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A Flawed Defence Procurement Policy

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(The editorial is based on the article “A flawed defence procurement policy” which appeared in LiveMint on 18th October 2018. It analyses the defence procurement policy of India.)

Post-independence defence procurement in India was heavily influenced by an ideological preference for public sector and high dependence on a single foreign exporter (the USSR). Technology transfer was limited, domestic capacity was often confined to integration of systems under licensing. But, after the end of the Cold War and especially after the Economic Liberalization of India (1991), the expansion of diplomatic and military relations with multiple countries led to complex multi-vendor negotiations for defence products. Focus also gradually shifted to increasing domestic quality and capacity building and (with foreign partners) for joint research, development and co-production.

Defence procurement has always been a messy business in India. Some of the famous scams are listed as follows:

- Tatra trucks scam: These trucks are manufactured in the Czech Republic. Since 1986, the Indian Army has bought over 7,000 Tatra trucks. According to the defence procurement guidelines, all purchases should be made from the original equipment manufacturer (OEM). But BEML (Bharat Earth Movers Limited) had been flouting the guidelines and had made purchases from a middleman in London.
- Scorpene Submarine scam: The Scorpene deal scam was a bribery scandal, in which USD 175 million (Rupees 1,100 crores) were alleged to have been paid to government decision makers by Thales (-is a French multinational company that designs and builds electrical systems and provides services for the aerospace, defence, transportation and security markets; headquarters are in Paris). Scorpene submarines are now being built in India under a technology transfer agreement that was part of that contract.
- AgustaWestland chopper scam: Controversy over the contract came to light, with arrest of Giuseppe Orsi, the CEO of Finmeccanica, AgustaWestland's parent company by Italian authorities as they found him guilty of bribery. Defence Ministry had allegedly tweaked technical requirements to enable Finmeccanica to bid for the deal with its AW101 helicopter. Rs 375 crore was allegedly paid as bribery to the middlemen in the deal.
- Coffin scam: After the Kargil war of 1999, there were allegations of corruption in the purchase of coffins by the then BJP-led Government. The government had incurred a heavy loss of 1,87,000 USD in the entire transaction.
- Bofors scam: Bofors (Bofors AB is a Swedish arms manufacturer) paid kickbacks to people from a number of countries including top Swedish, and Indian politicians and key defence officials to seal defence procurement deals.

Current Issue

- The Rafale controversy once again calls for the introspection of underlying problem in the country's Defence Procurement Procedure (DPP). It is time for an analysis of whether the DPP is transparent in decision making.
- The Opposition is intensely raising questions over the financial terms of the agreement and alleging crony capitalism while the government is rejecting all the accusations. The Opposition is also claiming that there is no transparency in the deal with Reliance Defence, and that the company will be a key financial beneficiary at the expense of the state-owned Hindustan Aeronautics Limited (HAL).

Background

- The Union Government released Defence Procurement Procedure in the year 2016, which replaced the Defence Procurement Policy of 2013.

- This was based on the recommendations of Dhirendra Singh committee which was appointed for the review of DPP 2013.
- The DPP 2016 was streamlined with a focus on indigenously designed, developed and manufactured weapon systems.
- It also added an additional category “Buy (Indian-IDDMM)” i.e Indigenously Designed, Developed and Manufactured, as the most preferred way of defence goods acquisition. Outright purchase of equipment and procurements under this scheme are categorized as Buy (Indian- IDDMM).
- This category refers to the procurement from an Indian vendor of either products that have been indigenously designed, developed and manufactured with a minimum of 40% indigenous content or products having 60% of it on a cost basis but not designed and developed indigenously.
- The policy has also significantly liberalised the offset liability for foreign vendors, which makes it compulsory for companies to invest, or source, at least 30% of the contract value in India.
- While offset was compulsory for all contracts more than 300 crore earlier, the minimum contract value has now been increased to 2000 crores.
- Capital acquisition scheme was classified into 3 main categories:
 - Buy and Make scheme: Here the procurements are categorized as Buy and Make, and Buy and Make (Indian).
 - Make scheme: For developing long term defence capabilities. (Make II procedure amended the original Make procedure in DPP 2016 for enabling greater participation of industry.)
 - Buy scheme: Direct purchase of equipment and procurements under this scheme are categorized as Buy (Indian- IDDMM), Buy(Global).
- This DPP allowed the Defence Acquisition Council to take a "fast-track" route to acquire weapons, something which was limited to only the armed forces till now.

Flaws in DPP 2016

- Offset requirements under the DPP are not helping it achieve its goal. (Offsets are a portion of a contracted price with a foreign supplier that must be re-invested in the Indian defence sector, or against which the government can purchase technology.)
- Besides, the recent Rafale controversy is the symptom of a larger underlying problem in decision-making, transparency and consistency of public policy.
- The DPP even seems to indicate that the foreign supplier has complete discretion on choice of the Indian offset partner (IOP). If assumed it to be true, it would result in a moral hazard at the outset and, by extension, would permit the Indian government to avoid public procurement rules when taxpayer money is routed through a foreign supplier towards “offsets”.

- While the procurement policy recognizes the need for domestic private partnership, it does not mandate a fair and diverse procurement process for offsets. Given the large contract values involved, this makes it likely that foreign suppliers will partner with just one or two large industrial groups to discharge their offset obligations.
- Lack of transparency in procurement contracts is another big drawback.

Way Forward

- Under Indian law, government procurement is treated as distribution of largesse by the state and, hence, must be fair, transparent and equitable—there can be no favouritism or nepotism in the award of public contracts.
- Regulations that restrict foreign investments in the defence sector also require a dose of reform.
- In the interest of fairness, foreign suppliers should be free to invest in India, yet at the same time, offset investments/procurement must be subject to safeguards along the lines of those that govern public procurement, because after all, they are expending public funds.
- Without substantive reforms in the DPP, there are likely to be more controversies, and perceptions and accusations of crony capitalism

What's next?

With the year-old Defence Procurement Policy not working as expected, the Government of India is planning to come up with a new policy soon. The Government has announced in the General Budget 2018-19, that it will bring out an industry friendly Defence Production Policy 2018 to promote domestic production by public sector, private sector and MSMEs.