

OVERVIEW OF DEFENCE CONTRACTS

Lecture - 1

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DEFENCE SERVICES: EXPENDITURE

TRENDS

(Rs. in Cr.)

Category	2017-18	2018-19(BE)	2019-20(RE)	2020-21(BE)
Revenue	1.72L	2.02L	2.15L	2.19L
Capital	.95	.99	1.15	1.18
Pension	.92	1.01	1.17	1.33
Total	3.79	4.03	4.48	4.71
% of Govt Expenditure	17.7	17.4	16.6	15.5
% of GDP	2.23	2.16	2.18	2.1

Source: General Budget

TRENDS IN MILITARY EXPENDITURE

Country	Spending (\$B)	% of GDP
USA	649	3.2
China	250	1.9
Saudi Arabia	67.6	8.8
India	66.5	2.1
Russia	61.4	3.9
Total	1822	2.1

Source: SIPRI Year Book 2019

TREND OF DEFENCE BUDGET

Rs. Crore

Category	2017-18	2018-19	2019-2020
Total	379702	405194	431011
Stores	42464 (11%)	42657 (10.5%)	45310 (10.5%)
Capital Outlay	90438 (24%)	93982 (23%)	103394 (24%)

- 2.1% of GDP and 15.3% of CGE
- Second highest importer of commercial arms
- 30% Self Reliance Index (Propulsion, Weapons, & Sensors)

GLOBAL TRENDS

- Total Military spending \$1822B, USA \$670B, Europe \$364B

MAIN EXPORTERS AND IMPORTERS

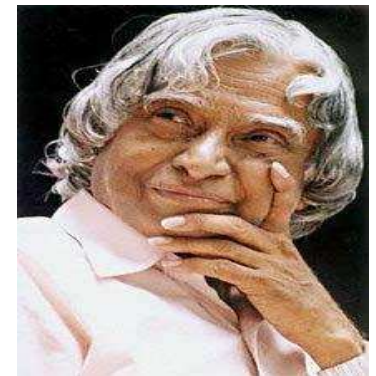
Exporter	Share	Importer	Share
1. USA	34	1. South Africa	12
2. Russia	22	2. India	9.5
3. France	6.7	3. Egypt	5.1
4. Germany	5.8	4. Australia	4.6
5. China	5.7	5. Algeria	4.4
6. UK	4.8	6. China	4.2

Source: SIPRI Year Book

SELF RELIANCE AS A STRATEGY

SRI COMMITTEE (1993)

- **Rapidly Changing Future War Scenario**
- **Its Mounting Technological Imperative**
- **Aggregate National Strength for Defence Preparedness**
- **Technology Imperatives**
 - **Intelligent EW**
 - **ASW**
 - **ABM**
 - **Long Range Defence Against High Density Air Attack**
 - **Satellite Based Intelligence and Communication**



SELF RELIANCE INDEX

- **A High Degree of Self Reliance in Small Arms, Ammⁿ. Bombs**
- **SRI – 0.3 (93) - 0.7 (2005)**
 - **Total Transfer of Technology by end of 9th Plan**
 - **Aircraft, Missiles, Tanks**
- **Strategy**
 - **Invest in Critical Technology**
 - **Pool Indigenous Technology Expertise**
 - **Mission Mode Organization Structure**
 - **Standing Inter-Services Board**

CRUCIAL TECHNOLOGIES TO BE DEVELOPED

- **Gallium Arsenide Devices**
- **Smart Weapons**
- **Fibre Optics**
- **Heavy Particle Beam**
- **Stealth**
- **Carbon Fibres**
- **Focal Plane Array**
- **Seeker Technology**



TRENDS IN GLOBAL DEFENSE **MANUFACTURING**

- **Defence is a Merit Good**
- **Oligopolistic, Monopsony**
- **Defence Budget in Real Terms**
Decreased (2.5%) per annum (DCs)
- **Equipment Cost has Increased by 10% in Real Terms**
- **Trend Towards PPP**
- **Comparative Advantage of Specialization**
- **Economies of Scale**
- **Competitive Tendering Decrease Cost by 5% - 40%**
- **Military Malthusiasm: Inflation in Defence Products**
higher than Civil Products: Mil Specs Vs COTS

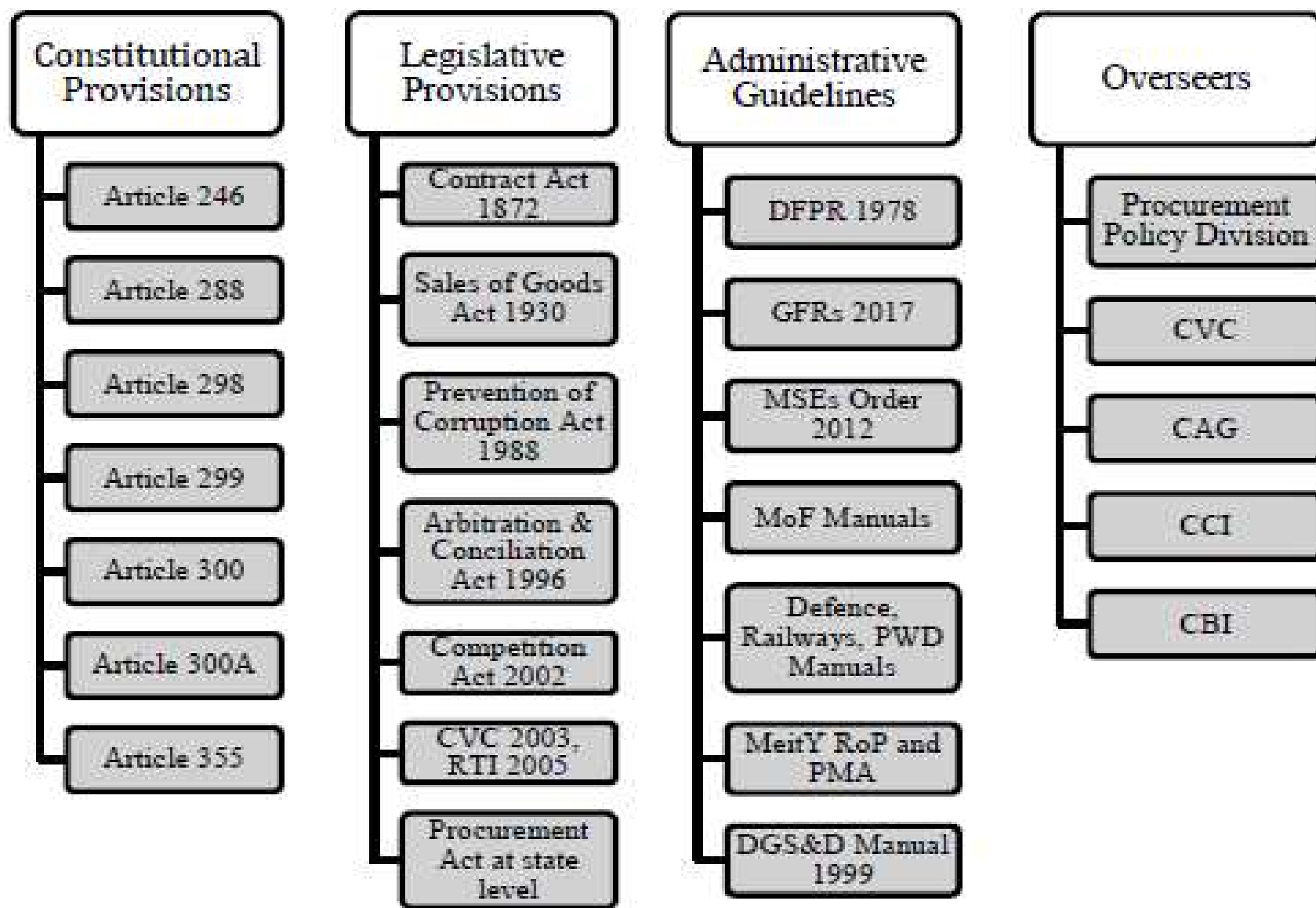


Prof. Keith Hartley : Father of Defence Economics

IMPORTANT POLICY DOCUMENTS

- **Liberalization in 2001:100% Participation of Private Sector, 26% FDI**
- **Kelkar Committee 2005 : PPP**
- **Defence Production Policy 2011: Indigenization**
- **National Manufacturing Policy 2011: India as Manufacturing Hub**
- **Joint Venture Guidelines 2012**
- **Offset Guidelines 2012 : In Sync with Global Practices**
- **Subramaniam Committee Report 1964 : (OEM Indian Industry Collaboration)**
- **Sisodia Committee(2009): DGA structure for India**
- **RamaRao Committee(2009): DRDO & Services, R&D as Part of Production agency: LCA, MBT**
- **Dhirendra Singh Committee(2015):SP Model**

Figure 1: Public Procurement Framework in India



PROVISION IN THE CONSTITUTION

- Article 298: Executive Power of Union and State make contract
- Article 299: Contracts in the name of the President and executed by authorised persons
- Article 399(2): No Personal Liability
- Article 300: Government of India may sue or be sued
- Article 246: Parliament has exclusive power to make laws as per Union List (Schedule 7)

OVERSIGHT AGENCIES

- CVC, CCI, CBI
- DPP, DPM (Defence)
- Competition Act (2000): Rigging, Collusive Bidding, Cartelisation
- Right to Information Act 2005
- Integrity Pact
- Prevention of Corruption Act (1988) & Prevention of Money Laundering Act 2002

CONTRACT ACT: 1872

Essential elements for a valid contract

- Agreement: Offer to be definite, meaningful and duly communicated
- Acceptance to be absolute, unconditional and duly communicated
- Legitimate Consideration: Section 23
- Capacity of parties: Minor, mentally unsound, disqualified (S11)
- Free Consent, Coercion, Undue Influence, Fraud, Misrepresentation (S20)
- Lawful Object
- Contract to be Written
- Assignment and Contingent contract

IMPORTANT POLICY DOCUMENTS

- **Arun Singh Committee Report 1986 : (Higher Delegation to Services)**
- **Nair Committee 1988 : Corporatization of OFs**
- **Rama Rao Committee Report 2009 : Closer Association of Services with DRDO Programs**
- **Sisodia Committee Report 2010 : Replicating DGA Setup**
- **Naresh Chandra Committee 2012 : Higher Delegation**
- **K. Subramaniam Committee Report (2001) : Integrated Decision Making**

PROCUREMENT OF GOODS AND SERVICES

- Government e-market place (GeM): For common use goods and services
- Reasonability analysis by using Business Analytics Tools (LPR)
- No splitting to avoid going to higher CFA
- Enlistment of India agent
- Reserved items: KVIC, ACASH
- MSME: Encourage
- No quotation upto Rs.25000/-
- 25000 – 2 lakh by Purchase Committee

CONTENTS OF BIDDING DOCUMENT

1. Instruction to Bidders
2. Condition of Contract
3. Schedule of Requirement
4. Specialisation and Technical Details
5. Price Schedule
 - Bid security: EMD except MSMEs
 - Performance Security: Successful bidder 5-10% of value of contract, DD or FDR
 - Valid for a period of 60 days beyond completion of all contractual obligation
 - Advance payment: $\leq 30\%$

PROCUREMENT OF GOODS AND SERVICES

- Publication of TF on CPPP
- National Security Items exempt for e-publication
- LTF: Upto 25 lakh to all regard suppliers, >3 firms
- Unsolicited offers should not be accepted
- Beyond 25 lakh: Demand is urgent, not possible to go for advertised term
- Sources of supply are definitely known
- Two bid system: High value P& M, complex & technical nature bids with commercial
- Technical bids, financial bid indicating items wise price
- Technical bids first
- Financial bids of these technically acceptable

TRANSPARENCY, COMPETITION, FAIRNESS AND ELIMINATE OF ARBITRARINESS

- Text of bidding DOC: Self contained and unambitious
- Prior turnover and prior experience to be relaxed for start ups
- Description and spec(s), quality, time and place of delivery
- Criteria for eligibility and minimum experience, technical capability, manufacturing facility and financial position
- Criteria for evaluation of bids
- Essential terms of procurement contract
- Provision for settlement of disputes
- Bids to be opened in public

GENERAL FINANCIAL RULES, 2017

Standards of Financial Propriety

- Same vigilance as a person of ordinary prudence for his own money
- Not more than occasion demand
- No exercise of power to directly/indirectly benefit
- Not for benefit to a particular person or section of people

GENERAL PRINCIPLES OF CONTRACT:

RULE 225

- Terms must be precise, definitive without any ambiguities
- Terms should not involve an uncertain or indefinite liability, except in case of Cost Plus contract or where there is price variation clause
- Standard forms of contract should be adopted
- Modification with financial and legal advice
- If not standard form, obtain legal and financial advice
- Cost plus contract to be ordinarily avoided
- Price variation clause in long term contract, beyond 18 months
- Base year price, Government indices

PRICE VARIATION CLAUSE: APP II

(GFR)

$$P_1 = P_0 [F + \alpha [M_1/m_0] + \beta [L_1/L_0] - P_0]$$

- Estimating
- P_0 = Contract price at base lend
- F = Fixed element not subjective to PV (10-25%)
- A = Material component
- B = Labour component
- L_0 , L_1 , Wage indices, M_0 & M_1 - Material Indices

PUBLIC PROCUREMENT BILL: 2012

- Efficiency, Economy, Transparency
- Fair & equitable treatment to bidders
- Promote competition
- L_1 is reasonable and consistent with quality required
- Mechanism to root out corrupt practices
- Integrity pact

Code of Integrity

- Prohibition of making offers, solicitation
- Disclosure of conflict of interest
- Collusion, bid rigging and anti-competition behaviour
- Contact public procurement portal
- Grievance redressal mechanism
- Public procurement bill 2015: Drops provision of Transactions above Rs.50 Lakh

PUBLIC PROCUREMENT (MAKE IN INDIA) ORDER 2017

- Increase local content through partnership, JVs
- Purchase preference: ≤ 50 lakh (local supplier)
- ≥ 50 lakh: Local supplier to match L_1
- Minimum local content 50%
- Verification of local content: Self certification
- > 10 crore: Certification from statutory auditor/
cost auditor
- False declaration will be a breach of code of
integrity
- WTO (TRIM)

Ease Of Doing Business: India

Parameters	India	China	New Zealand
Starting a business	17	9	0.5
Registering Property	49	9	3.5
Paying Taxes	250 hrs	138 hrs	140 hrs
Enforcing Contract	1445	496	216
