

Topic of the week for discussion: 21st to 27th Aug. 2014

Topic: FDI in Indian Defence sector: Debate

Background for the topic

FDI means Foreign Direct Investment. In Indian context, in simple terms it means setting of business of foreign companies in India.

Latest News

The Union Government on 6 August 2014 approved a proposal to raise the amount of foreign direct investment allowed in India's defense. Under this proposal the government is to increase the FDI limit in the defense industry to **49% from 26%**.

Status of Defense FDI at present:

- At present 26% FDI allowed through the Foreign Investment Promotion Board (FIPB) route.
- Clearance from the Cabinet Committee on Security (CCS) is required for FDI beyond 26%
- The FDI proposals in Defense are approved on a case-to-case basis at present

New position of FDI in Defence as approved by the Parliament:

- Up to 49% FDI would be allowed after approval from FIPB
- Management control of companies receiving these investments must remain in the hands of Indians.
- Proposals, even those for less than 26%, will require approval from the Foreign Investment Promotion Board (FIPB)
- Even after allowing 49% FDI in defense, clearances will be given on a case-to-case basis

Debate:

India is at present the world's largest importer of arms. It imports almost 70% of its military hardware. It, therefore, wants to open up the domestic weapons industry to help boost domestic manufacturing and modernize its Soviet-era military.

In May 2001, the defense industry was thrown open to the private sector. The Government permitted 100 per cent equity with a maximum of **26 per cent FDI component**, both subject to licensing. Unattractiveness of the policy became evident in a short span of time. By 2004, Defense Minister George Fernandez was forced to admit in the Lok Sabha that India had received no FDI proposal till then.

To attract foreign players, the union government has increased the cap to **49%**, against the foreign player's hope of 51%. Few feel that this new cap is as good as 26% as it does not give foreign players any independent control on production of armed goods and other Research & Development activities. Some analysts say the government should have raised the limit to **74 per cent** to give foreign firms actual control and even some supporters decry for 100% FDI in Defense sector.

Topic
Introduction

Industry bodies said the decisions to raise the FDI limit will help attract much-needed capital, create jobs, encourage collaboration and benefit cash-starved small and medium enterprises (SMEs).

But many are putting forward the argument that **FDI will stymie the growth of indigenous defense industry**. The indigenous industry has not been able to meet the demand as imports have now climbed to close to 75 per cent when it was expected to reduce from 70 % to 30 % in last 2 decades.

One reason is the dismal performance of the Defense Research and Development Organisation (**DRDO**) and the public sector. Although DRDO has 51 laboratories with 5,000 scientists and over 25,000 support personnel, it has not been able to develop a single system in the promised time-frame and conforming to the accepted parameters.

Another argument put forward is that more FDI will put the **security concerns** at vulnerable position. Apprehensions are often expressed that during operational emergencies, foreign investors may shut down their factories and choke supplies to the armed forces.

Presently, India is procuring all critical weapon systems produced/integrated abroad. It is not understood as to how India's security would get threatened if the same weapon systems are produced/integrated in India. As a matter of fact, indigenous production will insulate India from unilateral imposition of embargos on contracted supplies by whimsical foreign governments. The degree of assurance and resulting comfort accruing from indigenous facilities will always be significantly more than dependence on imports. Additionally, indigenous manufacturing facilities will also ensure better life-time support including supply of spares.

On the contrary, it is important to understand that any investment in defense production by a foreign player means a lasting and protracted relationship; he seeks a stable environment with long-term, well-defined economic policies which are fair and consistent. In addition, there are four factors which influence such decisions – availability of abundant raw material, skilled work force, low cost of production and lucrative market. It is the interplay of all these factors which influence an investment decision

If India is serious about attracting FDI in defense, it has to position itself as the most lucrative FDI destination with improved '**FDI Confidence Index**'. For that, it must make structural adjustment to provide functional freedom to joint ventures to respond to market dynamics.

Read further:

<http://scroll.in/article/666232/Why-some-people-fear-that-100-percent-FDI-in-defence-sector-will-compromise-national-security>

<http://www.thehindu.com/opinion/lead/indias-defence-needs-fdi/article4712277.ece>

<http://knowledge.wharton.upenn.edu/article/whats-ailing-indias-defense-sector/>

<http://thediplomat.com/2014/06/up-in-arms-foreign-investment-in-indian-defense/>