

Confusing signals: Why FDI in Indian Defence needs clarity

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On 16 July, 2013 the UPA government decided in principle to open up as many as 13 sectors for foreign direct investment - ranging from 49 percent to 100 percent - with different caveats. Some needed approval through automatic routes, some approval through Foreign Investment Promotion Board (hereafter, FIPB) and others with distinct riders. While the timing and other related aspects of this decision have already received much attention, there is enough confusion prevailing among stakeholders on increased FDI from the existing 26 percent to the conditional 49 percent in the Indian defence production sector.

When the decision went viral, stakeholders in the Indian defence sector (foreign arms manufacturers, Indian private companies that intend to produce defence items and services, state-owned defence public sector units, DRDO and other relevant agencies) became clueless for obvious reasons.

A set of inter-related questions was asked: a) what is the status of FDI in defence sector after this announcement; b) has it been increased from 26 to 49 percent across the board as per media reports; c) if so, whether through automatic route or through clearance from FIPB or any other method; and d) how should stakeholders devise their actions further.

In the absence of any meaningful clarification from the MoD or similar government quarters thus far, it is likely that interpretations of the decision can lead to different (often erroneous) conclusions. It is thus important to put the announcement in perspective and strive to draw reasonable conclusions.

For immediate reasons, I attempt to analyse this decision in a larger framework that has three dimensions: contextual, operational and factual. I will start from the last - factual.

Facts say the following: a) subject to any addendum/clarification from the MoD (which had not happened at the time of writing this piece), the FDI cap remains at 26 percent in the Indian defence sector, which means that there is no change; b) any business proposal beyond 26 percent where it brings in substantive state-of-the-art knowledge in defence science and technologies could get a look-in by the MoD, which need clarifications on terms used in the announcement; and c) eventual consideration of a proposal considered by the MoD is subject to

approval by the Cabinet Committee on Security (CCS), which is a routine procedure.

In sum, there is no change in the policy related to FDI in the defence sector, except for investors who want to invest in the Indian defence sector by offering next-generation products that are suitable for Indian purpose.

Now, let's examine the operational dimension. This is crystal clear: if a defence contractor (variously defined as an original equipment manufacturer (OEM), system integrator or a prime or sub-prime contractor specialising on critical aspects of defence and dual-use technologies) wants to invest in India, it has to share a substantive portion of its knowledge and abide by applicable national legal frameworks.

Simplistic contextual dimensions suggest an attempt by the Indian political leadership to thrust upon and impress the Defence Minister to open up the defence sector for foreign investment, which smacks of two types of desperation: a) to appease foreign stakeholders and b) to give a further boost to the ailing Indian economy by opening up a hitherto closed sector which has a vast economic/commercial potential. Pragmatic or otherwise, the minister and the ministry have not succumbed to this pressure from their peers. A little more pragmatism should have been shown by the highest level political leadership.

On the surface, it appears that indirect influence exerted by foreign prime defence contractors to raise their stakes in Indian defence sector has fallen flat as the MoD still restricts the FDI cap to 26 percent only, subject to selective approval. This entails implications for not only in the FDI domain, but also on offset obligations as well.

Bulk of the foreign prime contractors are likely to set different conditions for offset partnerships while discharging their overall contractual obligations in defence contracts. Such an apprehension suggests that while foreign primes would be reluctant to invest in financial or technical domains, the Indian state-owned public sector units and private companies would have to demonstrate their capabilities in order to attract large defence orders. In sum, both Indian and foreign companies will have to jostle for space in lucrative Indian defence market.

But, most importantly, the MoD must clarify its position on FDI, preferably through an official notification or a press release. Even that may not suffice! It must clarify and define, where applicable, terms like 'state-of-the-art', 'next-generation technologies', 'conditional approval', and the like. Inadvertently or otherwise, the Minister of Commerce Anand Sharma said that the Defence minister would define the term 'state-of-the-art' in due course of time. So, it is advisable that we must wait till we hear from the him or his ministry clarifying such terms.

In any case, we know that FDI in the defence sector is 26 percent, we also know that a foreign company can place a proposal before the MoD suggesting an

investment beyond 26 percent with difficult riders. Such proposals are likely to be rejected unless they conform to sharing 'state-of-the-art technologies'. This is what the MoD must clarify: what is a 'state-of-the-art-technology'? An official notification in this regard would be highly appreciated.

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