Why PLI Is Worth Doing

Critiques are missing both the immediate economic logic & its longer term strategic benefit

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The recent Vedanta-Foxconn semiconductor factory in Gujarat, at an eye-popping investment of \$20 billion, has unsurprisingly engendered a firestorm of commentary. It also reignited the policy critique of the government's flagship Production Linked Incentive (PLI) scheme, the programme that is the fount of investments like Vedanta-Foxconn. The critique received serious intellectual heft from ex-RBI governor Raghuram Rajan's cautionary analysis ('Making In India. But How?', September 12; bit.ly/3DSKm3Y) in these pages.

How rigorous is the critique, given that empirical evidence will take a few years to come in yet?

For starters, typically PLI on a specific product category is accompanied or preceded by higher tariffs on the product. This reverses a long trend of lower import tariffs, and usually results in higher sticker price for the Indian consumer. Rajan quite evocatively quoted the example of iPhone 13 – costing Rs 1.29 lakh in India versus Rs 92,500 in Chicago.

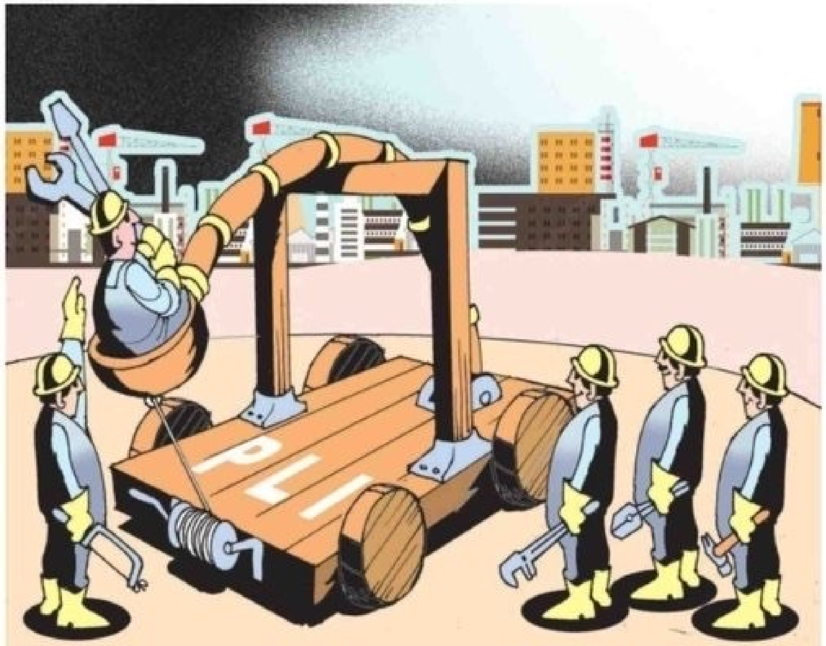
Sounds logical?

Perhaps in colloquial parlance. In the real policy-making domain, it's neither new nor terribly surprising. The sticker price of the Mercedes Benz S-class manufactured in India costs Rs 1.6 crore while being available for under Rs 1 crore in the US. The iconic Ralph Lauren Polo T-shirts, stitched in India, retails at price points starting from Rs 13,000 in India. In the US, it's available at nearly half of that price.

The need for PLIs

The reasons are complex – one of them being domestic tariffs. But economies incentivise exports via tax holidays on products where they have comparative advantages, to earn the foreign exchange required for essentials – hydrocarbons and capital goods in the case of India. Ergo, higher price of iPhones, a luxury product, isn't a really great handle to defend consumer affordability in a low-income country.

Indian manufacturing has been under a prolonged funk for a long time.



Despite 30 years of reforms, manufacturing as a proportion of GDP has not really picked up meaningfully. Poor infrastructure, labour laws, land acquisition laws, low HDI – the reasons are known enough to evoke a sense of déjà vu. PLI seeks to cut through the issue through a direct tactical intervention.

- First, it recognises that India's manufacturing productivity is perhaps 20-30% lower than the rest of Asia.
- Second, it recognises that perfect ambient conditions will probably take too long. As a solution, it offers a grand bargain to large corporations – if we are 30% less productive than China, then the government will, through PLI, monetise that productivity deficit for the private investor, provided the latter invests in large global-scale capacities.

It's the industrial variant of Direct Cash Transfer – ideally poverty should be eliminated via greater investments in education and healthcare. But given the long lead-times, DCT has become a popular policy tool globally as a direct attack on the problem. PLI isn't terribly different.

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We can afford it

Like any fiscal intervention, a key consideration justifiably, is around taxpayer burden to fund PLI. Is it affordable? The total estimated outlay, combined for the 14 PLI programmes rolled out, is Rs 3.46 lakh crore. Not a small amount at first glance. But this is expected to be spent over five years – within reasonable assumptions, it would be 1.5% of Union Budget outlay (0.2% of GDP).

Not small, but not something that will break the budget either. Further, the total outlay is dependent on milestone production achievements. If the maximum projected milestones are indeed achieved, they would likely generate enough additional taxes to pay for the programme by itself.

Post-PLI fears are misplaced

What happens post-PLI? Will the manufacturers wind down production as soon as PLI subsidies cease in five years, as Rajan fears? This betrays a fundamental disconnect on how business decisions are done. Let's take the Vedanta-Foxconn case. Going by reported numbers, the sponsors are investing \$20 billion, and over five years expect to receive \$10bn in PLI. It will be a reckless CEO to be spending \$20bn with a business model that is predicated on a \$2bn per year incentive as the only handle on his return on investment. Further, large ecosystems, once built, have their own momentum. The Indian auto industry is a great example – despite familiar issues of infrastructure, labour laws etc, it is a sprawling near-world-class industry today.

The strategic angle

In a post-Covid world, the rationale is not entirely economic either. Major economies are looking to build redundancies on critical products. This is especially true for strategically important products, like semiconductors and pharmaceuticals. The recently enacted Chips & Science Act in the US pledges, legally, to invest \$53bn into semiconductor research and production in the US. As a context, that is five times the amount pledged in India's semiconductor PLI, and larger than India's entire PLI outlay.

The great Shane Warne once commented on English spinner Monty Panesar – "Monty hasn't played 33 tests, he has played his first test 33 times." PLI isn't perfect, but it's a new experiment. At least, we will make new mistakes, which will give fresher insights to work off. Rather than trying to run the same playbook of labour laws, land acquisition and better HDI for a few more decades and make the same old mistakes.

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