



## Dilution of Offset Policy

This article is based on [“Offset dilution in defence, a flawed policy turn”](#) which was published in The Hindu on 21/10/2020. It talks about the benefits and associated challenges with the recent changes in offset policy.

Recently, the government diluted the “offset” policy in defence procurement. This Policy decision was taken with a view to reduce cost of defense deals and also in response to a [Comptroller and Auditor General \(CAG\) report](#) on the same issue.

Henceforth, the offset clause will not be applicable to bilateral deals and deals with a single (monopoly) seller. However, as the major defense deals of India are taken under the above mentioned route, this would virtually mean the scrapping of the [defence offset policy](#).

Due to this, many experts contend that the move is a setback for augmenting domestic capabilities or for realising the goal of Atmanirbhar Bharat. Therefore, the government should rethink its defense offset policy to leverage the associated benefits emanating from it.

### Offset Policy

- **Why Needed:** Developing country buyers often lack an industrial base and research and development (R&D) facilities. However, large buyers such as India seek to exercise their “buying power” to secure defense deals, not just the lowest price.
  - They also try to acquire the technology to upgrade domestic production and build R&D capabilities.
  - The offset clause is the instrument for securing these goals.
- **What is Offset:** The offset is an obligation by an international player to boost India’s domestic defence industry if India is buying defence equipment from it.
  - Since defence contracts are costly, the government wants part of that money either to benefit the Indian industry, or to allow the country to gain in terms of technology.
- **Key Objectives:** The key objective of the Defence Offset Policy is to leverage capital acquisitions to develop Indian defence industry by:
  - Fostering development of internationally competitive enterprises.
  - Augmenting capacity for Research, Design and Development related to defence products and services.
  - Encouraging development of synergistic sectors like civil aerospace, and internal security”.

### Case Study: Benefits of Offset Policy

- Offset policy was initiated in 2005, under which for contracts valued at ₹300 crore or more, 30% of it will result in offsets, implemented through Indian offset partners.
- The 2005 policy helped promote a vibrant aerospace cluster, [mostly micro, small and medium enterprises \(MSMEs\)](#) around Bengaluru.
  - By 2014, exports increased to \$6.7 billion from a paltry \$62.5 million in 2005, according to the United Nations Comtrade Database.

- The offset clause enabled India to join the league of the world's top 10 aerospace exporters; the only country without a major domestic aerospace firm.

## Issue With New Policy

- **CAG Report:** According to the recent CAG report, between 2007 and 2018, the government reportedly signed 46 offset contracts worth ₹66,427 crore of investments.
  - However, the realised investments were merely 8%, or worth ₹5,457 crore.
  - It also noted that there is not a single case where the foreign vendor had transferred high technology to the Indian industry.
- **New Policy:** In a response to CAG report, the government has decided not to have an offset clause in procurement of defence equipment if the deal is done through inter-government agreement (IGA), government-to-government or an ab initio single vendor.
- **Misplaced Rationale:** The government held that the offset load extra cost in the contract to balance the costs, and doing away with the offsets can bring down the costs in such contracts.
  - However, the higher (upfront) cost of the agreement due to the offset clause would pay for itself by: reducing costs in the long term by indigenisation of production and the potential technology spill-overs for domestic industry.
- **Impact of New Policy:** As most defence deals are bilateral, or a single supplier deal (given the monopoly over the technology).
  - The dilution means practically giving up the offset clause.
  - This would impact India's prospects for boosting defence production and technological self-reliance.
  - Further, India has voluntarily given up a powerful instrument of bargaining to acquire scarce advanced technology.

## Way Forward

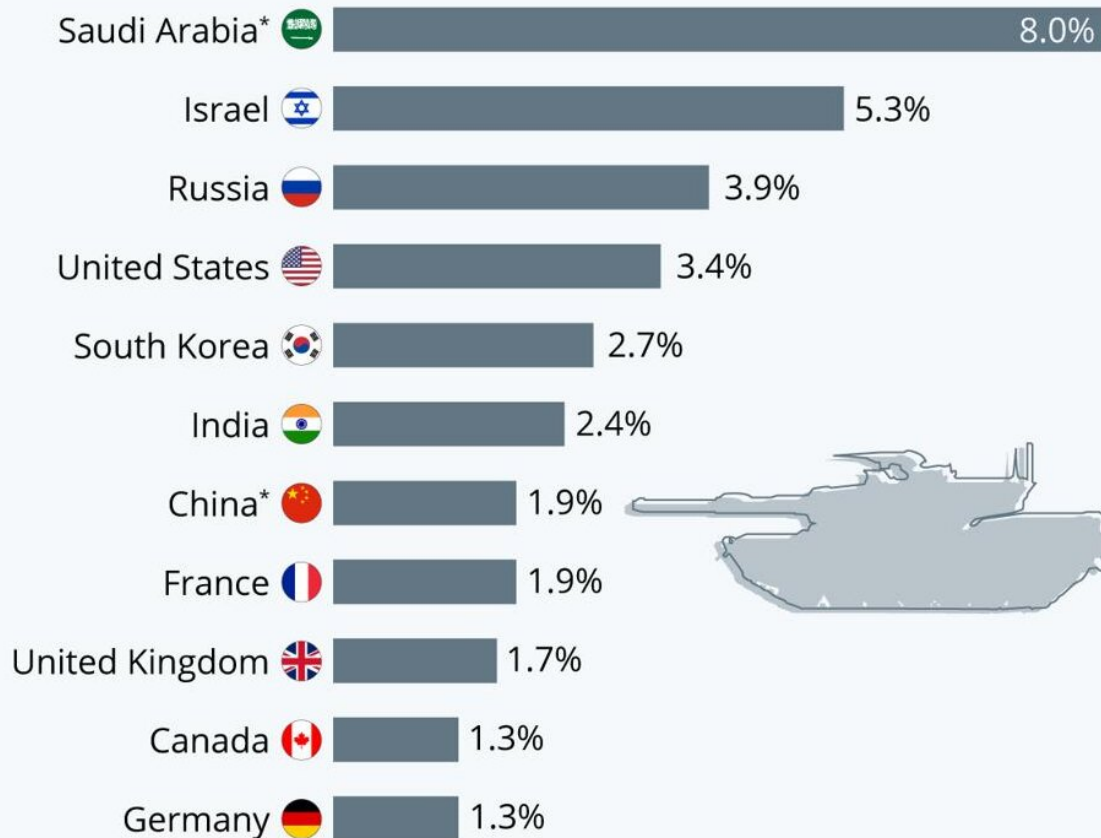
- **Review & Proper Implementation of Offset Clause:** The offset policy can succeed, if it is designed and executed correctly, as a parallel episode in the aerospace industry demonstrates.
  - Despite the heft of Hindustan Aeronautics Limited, India is a lightweight in global civilian aircraft manufacturing, as the public sector giant mostly devotes itself to defence production.
  - The much-touted [National Civil Aircraft Development \(NCAD\) project](#) — to come up with an indigenously designed Regional Transport Aircraft (RTA) — has remained a non-starter from day one.
  - Thus, apart from reviewing the current offset policy, there is a need to establish a formal mechanism for implementation of the defence offset policy.
- **Better Regulation & Facilitation:** While evidence suggests that domestic industry can absorb offsets, what India needs is an effective body to handle offsets, liberal FDI and licensing policies, and a better banking provision.
- **Need for Clear Roadmap:** Also there is a need for a clear roadmap for transfer of technology through offsets, keeping in view India's long-term military industrial objectives.

## Conclusion

India needs to re-conceive or re-imagine the offset clause in defence contracts with stricter enforcement of the deals, in national interest, and in order to aim for 'Atma Nirbhar Bharat Abhiyan', or a self-reliant India.

# Global Military Budgets As A Share Of GDP

Military budgets as a % of GDP in selected countries in 2019



## ***Drishti Mains Question***

Discuss what do you mean by an offset policy and issues linked with the recent policy changes.

This editorial is based on [“The significance of the Malabar exercise”](#) which was published in The Hindustan Times on October 19<sup>th</sup>, 2020. Now watch this on our Youtube channel.

PDF Reference URL: <https://www.drishtias.com/printpdf/dilution-of-offset-policy>