NMP is being delayed, local governments are actively carrying out the NMPs on their own. The state of Madhya Pradesh is taking various measures to pursue labor flexibility, provide development subsidies, offer tax reduction to companies that produce their own power, and run a land bank for convenient land purchase. The state of Gujarat is providing full support to the textile industry under the 2012 Gujarat Textile Policy, while the state of Maharashtra offers industrial subsidies, and the state of Uttar Pradesh has announced the 2012 New Industry and Infrastructure policy. India's central and local governments are making efforts to provide policy support for growing the manufacturing industry. India's manufacturing has high potential for growth.

Several plans to create SEZs, which had been actively implemented by the first UPA regime as a core policy for industrial development, have been delayed or canceled under the strict regulations on development. In response, the second UPA regime is expanding incentives and pursuing deregulation. For example, it plans to increase the percentage of the industrial zone eligible for tax benefits from 30% to 50%.

In addition, the UPA government plans to promote mineral development through the Mineral Development and Regulation (MMDR) Act, which was passed by the Parliament at the end of 2012. The MMDR clearly states that the period of permit validity for mining projects shall be shortened through the transfer of full issuing and regulatory authority for permits to the state governments, and contracts for mines, currently allocated to state-owned firms, shall be opened to the private sector through open bidding. Companies involved in mineral development should pay close attention.

All in all, the industrial policies of the second UPA regime are regarded as bolder, more effective ways of pursuing India's industrial development that apply the lessons from the former government.

The second UPA regime is expanding the mobilization of private capital in the infrastructure industry, which was successful under the first UPA regime, while sustaining efforts to overcome objections from existing interest groups that favor reformist policies in the manufacturing industry. In the run-up to the general elections in 2014, such industrial policies will be implemented more actively for more visible outcomes by 2013. If the incumbent government's political base falters due to the opposition from those who are against the policies, the drive to implement them may lose steam.