FICCI: 26% FDI CAP HAS ALREADY ATTRACTED TOP OVERSEAS DEFENCE OEMS

49% CAP CAN ONLY BE CONSIDERED ON THE BASIS OF CONDITIONS SUGGESTED BY FICCI

(A RESPONSE TO THE DISCUSSION PAPER RELEASED BY DIPP)

NEW DELHI, July 26, 2010. The 26% FDI cap in the defence sector has already attracted top overseas defence OEMs like BAe, EADS, Sikorsky, Lockheed Martin, Electtronica Defence Systems, etc to hugely invest in India's defence sector. Therefore, any increase in FDI Cap in a strategic sector like Defence will require careful thinking and analysis.

The following is an indicative list of the types of JVs between Indian and global companies that are currently operational in India (with 26% FDI cap):

- BAe – Mahindra & Mahindra, 26:74 JV addressing multiple platforms in Land Systems
- Sikorsky – TATA, 26:74 JV dedicated to manufacture of S-92 cabin;
- EADS – L&T Manufacturing Co. – Tripartite JV between EADS-L&T-L&T Holding-Operating (Design) Company, Proposed JV for EW Systems at 24.5:24.5:51;
- Speck –IAI, 26:74 JV for UAVs under evaluation by DIPP;
- recently announced Lockheed Martin – TATA 26:74 JV for Aerostructures;
- ITL Electro Optics – Alpha Design Technologies, 26:74 JV for;
- ElettronicaDefence Systems Pvt. Ltd. - Alpha Design Technologies, 26:74 JV for Solid State Trans-Receiver and
- Sofema Engineering & Systems Pvt Ltd - Alpha Design Technologies, 26:74 JV for engineering, warehousing & supply of spares and assemblies for CHEETAH & CHETAK helicopters to HAL.

Countries like Germany, China, South Korea, and Canada have recently revised their FDI policies in defence, post September 11, 2001 (9/11), making the policies much more stringent. They have inducted methodologies to punitively scrutinize FDI inflows in this sensitive and strategic sector.

In light of the above: (i) significant involvement of OEMs in the Indian defence sector at the existing 26% FDI Cap, (ii) recent global trends of a measured approach on FDI in defence, *any revision upwards from 26% will have to be approached carefully. 49% FDI Cap can only be considered on the basis of a set of conditions suggested below*:

- A higher FDI should be clearly linked with the full platforms being produced and has to be a minimum capitalization of US$100 million.

- The proprietary technology content being inducted in the JV is that what is sought by the country and will form the basis of further indigenous technological development.

- JV provides an undertaking to source between 50% to 70% of their components/ subsystems by value, indigenously, by nurturing Tierised Indian vendor industries.

- Export obligation of ten times the equity must be committed by the OEM within ten years of entering into the contract.

- The technology received, once cleared by the Home Country Government, should have no restrictions on its global exploitations.

- Post the transfer no retrospective law should be applicable to restrict the technology exploitation. All these should be in writing from by the Home country Government of the OEM / defence major. (Since there are dual use technology restrictions and a technology denial regime in many developed countries).

- The companies cleared with more than 26% FDI should not be eligible for “Make” funding.

- Under no circumstances the 51% Indian ownership pattern should alter. Any dilution in the equity structure of any sort has to be from the 49% portion of the foreign partner.

- Management of the company would be Indian and any and all understanding between the shareholders will be disclosed.

- All requests for up to 49% FDI must be linked with the fact that these companies will qualify for participation in the “Buy & Make Indian” category projects. Therefore, they must be mandated to at least 20% extra indigenous content in their products than the currently stipulated 50% limit applicable for all other Indian companies within 26% FDI limits.

These exemptions to 26% FDI limit should be done through wider participation of Industry in private and public sectors and should not be the exclusive preserve of Department of Defence Production & Supply.
In its response to the DIPP Discussion Paper, which has proposed a hike in the defence FDI cap to 74%, FICCI has maintained that globally, there are restrictions on allowing foreign capital in strategic sectors like defence for safeguarding of national security interests.

FICCI has pointed out and argued that FDI & transfer of technology are not always directly proportional, so raising FDI is no guarantee for true transfer of technology. The fact is that leveraging latest technologies from overseas suppliers would be difficult even if the FDI ceiling were raised as the OEMs exercise no control over the release of technology which is exclusively under their government’s control.

FICCI strongly believes that India would continue to attract OEMs for co-development and JVs at the existing FDI celing of 26%. This is so because India and China are only two countries where the spending on new defence platforms and systems will continue to grow in the post –global economic crisis period. In western countries, firstly, the defence markets are more or less saturated and secondly, the defence budgets have already started declining in the post economic crises period. For example in USA even a programme like F-22 was capped and their exports to Japan have been prohibited though Japan wanted to import F-22. Thus India is undoubtedly a promising destination for the foreign Defence players.

Additionally, defence is a long-term business case and given the current demand-supply dynamics of Indian defence sector, OEMs are convinced about the long-term benefits and business cases in India.

The following are the key recommendations by FICCI to facilitate a robust and qualitative growth of the Indian defence industry:

- The Government's objective should be to create defence industry verticals that are self sufficient, self reliant & export capable and across industry sectors (public and private).

- Creation and owning of IPR is critical to the growth of Indian defence Industry and to guarantee the long term national security goals. Toward this, FICCI would advocate that the Raksha Udyog Ratnas (RURs) scheme needs to be implemented to effect a 'Long term Product & Technology Strategy'.

- Along with the RURs for the SME sector there is a need to implement schemes like Technology Development Fund with up to Rs. 5 crore grant-in-aid to the SME sector. Concurrently, the autonomy of the DPSUs should be enhanced,

- 'Employment Generation' within the country is also a consideration when it comes to Strategic/Defence industry and we need to look at Long term Product and Technology Strategy along with indigenization to achieve the same.

- There needs to be a policy document duly ratified by the Parliament and linked with the overall procurement policy on indigenization. This policy document should articulate a roadmap and milestones to be set in terms of indigenization. The defence budget should be allocated in terms of the indigenization milestones to be achieved.

- Promoting indigenous capability as an essential instrument of National Security must get reflected through legislature measures relating to the GOI's Defence Procurement policy. The Defence Technology Commission proposed by Dr. Ramarao Committee is very relevant in this context.

- The Department of Defence Production should be restructured. A separate post of Additional Secretary with Joint Secretaries with sectoral (verticals) responsibilities should be created and mandated to look after private industry's issues and address the grievances of the private industry and provide active government support. Such vertical created for private sector should report to the Secretary (Defence Production) through institutionalized enhancement and enlargement in the role of

Department of Defence Production to look after private as well as government owned units.

- Identify current state of art of technologies needed to be developed / acquired by India. This list is to bear in mind that the “procurement” by MoD tends to be lumpy and suffers from the limitations on short term balance of power and capability rather than long term capability required to be developed / acquired by the country. The technologies enlisted may be prioritized for acquisition through allowing special case-to-case deviations to the 26% FDI limit.

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