Making In India. But How?

PLI aims to create a manufacturing base. More evidence is needed before extending the scheme

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An important element of Atmanirbharta is the Production Linked Incentive scheme (PLI), intended to create a sustainable manufacturing base in India. The scheme is being extended to new industries. Tariffs have been raised, and lakhs of crores have been promised as subsidies. Will it work though? More evidence is needed before GoI commits itself further.

What is PLI? It starts from the premise that India manufactures too little. But why is this so? GoI says, for example, that the electronics sector suffers a competitive disadvantage of around 8.5-11% on account of factors such as lack of adequate infrastructure in India, high cost of finance; inadequate availability of quality power; limited design capabilities in industry and its neglect of R&D; and the inadequacies in skills of Indian workers. Since addressing these weaknesses will take time, the government wants a faster alternative.

The cellphone industry offers an example of what is proposed.

- First, custom duties on mobile imports were increased to 20% in April 2018.
- This immediately increases domestic prices of mobiles, allowing producers to charge Indian customers more. For example, an iPhone 13 Pro Max is available for under Rs 92,500 in Chicago, US, inclusive of taxes while the same model with identical specs costs Rs 1,29,000 in India, a markup of nearly 40%.
- Next, GoI introduced PLIs, which offer manufacturers a government payment of 6% in the first year for every cellphone produced in India, down to 4% in the fifth year, provided they meet incremental investment and sales targets.
- There seems to be no requirement that manufacturers produce some minimum value of the cellphone in India.
- This is important, for it means that even if a manufacturer imports all the parts from abroad, and simply assembles it in India, he gets the 6% subsidy on the invoice price.
- Even if he goes up to the typical 17-25% value added of cellphone manufacturers in India, he gets a handsome subsidy of 24-35%.
- In addition, states further add to this through state-GST waivers (about 9% of the price), power, land and capital expenditure subsidies.

So, the combination of protection and subsidies make it very profitable to make in India, and even export. Therefore, manufacturers are flocking to be selected for the scheme.

Who pays?

- The Indian customer pays a higher price because of tariffs.
- The Indian taxpayer pays for subsidies, not just to Indian firms that are selected for PLI but also to international manufacturers like Foxconn and Wistron.

So how many and what kinds of Indian jobs are being created? Presumably, such estimates were made before GoI launched the scheme. It would be good to know.

While publicly available data cannot answer such questions, data on exports and imports in category HS code 8517, which is telephones, cellular phones and related equipment, are instructive.

We should not dismiss the PLI scheme on the basis of scanty data. Nevertheless, a key concern is whether manufacturers will continue to produce even after the scheme ends. They will if the disadvantages of 'Making in India' are addressed, but that requires government investment

- In the last third of 2019 (before PLI was introduced and before Covid), exports were $1.6 billion and imports $4.4 billion for a net deficit of $2.8 billion.
- In the last third of 2021 (after PLI was introduced), exports were $2.7 billion and imports $5.2 billion for a net deficit of $2.4 billion.
- So exports have gone up substantially, but they were already trending up before PLI.
- On the other hand, imports were trending down, and now are trending up, which is consistent with PLI encouraging manufacturers to import parts so long as the final assembly is done in India.
- More generally, given today's large current account deficit, GoI should also examine associated imports.

It is early days yet so we should not dismiss the PLI scheme on the basis of scanty data. Nevertheless, a key concern is whether manufacturers will continue to produce even after the scheme ends. They will if the disadvantages of 'Making in India' are addressed, but that requires government investment.

One could hope that manufacturers will continue to produce in India if their scale economies overcome continuing environmental disadvantages. The question is why would producers not shift production to better climes, say Vietnam, when PLI ends and achieve those scale economies without incurring disadvantages – given the small investment required to meet PLI eligibility (approximately $125 million over four years), there will be little tying them to India.

Or, manufacturers could continue to produce, but will require continued tariff and subsidy protection. Already, firms are lobbying for PLI to be extended to compensate for the pandemic period. They can threaten to close down when the scheme ends, firing workers. Fearing unrest, the government may agree to their demand.

If PLI-induced domestic production does not become globally cost-competitive, it will reduce exports in other sectors – high cost domestically produced PLI-favoured semiconductors will reduce the competitiveness of two-wheeler exports that rely on chips.

The real problem is that we are still trying policy shortcuts. They are no substitute for longer term tasks like enhancing human capital investment, creating a simple but fair land acquisition process, ceasing the constant rejigging of tariffs and taxes that make it hard for producers to invest, and strengthening infrastructure. Perhaps the government should pause and first assess whether PLI works?

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