Private Participation in Indian Defence Sector: An Overview

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Scheme of Discussion

- The Linkage between Technology and Law, Defence Law and Technology
- Regulations and Kinds of Defence Regulations
- Positive and Negative aspects of Globalization and its Impact on Defence Sector
- Forces and Phases Shaping the Global and Indian Defence and Security Industries 1. New actors: 2. New technologies: 3. New Frameworks 4. New Rules and 5. New budget and funding realities
- Five Phasis of India's defence industrialisation- Quest for self-sufficiency, Self-Sufficiency to Self-Reliance, Self-Reliance through Co-production, Self-Reliance through Private Sector Participation and Self-Reliance through Make in India Initiative
- Private Sector Participation and FDIs in Indian Defence Sector
- PPP in Indian Defence Sector and Recent Initiatives of Government of India in this context.

Law and Technology

- Law follows Technology or Technological Developments Needs Law
- Technology Driven Laws including Aviation Law, Space Law, IT Law, Cyber Law and IP Law
- Relationship between law and technology has always been un easy
- Law had been slow and lethargic to respond to new technologies
- Till recently the law makers handled problems presented by technology with out break down of legal resources
- Law-makers find it difficult to address Technical issues.
- The very science and technology that invented aeroplanes considerably reducing the travel time and thereby bringing countries closer to each other, has over the years been misused bringing with it untold destruction and misery.
- Benefits of Space Technology

National Aviation Regulations

- The aims & objectives of national regulation includes:
- to serve national defence.
- **Legislative component** (making of laws, policies, rules and regulations, and these rules for granting or denying of permission etc.)
- **Organizational Component,** Ministry of Civil Aviation and various other agencies like DGCA, Air India, Indian, other private airlines and AAI provides infrastructure
- Domestic Enforcement of International Missile Control Regime:
  1. Energy Act, 1962;
  2. The Chemical Weapons Convention Act, 2000;
  3. The Environment Protection Act, 1986;
  4. The Foreign Trade (Development and Regulations) Act, 1992;
  5. The Customs Act, 1962;
  6. The Unlawful Activities (Prevention) Amendment Act, 2004
  7. The Explosives Act, 1908.
  8. WMD Act -2005

Bilateral Regulations

- Bilateral regulations are regulations undertaken jointly by two parties or most typically by two states in international civil aviation.
- The main objective of bilateral agreement is the conclusion, implementation or continuance of some kind of intergovernmental agreement or understanding concerning air services between the territories of two countries.

(1) Salt-1(STRATEGIC ARMS REDUCTION TREATY)

(2) Salt-2(STRATEGIC ARMS REDUCTION TREATY

(3) Start-1(STRATEGIC ARMS REDUCTION TREATY)

(4) Start-2 (STRATEGIC ARMS REDUCTION TREATY)

(5) SORT(STRATEGIC OFFENSIVE REDUCTIONSTREATY)

(6) TTBT (THRESHOLD TEST BAN TREATY)

Regional Regulations

- Growing Importance of Regionalism
- Regionalism and International Law
- NATO
- Warsaw Pact
- Australian Group
- Wassenaar Agreement
- The African Nuclear Weapon Free Zone Treaty
- South Pacific Freezone Treaty
- South Asia Nuclear Freezone Treaty

Global or International Regulations

- Partial Test Ban Treaty
- Outer Space Treaty
- Nuclear Non-Proliferation Treaty (NPT)
- Seabed Arms Control Treaty
- Comprehensive Test Ban Treaty (CTBT)
- Biological and Toxin Weapons Convention (BWC)
- Chemical Weapons Convention (CWC

Development of Indian Defence Industry

- Since independence, the goal of self-reliance has propelled India to nurture and expand its defence industrial base.
- In 1947, majority of the defence infrastructure and equipment in India was inherited from her erstwhile colonial ruler, Britain.
- During the 1950s, India focused on its capability to indigenously produce equipment with little technical know-how, leaving the advanced equipment requirements to be addressed through imports.
- In 1956, the revised Industrial Policy Resolution reserved the arms and ammunition industry with the public sector.
- In 1958, the ordnance factories set up under the British rule became the core group of industries that formed the Defence Research and Development Organization (DRDO).

Indian Defence Industry Cont..

- The impetus for India's defence industry arrived when the country faced drastic reverses in its conflict with China in 1962.
- This prompted India to increase her defence expenditure from 1.5% of the nation's gross domestic product (GDP) to 2.3%.
- Following India's war with Pakistan in 1965, an embargo imposed by the United States of America upon the export of arms to India heralded an era of defence ties with the Soviet Union.
- In the 1980s, India began a renewed effort to galvanize its domestic defence industry by investing largely into DRDO and development of indigenous missile systems such as *'Prithvi'*, *'Akash'* and *'Nag'*.
- India also began the development of its flagship aeronautical project, the Light Combat Aircraft during this period.
- In 1998, India entered into an agreement with the Soviet Union to develop a supersonic cruise missile system, the *'Brahmos'*, through a joint venture.

Indian Defence Industry Cont..

- Towards the onset of the 21st century, India opened its doors to liberalization and progressive economic reforms.
- The era of State-run enterprises and centrally planned economy took a back-seat and paved the way for arrival of the private sector.
- The private sector was given complete access to the defence industry.
- Introduction of the ‘Make’ type of procurement in the Defence Procurement Policy 2006 allowed the industry to develop and produce advanced defence equipment, with government commitment to provide 80% of the development costs.
- FDI of 26% was also permitted in the defence sector. However, the government continued its reliance on import of advanced weaponry, with new fighter aircraft such as the Sukhoi 30 MKI being inducted into the Air force, submarines and missile destroyers being purchased for the navy and howitzers such as the BOFORS system being purchased for the army.
- In an attempt to boost domestic procurement, the government changed the order of preference in procurement under the Defence Procurement Policy of 2013- making it a preferred choice to develop, design or manufacture defence equipment indigenously.

GLP and Its Impact on Defence and Security Governance

- Globalization is the term used to characterize the processes of growing interconnection and interdependence among the different nations of the world.
- It offers to the increased flow of trade, people, investment, technology, culture, ideas among countries and creates a more integrated and interdependent world
- components of Globalization: globalization of markets, globalization of production, globalization of financial markets, globalization of technology , globalization of HR skills
- Globalization of markets is one of the most fascinating developments of the 20th and 21st centuries. Its impact on economic transactions, processes, institutions, and players is dramatic and wide ranging. It challenges established norms and behavior and requires different mindsets

Positive and Negative Aspects of GLP

- On the positive side, it generated by growing international economic, cultural, and political cooperation and solved many global problems. Promotes intense competition among multinational corporations (MNCs) and also makes local companies to be more competitive internationally.
- On the negative side, globalization also has profound implications for states such as the autonomy and policy-making capability of states are being undermined by economic and cultural internationalization.
- Shift of sovereignty from political to economic
- Role of States have Changed from Law-maker to Law-takers
- Role of States are changing from regulator to facilitators
- Many governments see their role as not to regulate markets but to facilitate their expansion.
- Globalization and regional interactions are wiping out national borders and weakening national policies.

Forces and Phases Shaping the Global and Indian Defence and Security

- **5 Forces reshaping the global defence and Security industry**
- 1. New actors: 2. New technologies: 3. New Frameworks 4. New Rules and 5. New budget and funding realities
- **5 Phases of India's defence industrialisation**
- (1) from independence till the mid-1960s, when self-sufficiency was an overall economic principle behind India's industrial development;
- (2) from mid-1960 till the mid-1980s, when the term self-reliance replaced self-sufficiency in defence production;
- (3) from mid-1980s till the early 2000s, when the emphasis on self-reliance was through co-production;
- (4) from the mid-2000s to late 2014, when self-reliance was tried through greater participation of the Indian private sector.
- (5) With the Modi government coming to power, Make in India has become the new model.

Forces Reshaping the Global Defence and Security Industry

- **New actors:** Defence and security companies face increasingly competitive environments filled with new actors from emerging markets and adjacent industries, many applying disruptive business models to increasingly constructive effect.
- The entry of a variety of emerging market companies that maintain the flexibility to offer 'good enough' solutions, technology transfer, and favourable financing terms has been a feature of export markets for several years
- In addition, demand for defence- and security-focused solutions in the cyber/information domain, new materials, wearable/flexible electronics, unmanned systems, artificial intelligence, big data analytics, and navigation and communication technologies are driving convergence between security and defence requirements and capabilities
- Dismissing the potential effects of high-tech companies—as competitors, partners, and merger and acquisition targets—on the global defence market will leave traditional industry actors vulnerable to powerful disruptive market shifts.

Forces Reshaping the Global Defence and Security Industry

- **New technologies:** Development, proliferation, and clever use of a range of emerging technologies have the potential to rapidly transform end-user capability requirements and shatter assumptions about the types of models that will enable success for corporate activities.
- Four categories of capability revolutions stand out: perception, processing, and cognition; human and materials performance; communication, navigation, targeting, and strike; an manufacturing and logistics.
- For example, the increasing incorporation of a range of advanced manufacturing techniques— especially additive manufacturing but also augmented-reality manufacturing—and growing research in novel materials such as composites will have significant and durable implications for all AD&S industry activities.
- Moreover, investment in next-generation manufacturing technologies, like synthetic biology manufacturing and 4D printing (and the smart materials required for 4D printing) signal a longer-term, but even more disruptive, shift in industry models and the capabilities industry will be asked to develop

Forces Reshaping the Global Defence and Security Industry

- **New frameworks:** The intersection of industry drivers with broad ‘megatrends’ related to economics, geopolitics, demography, immigration, challenges to Westphalian concepts of state sovereignty, and climate change will have far-reaching implications for global defence communities and the industry that supports them.
- The unravelling of current geopolitical frameworks and evolving economic realities related to global debt, slow growth, and emerging-market ‘mid-life crises’ will be particularly affecting for the future of the global defence industry.

Forces Reshaping the Global Defence and Security Industry

- **New rules:** Managing supply chains and business resilience amid increasing regulations focused on counterfeiting, cyber security, corruption, climate change, and conflict materials will bring new risks and constraints on partner identification and could even further constrain the nature of the markets to which companies can sell.
- In addition, innovation in defence and security products and services will require (indeed, stimulate) new laws and regulations to assuage legal, safety, security, business, infrastructure, and ethical concerns; think of ongoing legal, ethical, and security discussions related to technology areas such as human performance enhancement, autonomous strike, armed drones, near ubiquitous sensors and surveillance, and big data analytics technologies.

Forces Reshaping the Global Defence and Security Industry

- **New budget and funding realities**: The current environment of constrained procurement budgets will be matched by enduring spending crunches in research, development, testing, and evaluation (RDT&E) budgets across several regions later in this decade.
- The global defence industry is experiencing several enduring and intersecting technological, competitive, and market transitions that will impact both immediate and distant opportunities and risks.
- Cultivating new mindsets and perspectives through scenario planning will be critical to ensuring the agility and resilience necessary to navigate unsettled environments and a growing collection of risks and opportunities.

Indian Defence Industrialisation Phases

- India's defence industrialisation can be divided into five different phases:
- (1) from independence till the mid-1960s, when self-sufficiency was an overall economic principle behind India's industrial development;
- (2) from mid-1960 till the mid-1980s, when the term self-reliance replaced self-sufficiency in defence production;
- (3) from mid-1980s till the early 2000s, when the emphasis on self-reliance was through co-production;
- (4) from the mid-2000s to late 2014, when self-reliance was tried through greater participation of the Indian private sector.
- (5) With the Modi government coming to power, Make in India has become the new model.

Phase 1. The Quest for Self-Sufficient

- India's defence industrialisation immediately after independence was influenced by the country's socialistic and centralised planning system reflected in the first Industrial Policy Resolution adopted in 1948.
- The resolution emphasised the importance to the economy of securing a continuous increase in production and its equitable distribution, and pointed out that the State must play an active role in the development of industries.
- The resolution, which was revised in 1956, reserved the key industries – including arms and ammunition, railways, air transport and atomic energy – in the domain of the public sector and the State assumed the exclusive right for their development.
- The quest for self-sufficiency got a further push by the 1954 US-Pakistan strategic partnership and the border tension with China which became intense in the late 1950s. In 1954 Bharat Electronics Ltd (BEL) was set up with French assistance. The government also acquired two shipyards – Mazagon Dock Ltd and Garden Reach Shipyard – and placed them under the control of MoD with the intention of undertaking naval construction.

Phase 2. Self-Sufficiency to Self-Reliance

- The events of the 1960s, particularly the 1962 war with China and the India- Pakistan war of 1965 brought about a major change in India's defence policy. Not only India's defence budget as percentage of GDP increased in the subsequent years but also the approach towards arms procurement policy and indigenous defence production changed.
- On its part, given the Cold War politics, the Soviet Union was willing to provid arms and assistance to India on terms which were considered favourable to New Delhi.
- A major beginning of this close cooperation was made with the MiG-21 aircraft (signed in October 1962), which paved the way for the aircraft's licence manufacture by HAL. By 1980, roughly 70 per cent of Indian military hardware was of Soviet origin
- In this phase of India's defence industrialisation, the focus was more on licence production rather than on indigenous production. Apart from MiG- 21, a number of other programmes were taken up for licence production, including tanks, destroyers, etc.
- By the end of the Cold War, India was overwhelmingly dependent on the Soviet Union: 100 per cent for ground air defence, 75 per cent for fighter aircraft defence, 60 per cent for ground attack aircraft, 100 per cent for tracked armoured vehicles, 80 per cent for tanks, 100 per cent for guided missile destroyers, 95 per cent for conventional submarines and 70 per cent for frigates

Phase 3. Self-Reliance through Co-production

- Beginning with the mid-1980s, the government pumped up resources on R&D to enable DRDO to undertake high-profile projects. A major beginning in this respect was made in 1983 when the government sanctioned the Integrated Guided Missile Development Programme (IGMDP) at the initial cost of Rs 388.83 crore to develop four missile systems – Prithvi (surface-to-surface), Akash (surface-to-air), Trishul (naval version of Prithvi) and Nag (anti-tank) – and a Technology Demonstrator, Agni.
- In the same year, the government also sanctioned the Light Combat Aircraft (LCA) at a cost of Rs 560 crore to develop an indigenous fighter aircraft.
- The indigenous efforts were however not adequate to meet the growing requirements of the armed forces. This forced the government to look for alternatives from external sources
- Apart from Russia, India has also signed joint developmental programmes with Israel, which has become one of the top suppliers of arms to India. Cementing the growing defence trade between Tel Aviv and New Delhi,

Phase 4. Self-Reliance through Private Sector Participation

- While co-development/co-production remains a distinct feature of India's defence industrialisation process since the late 1990s, the approach towards self-reliance has taken a major turn since the early 2000s, when the government decided to allow 100 per cent participation of the private sector in defence production. However, the liberalisation process has been a long-drawn-out process, dating back to the constitution of six task forces in 1998 to explore the question
- Consequent to their recommendations, the government finally opened the defence industry in 2001 to the private sector, with the further provision of foreign direct investment (FDI) of up to 26 per cent.
- This did not however mean an easy access to defence contracts as MoD's Defence Procurement Procedure (DPP) – which stipulates detailed rules and procedures for capital procurement and the source of procurement– did not have enough provisions to facilitate private companies' participation in defence contracts.
- In order to create such provisions, successive DPPs have included a host of enabling provisions that include an offset clause, two new procurement categories – Make and Buy and Make (Indian) – and a host of other measures

Phase 5. Self-Reliance through Make in India Initiative

- The Make in India initiative is not restricted to the defence industry; it covers 25 diverse sectors and constitutes a part of the Modi government's larger economic plan to propel the share of manufacturing in GDP to 25 per cent (from 16 per cent at present) and create 100 million additional jobs by 2022
- Also, the model is not very different from the previous model: both of them focus on achieving the same broad goal of self-reliance in defence manufacturing through greater participation of the private sector
- The new model reposes a great deal of trust with the private sector. More importantly, to facilitate private sector participation the government has brought in a host of 'ease of doing business' measures, besides bringing in an element of decisiveness in decision making
- the Modi government has already taken several broad reform measures pertaining to the defence industry. These pertain to industrial licensing, FDI cap, defence exports and level playing field between private and public sectors.
- The reform in licensing which came in the form of a series of government notifications issued between 26 June 2014 and 22 September 201540 is an attempt to codify and simplify the process of granting industrial licence (IL) and remove procedural hurdles and other complexities in the process..

Private Sector and Defence Industry

- **Introduction:** It is estimated that India's defence sector requires $130-150 billion for modernization and restructuring in order to become self-reliant in the coming decade.
- The recent Strategic Partnership policy for defence production is aimed at increasing private sector participation in defence manufacturing in India.
- Private sector needs a level playing field.
- FDI liberalisation, slashing of red tape and tax incentives can make a difference.
- **Benefits of private sector:** It would bring in competitiveness resulting in lesser costs, better quality equipment and adherenc to laid down delivery schedules.
- Enhancement of indigenous production capacity
- Generation of additional jobs and employment opportunities within the country.
- Impetus would be given to the field of research in defence equipment sector indigenously.
- Set up joint ventures with overseas equipment manufacturers, negotiate technology transfers and find new export markets.

Private Sector in Defence Production Cont..

- **What drags private sector:** Risk on returns due to the rigorous checks in the sector, stringent policy framework, and scarcity of resources and skilled manpower.
- Lack of economies of scale in production and long gestation periods.
- Private sector feel that they are alienated, thereby resulting in a lack of a level playing field vis-à-vis the public sector
- Infrastructure, investments, technology collaborations, facilitated by the government for the public sector.
- **Concerns / Challenges:** The private sector has not shown any success from research and development, technological advancements and collaborations in the defence sector.
- Private sectors in India are not keeping pace with other countries.
- The defence sector is governed by varied policies including industrial licensing, import, export, security manuals, tax regulation and procurement policies.
- Superfluous controls and restrictions and unclear legal framework severely affect the efficiency and productivity.
- The multiplicity of approvals and bureaucratic delays in obtaining the approvals act as a deterrent to the inflow of foreign investment

Private Sector in Defence Production Cont..

- **Recommendations: FDI liberalisation**
- a. This can boost an inflow of technology and subsequent export of defence products manufactured domestically.
- b. Having the right checks and balances in place to regulate the environment and end use of the outputs.
- c. Indian subsidiaries of foreign companies should also be given an equal platform vis-a-vis Indian public and private undertakings.
- d. India can benefit from the advanced technical know-how and manufacturing capabilities of the foreign investors.
- **Simplification of policy**
- a. All the policies should be harmonised and synchronised to a single window clearance mechanism so that operational time frame is reduced.
- b. This would boost the ease of doing business campaign of the government for the defence sector.

Private Sector in Defence Production Cont..

- **Tax incentives:** a. The Government may consider giving the sector an infrastructure status wherein they could enjoy 100 per cent of profits for a stipulated number of years.
- b. Cutting down the duties on import of capital equipment and manufacturing defence products in the country
- c. This would help to manufacture better priced and quality products for domestic use and exports.
- d. Foreign collaboration wherever needed to strengthen Indian defence players.
- e. India's future in defence manufacturing is very promising and in sync with the Make in India initiative.
- F. It is a matter of proactive management of the current and potential resources and a supportive push from financial and regulatory stand point.

FDI in Defence Sector

- What is the concept of FDI? What are the likely implications of enhanced FDI in Defence Sector on India's stated aim to achieve self-reliance and indigenisation in defence?
- The concept of FDI is closely linked with the concept of Globalisation and is primarily based on want/ requirement of foreign capital by an enterprise that is resident in the economy of the host nation.
- The Defence Sector in India, being a strategic sector, was traditionally reserved for the Public Sector till 1991.
- Defence Public Sector Undertakings (Defence PSUs) and Ordnance Factory Board (OFB) monopolised defence products manufacturing while Research & Development (R&D) was the exclusive ly with of DRDO.
- The concept of FDI in general was introduced in India in 1991 with the opening of the Indian economy.
- Certain factors which are likely to impact foreign investors' decisions include availability of a highly lucrative market, adequate and cheap raw material, reasonably developed infrastructure, trained workforce, low production cost and ease of doing business. The interplay of these factors greatly influences potential foreign vendors' investment decisions

Evolution of FDI in Indian Defence Sector

- **The defence industry in India was thrown open to the private sector in May 2001** (Press Note 4 of 2001 Series) when the government permitted 100 percent equity with a maximum of 26 percent FDI component, both subject to licensing. This was because (i) development of indigenous defence manufacturing base has both economic and strategic objectives and (ii) involving FDI has security implications also
- Subsequently, the Department of Industrial Policy and Promotion (DIPP) issued detailed guidelines, after consultations with the Ministry of Defence (MoD), for the issuance of licence for the production of arms and ammunition in January 2002 (Press Note 2 of 2002 Series)
- However, **the policy of 26 percent cap on FDI has failed to attract any substantive FDI in the defence sector**, with only approximately Rs 70 lakh flowing in as FDI between 2001 and 2009.
- There have been frequent calls by various industry bodies like the ASSOCHAM in 2008 and CII in 2010 to raise the FDI cap from 26 percent to 49 percent.
- In December 2008, the Parliamentary Standing Committee on Defence has also asked the government to consider enhancing the FDI cap to 49 percent

The Need for more Foreign Investment

- **Greater FDI inflow in defence sector provides substantive economic advantages.**
- Other than the increased flow of funds from a foreign source, greater FDI leads to more employment opportunities for the local population.
- It also means that taxes and other revenues will flow back to the local economy. The cap is an inhibiting factor towards the entry of foreign firms into the Indian defence market.
- Few foreign firms are keen to invest resources in a venture where they have no significant control, strict capacity/product constraints, no purchase guarantees, no open access to other markets (including exports) and an unfair advantage to the local public sector.
- Moreover **when MoD is already buying directly from foreign suppliers there is no incentive for the foreign firm to create a 26 percent-owned company in this country.**

FDI Cont..

- Post detailed discussions with all stakeholders DIPP/ MoC&I reviewed the FDI Policy in Defence Sector, in August 2014 and raised the limit up to 49% through Government (Foreign Investment Promotion Board or FIPB) route and above 49% through CCS, on case-to-case basis.
- It was amplified in the policy that whenever it is likely to result in access to modern and “state-of-the-art” technology in the country, up to 100% foreign ownership will be allowed.
- DIPP/MoC&I issued a consolidated FDI Policy, effective from May 12, 2015, in which the percentage of Equity/FDI cap through Government route was reiterated up to 49% and above 49% with approval of CCS.
- The portfolio investment was not permitted to exceed 24% of the total equity of the investee for JV Company. Portfolio investments were permitted under automatic route.
- Post numerous detailed and comprehensive discussions with all stakeholders, the Goverment formulated and issued a revised “Consolidated FDI Policy” effective from 07 Jun 2016.
- The FDI policy in Defence Sector is subject to industrial licensing under the Industries Development and Regulation (IDR) Act, 1951

FDI Cont…

- **FDI: Methods and Classification**
- **Methods.** FDI is feasible in various sectors in different methods as under:
- Joint ventures
- Financial collaborations
- Private equity or preferential allotment
- Capital markets.
- **Classifications.** : **Classification I**
- Inward FDI: Investment made by other countries in the domestic country.
- Outward FDI: Investment made by domestic country in other countries.
- l **Classification II**
- Horizontal FDI: Horizontal FDI arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.
- Vertical FDI: Vertical FDI arises when a firm moves upstream or downstream in different value chains through FDI

Advantages of FDI in Defence

- **Transparency.** Reduced imports are likely to lead to greater transparency with a diminishing role for middlemen.
- **Quality Products.** Infrastructure facilities are likely to improve due to higher capital infusion. Manufacture of improved quality products due to inflow of technology, expertise and better production facilities
- **Reduction of Reserves.** Higher FDI translates into better infrastructure, enhanced capacities and greater self-reliance.
- **Boost to Economy.** The capital base of the country will be positively affected due to inflow of foreign capital. The FDI will spur the GDP growth and boost the economy
- **Positive Performance Pressure on Public Sector Enterprises.** The public sector enterprises, namely, Defence Research and Development Organisation (DRDO), Defence PSUs and OFB will face increased performance pressure.
- **Employment Opportunities.** The FDI creates employment opportunities, both in organised and un-organised sector, for large number of unemployed people due to increased level of economic activity.
- **Increase in International Trade.** Increase in international trade, both by value and volume, due to enhanced production capacity and export-oriented outlook

Disadvantages of FDI

- **Security Concerns.** Security issues especially with respect to proliferation of modern communication equipment, electronic counter/counter-counter measure equipment and small arms may arise. In addition, in India which has significant internal security issues to include Naxal violence and terrorism, permitting enhanced FDI for all items in the Defence Products List20 has a fair potential to give negative results.
- **Competition for Domestic Private Industry.** It needs to be considered that the Indian Private Industry is not yet well established in the Defence Sector.
- **Overbearing Presence of Foreign Companies.** Unrestricted FDI in Defence Sector may lead to overbearing presence or a kind of monopoly in production of high technology weapons and equipment by select foreign companies in the absence of majority stake holding by Indian citizens and/or lack of adequate control by the Indian Government. This would not be a desirable state.
- **Sharing of Benefits.** Foreign investors may tend to utilise the domestic resources without sharing adequate benefits with the host country.
- **Emergence of Cartels and Lobbies.** There is a likelihood of the emergence of cartels and lobbies which collude to raise defence expenditure or garner greater share of the defence procurement pie.

National PPP Policy 2011 of India

- The Government of India envisions a substantive role for PPPs aimed at employing private sector investment and operational efficiencies in the provision of public services. The National PPP Policy Draft for consultation (2011) lays out the principles for implementing a larger number of projects across diverse sectors.
- The policy defines PPPs, elaborates on principles governing implementation of PPP and describes the PPP process. It also brings out the enabling frameworks and the institutional and governance mechanisms required for implementation
- The definition of the PPP model as provided by the Government of India in the National PPP Policy is as follows:
- Public Private Partnership means an arrangement between a government/statutory entity/government owned entity on one side and a private sector entity on the other, for the provision of public assets and/or public services, through investments being made and/ or management being undertaken by the private sector entity, for a specified period of time, where there is well defined allocation of risk between the private sector and the public entity and the private entity receives performance linked payments that conform (or are benchmarked) to specified and pre-determined performance standards, measurable by the public entity or its representative.

National PPP Policy Cont..

- **The desirable conditions or good practices for a PPP are as follows:**
- Allocation of risks in an optimal manner to the party best suited to manage the risks.
- Private sector entity receives cash flows for their investments in and/or management of the PPP either through a performance linked fee payment structure from the government entity and/or through user charges from the consumers of the service provided.
- Generally a long-term arrangement between the parties but can be of shorter term dependent, for instance, on the sector or focus of the PPP.
- Incentive and penalty-based structures in the arrangement so as to ensure that the private sector is benchmarked against service delivery.
- Room for innovation and technology transfer in project execution implementation by the private sector entity.

PPP in Defence Industry

- Public-private partnerships are arrangements under which the private sector supplies goods or services which were traditionally provided by the governments.
- The Government of India has already put in place broad guidelines regarding PPP, and these have been implemented extensively in the infrastructure sector in India.
- Public–private partnership between the Indian public sector undertakings (PSUs), ordnance factories (OFs), agencies of defence forces and private sector companies will enhance the capabilities
- The rationale and motivation behind focusing on PPP in the defence sector is the potential of PPP-based arrangements to address systemic problems, such as foreign dependency for defence equipment and insufficient integration of private sector for provisioning of defence goods and services, and other structural constraints in India's ability to provide sustenanc in Indian defence sector

PPP in Defence Industry Cont..

- PPP models in defence provide a strong impetus for technological innovation and industrial deepening for domestic private manufacturing.
- Implementation of PPP models contribute to the evolution of a domestic ‘techno-industrial’ capability for the production of defence equipment and services.
- Moreover, PPP contracts enable the government to acquire management and technological capabilities often locked into the private sector.
- PPP arrangements benefit not only the government but also offer distinct advantages to the private sector, leading to win-win situations with mutual benefit for all participants.
- The private sector stands to benefit from the significant pool of built-up assets of the government that is already in existence.

PPP in Defence Industry Cont..

- Since the effectiveness of the armed forces depends on the timely availability of equipment, arms and ammunition, and their maintenance in battleworthy condition, the sustainment management system (SMS) for military equipment is a key determinant of the combat power of an army.
- The various weapons and equipment, such as tanks, guns, aircraft, launch vehicles and other end items, require regular ‘maintenance, repair and overhaul’ to ensure their combat readiness, so as to enable the defence forces to operate efficiently and cost-effectively.
- Allowing private sector access to the existing resources of the government can contribute to profitability and enhancement of capacity of the private sector, and this is especially relevant in th MRO sector.
- PPP through financial investment, talent sharing, management skill transfer and provision of additional resources—can be pressed into service for furthering the national security of the country.

PPP in Defence Industry Cont..

- India is preceded by many other advanced nations who have consistently and progressively augmented the role of the private sector in the defence domain through PPPs, notably the US, the United Kingdom (UK), France, Australia and others
- PPPs can offer diverse advantages, such as the reduction of capital investments, creation of new capabilities and early influence of new technologies, all of which can allow the armed forces to more exclusively focus on their core missions.
- The PPP model for defence has many clear advantages, and the benefits of such a modern acquisition model are well documented.
- The concept of prioritisation and category preference was introduced in 2013, with higher preference given to 'Buy (Indian)', 'Buy & Make (Indian)', and 'Make' categorisation as brought out in the foreword of DPP 2013 by the Raksha Mantri
- The 2016 policy further introduced a new category, the 'Buy (Indian-IDDM)', with the objective of promoting indigenous design, development and manufacturing.11 This will also have a bearing on the sustainment of equipment through the indigenous route

Defence Procurement Procedure 2016

- Until 2014, dearth of focus and funding for research and development (R&D) in the public sector, coupled with absence of an enabling eco-system for flourishing of foreign direct investment (FDI) and the private sector, prevented India from building its defence capabilities.
- However, the years since 2014 have witnessed a tectonic shift in the defence plateau. The industry has witnessed a powerful influx of progressive reforms. Policy initiatives have been adopted to ensure efficacious procurement, ease of business and lower entry barriers.
- On March 28, 2016, the Defence Procurement Procedure 2016 (DPP 2016) was introduced with substantial amendment to DPP 2013, to provide for efficient and expedited procurement of defence technology and equipment, large incentives to the private sector - promising transparency and probity to the process.
- It aims to promote the 'Make in India' initiative by fostering growth of the domestic defence industry, and introduces the Buy (Indian-IDDM) and Buy and Make (Indian) categories of procurement.

Recent Developments in Defence Technology

- Towards the onset of the 21st century, India opened its doors to liberalization and progressive economic reforms.
- The era of State-run enterprises and centrally planned economy took a back-seat and paved the way for arrival of the private sector.
- The private sector was given complete access to the defence industry.
- Introduction of the 'Make' type of procurement in the Defence Procurement Policy 2006 allowed the industry to develop and produce advanced defence equipment, with government commitment to provide 80% of the development costs.
- FDI of 49% was also permitted in the defence sector. However, the government continued its reliance on import of advanced weaponry, with new fighter aircraft such as the Sukhoi 30 MKI being inducted into the Air force, submarines and missile destroyers being purchased for the navy and howitzers such as the BOFORS system being purchased for the army.
- In an attempt to boost domestic procurement, the government changed the order of preference in procurement under the Defence Procurement Policy of 2013- making it a preferred choice to develop, design or manufacture defence equipment indigenously.

International involvement in India

- The Indian Defense sector has established its presence worldwide by a continuous progressive escalation and showing tremendous progress in infrastructural development in the area of nuclear and rocket technology. India is the largest importer of arms in the world with the amount going as high as 60% of its requirements
- Various global defence companies have increased their investments into India. There have been various joint-venture announcements in the sector in the last two years. Major A&D companies such as, Airbus, Boeing, Lockheed Martin, and Safran already have a footprint in the Indian market, with some of them planning further investments.
- For instance, Airbus announced a joint-venture with Mahindra Defence Systems last year to manufacture helicopters for the Indian military.
- Similarly, Boeing entered into a joint-venture with Tata Advanced Systems in December 2015, wherein they will manufacture fuselages of *Apache* Helicopters in India
- One of the largest defence contracts in history is the Medium Range Multi-Role Combat Aircraft deal with the French manufacturer *Dassault* for 36 *Rafale* fighter jets

Issues and Challenges

- India’s pace of defence modernisation has been slow because of a number of inherent holes in the system, such as the lack of a National Security Strategy doctrine, or a long-term strategic defence plan, which are impediments in terms of evolving a clear-cut strategy to meet the defence requirements of the Armed Forces by making a thorough analysis of the security challenges in the immediate regional security environment.
- Moreover, India’s inability to produce advanced, sophisticated weapons systems and advanced defence technologies indigenously has severely affected its aspirations of becoming self-reliant in defence production, thereby remaining heavily dependent on foreign sellers for defence purchases, which in a way or other, do expose India’s vulnerabilities
- India’s indigenous defence production capabilities have, however, not grown because of a number of challenges.
- There is a lack of the greater political will that has severely affected decision-making in terms of acquiring weapons on time as per the needs of the Armed Forces.

Issues and Challenges

- The Indian defence industry suffers because of under-utilisation of human resources that has negatively affected India's defence R&D base.
- Because of the unfriendly defence industrial procurement system, it has resulted in few co-development and co-production ventures with foreign firms.
- The lack of a conducive financial framework for the local industry to do business in the defence sector, especially for the private sector, has also negatively impacted private participation in the defence sector.
- Therefore, the urgent focus for the Indian government should be to encourage private individuals and entities in India that could contribute in indigenous defence production.
- This would mean that India would achieve its goal of self-reliance only if it allows more private players in India to participate in the defence sector, and the true potential of the Indian minds are utilized.
- However, Government of India has taken a number of measures to increase the participation of Indian companies in the Defence Sector. From liberalizing the licencing regime to making remarkable changes in the Defence Procurement Procedures.

Recent Govt. Initiatives

- Presently, India is one of the largest importers of conventional defence equipment. According to government statistics, roughly 60% of India's defence requirements are met through imports.
- India has the potential to emerge as a global platform for defence research, manufacturing, supply chain sourcing, software development, and offsets, which will strengthen our defence capabilities and spur industrial development as well as exports in this sector.
- Government is also carrying out reforms in defence procurement to increase efficiency, invite foreign players with excellent capabilities and encourage domestic industry. It has introduced policies to strengthen technology transfer, including liberalized FDI in defence production.
- Also, Make in India the new flagship program of Government of India has put a renewed emphasis on creating a conducive policy environment for improving domestic defence manufacturing
- This will also further India's objective to create jobs, catalyze technology development, and transform India into a self-reliant nation with export capabilities in defence sector. India's existing wealth of talent, technology and cost advantages together can help make defence products globally competitive

Recent Govt. Initiatives

- The private sector is expected to assume a bigger role in transforming the "Make in India" vision into reality.
- To this end, several initiatives have been taken - FDI norms have been relaxed; the list of items to be manufactured under industrial licences has been substantially revised; the industrial licensing process has been streamlined and the licence validity extended; and exchange rate variation protection has been made applicable to the Indian private sector at par with PSUs.
- The new Defence Procurement Procedure (DPP) 2016 also focuses on achieving self-reliance in design, development and manufacturing
- A new procurement category –indigenously designed, developed and manufactured (IDDM) - has been introduced.
- The offset policy has been relaxed to encourage engagement from foreign OEMs and the export regulations have been simplified

What Further We Need to Do?

- However, the government and the industry would together have to iron out several issues such as inadequate investments in innovation and R&D, bureaucratic delays in procurement, a limited vendor base, non-conformity of the offers with request for proposal (RfP) conditions, long field trials, complexities in contract negotiations, and long lead times for indigenisation, to achieve a faster turnaround of capital acquisition projects
- Further Indian Private Industry including Larsen and Toubro, Ashok Leyland, Mahindra and Mahindra, Reliance Infra, Tata group, Adani Group etc., should be involved in defence manufacturing to produce military platforms like fighter jets and submarines in India.
- This kind of discussions government can boast the private participation under Make in India framework and create domestic expertise in key areas, specifically, fighter aircraft, helicopters, submarines, and armored vehicles & main battle tanks.

Thank You