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DO PRODUCTION-LINKED INCENTIVES FOR MANUFACTURING WORK?

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Electric vehicles in Hyderabad. | Photo Credit: RAMAKRISHNA G.

In a recent note, former Reserve Bank of India (RBI) Governor Raghuram Rajan questioned the success of the production-linked incentive (PLI) scheme in boosting India’s domestic manufacturing and exports. The PLI scheme was introduced by the Centre in 2020. Lakhs of crores of rupees have been allocated towards subsidising companies that manufacture in India. The Centre believes that the PLI scheme has boosted the domestic manufacturing sector, but critics have questioned its success. Do PLI schemes for manufacturing work? **Arun Kumar** and **Nagesh Kumar** discuss the question in a conversation moderated by **Prashanth Perumal J**. Edited excerpts:

What do you think of the policy of subsidising certain domestic sectors and, on the other hand, imposing tariffs on imports to favour domestic manufacturers?

Arun Kumar: Globally, nations are trying to capture the markets of others by exporting more than what they import. So, that is what brings us to the question of defending national markets for protecting employment and incomes in the domestic market, and there can be different strategies for doing that. Rather than protect large-scale industries, we need to boost the micro sector, which is where the bulk of the employment is, so that we can generate enough demand in the economy. But unfortunately, what is happening in India is the demand is shifting from the unorganised to the organised sector, because of the various steps that the government has taken. That has led to the further marginalisation and decline of sectors where employment generation is high. So, in a sense, what we face today is shortage of demand and economic slowdown. And that should be the number one priority to be dealt with.

Nagesh Kumar: There are core sectors — sectors that have high externalities or multipliers for other economic activity. If you begin by investing in or developing certain core sectors, it will help in propelling development at large. In the past, we had the policy of promoting such industries, like machine tools, which was considered as a core sector. In the current context, one could think about the semiconductor industry or the electric vehicles industry as a core sector which will help in fostering industrialiasation. These are the kinds of policies which are found in different countries.

How exactly do you go about subsidising certain sectors given that the process of doling out subsidies involves discretion and is prone to cronyism?

Nagesh Kumar: Targeting is very important when you decide to incentivise certain industries. Governments typically target certain strategic sectors which have huge potential. These days, looking at the future of sustainability considerations, there's a huge emphasis on green industries. And so, this is one set of industries which will have booming demand because every country is committed to net-zero goals. The U.S. government has put on the table $720 billion to be distributed either as subsidies or incentives to companies, which will manufacture high-tech equipment such as semiconductors, green hydrogen and electric vehicles. So, there is intense competition between countries. Industrialisation and manufacturing don't happen in a vacuum in this globally integrated world. So, we need to be watchful of what other governments are doing and develop our own strategies accordingly.

Why exactly do you need a scheme that spends lakhs of crores of rupees of taxpayer money to subsidise businesses? Why can't businesses simply be left to cater to market demand without the help of subsidies?

Arun Kumar: At the macro level, PLI is a freebie to the corporate sector. And it is based on the idea of supply side economics, which means that we give incentives to the private sector to produce, but this will not work when demand is short. And if demand is a problem, these policies will not deliver. As we are seeing currently, our rate of growth is tending to stagnate. As a result, even before the pandemic, our rate of growth declined quarter on quarter for eight quarters from 8% to 3.1% quarterly rate of growth. Now, to boost demand, what you need to do is reduce inequalities, so that demand for mass consumption items will give a boost to the economy as a whole. So, demand is a structural problem. And the bulk of the PLI is focused on the organised sector in which employment generation is very little because of automation. So what we need to do is create good employment data. While there are 320 million Indians who have proper employment, 270 million Indians don't. And that's why there is low demand in the economy. The other structural problem that needs to be highlighted is the inadequacy of research and development (R&D) by businesses. Imports deter local R&D. We have been facing this problem for the last 50-60 years. India invests much less than most dynamic economies spend on R&D. Indian businesses spend less than others because investment in R&D is very risky. So the conditions that need to be created are to lower the risk of investment in R&D. But what's happening is that we repeatedly import technology rather than build internal strength. And that is what has characterised the various sectors in the economy even after 1991. These problems need to be tackled before the PLI scheme can really deliver.

Don't you think the basic problem with the manufacturing sector is bureaucratic control? If so, don't we need to address that problem rather than subsidising companies?

Nagesh Kumar: It is very clear that we need to address the structural issues. Infrastructure has to be fixed, the quality of education has to be improved at all levels, R&D investments have to be enhanced. I think one issue which Professor Arun Kumar raised is that there is a problem of demand. I think there are demand problems, but for the strategic industries that are being targeted under PLI, demand is not an issue. I want to emphasise this because we are meeting our demand, whatever it is, through imports. So, there is an existing demand which is not being catered to by local production. There are projections that by 2025 also we might be importing $400 billion of electronics every year. Why are we importing this when we can manufacture it in India? There is a ready demand waiting to be exploited for some of these industries in the country. For the rest of the industries, we need to provide a demand stimulus.

The other thing is regarding PLI being a freebie offered to companies. We need to keep in mind that the context of industrialisation has changed since 1991. Today we are talking of a globally open and integrated economy. Every investor, whether domestic or foreign, looks at whether other governments are giving bigger subsidies, and if so, investments will simply flow there. So, if we don't put in some effort towards promotion, facilitation and incentivisation of investment, we might as well forget about those investments. PLI is not a handout. It is a post-facto incentive given when you have delivered the incremental output. So, once you have delivered the incremental output, only these incentives come to you.

Arun Kumar: PLI basically is a subsidy. And given the lack of political accountability in our system, what we find is that there's a large amount of cronyism, and the bureaucratic approach that you were referring to needs to be relaxed. Which companies and which sectors get the subsidy and which get the priority then is influenced by cronyism to a large extent in the Indian context. Further, subsidies need to be distinguished. A general subsidy is one that is necessitated by the macro situation of the economy, whereas a specific subsidy is given to sectors or to companies and are based on micro-level decisions that are taken by the government. In the case of the latter, cronyism can play an important role there, which is not necessarily an efficient thing to happen. In the case of the former, the bigger issues become employment, living conditions, etc. Subsidies often necessitate high indirect taxes. And because of high indirect taxes, costs, and prices rise; when this happens, subsidies become necessary for exports and for the poor. Therefore, these are the issues that need to be looked at before we think about what we do for industries that have the technology and the capability to supply goods in the market on their own. Now, indirect taxes tend to be regressive, so those at the bottom need to be supported by subsidies. So, what we need to do is have living wages.

Arun Kumar is a retired professor of economics at Jawaharlal Nehru University; Nagesh Kumar is Director of the Institute for Studies in Industrial Development

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