Defence Offset Dilution

Why in news?

The government has diluted the offset policy in defence procurement.

Why was it diluted?

- Reportedly, it was diluted in response to the Comptroller and Auditor General (CAG) of India's report.
- Many contend that the move is a setback for augmenting domestic capabilities or for realising the goal of Atmanirbhar Bharat.

Why defence trading is done?

- Most countries restrict trade in defence equipment and advanced technologies in order to safeguard national interest.
- Yet, for commercial gains and for global technological recognition, governments and firms do like to expand the trade.
- Negotiated bilateral sales between countries are a way out of the dilemma.

What are the factors?

- **Soft credit** often sweetens the deals with restrictions imposed on use, modification and resale of such equipment and technologies.
- In such trade negotiations, the price of the product is one of the many other factors.
- **Geopolitics** and the **technical knowhow** involved in the equipment weigh-in considerably as the contracts are for the long term, with technological fixities.
- The **product and technology** compel buyers to stick to them for:
    1. The advantages of bulk purchase, and
    2. Dependence on the supplier for spares and upgrades.
- In other words, there is considerable "path dependency" in such choices, rendering the decisions difficult to reverse.
- Developing country buyers often lack an industrial base and research and development (R&D) facilities (which take a long time to mature).

How will offset clause help?

- The price and the terms of the contract reflect the government's relative bargaining strength, and political and economic considerations.
- Large buyers such as India seek to exercise their "buying power" to secure not just the lowest price.
- They also try to acquire the technology to upgrade domestic production and build R&D capabilities.
- The offset clause is the instrument for securing these goals.

What was the initial offset clause?

- Initiated in **2005**, the offset clause has a requirement of sourcing 30% of the value of the contract domestically.
- Indigenisation of production in a strict time frame, and training Indian professionals in high-tech skills, required for promoting domestic R&D.
- However, the policy has been tweaked many times since.

What are the changes made?

- As of November 2019, the Defence Ministry had signed 52 offset contracts worth $12 billion via Indian offset partners, or domestic firms.
- The duration of these contracts extends up to 2022.
- According to the CAG report, between 2007 and 2018, the government signed 46 offset contracts worth ₹66,427 crore of investments.
- But, the realised investments were merely 8%, or worth ₹5,457 crore.
- Reportedly, technology transfer agreements in the offsets were not implemented, failing to accomplish the stated policy objective.
- Recently, the government has diluted this policy further.
- Henceforth, the offset clause will **not be applicable to bilateral deals** and deals with a **single seller** (monopoly), to begin with.

Why is it a setback for defence?

- Most defence deals are bilateral, or a single supplier deal (due to the monopoly over the technology).
- The dilution means practically giving up the offset clause.
- This may mean an end to India's prospects for boosting defence production and technological self-reliance.
- But, the government defended the decision by claiming a cost advantage.
- Price is but one of many factors in such deals, as explained above.
- The higher (upfront) cost of the agreement due to the offset clause would pay for itself by,
    1. Reducing costs in the long term by indigenisation of production,
    2. The potential technology spill-overs for domestic industry.

- Hence, giving up the offset clause is undoubtedly a severe setback.

What should be learnt from the aerospace industry episode?

- Despite the heft of Hindustan Aeronautics Limited, India is a lightweight in global civilian aircraft manufacturing.
- This is due to the fact that the public sector giant mostly devotes itself to defence production.
- With the introduction of the offset policy in 2005, things changed dramatically.
- For contracts valued at ₹300 crore or more, 30% of it will result in offsets, implemented through Indian offset partners.
- As aerospace imports rose rapidly, so did the exports via the offsets by 544% in 2007, compared to the previous year.
- By 2014, exports increased to $6.7 billion from $62.5 million in 2005.
- The offset clause enabled India to join the league of the world's top 10 aerospace exporters.
- The success was short-lived, however. The policy dilution undid success.
- Exports plummeted after the offset clause was relaxed.

What could be done?

- Because of the CAG's critical remarks in its latest report, the government has virtually scrapped the defence offset policy.
- Thus, India has voluntarily given up a powerful instrument of bargaining to acquire scarce advanced technology.
- But, there are successful examples to draw lessons from, as the aerospace industry episode demonstrates.
- India needs to re-conceive or re-imagine the offset clause in defence contracts with stricter enforcement of the deals.
- This should be based in national interest, and in order to aim for 'Atma Nirbhar Bharat Abhiyaan', or a self-reliant India.

Source: The Hindu

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