



**Centre for Land Warfare Studies, New Delhi**

**National Seminar**

**on**

**Defence Acquisitions and Offsets Series -1**

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**Executive Summary**

## **INTRODUCTION**

➤ India boasts an extensive Defence Industrial and Research Base consisting of 42 Ordnance factories, nine Defence Public Sector Units (DPSU) and 52 Research & Development laboratories yet the hollowness of arms and equipment in the field Army has reached alarming levels. Why are the acquisition reforms not being implemented? Why is it that the exhaustive recommendations of various high level reform committees have been gathering dust for decades? These are certain issues that need serious introspection. It was with a view to address these issues and certain other new areas of reform that the Centre for Land Warfare Studies organised a National seminar on Defence Acquisition and Offsets in Gulmohar Hall at the India Habitat Centre on 21 Aug 14. First of the series of two seminars being organised on this contemporary topic this event focussed on the **impediments to acquisition reforms** recommended by various high powered committees on the Indian capital acquisition system spanning last 50 years. Major stakeholders of the acquisition system namely **senior serving and retired Service Officers, Heads of Corporate**

**Sector and Senior Civil Servants from various ministries and departments such as Ministries of Railways, Commerce and Defence Research and Development Organisation (DRDO)** presented their views in the seminar. Certain important concepts such as , capital procurement in the Railways and the concept of **Defence Economic Zones (DEZs)** by **Additional Director General of Foreign Trade from the Ministry of Commerce and Industries** were discussed for the first time in this seminar.

## ANALYSIS

- Unless the Services steer the acquisition system by staking their ownership and stress on building structures and models rather than only writing policy, defence capital acquisition is not likely to see much reform. The realities which the stakeholders of the acquisition system must contend with are, that firstly, there will be control regimes orchestrated by foreign powers who would like to sell military hardware for huge profits and these regimes cannot be wished away, secondly, any attempt to usher in serious reform will be met with stiff resistance by the existing stakeholders within the acquisition system in order to maintain status quo and to protect their turf. Lastly, the '**us and them**' syndrome in the system is here to stay unless there is cross staffing and true integration between the Ministry of Defence (MoD) and Service Headquarters (HQ).
- Indian Navy has made great headway with respect to acquisition and a number of recommendations made by various reform committees already stand implemented in the Navy as also in other departments in the Government of India namely the Department of Atomic Energy (DAE) and Department of Space (DoS). The methodology used by the Navy needs to be emulated.

## KEY ISSUES

- **Reduction in Spending on Modernisation.** Army's expenditure on equipment modernisation is steadily falling. In 2008-09, the Army spent 27 paisa of each rupee on capital expenditure. This fell to 24 paisa in 2009-10; 23 paisa in 2010-11; 20 paisa in 2012-13 and just 18 paisa in the last two years. Additionally, there is a major delay in key acquisition projects . In 2012, Army shortlisted a total of 680 projects worth Rs two lakh crores to fructify in the twelfth Army plan period. A critical list of thirty one out of these 680 projects in the pipeline was identified to include Assault Rifles, Howitzers, Bullet Proof Jackets, Tank and Artillery ammunition, as priority one. Surprisingly, even in 2014, the above contracts still remain priority one most being struck in procedural wrangles.

- **Lack of Accountability.** There is a visible lack of involvement and accountability among the stakeholders and the 'us and them' syndrome between the MoD and Service Headquarters is taking its toll on the system. There is a hands off approach to acquisition in the MoD at the subordinate level. There is also a systemic lethargy across the acquisition supply chain and there have been occasions where the quotes for a particular contract have been opened but commercial negotiation committee (CNC) has not declared the L1 for as long as one year for critical acquisition cases.
- **General Staff (GS) Evaluation.** Traditionally the General Staff has been the strongest arm of the Defence Services because it examines issues from an operational perspective. GS evaluation as a phase of acquisition through the Defence Procurement Procedure (DPP) has been unfortunately reduced to mere compliance verification exercise about the field trials. Crucial General Staff recommendations based on operational factors are rejected by the Acquisition Wing in the MoD citing commercial considerations. Acquisition process is thus essentially a strait jacketed procedure with no flexibility or provisions for operational urgency and logic which is the bedrock of General Staff recommendations.
- **Hands Off Approach by the Stakeholders.** The stakeholders in the acquisition system including the Service Headquarters (HQ) are unwilling or unable to take pragmatic and informed decisions and steer the acquisition process as per operational requirements. Where the decisions have been taken, the system has responded as in the case of Navy, where almost 80 percent indigenisation in the field of platforms has been achieved. The radical recommendations that have been put forth by various reform committees on defence acquisition already stand implemented decades ago in other government departments such as DAE and DoS.
- **Achieving Self Reliance.** In the technology intensive sectors such as Space and Atomic Energy, India has not taken more than a decade plus to achieve self reliance and the same can easily be replicated in the defence sector. If acquisitions imports are disallowed for the next 15 years our military industrial complex will be able to achieve self reliance. Given the size of Indian market, many countries will still be willing to offer their knowledge and Intellectual Property Rights (IPR) at our terms. India currently has a strategic window of

opportunity with Pakistan whose current state of political instability has reduced its conventional edge vis a vis India by at least a decade. Similarly the Chinese are not looking at another armed conflict with India. This ten year window has provided India with an opening to manufacture its own arms and ammunition. Efforts should be made to upgrade the domestic weaponry to high end quality in this ten year window. Linking this with the proposed DEZs will bring in rich dividends for India's Military Industrial Complex as well as its economy.

- **Defence Expenditure as a Profit Centre.** In advanced economies, defence expenditure is viewed as an integral multiplier of the GDP rather than being seen as a percentage of expenditure of GDP. Indian policy makers need to view Defence expenditure in India as a profit centre and not a cost centre. DEZs once established would be able to cater to the demand within India as well as provide world class products for exports thus contributing to the GDP.

- **DPP Provisions and Delays in Acquisitions.** DPP is an inflexible and a restrictive document which retards acquisition. There has been a visible reduction in the indigenisation capability of the Indian Navy post implementation of DPP in 2002. DPP needs to be re written. To start with, the restrictive provisions of the DPP need to be amended on an immediate basis. DPP needs to differentiate between information technology, electronics, systems and clothing items as they are all different categories of inventories and need different treatment. Acquisition process needs to be more collaborative when dealing with the stakeholders in the supply chain.

- **Linkages with Academia.** DRDO has established strong linkages with a number of academic institutes abroad and is presently carrying out contract research through almost 150 universities. There are approximately one thousand universities in India which are willing to provide linkages for fundamental research to the government and the private sectors. The Services and MoD should exploit this knowledge base to refine their processes and structures. Weapon and Equipment Systems Engineering Establishment (WESEE) owes most of its successes to its linkages with the academia the latest being the indigenously developed complex combat management system of the recently commissioned Indian Naval Ship (INS) Kolkata.

- **Models and Structures to Achieve Indigenisation.** Technology absorption is a multi dimensional multi contextual subject and not a simple induction through Transfer of technology (ToT). Technology absorption cannot be achieved unless structures and models for technology absorption are created. While policies are in place and are being constantly refined, their implementation

remains a matter of concern. Creation of structures and models need to be effected in order to implement these policies. The Indian Navy in a well planned manner has created a structure for indigenisation and technology absorption in WESEE. Another pioneering initiative of the Indian Navy in setting up the RC Bose Centre of Cryptography Kolkata has achieved capability creation at the national level. Such initiatives need to be emulated by the Army.

- **India's Offset Policy.** India's Offset Policy is a high threshold low multiplier policy and has not resulted in any substantial gains since its inception in 2005. Since its inception, India has signed offsets agreements of USD 4.8 Bn not even 20 percent of which has been realised. The average European Union (EU) Offset rate is 100 percent as against 30 percent in India. The offset policy only applies to the manufacture of products completely ignoring the service sector. Countries like Turkey through a coherent offset policy has harvested USD 1.2 Bn exports in 2013 of which Eighty percent are offset induced. India has no National Offset Policy as the offsets are limited to MoD only. Therefore, all other departments such as Ministry of Home Affairs import expensive equipment from abroad without any offsets.

## RECOMMENDATIONS

- **Annual 'Strategic Defence Review'.** There is a need to create awareness and build public opinion on national security. It is recommended that a '**Strategic Defence Review**' be carried out at the political level during the first session of the parliament every year. This review can be in two parts. One part open to the public domain on lines of the annual 'Economic Survey' and other part classified. This would give a much needed exposure to the general public about the state of readiness, requirement and the aspirations of the Armed Forces.
- **Structure for Achieving Technology Sovereignty.** To ensure acquisition reforms are implemented, structural changes are necessary. It is recommended to raise a '**Defence Technology Mission**' and '**Project Implementation Agency**' on the lines of the Atomic Energy Commission accountable to the Parliament through the Cabinet Committee on Security (CCS) to take a national view of the various acquisition/ technology projects. There is also a need for a **defence technology cadre** which has a say in the government and staffs the proposed Defence Technology Mission and Project Implementation Agency.
- **A Separate Ministry for Defence Production.** The governance structure that exists today in the Ministry of Defence is not suited for creation and sustenance

of a responsive acquisition supply chain. It is recommended that India's 'Military Industrial Complex' consisting of the Ordnance Factory Board and Defence Public Sector undertakings should be under a separate ministry namely the '**Defence Production and Indigenisation Ministry**' the charter being to oversee the functioning of the Ordnance factories and DPSUs which first need to be modernised. Additionally, **a separate Secretary should be appointed for the private Industry** involved in Defence production on the lines of Secretary (Defence Production) in the proposed ministry.

- **Expansion of Defence Acquisition Wing.** A small country like Netherlands has eight thousand personnel carrying out defence acquisitions. United States has established a Defence Acquisition University to train people in the specialised field of acquisitions. In India, a mere thirteen member Defence Acquisition Wing in India deals with acquisition worth thousands of crores of rupees annually. There is a need to invest money in models and structures as only policy making and refinement of processes will no longer help. There is little synergy between various elements in the acquisition system namely academia, industry, policy making, MoD which can only be bridged by creating structures and models. **It is therefore recommended that an integrated Directorate of Acquisition with a broader frame work incorporating all the above mentioned stakeholders and more staff with structure supported by a state of art technology is set up to carry out defence acquisition.** There is also a need to generate more centres which practice technology such as the WESEE in contributing towards India's quest towards achieving technology sovereignty.
- **Dedicated Trial Units for Army and Navy.** Dedicated trial units in the Army on lines of the Indian Air Force's '**Aircraft and System testing Establishment**' should be raised. This will hasten the process of field trials which is currently a weak area with the Army. **It is recommended that trial wings of each arm / service within the Army already existing in Category A training establishments should be strengthened and converted to trial units.**
- **Defence Procurement Procedure.** DPP is a restrictive document and rather than being a facilitator towards acquisition, it has adversely affected the acquisition as well as the indigenisation efforts of the Services. **It is recommended that a study in the direction of re writing the DPP be commenced and views of all stakeholders be obtained.** The DPP should be prepared by the academia together with a domain specialist interface and should

include international best practices in the field of acquisition as well as inputs from progressive government departments such as the Railways, DAE and DoS rather than being a Defence Accounts Department (DAD) effort as hitherto. On an immediate basis, certain amendments as listed in the succeeding paragraphs be incorporated in the interim till the revision is carried out.

- **Strengthen General Staff Evaluation.** The GS evaluation which is supposed to be the final operational acceptance of the equipment has been reduced to an exercise of measuring the compliance to trials. Commercial considerations take a greater priority over operational imperatives. On occasions considered opinion of the Services is ignored by the Director General Acquisition and the MoD citing contractual constraints and propriety. **It is recommended that structure and charter of GS evaluation be amended in the DPP after obtaining the views of Service HQ to make GS evaluation an enabling provision rather than a mere compliance measure.**
- **Disallow Arms Imports.** India has remained in the ToT domain for the last 60 years. India not only pays for equipment imports, but also for transfer of technology, spares and upgrades. No other country in the world follows such a model any more. It is thus recommended that **as a national policy, no imports of weapons and equipment be allowed for a period of ten years** and indigenous weaponry be developed by studying the developmental cycles of other strategic sectors such as space and Atomic Energy. Suitable amendments be carried out in the DPP accordingly.
- **Joint Ventures (JVs) between PSUs and Private Sector.** It is recommended that the Private sector can enter into a **non equity based teaming JV with Defence PSUs for co development and co production of critical high technology products.** Success stories of such teaming agreements between premier private players such as Larsen and Tubrou (L&T) and PSUs in sectors such as DAE and DoS are available and can be replicated in the Defence Services acquisitions.
- **Hedging against Inflation and Exchange Rate variation (ERV).** It is recommended **that the DPP be amended to include the provision to enable vendors operate Escrow accounts which will hedge the prospective vendors against inflation given our delayed decision making in the acquisition process.** The MoD needs to articulate a strategy to hedge against

ERV and not unload the entire burden on the vendors citing a 'Fixed price Quotation' (FPQ) contract.

- **Acquisition System of Railways, DAE and DoS.** Railways follow a system of L1 along with Q1. There is also a differentiation between the categories of vendors based on the reliability and past vendor rating of the vendors. Vendors with high vendor rating are segregated and a preferential treatment is given to them for future orders. **It is recommended that a similar system can be followed for Defence Acquisitions. A study be ordered to be conducted by College of Defence management (CDM) / Centre for Land Warfare Studies (CLAWS) / Army management Studies Board (AMSB) /Academia etc, on the system of procurement by the Railways and its applicability for the MoD.** More importantly, the organisation and structure in the DAE and DoS can be studied to examine the possibility of replicating a similar system for the Defence Services.
- **Offset Policy.** There is a need to lower the threshold limit of offsets to Rs 100 crs from the existing limit of Rs 300 crs. The offset percentage should be increased to minimum 50 percent from the existing 30 percent. A uniform value addition needs to be adopted for manufacturing and service sector. Both direct and Indirect offset obligations of domestic companies should be equal to the foreign companies and the Indian companies should have a level playing field as far as the discharge period of offsets are concerned. Selected offsets should be asked in the Request for Proposal (RFP) itself. The Charter of Defence Offsets Management Wing (DOMW) should be enhanced to make it a single window clearance agency for Defence Offsets management in India. A national offset policy is the need of the hour to obtain offsets from all sources and there is a need to establish a defence offsets fund to derive full benefit from offsets.
- **DRDO Infrastructure for Use by Private Sector.** DRDO needs to **make available its labs, ranges and other assets to private sector** to enable them to test various facilities / equipment before fielding them for user trials. A mechanism be designed to provide such facilities at a charge of a suitable fee.
- **Services-Industry – Academia Linkages.** There is a need **for the Industry to interact with academia available in the country and suggest the specific areas in which they would like output or skills from the universities existing in India.** The Private sector and the MoD can sponsor chairs of excellence for their personnel in these universities as also task the academia to carry out fundamental research or projects on contract basis.



- **Private Sector to Manufacture Ammunition.** There is an urgent need **to throw open the manufacture of ammunition to the private sector.** L&T is holding a licence for ammunition manufacture however it is not making investments into establishing a plant as the present L 1 regime does not promise an assured business. This needs to be corrected.
- **Defence Economic Zones.** The concept of Defence Economic Zones on the lines of SEZs is a viable concept and should be taken forward with the help of the private sector. Suitable amendments to the SEZ act can be sought by submitting a proposal through the Directorate General of Foreign Trade (DGFT), Ministry of Commerce and Industry. **It is recommended that a study be ordered to be conducted by CDM/CLAWS/ AMSB/Academia etc, the results of which can be then submitted as a proposal for establishments of Defence Economic Zones to the Ministry of Commerce and Industry.** Export earnings from defence hardware will facilitate conversion of defence expenditure into a profit centre and not a cost centre as is the case with advanced countries.