

Amendments to DPP-2011: An Analytical Overview

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Summary

On April 20th, the Defence Acquisition Council (DAC) of the Ministry of Defence announced 15 major amendments to the defence procurement and production policies, with the hope to incentivise indigenous defence manufacturing while promoting transparency and efficiency in the procurement process. Among others, amendments have been brought in to articulate, for the first time, the order of priority of various procurement categories; bring out a public version of the armed forces' latest long-term plan; abolish the power of Department of Defence Production (DDP) to nominate its production agencies for receiving maintenance technology; expedite projects worth Rs 1200 billion under 'Make' and 'Buy and Make (Indian)' categories; define defence items, and indigenous content of home-grown products; and provide fiscal and financial measures to incentive small and medium enterprises (SMEs) engaged in defence manufacturing. At the same time, changes have also been made in the process leading to and post grant of Acceptance of Necessity (AoN), and in the powers enjoyed by the defence minister and the service chiefs.

This Issue Brief provides an analytical overview of the amendments announced by the DAC. It observes that while some of the amendments are genuine reform measures and, if pursued to their logical conclusion, are likely to achieve the intended objectives, some others are mere cosmetic changes. In particular, the decisions to expedite 'Make' and 'Buy and Make (Indian)' projects, create a level playing field for the private sector, and provide fiscal and financial measures for SMEs - are likely to benefit India's defence industrialisation process. On the flip side, the decision to prioritise various procurement categories without any change in existing institutional set up may not induce more contracts for the domestic industry. Similarly, freezing of tender conditions before the AoN and reducing the latter's validity may not necessarily expedite procurement, as some of the root causes of procurement delays are still remain unaddressed.



Introduction

On April 20, 2013, the Defence Acquisition Council (DAC), the highest decision making body of the Ministry of Defence (MoD), gave its thumb of approval to 15 major amendments to the defence procurement and production policies. The amendments, the highlights of which were announced in the form of a press release, will be formally included in the revised Defence Procurement Procedure (DPP), which is expected to be announced shortly. Pending the finer details in the amended DPP, the changes suggested in the press release seek to strengthen India's defence manufacturing base while achieving efficiency and transparency in the procurement process. This Issue Brief provides an analytical overview of the latest changes brought out in the MoD's April 20th Press Release.

Changes to DPP-2011: Analytical Overview

Prioritisation of Procurement Categories

The first major change brought in through the recent amendment is the priority accorded to procurement categories the number of which has increased over the years to count four broad categories in the latest Defence Procurement Procedure (DPP): 1. 'Buy' (which is further subdivided into 'Buy (Indian)' and 'Buy Global)', 2. 'Buy and Make with Transfer of Technology (ToT)', 3. 'Buy and Make (Indian)', and 4. 'Make' (see Table for various aspects of India's defence procurement categories). Setting the priority for the first time, the DAC has given an order of preference with the first priority being accorded to 'Buy (Indian)', followed by 'Buy and Make (Indian)', 'Make', 'Buy and Make with (ToT)', and lastly 'Buy (Global)'. The inherent rationale behind according the priority is to compel the procurement authorities to exhaust all the higher preferred options for an indigenous solution, before resorting to procurement from foreign sources, which not only affects Indian self-reliance drive but could lead to some unpleasant situation for the government as is seen from the recent controversy over the Agusta Westland deal.

The biggest message behind the prioritised list is however the subtle shift of onus onto the armed forces, who, as the first movers or *sponsors* of procurement proposals, are now required not to look at foreign-source procurement / lower preferred category as a 'default option'. This is a marked departure from the previous practice, where the onus for any change of category into a higher one was on other stakeholders. To ensure that the order of preference is followed while processing a procurement proposal, the amendment requires the sponsors of a procurement proposal to mention the "reasons for excluding the higher preferred category/categories." In some way, the amendment tacitly recognises hitherto an unreported gap in the existing procurement set up that sometimes tend to overlook an indigenous offer for a foreign made product.

But the larger question is whether a mere extra step by way of compelling the authorities to articulate the reasons of excluding higher preferred category/categories would

significantly pave the way for larger number of contracts for domestic industry, which would in turn lead to higher self-reliance. The answer to the above question is ironically 'no'. A deeper reading of the DPP's provisions would reveal that the mere extra step that the recent amendment talks of is really a cosmetic change and does not really upset the existing practice. In the present scheme of things, while a procurement proposal is processed it goes through a number of agencies for on-file comments before a decision in favour of a particular category is taken in a meeting sponsored by the Head Quarters Integrated Defence staff (HQ IDS) and attended by various stakeholders including the officials from the armed forces, the Department of Defence Production (DDP), Department of Defence (Finance), and the Defence Research and Development Organisation (DRDO). The same reasons of why a particular category is preferred can always be used to justify why a higher category is ignored. In other words, by compelling authorities to write down the reasons for exclusion does not amount to a big change the decision making in favour of higher preferred category or categories.

However, since the amendment tacitly accepts a crucial problem in the current acquisition set up that sometimes ignores a higher preferred category, it is worthwhile to examine the issue in some depth. In the existing set up, the defence industrialisation process is largely driven by competing and, at times conflicting, goals of various powerful stakeholders, primarily the armed forces, DDP, and the DRDO. While the priority of the armed forces is to buy a system irrespective of the source of suppliers, the other two are more interested in what is now termed as higher preferred category/categories. Ironically there is no high-powered institutional mechanism to act as a bridge and take decisions in the interest of indigenous production and self-reliance. Repeated suggestions for creation of such high-level body by various expert bodies, including the Group of Ministers, Sisodia Committee, Rama Rao Committee, and VK Misra Committee are yet to take effect. It is high time that recommendations of these committees are looked at again if the self-reliance is to be achieved.

Public Version of LTIPP 2012-27

In a move to keep the Indian industry, particularly the private enterprises, informed about the MoD's long-term procurement plan and at the same time allow them much needed time to prepare for such opportunities, an amendment is made for release of a public version of the armed forces' latest Long Term Integrated Perspective Plan (LTIPP) that covers three plan periods from 2012 to 2027. The amendment promises that the public version of LTIPP 2012-27 would be published in the form of a document titled Technology Perspective and Capability Roadmap (TPCR) and would give "useful guidance to the Indian industry for boosting its infrastructural capabilities and directing its R&D and technology investment." With the promise in place, the onus for making necessary investments now shifts onto the Indian industry, which had a long-standing grievance about that lack of advance information, inhibiting their plan of action for long-gestation projects.

Table: Aspects of India's defence procurement categories

Procurement (Sub-) Category		Meaning	Indigenous Requirement	Nature of Involvement of Domestic Industry
'Buy'	'Buy Indian'	Outright purchase	30 per cent	100 per cent-owned Indian company, majority-holding Indian JV
	'Buy Global'		Not Applicable	A majority holding Indian company can participate in global tender
'Buy & Make'		Import followed by indigenous production through ToT	Supposed to increase to 100 per cent as production matures	A nominated Indian company
'Buy & Make (Indian)'		Indigenous production with partnership with foreign company	50 per cent	majority-holding Indian JV
Make	Strategic, complex and security sensitive systems	Indigenous R&D, design and development	Supposed to be 100 cent	DRDO, Academia, and Indian company
	'Buy Indian' (Low technology mature systems)	Outright purchase	30 per cent	Indian Company
	'Make' (High technology complex systems and upgrades)	Indigenous R&D, design, development and production	Supposed to be 100 per cent	Indian Company

Source: Table prepared by the author based on the information contained in Ministry of Defence, Government of India, *Defence Procurement Procedure 2011 (Capital Procurement)*

It is however noteworthy that the promise of a public version of LTIPP is not new. The promise was first made in 2009, after repeated calls from the industry and other stakeholders, including think tanks such as Institute for Defence Studies and Analyses (IDSA). The promise was then repeated in the first ever Defence Production Policy (DPrP) announced in January 2011 and also in the DPP-2011. Consequent to these repeated announcements, an 88-page document, coincidentally in the same title of TPCR was put on the MoD website. But soon after, it was withdrawn from the website for some unspecified reasons. It is hoped that this time the promise would be kept and the revised TPCR would be made available to wider public sooner than later. More importantly, it is vital that the content of the revised TPCR should be such that industry can easily decipher and make use of the information for translating the technology and capability requirement of the armed forces into hardcore defence items, which is the ultimate aim of releasing a public version of the long term plan. It would be worthwhile if the HQ IDS, the tri-service body responsible for preparing such document, engages the industry and other concerned stakeholders to sensitise in an appropriate manner about the content and intent of the TPCR, as and when they are released.

Level Playing Field to the Private Sector

In a significant breakaway from the past, the DAC has taken a bold decision to abolish DDP's power to nominate the state-owned enterprises - i.e., Defence Public Sector Undertakings (DPSUs) and Ordnance Factories (OFs) - for receiving Maintenance ToT (MToT). This would pave the way for the private sector to compete for such ToT and gain from contracts related to maintenance, repairs and overhaul of weapon systems and platforms. This is undoubtedly a step forward in creating a level playing field for the private sector enterprises which had some serious grievances against the DDP's way of functioning. However it is to be noted that the above decision does not mean the complete abolition of discrimination that the private sector complain about from time to time. The DDP still retains even bigger power in nominating its enterprises for major warship construction projects and for contracts under the 'Buy and Make'. However, with the wind of change blowing in right direction, it is expected that with the time, these powers would also be abolished so as to create a genuine level playing field for private sector.

Expediting 'Make' and 'Buy and Make (Indian)' Projects

From India's self-reliance point of view, the most significant amendments are perhaps the ones pertaining to 'Make' and 'Buy and Make (Indian)' categories which are in existence since 2006 and 2009, respectively. A number of measures have been taken or promised to expedite projects worth Rs 1200 billion under these two categories. It is noteworthy that when the 'Make' category was first announced in DPP-2006, it was hoped that the new category would bring in a drastic change in the India's defence industrial process. Breaking away from the past culture of license-based production, the category sought to award high-value and complex projects to Indian industry, including the private enterprises, which would be responsible for the entire task ranging from the design work to prototype development and final production. To share the risk elements associated with such complex projects, the MoD also made a provision of sharing up to 80 per cent of the developmental costs. However as the time progressed, it became clear that the category is struck in cumbersome processes with virtually no progress being made nearly seven years after it was first announced. This is amply evident from India's latest defence budget, which throws some crucial piece of statistics. As the budget shows, of the total allocation of \$16.4 million made in 2012-13 for 'Make' projects, not a single pie could be utilised. Moreover, the allocation has further been reduced to a mere \$0.2 million for 2013-14, implying that no major work can be undertaken for the two army projects - Tactical Communication System (TCS) and Future Infantry Combat System (FICV) - which have been indentified for development by the domestic players.

Similar is the fate with 'Buy and Make (Indian)' category under which the Indian enterprises, irrespective of their affiliation to the government or the private shareholders, are allowed to bid for MoD contract and execute them either on own capability or in partnership with foreign companies. Like in the 'Make' category this one also ran into cumbersome procedural hurdles although a degree of success has been achieved and that

too after some dilution of the prescribed procedures in the DPP. The \$3.0 billion 'Avro Replacement Programme' (of the Indian air force for procurement of 56 transport aircrafts) - the only project processed so far under this category - is the glaring example. Contrast to the DPP's laid down procedure of awarding the contract to the Indian industry; the tender has been floated to the foreign companies who are in turn asked select Indian private partners to deliver the aircrafts!

To overcome some of the procedural impediments associated with the above two categories, the DAC has taken a key decision to simplify their procedures for faster execution of contracts. It is to be noted that the while simplification of procedures of 'Buy and Make (Indian)' category has already been approved by the DAC that of 'Make category' will follow later, with the MoD constituting a 'high level committee' to look in to the matter. To give a further fillip to 'Make' projects, another amendment is made by way of providing a window for advance consultation between the industry and the Service Head Quarters (SHQs). It is hoped that the window of interaction together with the advance information of LTIPP would help translate the capital acquisition plans of the armed forces into national defence R&D and production plans.

Defining Defence Industry

In a rather surprising move, the DAC has taken two interrelated decisions to define defence items, and restricting the prior industrial licensing requirement to them only. For the purpose of definition, a list of defence items, prepared by the MoD, has been forwarded to the commerce ministry for notification. The formal notification will bring in a much needed clarity for the Indian industry, particularly the private sector enterprises, which are now required to seek industrial licenses only if the item in question features in the list. For the non-listed items, including the dual-use ones, mandatory licensing condition, which was not so clear earlier, is now waived.

Pending the final notification of the list, there are, however, four issues that need some deliberation. First, it is hoped that the defence item list will populate the reserved Category 6 of SCOMET (Special Chemicals, Organisms, Materials, Equipment and Technologies) list, which is not only consistent with India's obligations to various arms control regimes, but is harmonised with the commerce ministry's Indian Trade Classification (Harmonised System) Code for the effective control of export/import. The Indian industry interested in producing an item that features in updated SCOMET list would have full clarity not only about product's licensing requirement but item's trade aspects also. Second, it is also hoped that the defence item list is compressive and meets the international norms, especially the ones followed by 'Wassenaar Arrangement' group of countries. Since India is hopeful of getting the membership of above arms control regime, it is only logical for the country to have a list which is in harmony with that of the international group. The added advantage of such harmony is that India will find it easy to revise it as and when Wassenaar list gets revised. Third, with the defence item list in

sight, there is a need to relook at the list of eligible products/services which the DPP contains in the context of offsets. Logically the DPP's product list would become irrelevant after the commerce ministry's populates category 6 of SCOMET list with all the defence items. Four, it is not clear what would be the status of the industrial licenses already given to a host of Indian enterprises. This aspect assumes significance for those licenses which are not in conformity with the list of items to be notified soon.

Defining Indian Product

Like many other developing countries, India's defence industrialisation process has always had a strong foreign element, manifested in an overwhelming share of the imported parts, components and raw materials in what is often portrayed as indigenous product. Nonetheless, it has been a constant endeavour of the MoD to seek a certain percentage of indigenous content in the products supplied by the domestic enterprises under various procurement categories (see column 3 of Table). The MoD's intention notwithstanding, its successive DPPs till date did not articulate a clear methodology for estimating indigenous content, potentially leading to divergence of arguments/claims between the industry and the MoD. To overcome above shortcoming, the recent amendment seeks to define indigenous content in an "unambiguous manner, providing requisite clarity and a common understanding." It is hoped that the revised definition would facilitate Indian industry, particularly the private sector entities (which unlike their MoD-controlled counterparts, are always viewed suspiciously regarding their claims on indigenous content) in devising optimum strategy with respect to the source of their sub-suppliers.

Fiscal and Financial Measures

Apart from the above mentioned measures, DAC has also taken two major fiscal and financial decisions to stimulate indigenous defence manufacturing. As regards the fiscal measure, the DAC has promised to take up with the finance ministry to rationalise the tax and duty structures affecting indigenous defence manufacturing, and provide deemed export status to certain defence projects. These decisions, when get fructified, would not only address a long-held grievance of the Indian industry (particularly the private sector) but also enhance price competitiveness of home-grown products. As a financial measure, acting upon the promise first made in the DPrP in January 2011, the DAC has finally decided to create a fund to assist the small and medium enterprises (SMEs) engaged in defence manufacturing. In this regard, the MoD has persuaded SIDBI, a bank with exclusive dealings with SMEs, to earmark Rs 5.5 billion for providing financial and equity support. Considering that SMEs constitute the backbone of any industry and are at the heart of technology innovation, this crucial piece would greatly benefit India's manufacturing and technological base in the years to come.

Streamlining Procurement Provisions

In a move to further streamline the defence acquisition process, the DAC has brought in three changes, including that of powers enjoyed by the defence minister and Service Head

Quarters (SHQ). The power of the defence minister to approve deviations from the DPP provisions has now been delegated to the DAC. At the same time, the SHQs have now been delegated enhanced powers to process capital procurement worth up to Rs 1.5 billion - a three-fold increase from earlier power.

The most vital amendment to the procurement provision is however the one related to process before and after the grant of Acceptance of Necessity (AoN) which in other words means in-principle approval for procurement by the DAC. In a breakaway from the past, the new amendment has sought to freeze the technical and operational features - which are known as qualitative requirements (QRs) in Indian military parlance - of an equipment (processed for procurement) before the formal approval is given by the DAC. The new measure, which comes in the wake of allegations of change of parameters post-issuance of the VVIP helicopter tender, is intended to put a lid on such controversy in the future. Regarding the post-approval process, the amendment seeks to expedite acquisition process by way of squeezing the validity of approval period from previously years to one year now.

Although the above measures are undoubtedly courageous ones, and are taken with the best intention to “expedite the acquisition process and increase transparency”, they still fall short of addressing a fundamental lacunae in the acquisition process that often lead to delays, if not controversy. It is a fact that the armed forces, particularly the army, are often found constrained in expediting their acquisition proposals largely because of poor quality of QRs and faulty market survey among others. These aspects have been highlighted by various authorities including the Defence Secretary who in his submission before the parliamentary standing committee a year ago had informed that as many as 41 tenders of the Army were retracted because of the above deficiencies. Given this, freezing of QRs before the grant of AoN or limiting timeframe for issuing tender may not expedite the acquisition process as the existing problem still remain unaddressed. It is perhaps high time to go deep into the root causes and find some genuine solutions.

Conclusion

The DAC's April 20th decision to bring in 15 major amendments to the procurement and production policies is indicative of the establishment's further intent to strengthen indigenous defence manufacturing base, and promote transparency and efficiency in the procurement process. To a large extent, the intent this time is quite forceful and goes a long way in addressing some of the long-standing grievances of the domestic industry. It is hoped that with the wind of change blowing in the right direction, reforms in other areas, where the amendment have fallen short of expectation, would also be looked into sooner than later.