Production Linked Incentive Schemes – Compatibility with WTO Norms

Date : April 23 2021

Sudipta Bhattacharjee, Partner, Khaitan & Co

Vikram Naik, Principal Associate, Khaitan & Co

Introduction and background

In May 2018, the US challenged export subsidies provided by India under five sets of schemes viz; Export-Oriented Units, Electronics Hardware Technology Park and Bio-Technology Park (EOU/EHTP/BTP) Schemes; Export Promotion Capital Goods (EPCG) Scheme; Special Economic Zones (SEZ) Scheme; Duty-Free Imports for Exporters Scheme (DFIS); and Merchandise Exports from India Scheme (MEIS) before a panel constituted under the WTO Dispute Settlement Body (WTO Panel).

In the complaint, the US alleged that export subsidies granted by India under the EOU/EHTP/BTP Schemes, EPCG Scheme, SEZ Scheme, and DFIS consist of exemptions and deductions from duties, while benefits under MEIS consist of government-issued scrips that can be used to by the exporter to pay duties, all of which are prohibited under the WTO Agreement on Subsidies and Countervailing Measures (ASCM).

The WTO Panel in its decision concluded that the export incentives were in violation of the ASCM and recommended that India withdraw the incentives under DFIS, EOU/EHTP/BTP Schemes, EPCG Scheme, MEIS and the SEZ scheme. While India has notified its decision to appeal the WTO Panel's decision to the Appellate Body of the WTO and the appeal is still pending. However, this decision of the WTO Panel led the Indian government towards introspection and analysis and in quest of adopting a WTO-compliant incentive structure which has culminated in the Remission of Duties and Taxes on Export Products Scheme (RoDTEP) and the various Production Linked Incentive (PLI) schemes.

Introduction of Production Linked Incentive Scheme

In order to boost domestic manufacturing and cut down on import bills, the central government introduced PLI schemes that aim to give companies incentives on incremental sales from products manufactured in domestic units. The PLI schemes encourage foreign companies as well as local companies to set up or expand existing manufacturing units. The eligible companies will receive incentives on achievement of incremental investments and incremental sales over the base year, for a specified number of years subsequent to the base year.

The Government of India has announced the amount of the benefit available, the tenure of the benefit and investment thresholds for several sectors. The relevant details for the key schemes are summarized below:

Name of the Industry	Quantum of Benefit	Investment Threshold	Requirement for Local Value Addition
Large-scale electronics manufacturers (Mobile phones and Specified Electronic Components	4-6 %	For Mobile Phones – Domestic Firms: INR 200 Cr over 4 years Foreign Firms: 1000 Cr over 4 years For specified electronic components INR 1000 Cr over 4 years	For Mobile Phones – Plan for Local Value Addition For specified electronic components - Plan for Local Value Addition
Specified Electronic Component Manufacturers	3-5%	INR 25 Cr. Over 4 years	
IT and Hardware Products (Laptops, Servers, All in One PCs)	2-4%	Domestic Firms: INR 500 Cr over 4 years Foreig-6%n Firms: 20 Cr over 4 years	Plan for Local Value Addition
Telecom & Networking Products	MSME: 4-7% Non-MSME: 4%	MSME: 10Cr over 4 years Non-MSME: 100 Cr over 4 years	
White Goods (ACs and LEDs)	4-6%		Plan for Local Value Addition
Medical Devices (Specified Devices)	5%	Completely Relaxed	
Pharmaceutical Drugs (specified drugs, intermediaries, and API)	5-20%	Completely Relaxed	
Pharmaceutical Drugs 2.0 (specified drugs, intermediaries, and API)	5-10%	Awaited	
High Efficiency Solar PV Modules	Awaited		

There has justifiably been a significant level of excitement about PLI schemes amongst Indian and foreign companies. However, in light of the impact of the aforementioned WTO Panel's decision declaring the earlier export incentives as being WTO-inconsistent, there is a need for certainty of continuity of the benefits under these PLI schemes without the looming threat of such schemes or programs being discontinued or impacted owing to lack of compatibility with the WTO norms.

In contradistinction from the earlier export schemes which were held as WTO non-compliant, the PLI schemes mandate investment thresholds and targets for increment in sales for availing the scheme incentives but do not mandate any export obligations on the applicant-manufacturer. The PLI Schemes seek to stimulate local production and investments by incentivizing the increments in investment and sales, without distinguishing between domestic or export.

Nonetheless, it is pertinent to examine, , if any part of the PLI schemes may be vulnerable to challenge as being WTO-incompatible, as discussed below.

Compatibility of the PLI Schemes as a 'Subsidy' under WTO norms

Under the ASCM, a subsidy contains the following basic elements:

> (i) a financial contribution (ii) which is given by a government or any public body (iii) which confers a benefit and (iv) is specific (i.e. whether it is specifically provided to an enterprise or industry or group of enterprises or industries). The ASCM creates two basic categories of subsidies, prohibited, and actionable.

Two categories of subsidies are prohibited by the ASCM;

> (i) subsidies contingent, in law or in fact, whether wholly or as one of several conditions, on export performance
>
> (ii) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

Unlike the earlier export incentive schemes, the structure of the PLI schemes do not link the eligibility or quantum of the incentives to exports, and there is no express requirement of use of domestic goods over imported goods. Hence, the PLI Schemes may not considered to be prohibited subsidies.

Here, it may be noted that under a few of the PLI Schemes, applicants are required to declare a plan for domestic value addition, employment generation and exports during the tenure of the scheme.

Under the PLI Scheme for Mobile Phones, 'Domestic Value Addition' is defined as 'Net Sales Turnover minus value of non-originating material and services used in manufacturing divided by Net Sales Turnover'. This may be used by some other countries to argue that the said PLI Scheme prescribes utilisation of domestic goods as a pre-condition to allow grant of the incentives which would be a prohibited subsidy under WTO. Similar arguments may also be explored for suggesting that such PLI Schemes are in violation of the WTO Agreement on Trade-Related Investment Measures (by inferring a mandatory utilisation of domestic materials under the domestic value addition plan).

However, we believe that such arguments can be rebutted since the quantum of incentive under the PLI Schemes requiring a domestic value addition plan does not appear to have any direct linkage to/contingency upon a mandatory quantum of local value addition. This is also buttressed from the fact that applicants are required to declare a plan for domestic value addition only under a few of the PLI Schemes. For example, while under the PLI Scheme for Mobile Phones, provision of plan for Domestic Value Addition is prescribed, under the PLI Scheme for Telecom and Networking Products, there is no requirement of a plan for domestic value addition.

However, to remove any doubts whatsoever in this regard and in the interests of the long-term success of PLI Schemes as well as certainty of business environments, it would be ideal if the Government of India can through a formal circular/notification clarify that:

- The PLI Scheme and Guidelines do not envisage such domestic value addition plans either to be binding, or
- as a 'condition precedent' for grant of the incremental incentives;
- nor is such a requirement of domestic value addition mandatorily required be fulfilled by use of domestic goods over imported goods as an eligibility condition for incentives.

Such a clarification will go a long way to shield PLI Schemes against any challenge at the WTO level as 'prohibited subsidies'.

At this juncture, it is pertinent to highlight even if subsidies given by a country are not 'prohibited' under WTO, importing countries adversely affected by such subsidies in the exporting country may still try to offset/countervail the impact of such subsidies – subsidies of this nature are referred to as 'Actionable subsidies'.

Actionable subsidies are not prohibited but are subject to challenge by importing countries adversely affected by grant of such subsidies in the exporting country, either at the WTO or through countervailing action, in the event that they cause adverse effects such as:

- injury to a domestic industry caused by subsidized imports;
- serious prejudice as a result of adverse effects (e.g., export displacement);
- nullification or impairment of benefits accruing under the GATT 1994, which arises most typically where the improved market access presumed to flow from tariff reductions by a country is undercut by subsidization in the export country.

Hence, in case of exports by beneficiaries of the PLI Schemes, if such exports become subject to a countervailing duty investigation in the importing country, or if such exports cause serious prejudice, there is likelihood of countervailing action by other countries including levy of countervailing duties.

Needless to add, the future possibility of such countervailing action in certain cases does not impact the validity of the PLI Schemes *per se* in any manner.

Conclusion

The overall structure of the PLI Schemes indicate the linkage to incremental investment and production and are not contingent on export performance. Thus, the challenges faced by India's export schemes at the WTO appear to have been mitigated and possibility of challenges is reduced so that the overall objectives of the schemes can be continued with certainty.

However, as suggested, a formal clarification in the lines discussed above, will go a long way to shield PLI Schemes against any potential challenge at the WTO level as 'prohibited subsidies' – it is hoped that such a clarification will be issued on priority by the Government of India.