

## **Indian Defence Offsets Policy: Evolution or Flip Flop?**

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The Ministry of Defence (MoD) had promulgated a thoroughly revamped Defence Offset Guidelines in August 2012. The guidelines were not considered perfect but were largely inspired by existing global best practices. Barring the provision for offset trading, the guidelines had practically everything that the industry had been asking for, ranging from multipliers to a well defined list of products and services eligible for discharge of offset obligations.

As expected, sceptics were quick to find flaws with the guidelines. To be sure, there was – and continues to be – some substance in the criticism. In fact, there were some fundamental flaws, such as the absence of a provision in the new guidelines for demanding discharge of offset obligation in an area to be specified by the MoD in the Request for Proposal (RFP). This would have put the MoD in the driver's seat rather than the offsets being driven by the foreign vendors. But such flaws did not prevent the feel good factor generated by the new policy, which had been in the making for more than a year before it was announced.

It was also expected that the MoD would take note of the issues and fine tune the policy with a sense of urgency. But that did not happen and since then the excitement has ebbed considerably. It is doubtful that the MoD will have any offset contract signed under the new guidelines to show on the first anniversary of promulgation of the new guidelines. While it is true that one cannot attribute it entirely to the new guidelines, there has been a significant development which belies the hope of these guidelines paving the way for achieving the stated objectives of the policy.

This development relates to release of the Defence Procurement Policy (DPP) 2013 on June 1, 2013 by the MoD. There was an appendix in DPP 2011 which dealt with offsets. This appendix has been replaced by the document released last year outlining the new offset guidelines without addressing any of the several issues that had been raised by various stakeholders about those guidelines.

Interestingly, in the DPP 2013 hosted by the MoD on its website (the printed version is not yet available), there is no mention of the fact that just a week before its release, an office memorandum had been issued holding in abeyance till further orders the portions in the guidelines related to services being an eligible mode of discharging the offset obligation.

This development signifies two things. One, that the MoD did not either consider the issues raised by various people about the 2012 guidelines, or, if it did consider them, it did not find any reason to fine tune the guidelines before incorporating them in DPP 2013. Two, that the MoD is unable to take a final call on eligibility of services as a valid mode of discharging the offset obligation. These orders, dated May 23, 2013, are applicable not only to all the RFPs to be issued after that date but also to the RFPs that have already been issued but where the last date for submission of the techno-commercial bids has not yet passed.

This is quite disappointing. More so, because there has been no word from the MoD about the reasons why the offset guidelines were not fine tuned before incorporation in DPP 2013 and why

'services' as a valid mode of discharging the offset obligation have been held in abeyance. While the former indicates an inexplicable rigidity, the latter signifies an equally inexplicable vacillation on the part of the MoD on an important policy issue.

Suspension of 'services' from the list of eligible avenues for discharge of offset obligation is clearly related to revelations in the VVIP helicopter case of the kickbacks being allegedly routed to an Indian company under the garb of an offset partnership arrangement for development of software for the prime vendor. These revelations were made several months back and, if the MoD felt that there is no way it could prevent the misuse of 'services' as a mode of discharging the offset obligation, it would have been perfectly in order to delete it permanently from the list of eligible offsets. There was sufficient time to take a final view in the matter. Alternatively, the reasons for holding the services-related provisions in abeyance could have been disclosed in the interest of transparency and for the sake of generating a debate on the issue.

Quite often, it is difficult to undo what has been done but, by comparison, it is always much easier to do what has not been done. Fortunately, the cobwebs that seem to be surrounding the offset policy can be removed by doing what has not been done: taking the issues head-on. But before the issues could be taken head-on, there is a need to identify them. A lot has been written about the offset guidelines of 2012 and much more has been spoken about it at seminars and conferences. The MoD itself would have received representations from interested individuals, companies and industry associations. The challenge is to sift real issues from rhetoric and bluster and then get down to business. Ideally, this should be the responsibility of the Defence Offset Management Wing (DOMW), as formulation of the policy lies in its domain, but apparently this wing is far from acquiring the vibrancy required for handling policy issues.

One only has to visit the DOMW webpage to get an idea of how badly it needs to be invigorated. There are two tickers in the box showing 'what's new'. One ticker is about establishment of DOMW in the Department of Defence Production from 1<sup>st</sup> August 2012 and the other ticker informs you that the erstwhile Defence Offset Facilitation Agency (DOFA) stands *subsumed* in DOMW. Surely, almost a year after setting up of DOMW this is not news anymore. This is not all. The FAQ page continues to reflect the same six questions with their one-sentence answers which were perhaps posted on this page at its inception. Surely, DOMW would have received scores of queries since August 2012. It is difficult to understand why those queries do not find place on the FAQ page. Most interestingly, when you open the home page it prompts you to click at the login button but it is difficult to figure out who is eligible to register and what is the process for registration.

Capacity building was the bane of DOFA and now DOMW seems to be going the same way. Is it, therefore, not the right time to think differently and entrust the functions, presently assigned to DOMW, to a non-ministerial agency under some kind of outsourcing arrangement? It does not really have to be a private agency. But there is a need for an agency which is not dogged by the problem of lack of continuity and expertise. An agency like this may not be able to take policy decisions but it could surely flag the issues before the decision makers and pursue them till they are resolved. However, this is unlikely to happen. Therefore, MoD has no option but to energize DOMW as there are a number of issues awaiting resolution.

What are the issues that need to be addressed? The first issue concerns the realization of the objective of the offset policy. The stated objective is to leverage capital acquisitions to develop the Indian defence industry by (i) fostering development of internationally competitive enterprises, (ii) augmenting capacity for research, design and development related to defence products and services, and (iii) encouraging development of synergetic sectors like the civil aerospace and internal security. The question is: how are these goals to be achieved? The offset guidelines deal with the procedural aspects but where is the roadmap?

The *laissez faire* which allows the vendors to choose the manner in which they would discharge the offset obligation is anathema to channelization of offsets into areas in which these are needed to achieve the stated objective of the policy. A provision in the policy that enables the MoD to specify in the RFP the area(s) in which the vendors would be required to discharge the offset obligation could make all the difference. This, of course, presupposes that there is a roadmap in place and there is an overarching entity to oversee channelization of the offsets.

This issue also links up with the broader issue of whether tangible value addition should be the main criterion for drawing up the list of eligible offsets as this is what would actually spawn manufacturing activities in India. Viewed in this perspective, direct purchase of products and services from the Indian companies or conducting training courses in India would not qualify as eligible offsets. A foreign vendor would in any case buy an Indian product or service if it makes business sense. Not much can be gained by creating a situation in which he feels compelled to do so only for the sake of discharging the offset obligation. It would also amount to protectionism of the Indian industry with no incentive for diversifying into newer areas of manufacturing. Similarly, training does not entail any value-addition in India. These avenues would certainly not fit into the objective of the offset policy if value-addition becomes the defining criterion for offsets.

The next issue concerns the selection of the Indian Offset Partners. The foreign vendors have long been complaining of the inability of the Indian industry to absorb the offsets. The problem, whether real or imaginary, is exacerbated by the problems related to industrial licensing and formation of joint ventures. The munitions list has been notified by the Department of Industrial Policy and Promotion (DIPP) and it is certainly a positive step but it does not automatically make it easy to obtain an industrial license. The issues regarding requirement of industrial license for manufacture of dual-use items (as indeed the definition of the dual-use item) and eligibility of wholly owned subsidiaries as the Indian Offset Partners for discharge of the offset obligation in civil aerospace sector where 100 per cent foreign direct investment is allowed remain unaddressed.

There are issues related to acquisition of critical technologies by the Defence Research & Development Organization (DRDO) through the offset route. The critical technologies required by DRDO have been listed out but the scheme seems to be open-ended. What if the same technologies are offered by different vendors under various acquisition programmes? The DRDO might accept the first offer and reject the subsequent ones but what if the prime contract in the context of which the first offer was made does not go through? This could be exasperating.

It is difficult to draw up a comprehensive list of the issues that need to be addressed. What is important is the determination on the part of the MoD to resolve the already existing issues and the issues that might arise in future. This calls for sustained efforts. Given the pre-occupation of the functionaries in the ministry with the day-to-day issues, MoD could rope in a think-tank, such as the

Institute for Defence Studies and Analyses, which is fully funded by it, to reach out to the stakeholders for consultation, articulate the issues that need to be resolved and offer various alternative solutions for consideration by the ministry.

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