OPINION

India’s proposed offset policy: Can it be the new dawn?

India’s offset policy was meant to reduce imports and promote self-reliance in defence manufacturing. But it continues to be a highly import-dependent nation for its military equipment requirements.

By **KARISHMA MANIAR**, **Jul 29, 2018**
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The concept of offset, as understood in the defence sector, primarily aims to benefit a buyer over and above the procurement of the defence product from a foreign supplier. Historically, most developing countries have always had provisions of offset in their defence procurement policies. Such procurements involve a substantial amount of public money and offsets allow for repatriation of some of these monies (through sub-contracting or other indirect means) back into the economy of the purchasing country through discharge of offset obligations by the seller.

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India's offset policy, since it's introduction in 2005, has been to reduce imports and promote self-reliance in defence manufacturing. However, 13 years later, India continues to be a highly import-dependent nation for its military equipment requirements.

When considering the factors for the limited traction on offsets, it can be argued that the issue has not been with the policy making, but the implementation. To be sure, the Government of India has frequently tweaked and revised offsets policies to address industry's concerns and accordingly, has given a boost to MSME sector, introduced change norms of changing Indian offset partners (IOP), increasing FDI limits to 49%, clearly defining the value addition norms, among many others similar initiatives which have been welcomed by all the stakeholders. Despite all these measures, the fundamental bottleneck has been the lack of modern technology possessed by our DPSUs, Indian private companies and MSMEs, which essentially restricts companies from effectively applying the transferred technology to their own manufacturing processes and, as a result, restricts the ability of foreign original equipment manufacturer (OEMs) from effectively discharging their offsets through this method, in a cost-effective manner.

Additionally, regulatory and operational challenges in India add to the headwinds faced by foreign OEMs while implementing offsets .

While countries such as Israel, Japan, Spain have had a very fruitful implementation of their offsets policies, a 'one size fits all' approach may not work for any country and certainly not for India. The country has different challenges and we need to find a balance between what we can offer to the foreigner manufacturers and what we would like to get in return.

To this end, the government of India has proposed draft amendments to the offsets policy which are a significant departure from the traditional ways of detailing offsets and are discussed below.

'Out-of-the-box thinking' proposal by the government of India

The government has introduced, in May 2018, a draft amendment to its offset guidelines which provides additional ways in which the foreign OEMs can discharge their obligations and at even higher multipliers. Besides the traditional forms of direct and indirect offset multipliers.

Investment in equity in a defence company

The policy proposes to open up any investment in equity in defence sector by a foreign OEM as an avenue for discharge of obligations. While entering JVs has been one of favourite means for foreign OEMs to invest in technology transfer and creation of capacity in the country, a recent data point quoted by minister of state for defence stated that since year 2000, only $5.13 million worth of FDI has been received under 41 proposals for FDI/JVs that are approved. This clearly reflects the preference foreign OEMs have to form JVs, but the actual investment under the JVs is paltry implying no technology transfer or capability creation. However, this new avenue for discharge of offsets acts an added incentive to increase the actual inflow of FDI, provided other operational requirements can be ironed out. If the government proposal of increasing the FDI limits for defence to 74% is indeed approved, this will be the most attractive avenue for discharge of offsets in a long-term perspective.

Defence industrial corridor

As per the draft defence production policy of 2018, defence industrial corridors (DIC) will be set up in collaboration with states (Tamil Nadu and Uttar Pradesh) to provide state-of-the-art infrastructure and facilities for setting up defence production facilities. This will allow for concentration of the defence industrial base from a long-term perspective. Investment by foreign OEMs in these defence corridors will enjoy a higher multiplier as compared to other areas with regard to the discharge of offsets.

Introduction of defence funds

The government has introduced SEBI regulated 'funds' for defence, aerospace & internal security. By investing in such funds, a foreign OEM can benefit in multiple ways such as (a) immediate discharge of offset obligations; (b) considerable reduction in quantum of offset obligations in light of the proposed multiplier of 3; and (c) escaping the operational challenges in searching for local offset partners and ensuring implementation by the offset partner. Such SEBI regulated funds, which are expected to be managed by industry

Analysis of the proposal

The amendment proposed by the government of India in 2018 contains major game-changing ideas and concepts. The effective use of multipliers to incentivise the defence corridors would benefit MSMEs to have a cluster approach to development, while the concept of a defence fund to discharge offset obligations would mitigate some of the risks that come with dealing with a domestic player directly.

While there is some pushback from the industry for effectively reducing offset obligations of the foreign OEMs through these means (and rightly so), this proposal seems to be a viable solution to India’s unique challenges discussed earlier in this article. Several concerns raised by the local industry seem justified when taking a long-term view for development of a domestic military-industry manufacturing base in the country. However, in the short-term, India needs immediate access to technologies, funds and professionals to deploy these funds in the right manner, in order to become a self-sustaining defence industrial base.

All of these objectives can be met with this proposed amendment to offset policy, without prejudice to India’s rights to revisit its policies in the coming times–a policy most countries follow and is also supported by Article XXIII of agreement on government procurement (GPA) by the World Trade Organisation which allows countries to revise its commercial policies to protect its essential security interests. It remains to be seen if these ‘out-of-the-box’ ideas will be implemented or not and how soon, but these developments are a testimony to the government’s ongoing efforts to boost defence manufacturing in India which truly is an urgent need for our nation.

(Views expressed are personal.)

The author is associate director at ELP in the defence & aerospace practice. With over 11 years of experience in the defence sector. She has been the lead on many large contract negotiations with the ministry of defence and foreign OEMs.

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