Is the Make in India Initiative Working? | Mihai Varga on World Bank-Led Land Reforms in Eurasia

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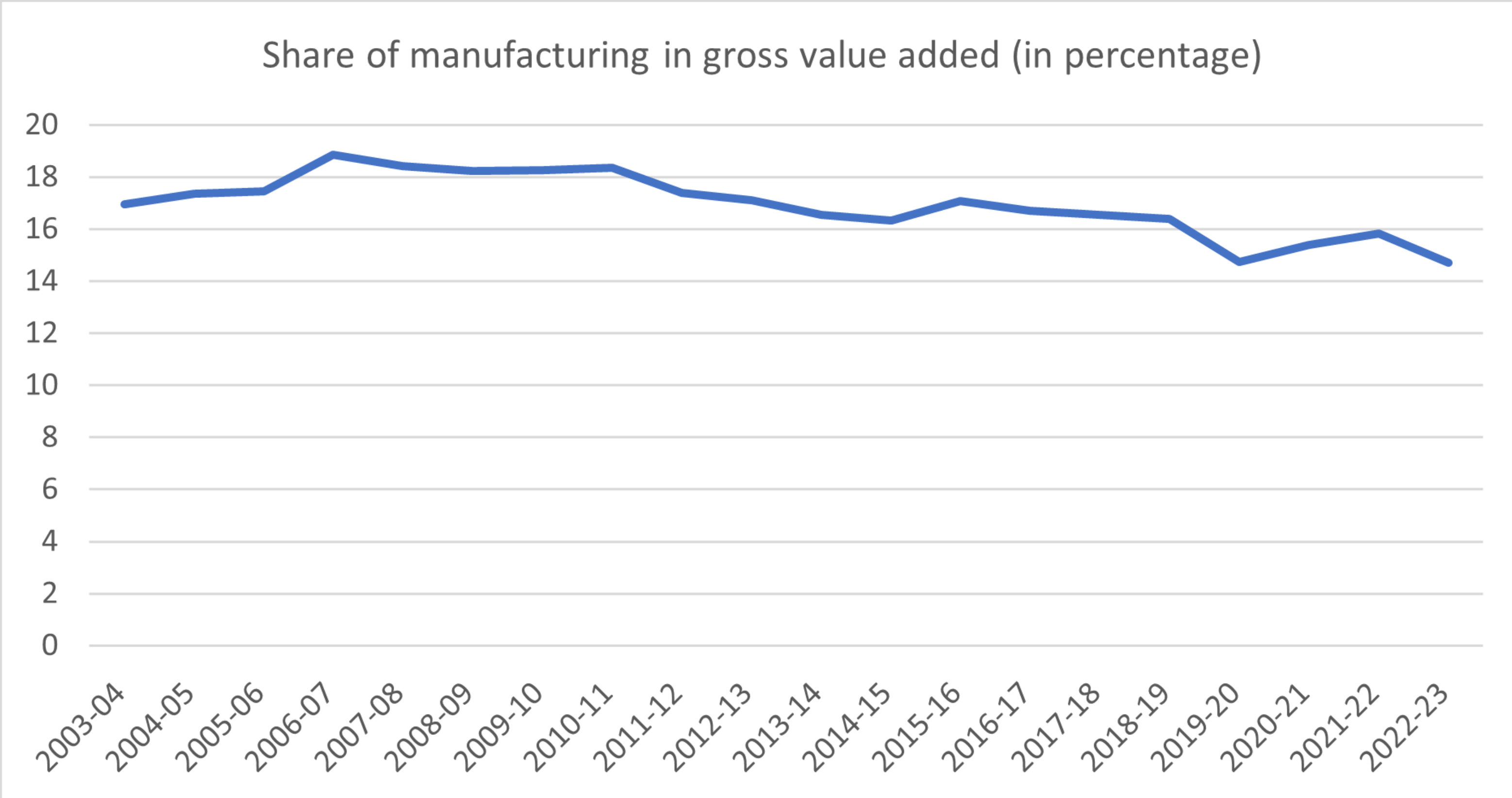
Analysis

Thinking Through the Make in India Initiative

Last week, Micron Technology broke ground to build a semiconductor plant in Gujarat. In recent years, there have been many announcements of new manufacturing facilities, and many of them have started making goods in India. From semiconductors to smartphones, it seems that India is becoming a manufacturing hub for goods that were earlier not made here at a large scale. It would appear that the Union Government's Make in India initiative, which was launched in September 2014 with the stated objective of promoting India as a preferred destination for global manufacturing, is succeeding.

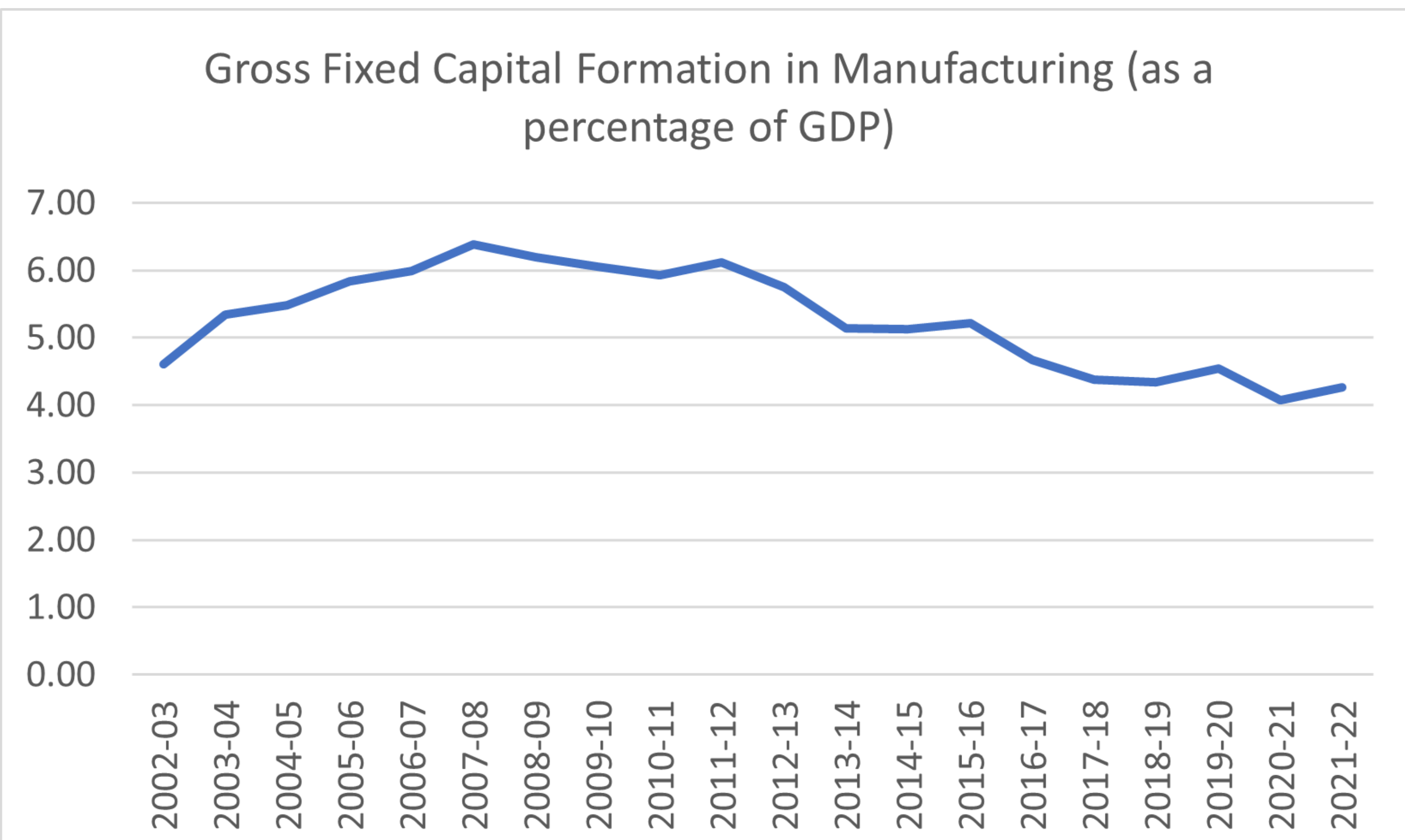
Large-ticket, high-profile investments make it to the news, but the very fact that they attract such attention can bias our understanding of what is going on. So, we should consider such news in the context of the aggregate performance on the objective of promoting manufacturing in India.

An important indicator for this purpose is the share of manufacturing in the gross value added (GVA) by the economy. The following graph shows India's performance on this indicator in the last twenty years—there has been no improvement on this indicator since the launch of the Make in India initiative. At 14.7 percent, the share of manufacturing in GVA in 2022–23 was the lowest since 1968–69. Even in 2019–20, the year just before the pandemic, it was only slightly better—14.72 percent.



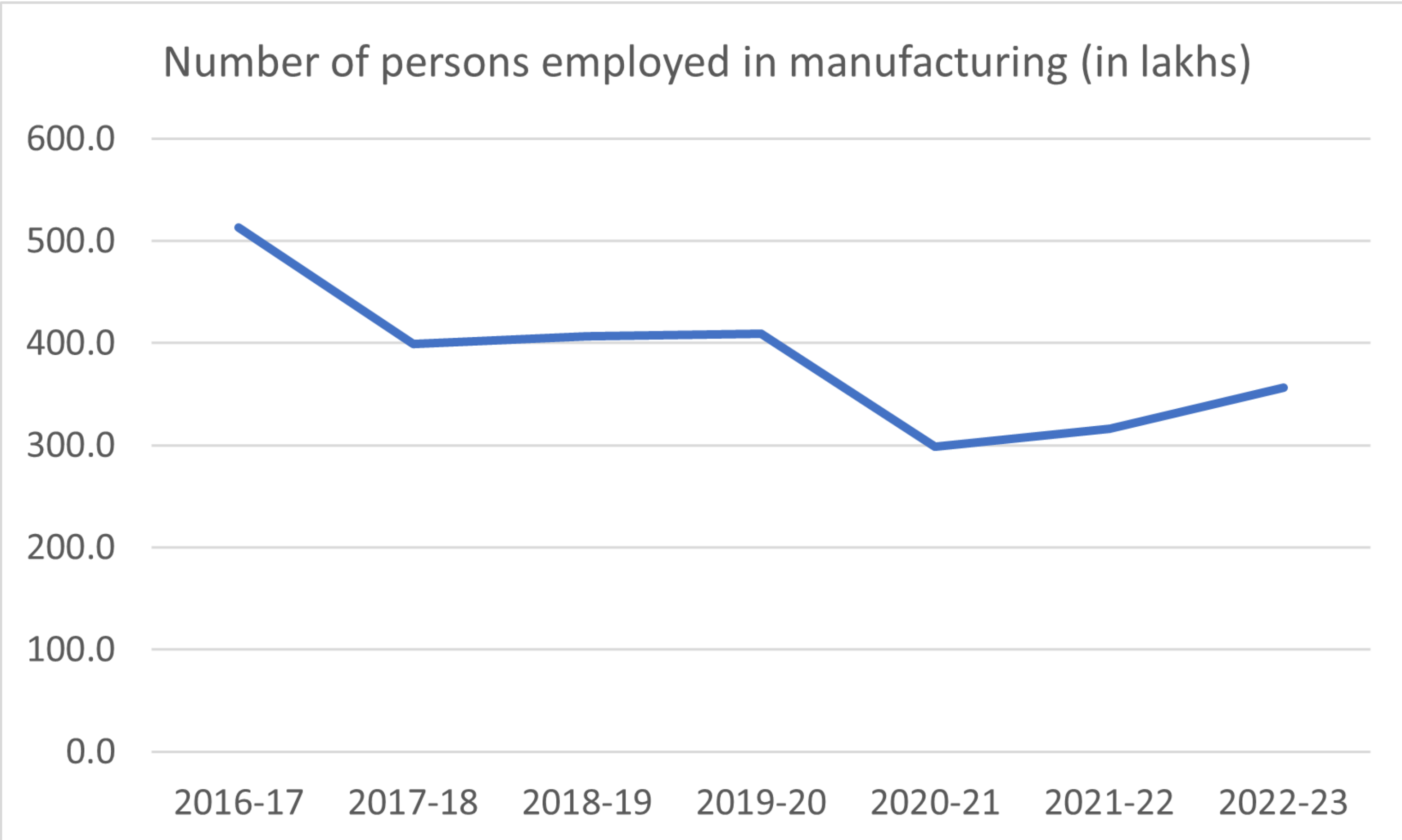
Source: National Accounts Statistics, National Statistical Office, Government of India

Another way to understand progress on this objective is through the data on investments in the manufacturing sector in India. A relevant measure of this is the gross fixed capital formation in manufacturing as a percentage of the GDP. A rise in this measure would suggest that investments in manufacturing capacity have increased, which could mean that more manufacturing would happen in the subsequent years. The following graph shows performance on this measure in the last twenty years. Even if we do not consider the pandemic years, when capital investments were difficult to make, there has been no progress on this measure since the Make in India initiative was announced.



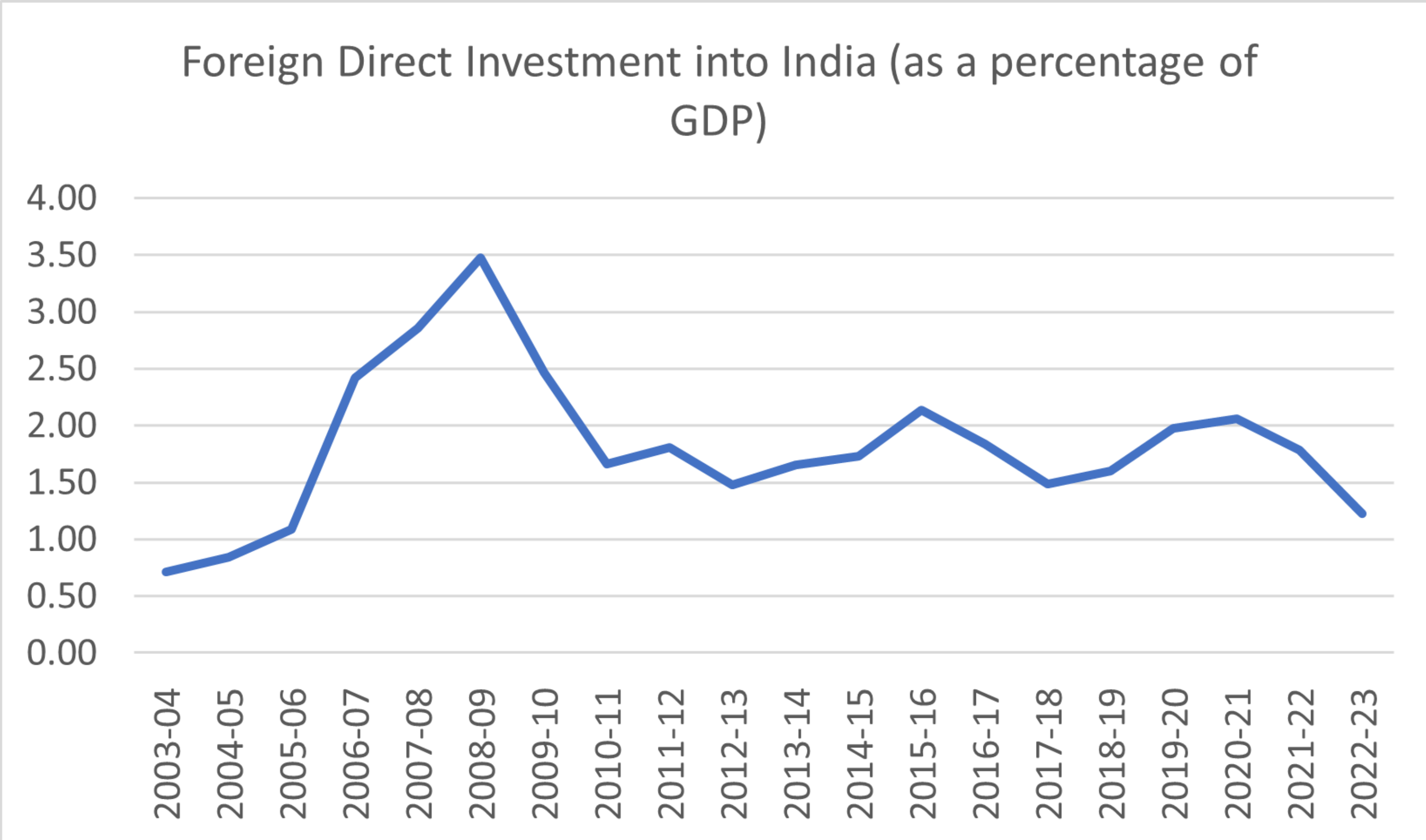
Source: National Accounts Statistics, National Statistical Office, Government of India

Another measure of the success of the initiative is the employment generation in manufacturing. It is possible that even if the share of manufacturing in GVA has not increased, employment in manufacturing may have if the share of labor-intensive manufacturing has grown. The Consumer Pyramids Household Survey conducted by the Centre for Monitoring Indian Economy reports data on the number of employed persons industry group-wise. This series goes back to 2016–17. As the graph below shows, according to this survey, there has been a considerable decline in the number of persons employed in manufacturing. Between 2016–17 and 2022–23, the number of persons employed in manufacturing fell by almost 1.57 crore. Part of this seems to have happened due to the pandemic, but even before that, there was a large decline.



Source: Economic Outlook Database, Centre for Monitoring Indian Economy

Since the Make in India initiative is significantly targeted at foreign investors, a partial measure of its success is the foreign direct investment (FDI) into India. FDI is often associated with transfer of knowhow and increasing the share in global value chains. Therefore, even though the FDI is a small part of the total investment in the economy, its impact can be quite significant. The following graph shows the trends of the FDI into India as a percentage of the GDP in the last twenty years. On this measure as well, there has been no increase since the Make in India initiative was launched, even though the government has often used nominal numbers to claim improvements. In the eight full financial years since the launch of the initiative, the FDI has averaged 1.76 percent of the GDP, while in the preceding eight years (2007–08 to 2014–15), it had averaged 2.14 percent of the GDP.



Source: Reserve Bank of India Bulletin, Reserve Bank of India

Finally, a key measure of manufacturing success is export success. The following graph shows the value of exports of manufactured goods as a percentage of India's GDP for the last twenty years. On this measure as well, there has been no noticeable improvement. As discussed in a previous issue of this newsletter, India's merchandise exports have declined for much of the last one decade, except for a few quarters in 2021 and 2022, when opportunities temporarily created in developed economies led to a spike in exports, which have since declined.

Sources: Foreign Trade Statistics of India, Ministry of Commerce and Industry; National Accounts Statistics, National Statistical Office, Government of India

The Two Phases of Make in India

Based on these economy-wide measures, it can be argued that the aggregate picture is very different from the one that is painted by the news around big-ticket investments. Perhaps this disconnect can partly be explained by the shift in the government's strategy for promoting India as a manufacturing hub. One can arguably delineate two phases in the strategy.

In the first phase, the focus was on promoting and facilitating investment as well as improving the ease of doing business. The former meant expanding and energizing Invest India, India's main investment promotion agency. The latter meant creating a top-down system of monitoring wherein the relevant government departments and agencies were asked to take the steps necessary to improve their performance on different components of the World Bank's ease of doing business index.

In the second phase, even as the attempts to promote investments and improve ease of doing business may have continued, there has been much more focus on the use of fiscal policy. Three types of fiscal policy instruments have been deployed—tariff hikes, tax cuts, and expenditure commitments. This phase began with the hikes in import tariffs on several products in late-2017. Since then, there have been many changes in import tariffs, and a wide range of goods now attract higher import duties. The government has also announced import restrictions on some product categories.

In September 2019, the government announced tax cuts for new manufacturing enterprises—those set up after October 1, 2019, were given an option of paying income tax at the rate of 15 percent as long as they did not avail any exemptions or incentives and commenced their production on or before March 31, 2023. This was later extended to March 31, 2024. For other companies, the tax rate was cut to 22 percent, again subject to the condition that they do not avail any exemptions or incentives.

Finally, from March 2020 onward, a series of production-linked incentive (PLI) schemes were announced. These schemes involved certain expenditure outlays. The incentives are to be given to those firms whose applications have been accepted and met the targets given in the scheme guidelines. Initially, the PLI schemes were focused on key starting materials, drug intermediates, active pharmaceutical ingredients, large-scale electronics, and medical devices. Later, they were extended to eleven more product categories: electronic/technology products, pharmaceutical drugs, telecom and networking products, food products, white goods (ACs and LEDs), high-efficiency solar PV modules, automobiles and auto components, advance chemistry cell batteries, manmade fiber and technical textiles, specialty steel, and drones and drone components.

These shifts in the strategy might partly explain the disconnect between the aggregate indicators and the narrative shaped by the news articles. Consider the PLI schemes. By design, they are much easier for larger firms to access. The quantitative thresholds and targets with which the fiscal incentive is linked are much easier for larger firms to achieve. For instance, in the PLI scheme for the automobile and auto component industry, the incentive slabs are in nominal rupee terms with the fiscal incentive increasing as the additional sales value rises. The additional sales numbers are easier for the larger automobile firms to achieve. Further, administrative capacity constraints may be creating a bias toward larger firms. It is easier to process a few large-ticket applications from larger firms and to monitor their compliance than to do so with many applications from smaller firms.

In areas like semiconductor manufacturing, the combination of large subsidies and the special treatment being given to the investors in overcoming problems of factor markets and business regulations makes it easier for large firms to make big-ticket investments that make it to the news headlines. The Micron plant is estimated to require a $2.75 billion investment, of which $825 million will be put in by Micron and the remaining will come from the Union Government and the state government of Gujarat. Understandably, the government also seems to be putting in special efforts to make it easy for such firms to establish and operate these facilities. It is worth mentioning that such special deals have enabled investments in many other countries as well.

Further, protectionist tariffs on product categories such as smartphones have also led to large facilities being established in India. Since India is now a large market for these products, high tariffs can make companies establish facilities here. In essence, such policies lead to an increase in manufacturing in a country by forcing a transfer from the consumers in the country to the producers. If, over time, such policies lead to efficient, globally competitive production in the country, a case could be made that they have succeeded, although, as discussed later in this essay, this is an empirical question to be answered with rigorous analysis. In India's automobile sector, more than three decades of protectionism and other forms of support have led to considerable manufacturing of automobiles and components in India, but India's share in the world automobile trade remains small.

Course Correction by Performance Measurement

To misquote Robert Solow, we can see the success of Make in India everywhere except in the national accounts statistics, employment figures, foreign investment figures, and trade flows. This is not to suggest that it will not eventually show up in these. It can be argued that it is too early to assess the success, especially for the turn in strategy that began six years ago and for the elements such as PLI schemes and tax cuts that have been added in the last three to four years. The pursuit of structural transformation is a long process, and a variety of policy approaches should be tried to enable it. What matters is that the strategy should work.

We need to be clear about how success should be defined and measured. Here is a question: If the share of manufacturing in GVA rises significantly in the coming years, is it sufficient evidence of the success of the government's strategy? It would indeed mean that the strategy has succeeded in promoting manufacturing in India. However, there is one more aspect that needs to be considered—the costs of this strategy. While considering the benefits of any government intervention, we should compare them with the direct as well as indirect costs of the intervention. PLI schemes involve expenditure that could have gone to something else. Tariff hikes increase the price at which a product can be purchased. The government's own estimate is that the tax cuts for corporations cost around INR 2.3 trillion in the first two years. The government may have increased taxes elsewhere in the economy to make up for some of this loss and/or raised borrowing from the market, thereby raising the cost of borrowing.

There are two broad, mutually complementary ways of evaluating this ambitious initiative.

First, the policies should be subject to standard cost-benefit analysis. Drawing on microeconomics, such analysis is built on a careful identification of costs and benefits of government intervention. While such analysis should consider indirect costs and benefits as well, in practical application, there are limitations in doing so. They are still useful and often used for project evaluation in India but rarely for evaluation of policies and regulations. In many other countries, policies and regulations are also subject to such analysis. If done well, such analysis can be useful in choosing the right policies, undertaking course corrections, and understanding the impact after the implementation.

Second, it is important to consider the macroeconomic impact in terms of how the initiative is affecting the economic growth and employment. It is possible to promote one sector in a manner that harms other, possibly more productive sectors. For instance, if taxes are cut for one sector but the shortfall is then demanded from other sectors, the latter might see a dampening of economic activity. This would show up in the aggregate GDP growth figures. So, a macroeconomic analysis is also required. Macroeconomic models that consider multiplier effects on the economy, which are usually not captured in cost-benefit analysis, can help make this assessment. While professional economists might do such analysis to publish papers at some point, to inform policies here and now, such model-driven analysis must accompany the initiative, preferably housed in research institutions operating at an arm's length.

A problem with the Make in India initiative, as with many others in India, has been the lack of transparency about the intellectualism that went into designing them. If the rationale for a policy is published and the ongoing progress is documented in detail, others can critique and help improve it. If things are not working well in the aggregate, it might mean that course correction is required. This realization should then trigger analysis of specific elements of the strategy. This analysis can be done internally by the government or through external institutions.

Chances of businesses offering evaluative criticism about the overall strategy are slim because incumbent businesses generally stand to benefit from measures like financial incentives, tax cuts, and protectionist barriers. Since the PLI schemes were launched, firms in many sectors have clamored for more such schemes. The state-capital interactions are probably now focused more on lobbying for such benefits and less on advocating for reforms.

Finally, it is important to remember that it is very difficult to get industrial policy right, especially in a moderate-capacity state like India. This calls for care and caution. Any strategy of industrial policy implies a particular theory of change, which is underpinned by a view on what objective is worth pursuing, a perspective on how the world works, and assumptions about how policies will be implemented. The theory can be wrong on any of these counts, but the sunk cost fallacy is quite common in such matters, especially in a context where there is a large community of narrative-shapers who are willing to claim success too easily. Therefore, only careful analysis can help the government realize the need for timely course corrections.

—By Suyash Rai

Review

Mihai Varga on the World Bank-led Land Reforms in Eurasia

Changes in land ownership arrangements through redistribution of land or land titling are often argued to be enablers of economic growth. Land redistribution was tried extensively in India, with debatable success. In recent years, those arguing for a direct relationship between land and economic growth have espoused improving land records and according land titles. In 2021, the Union Government launched the Survey of Villages Abadi and Mapping with Improvised Technology in Village Areas (SVAMITVA) Scheme to provide property titles to the owners in village residential areas. This complements the long-running program to digitize India's land records under the Digital India Land Records Modernization Program.

The underlying rationale for improving land records and providing land titles is the assumption that asset-poor households that own land will be able to access credit and investment by collateralizing their lands. Hernando de Soto's book *The Mystery of Capital* (2003) made a strong case for using the mechanism of land titles to commodify or "capitalise" land. However, even earlier than this, others viewed the transfer of ownership of land to small farmers as a critical step in their formalization and economic growth.

The World Bank is one such agency that has promoted the idea of land transfers and titling to attain economic growth. In *Poverty as Subsistence: The World Bank and Pro-Poor Land Reform in Eurasia* (2023), Mihai Varga critiques the poverty alleviation efforts proposed by the World Bank that focused solely on land-related policies. The World Bank's intellectual contribution, backed up by financial assistance, was an important source of reforms in these countries after the breakup of the USSR.

Through a comprehensive analysis of the World Bank's publications and the actual outcomes of land reform programs, the author presents a compelling argument to highlight the gaps and internal contradictions in the policy prescriptions provided by the World Bank in countries like Ukraine, Romania, and Moldova. Varga's analysis is burnished by his field work conducted in Ukraine and Romania, which informs the second half of this book.

In the first chapter, Varga delves into the literature and intellectual framework produced by the World Bank to prescribe a series of reforms in the newly independent Eurasian countries after the dismemberment of the USSR. He surveys what he refers to as the "landmark publications" of the World Bank, which served the purpose of creating the intellectual framework of the World Bank's land-titling policies in the Eurasian region after the breakup of the USSR—"The most representative formulations of the World Bank's land reform narrative were several publications that appeared in the 1990s and early 2000s."

Varga implies that the initial phase of the production of these landmark publications was characterized by neo-liberal ideas of property and markets. However, he also argues that though these publications promoted neo-liberal policies in the field of land reform, this was a highly attenuated neo-liberal conception, which focused only on property rights to the exclusion of all other efforts necessary to complement their distribution. This survey of World Bank documents is intended to highlight the internal intellectual contradictions present in these prescriptions.

On the one hand, there is an emphasis on providing property rights, which, according to the author, is a neo-liberal idea. On the other hand, there is an emphasis on the redistribution of property rights. Here, while the contradiction is apparent and important, Varga seems to be missing the longer lineage of redistribution-type programs. Land redistribution policies in China, India, Taiwan, and other countries were not concerned so much about property rights per se but about extinguishing one set of property rights in favor of the new set of property rights holders. Land redistribution was not the culmination of neo-liberal ideas focused on property rights but a socialist policy implemented by multiple nations to extinguish existing property rights. While land titling does have its origins in the idea of property rights, compulsory land redistribution does not.

At the end of the first chapter, Varga summarizes his main problem with the policies adopted by the World Bank. He points out that the key characteristic of its landmark publications was the "institutionalist simplification of reducing complex questions of development to the adoption of one institutional fix while reducing the operation of markets to the issue of land ownership." He elaborates on this claim in the subsequent chapters.

The second chapter explores the experiences of some post-communist countries in Eurasia, mostly Ukraine and Romania, where land reforms—redistribution of erstwhile collective farm land and land titling—led to an increase in subsistence rather than the progressive commercialization anticipated by the World Bank's landmark publications. First, Varga challenges the premise that subsistence agriculture is a negative outcome, highlighting its role in providing a safety net for millions of families in the face of economic crises and difficult reforms. Second, and most importantly, he argues that the proposals of the World Bank implemented in these countries were heavily influenced by the success of land-related policies in China that led to the country's rapid economic growth. According to Varga, however, the intellectual contributors to this learning process misunderstood the Chinese transition and drew the wrong lessons.

The author argues that while these landmark publications were heavily influenced by the success of the Chinese in implementing land reforms to attain economic growth, they ignored statist measures taken by the Chinese state, such as the increase in procurement prices and subsidy programs that enabled the Chinese economic transformation. Varga provides a chronological description of the Chinese measures from 1978 onwards to demonstrate that the easing of restrictions in land markets was accompanied by an increase in foodgrain prices, the increased role of state agencies in procurement, and a significant increase in subsidies. He also notes that land in China was not, in fact, privatized but allowed to be contracted out.

He also notes that World Bank authors overlooked the fact that "the state still acted as the most important buyer of smallholder produce." This happened even as the Chinese state kept removing restrictions on the use of mechanized vehicles for long-distance transport, wholesale trade in rural areas, and so on. The Chinese story of reform is, therefore, in Varga's analysis, a story of the simultaneous introduction of pro-market reforms and a continuing state support to enable the development of these markets. The Chinese treated land as it ought to be treated—one factor of production, and not the only one.

According to Varga, this incorrect understanding of the Chinese model was a critical determinant in the failure of the World Bank-led policies in Eurasian countries. While China significantly increased rural productivity and incomes and achieved a transformation of the economy in the two decades after 1998, growth in Eurasian countries was disappointing and was marked instead by an initial increase in the rise of subsistence farming, with many households choosing to transact in the informal economy. This, in turn, led to a change in how the World Bank's landmark publications viewed subsistence agriculture.

Varga pithily summarizes these intellectual changes. He points out that the publications went through three phases—first, when they prioritized land titling and transfers; second, when they became critical of subsistence farming (even though they knew about its existence even earlier) because it was not considered commercial or transformative enough; third, when the collective farms established during the Soviet Union finally started disappearing, but the economic activity was still disappointingly informal. He remarks, "The understanding of poverty changes from one of poverty due to lack of assets to one of 'subsistence' due to absent markets (in Romania and Moldova) and the continued existence of informal arrangements between former state farms and rural populations (in Tajikistan and Ukraine)."

The third chapter delves into the discursive construction of subsistence prevailing in the World Bank's expert network. Here, the author makes a conceptual argument about how the World Bank publications equate farming on individual land plots with subsistence farming. This leads to a measurement problem, where subsistence farming is measured only in terms of farm size and the number of subsistence farms. And since subsistence farming is considered a sign of poverty, the number of subsistence farms and the size of farms become a proxy for rural poverty. As the author points out repeatedly, farmers enter into multiple economic relationships like contractual leasing-in of more land where required, rearing of livestock, and so on. He also points out that the World Bank itself states that the number of rural households relying mainly on agriculture for consumption has declined significantly.

Varga also argues that the World Bank failed to understand that the rise in subsistence was a natural fallout of the dismemberment of the erstwhile socialist state but without any provision for supportive measures to enable this transition.

The next three chapters examine issues of small farmers resisting moves toward formalization and the subsistence economy as a sign of resilience rather than a primeval form of existence.

The fourth chapter, for example, provides a sociological understanding of the economic behavior of the "small holder" farms and households based on Varga's field work. He presents rich evidence of the entrepreneurial behavior of these households, arguing that contrary to the perception of subsistence farming that motivates national and World Bank policies in these countries, subsistence farmers do, in fact, transact with the formal economy, at least in part and that it is the nation-state that makes this complex economic behavior illegible to itself by viewing the subsistence economy through a simplistic lens.

Through a detailed description of the subsistence economy in these countries, the author is able to provide a rich context to his intellectual disagreement with the landmark publications of the World Bank that led to the policies related to land transfers and titling. He provides a complex ethnographic account of the traders who buy and sell smallholder produce and highlights how personal familiarity provides them advantages that large corporate traders are unable to replicate.

Varga, therefore, emphasizes the need for a nuanced understanding of the social and economic context in which land reforms take place. While the book is primarily a critique of World Bank-led efforts in Eurasian countries, many of these insights are meaningful to transitional economies in general. Perhaps the most important of these is that the necessary retreat of the state from over-regulated land markets has to be accompanied by supporting measures to enable a successful structural transition within the economy. Overall, the book is a provocative and insightful examination of the assumptions behind land-related reforms and is worth a read if only to understand the complexities of land reforms and their consequences.

—By Anirudh Burman
