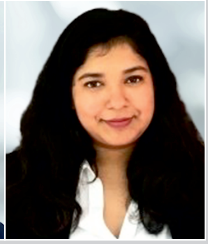
Production Linked Incentives (PLI) – A Boon for the Next Generation of US Investments in India?



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Introduction

The United States is one of India's largest foreign investors, with a long history of investment and joint ventures that have stood the test of time. From automobiles to heavy industry to entertainment – iconic American brands such as Ford, General Electric and Apple are household names in the Indian market today. The US is the 3rd largest investor in India, having invested $45.55 billion between April 2000 and June 2021. This represents 8.3% of the total foreign direct investment into India during this period.

However, with symbiotic factors at play - strategic geopolitical alignments, excess global liquidity and a competitive all-new 'incentive based' manufacturing regime in India - the Indo-US economic relationship in high-value manufacturing appears poised for exponential growth. This article provides an overview of India's Production Linked Incentive Schemes (**PLI Schemes**), and their significance for US investments in manufacturing in India.

Production Linked Incentives (PLI) - Key common features

Between 2020 and 2021, India announced a series of PLI Schemes aimed at accelerating domestic manufacturing in India. The bedrock of the PLI Schemes is a system of annually disbursable direct financial incentives, or 'cash-backs', from the Government of India (GoI) to eligible manufacturers under the relevant PLI Scheme.

The overarching common attributes of the PLI Schemes are:

1) Duration : The lifetime of each Scheme is for a specified block of 5 (five) financial years, (**Incentive Block**). Within an Incentive Block, a manufacturing entity or firm, is responsible for achieving annual investment, production and sales targets as specified under the relevant PLI Scheme.

2) Eligible Products : Each PLI Scheme sets out specific products that are eligible for manufacture. Most recent PLI Schemes include pharmaceutical products, air-conditioners, LED lighting products (including components and intermediates), and telecom equipment.

3) Barriers to entry : In selecting applicants, PLI Schemes ascribe weightage to factors such as the applicant group's existing manufacturing capacity (globally and in India), consolidated global revenue and net worth; apart from sector-specific achievements (such as, in the case of pharmaceuticals, the number of product registrations with recognized regulators such as USFDA). The qualification criteria above naturally weigh in favour of established multinational firms with a sectoral track record.

4) Minimum Committed Investment and Threshold Sales Growth Targets: For firms to be eligible to claim the financial incentives above, the Schemes set out certain minimum annual and cumulative investment and *year-on-year* incremental sales targets ("**Stipulated Threshold Targets" or "STTs**") that a firm must demonstrate as having achieved. The Stipulated Threshold Targets are hardcoded into the text of the Scheme Guidelines.

5) Financial Incentives: If a firm meets its annual STTs under a PLI Scheme, it will be entitled to claiming a "financial incentive". The financial incentive is calculated by multiplying "*net incremental sales of eligible product(s)*" achieved in the relevant financial year by a % "*rate of incentive*" specified in the relevant Scheme.

6) Project Management Agency: Each PLI Scheme has a nodal designated Project Management Agency, which is an entity appointed by the relevant governmental department responsible for projecting-managing the concerned PLI Scheme and verifying the firm's financial claims under the concerned PLI Scheme.

Analysis

The first generation of PLI schemes, rolled out between 2020 and the early part of 2021, covering 13 sectors, has generated considerable uptake from bidders/prospective manufacturers. Some sectors such as telecom, hardware equipment/mobile handset manufacturing have seen significant market traction and have attracted the biggest and best of global manufacturing into India[1].

[1]Apple iphone manufacturing partners, Foxconn and Winston, have increased their production in India to be on target to achieve this year's goals and gain an advantage under the production-linked incentive (PLI) scheme. As per Counterpoint Reserach, the Indian market's share of deomestically manufactured iphones increased 17% in 17% in 2018 to 76% in 2021.

However, for certain other sectors, such as electronics and the auto sector, the success has been less visible, because relocating manufacturing into India under PLI does not address the issue of intermediate components such as semiconductor chips which are still globally sourced[2].

Thus, while it is beyond debate that PLIs are a necessary step towards boosting manufacturing capability in India, import substitution, self-reliance and building an export focused ecosystem similar to our East Asian neighbours, the success of the various Schemes would depend on addressing the drawbacks and disadvantages intrinsic to manufacturing in India, such as:

- The high cost of domestic debt;
- The lack of intermediate components, domestic substitutes for cutting-edge technology and capital infrastructure such as specialist foundries (for instance, for specialty steel) in India;
- The exclusion, through Indian policy and regulation, of ancillary components originating from China;
- The reduction of the incentive period in certain sectors such as Drones, where the incentive block has been reduced from 5 years to 3 years;
- The risk of technology obsolescence: This is relevant for sectors such as PLI in photovoltaic (PV) components in the solar sector and for lithium-ion storage batteries, and drones, where the technological advancement may outpace the speed of manufacturing facilities that come up in India; and
- Sector specific risks: In the solar sector, the timeline for developing utility scale solar projects that are tendered out by various government procurement agencies, are specific. Therefore, if there are delays in manufacturing solar modules under PLI, it is likely that the project developer would face downstream delays in project implementation. For PLI sectors such as drones, their efficacy would depend on the feasibility of end utilisation of drones, e.g., use in imaging for infrastructure projects such as highways and irrigation. For a number of technical reasons, the current generation of drones are of limited utility in this regard.

Overall, it is also unclear whether the current package of financial incentives is sufficient to lure intermediate manufacturing from other cost competitive jurisdictions such as China and Vietnam. Therefore, for PLIs to succeed, it is important that the government streamlines the incentives provided within each sector and address the issues at the core of each sector rather than just promoting production.

Conclusion

From a legal perspective, PLI Schemes are a clear and transparent enunciation of the financial ince-ntives available to manufacturing firms and the conditions for claiming them. A unique/compelling feature of PLI Schemes is that the scheme based financial incentives on offer are backed by guaranteed budgetary outlays of the GoI that are provisioned into individual departmental budgets each year.

However, applicants and firms in PLI projects are advised to be mindful of the following:

1) Negotiating the disabilities of India's manufacturing ecosystem: PLI Schemes, in essence, are compensatory. Fiscal incentives in themselves do not address the intrinsic disabilities in manufacturing in India. Therefore, before committing to investments and production targets under PLI, firms should carefully evaluate and ensure the availability of adequate infrastructure, supply chains, local components and intermediates (to avoid paying basic customs duty on importing these), logistics, financing, power, design capabilities, R&D, manpower and skills.
2) Binding targets under PLIs : Aside from a "*gestation period*" of up to 2 years before commencing production, PLI schemes do not excuse firms from meeting their committed targets. Investors should mitigate manufacturing under performance and delays through watertight contractual arrangements and insurance.
3) Project planning : PLI Schemes do not underwrite or guarantee any other aspect of the project (land and approvals), which investors should tie up in advance.
4) Finite Window for Incentives : Financial incentives to SEs are only available for the duration of the Incentive Block, and against the specific financial year that such incentive pertains to. Firms do not have the option to 'bank', defer or 'catch up' on unclaimed financial reliefs on future dates.
5) Fine print : The calculation of STTs under PLI is subject to various prescriptive exclusions. As achieving the stipulated STT threshold on an annual basis is a prerequisite to claiming financial incentives, firms should be wary of expensing 'excluded items' that cannot be claimed.

[2] A global shortage of computer chips has impacted everything from automobiles to video game consoles and now smartphones. Semiconductors have been in short supply this year, due to a number of reasons including factory closures resulting from the Covid-19 pandemic and heightened demand for consumer electronics. Automakers have been especially impacted by the shortage, with companies like General Motors and Ford reducing or even halting production of certain vehicles.

6) Change of Ownership : The transfer of eligible benefits during an Incentive Block to a successor firm is subject to the approval of the relevant governmental authority.

7) Technology risks and obsolescence : This is relevant for PLIs in high-value emerging technology related areas such as Drones, Solar PV and Storage Batteries.

Thus, while PLI Schemes present an ideal opportunity for international firms with manufacturing capability, expertise and a demonstrable track record, - success in India would depend upon the strength of local production systems and partnerships, advisory support, innovation and the ability to pre-empt and mitigate some of the disabilities and complexities intrinsic to the Indian manufacturing ecosystem. In this regard, US firms as natural beneficiaries of a treasured bilateral relationship between our nations, strongly entrenched manufacturing networks, lobbies, and business experience in India, stand to gain.

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