India’s Modinomics and Korea’s New Southern Policy

Since Narendra Modi took the prime minister’s office in May 2014, India has grown into one of the fastest growing emerging markets with an annual average economic growth rate of over 7%. Under the vision of “sustainable economic growth based on structural reforms and open policy,” the Modi government focused on lifting restrictions on investment, building governance, expanding infrastructure, and strengthening international economic cooperation to achieve macroeconomic stability and stimulate investment. Thanks to the government’s so-called Modinomics, India’s economic growth rate has risen above China’s, and the country has grown to become the sixth largest economy in the world as of 2017.

I. Achievements and Challenges of Four Years of Modinomics

Strong Economic Growth and Macroeconomic Stability

India’s economic growth rate, which had fallen to an average annual rate of 5–6% since the end of 2010, shifted to the 7% mark along with the launch of the Modi government. Although there was a temporary slowdown due to the demonetization measure carried out in November 2016 and the introduction of Goods and Services Tax (GST) the following year, the economy started to recover from the last quarter of 2017. In the latest quarter, or the second quarter of 2018, India recovered its quarterly growth rate of 8% mark for the first time in two years (Figure 1). Foreign direct investment, which stood at $23.4 billion annually from 2010 to 2013, doubled to $46.4 billion in 2016 and $43.6 billion in 2017, driven by the government’s aggressive policies to attract foreign investment (Figure 2). Along with the increase in foreign capital inflows, stock prices have repeatedly hit new highs. The inflation rate, which remained double digit due to rising oil prices and massive fiscal spending by the previous government, quickly stabilized following aggressive stabilization measures by the Modi government and the Reserve Bank of India (RBI), and the drop in

1 On November 9, 2016, the government carried out a massive currency exchange of high-denomination currency notes to eradicate illegal and counterfeit bills. The sudden currency reform resulted in a shortage of cash due to lack of new bills to replace the high-denominated bills and insufficient preparation of ATMs, which led to a temporary economic slowdown as rapid contraction in consumption and production decline coincided with the adoption of the GST.
global oil prices (Figure 3). Moreover, the government has successfully cut its fiscal deficit to 3.5% of GDP in FY2017/18 from 5.9% in FY2011/12. Accordingly, in November 2017, Moody’s upgraded the sovereign credit rating of India to Baa2 after a gap of 13 years, citing Modi’s wide-ranging economic and institutional reforms.

Figure 1. Economic Growth Rate of India
Unit: percentage change YoY

Make in India: Transforming India into a Global Manufacturing Hub

In the interest of fostering the manufacturing industry, the Modi government selected 25 key sectors to concentrate policy support and stimulated foreign investment by easing FDI regulations. The government currently allows 100% FDI in most of the 25 sectors with a simplified government approval process, and provides incentives such as investment subsidies and tax reductions. In addition, the Modi government is pursuing complementary policies such as “Skill India,” to nurture the manufacturing workforce, and “Digital India,” to foster digital industry in preparation for the era of the fourth-industrial revolution.

Make in India has helped to improve India’s business environment and increase foreign investment. According to the RBI annual report, FDI in manufacturing expanded by 87.6% compared to FY2013/14, breaking through $11.9 billion in FY2016/17 (Figure 4). Moreover, India ranked 100th in the World Bank’s

2 As a core policy of Modinomics, the “Make in India” initiative aims to increase the share of manufacturing in GDP to 25% and create 100 million jobs by 2022, through 12–14% annual growth in the manufacturing sector.
Ease of Doing Business Index for the first time in 2018, jumping from 142nd largely due to its significantly improved business environment.

However, not only has the share of manufacturing in total FDI inflows declined, much of the FDI inflows have been diverted to brownfield projects which have little impact on job creation. According to India Briefing, FDI inflow in brownfield projects increased by 25% over the year, reaching 48% in 2016. Above all, the annual average growth rate of manufacturing GVA for the last four years is only 6.8%, increasing the share of manufacturing in GDP only slightly from 17.2% in FY2013/14 to 18.1% in FY2017/18, and falling much short of the target of 25% by 2022.

Reforms in Tax, Labor and Land Acquisition

In order to improve the poor business environment and promote investment, the Modi government selected three major reform agendas: (1) introduction of GST, replacing the complicated taxation system, (2) amendment of rigid and complicated labor laws, and (3) reform of inefficient land acquisition. So far, the introduction of GST has been successful, while reforms on labor law and land acquisition have been hampered by repeated failures to pass the parliament.

The GST, introduced in July 2017, caused a temporary economic slowdown in the early stages of institutional turmoil, but as the system started to stabilize, the country has been showing improvement in logistics and economic recovery. As of the end of 2017, the number of registered taxpayers increased by roughly 50% compared to the previous year, and the average monthly GST inflows between August 2017 and March 2018 turned out to be Rs. 89,885 crore ($12.6 billion), close to the target of Rs. 91,000 crore ($12.7 billion). In April 2018, GST inflows surpassed Rs. 1 lakh crore ($14 billion) for the first time (Figure 5). According to the State Bank of India, tax inflows in FY2018/19 are projected to increase by 14–16% year-on-year due to economic recovery, introduction of the E-way Bill, and stabilized GST system.

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3 India Briefing (November 1, 2017), “Make in India: Still Falling Short after Three Years.”

4 An online reporting system for freight transport introduced in April 2018, which requires relevant information to be reported to designated electronic portals when freight is over Rs. 50,000 ($700).

5 GST India Guide (March 6, 2018), ‘GST revenue in 2018-19 to grow at 14-16%: SMI Ecowrap.’
The revision of the labor law, designed to consolidate 44 individual laws into four simplified codes – the Code on Wages, Code on Industrial Relations, Code on Social Security and Welfare, and Code on Occupational Safety, Health & Working Conditions – was carried out for the purpose of increasing flexibility in the labor market and creating jobs. However, most of these four labor codes have not yet been proposed to the parliament due to their pro-business content which would, for instance, relieve workers’ dismissal requirements. Yet the Code on Wages is likely to come into effect soon, as the government is currently working towards passing it in the lower house of the parliament (Lok Sabha).

Meanwhile, an amendment to the land acquisition law, aiming to offer more relaxed conditions for private and foreign investors when securing land, was officially suspended in August 2015, as it faced growing opposition and massive protests by farmers. Hence, instead of pursuing it at the central government level, individual state governments such as Gujarat and Rajasthan are selectively amending related laws to allow investors acquire land more easily.

Flagship Urban Development Programs

Smart Cities, AMRUT, 6 Clean India (Swachh Bharat), 7 Housing for All (PMAY) 8 are some of the six Flagship Programs of the central government for urban development. Smart Cities, for example, aims to rejuvenate 100 selected cities in India by 2022, through retrofitting, redevelopment and greenfield development. 9 However, contrary to the highly publicized initiatives, only 21.6% of the budget released has been actually utilized by the six urban development programs since launch. According to a report from the Parliamentary Standing Committee on Urban Development, Smart Cities’ utilization rate came out the lowest at 1.8%, while AMRUT, Clean India, and Housing for All utilized 28.7%, 38.0%, and 20.8% out of the budget, respectively (Table 1). This poor budget execution can be attributed to ambiguous project design, lack of urban planning architects and local government capacity, and slack implementation.

Nevertheless, public-private partnership (PPP) projects are actively being carried out in the fields of housing, waste to energy plants, smart parking, public bike sharing, Smart Card app, etc. According to the Press Information Bureau of Government of India, by the end of December 2017, there were a total number of 278 PPP projects worth Rs. 24,408 crore ($3.4 billion) ongoing across 60 cities selected in advance.

6 Development of basic infrastructures for 500 small and medium cities.
7 Installation of toilets in every house, community and public place to eradicate open defecation by 2019.
8 Building 60 million affordable houses for the poor by 2022.
9 For more information, see http://smartcities.gov.in/content/innerpage/strategy.php
II. Future Modinomics and Measures to Expand Cooperation between India and Korea

The Indian economy is expected to continue its high economic growth of around 7%, driven by Modinomics. At the World Economic Forum held earlier this year, Prime Minister Modi affirmed that India will double its economic size to $5 trillion by 2025. According to the IHS Markit (or Global Insight), the Indian economy is likely to surpass $3 trillion in GDP by 2020 and $5 trillion by 2023, as the economy enters a high growth period of 7%, completely shaking off the aftermath of its massive denomination and tax reform (Figure 6).

As Modi’s chances of being re-elected in the 2019 election increases, it is expected for the government to continue its structural reforms and open policy. If the Modi government wins another five years, there are high expectations that India may look forward to some tangible outcomes in labor and land reforms, as well as ongoing infrastructure construction projects. For the moment, with eyes on the upcoming general election, Prime Minister Modi seems to be concentrating on creating more jobs for youth and empowering the rural population.

Table 1. Actual Utilization of Funds under six Flagship Programs for Urban Development

<table>
<thead>
<tr>
<th>Program</th>
<th>Allocated (A)</th>
<th>Released (B)</th>
<th>Utilized (B)</th>
<th>B/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smart Cities</td>
<td>10,084</td>
<td>9,943</td>
<td>183</td>
<td>1.8</td>
</tr>
<tr>
<td>AMRUT</td>
<td>12,447</td>
<td>8,629</td>
<td>2,480</td>
<td>28.7</td>
</tr>
<tr>
<td>Clean India</td>
<td>7,691</td>
<td>5,848</td>
<td>2,223</td>
<td>38.0</td>
</tr>
<tr>
<td>Hosing for All</td>
<td>15,026</td>
<td>10,012</td>
<td>2,081</td>
<td>20.8</td>
</tr>
<tr>
<td>HRIDAY</td>
<td>700</td>
<td>247</td>
<td>34</td>
<td>13.6</td>
</tr>
<tr>
<td>DAY-NULM</td>
<td>2,601</td>
<td>1,515</td>
<td>850</td>
<td>56.1</td>
</tr>
<tr>
<td>Total</td>
<td>48,549</td>
<td>36,194</td>
<td>7,851</td>
<td>21.6</td>
</tr>
</tbody>
</table>

Note. 1 USD = 70.926 INR as of the end of August 2018.

Since the economic growth started to accelerate supported by Modinomics, India has been aggressively expanding its economic cooperation with its neighboring countries. China has already become the largest trading partner of India, and is building up partnerships in the Indian infrastructure development market as well. Japan has also emerged as the biggest FDI investor in India. In contrast, cooperation between India and Korea has remained relatively low so far. Even though nine years have passed since the Korea-India Comprehensive Economic Partnership Agreement (CEPA) came into effect, bilateral trade is still stagnant, not to mention investment or Official Development Aid (ODA). When considering its high economic dependence on China and the United States, in the face of intensifying trade war, the Korean government should strengthen economic cooperation with India – the future new G3 and a key member of the New Southern Policy.

Figure 6. Economic Forecast of India

Source: IHS Markit (accessed on August 29, 2018).

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10 Development of 12 cultural heritage cities’ infrastructure by November 2018.
11 Technical training for urban poor.
New Southern Policy towards India

President Moon has proposed a “3P Plus” partnership with India, meaning a new partnership which focuses on People, Peace, Prosperity, and future cooperation for the fourth Industrial Revolution, to strengthen future cooperation with India and ASEAN. His visit to India in July 2018 marked the move towards “launching the New Southern Policy in earnest,” upgrading the cooperative relationship to the level of Korea’s ties with the original four superpowers – U.S., China, Japan, and Russia.

To start with, on August 28, the Moon administration launched a new Presidential Committee on New Southern Policy, to shape the new policy and come up with actual projects as part of promoting relations with India and ASEAN.

Based on the shared vision, first of all, India and Korea should improve and revitalize the CEPA, which shows low rates of preferential concessions and utilization. As agreed in the Early Harvest Package for the Korea-India CEPA last July, the ongoing negotiation to upgrade the CEPA should be concluded as soon as possible, with active high-level talks if needed. We can also expect better upgradation and higher utilization of the CEPA by establishing a cooperation fund for the Korea-India CEPA, which could be used to resolve trade imbalances and promote exchanges between professionals in the two countries.12

Secondly, projects that can leverage the $10 billion financial package should be started at the earliest. The financial package support for infrastructure development in India was agreed upon by the two countries in 2015, but not a single project has been properly addressed so far. Considering the size of the fund and the capabilities on both sides, medium-sized projects may be appropriate. Developing manufacturing-focused Korean-style Smart Cities, for instance, based on Korea’s experience with building new cities in short periods of time, could add momentum to enlarging economic cooperation between India and Korea.

In addition, the two countries should expand their mutual exchange of people and in the field of science & technology, if they are to lead the era of the fourth Industrial Revolution. The conditions for the entry of Indian professional workers, businesspersons, and cultural artists into the Korean market should be flexibly adjusted, along with improvement in visa conditions and an increase of direct flights. In addition, research and technical cooperation must be promoted in the fields of high-tech industry, aviation science and innovative start-ups, closely linked with the Skill India and Digital India policies.

Above all, regularizing summit meetings is essential. India and Korea should set up medium and long-term visions that embrace their respective cooperation goals, directions, and tasks. Under such a coherent vision, it would become possible to build a sustainable system for cooperation by integrating and regularizing ministerial-level meetings – which have been held on an irregular and redundant basis among different ministries and sectors – and pursuing the projects discussed in the sub-committees.

12 The Korea-ASEAN Economic Cooperation Fund has been pursuing cooperation projects between ASEAN countries and Korea, across 19 sectors with an annual capacity of $500,000, since 2006.