

India's Defence FDI Policy: Issues and Prospects

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**India's Inward FDI Experience in the Post-liberalisation Period
with Emphasis on the Manufacturing Sector**

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**India's Post-1991 Inward FDI Experience:
Looking Beyond the Aggregates**

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List of Abbreviations

BEL	Bharat Electronics Ltd
CII	Confederation of Indian Industry
COO	Chief Operating Officer
CTO	Chief Technology Officer
DFI	Direct Foreign Investment
DIPP	Department of Industrial Policy and Promotion (India)
DOD	Department of Defense (US)
DP	Discussion Paper
DSIR	Department of Scientific and Industrial Research (India)
DTAG	Defense Trade Advisory Group (US)
DTI	Defense Trade Initiative (US)
DTSA	Defense Technology Security Administration (US)
DTTI	Defence Trade and Technology Initiative
ECR	Export Control Reform (US)
FDI	Foreign Direct Investment
FICCI	Federation of Indian Chambers of Commerce and Industry
FII	Foreign Institutional Investor
FIPB	Foreign Investment Promotion Board (India)
FPI	Foreign Portfolio Investor
FVCI	Foreign Venture Capital Investors
IDDM	Indian Designed, Developed and Manufactured
IOP	Indian Offset Partners
ITAR	International Traffic in Arms Regulations (US)
LMAC	Lockheed Martin Aeroframe Corporation
MoD	Ministry of Defence (India)
NATO	North Atlantic Treaty Organisation
NFDR	New Framework for the U.S.-India Defense Relationship
NMCC	National Manufacturing Competitiveness Council (NMCC)
NRI	Non-resident Indian
OEM	Original Equipment Manufacturers
OFs	Ordinance Factories
PSUs	Public Sector Undertakings
QFI	Qualified Financial Investors
RFP	Requests for Proposals
TLM	Tata Lockheed Martin Aerostructures Ltd
ToT	Transfer of Technology
USIBC	US-India Business Council

India's Defence FDI Policy: Issues and Prospects

Section 1 Introduction

India took the first step towards opening the defence sector to foreign investment in 2001 when foreign direct investment (FDI) up to 26% share in equity holding of a joint venture, subject to industrial licensing was allowed.¹ Defence manufacturing being the bedrock of national security, a set of conditions was introduced subsequently² with a view to ensure that resident Indians have the control over a joint venture company. Thus, resident Indians were entrusted with the management control over a company through majority on the Board, and the Chief Executive of such a company was required to be a resident Indian. No category of foreign investors, including NRIs and Overseas Corporate Bodies (with 60% or more of NRI stake), were expressly ruled out from taking up equity.³ A further amendment of the policy was effected in 2013, when foreign investors were allowed to hold equity shares in excess of 26%, on a case by case basis, if they offered 'state-of-art' technology.⁴ Foreign portfolio investment (through FPI/FII) was explicitly disallowed, further underlining the importance of technology accompanying investment. However, existing investors could continue.⁵ Seen in the context of India's experience of opening

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¹ Press Note No. 4 (2001 Series), dated 21 May, 2001, available at: http://www.dipp.nic.in/English/policy/changes/press4_01.htm.

The issue of what is FDI among all types of foreign investments, though is relevant, is not being dealt with here as the discussion on it itself would be subject matter for a separate paper. In India, the internationally prescribed minimum of 10% shareholding is not strictly adhered to. In general, irrespective of the extent of holding, if a non-resident acquires shares in a company other than by way of acquisition from the stock market it is considered as FDI. See: Reserve Bank of India, *Balance of Payments Manual for India*, September 2010. Following the announcement in the Union Budget 2013-14, a Committee was appointed to rationalize the definitions of FDI and FII. The Committee submitted its report in June 2014. Its recommendations can, however, be termed as intermediate. While trying to distinguish between investments in listed and unlisted companies and generally basing on the criterion of 10% share, the Committee recommended that "[F]oreign Investment in an unlisted company irrespective of threshold limit may be treated as FDI." See: Government of India, Ministry of Finance, *Report of the Dr Arvind Mayaram Committee on Rationalising the FDI/FII Definition*, available at http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_division/Report%20of%20Dr%20Arvind%20Mayaram%20committe%20on%20FDI_FII.pdf

² Press Note No. 2 (2002 Series), dated 4 January 2002, available at: http://dipp.nic.in/English/policy/changes/press2_02.htm.

³ This interpretation is based on the guidelines provided by the Press Note specified that there would be a three-year lock-in period for transfer of equity from one foreign investor to another foreign investor (including NRIs & OCBs with 60% or more NRI stake).

⁴ Press Note No. 6 (2013 Series) dated 22 August 2013, available at: http://dipp.nic.in/English/acts_rules/Press_Notes/pn6_2013.pdf.

⁵ According to the 2014 Consolidated FDI Policy, "FPI/FII (through portfolio investment) in companies holding defence licence as on 22 August, 2013 (date of issue of Press Note 6 of 2013) will remain capped at

up to FDI after 1991 when transfer of technology was not insisted upon, the stipulation that foreign investment should be accompanied by technology transfer was a welcome development. A Discussion Paper⁶ of the Department of Industrial Policy and Promotion (DIPP) circulated in 2010 suggested that the foreign investment limit should be raised to 74%. This suggestion did not find favour because of Defence Ministry's opposition⁷.

From 2001, when India opened the sector to FDI, and till August 2013, when the cap of 26% was virtually removed, the reported FDI inflows into the sector were a mere \$4.94 mn. No additions took place since then and till the end of June 2014. This lack of interest on the part of foreign investors was probably the reason why opening up the defence sector to 100% FDI participation was back on the policy agenda. It is also relevant to note that India introduced the defence 'offset' policy⁸ in 2005, much later than many countries, and the first such agreement took place in 2007.⁹ It is understandable that a country with heavy dependence upon imports¹⁰ would like to promote domestic production not only to ensure uninterrupted supplies in critical times but also to reduce the import burden, besides providing fillip to local manufacturing. The extant policy having failed, the government showed its intent to further open the doors of the defence sector to foreign investors. However, as noted above, after the 2013 policy change, there is no bar on allowing a wholly foreign owned defence firm, provided there is transfer of 'state-of-the-art' technology, the investors are genuine¹¹ and the majority of the company's board and the Chief Executive are resident Indians. The demands to enhance

the level existing as on the said date. No fresh FPI/FII (through portfolio investment) is permitted even if the level of such investment falls below the capped level subsequently", p. 45, available at: http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf.

- 6 Ministry of Commerce and Industry, Department of Industrial Policy and Promotion (DIPP), "Foreign Direct Investment (FDI) in Defence Sector", available at: http://dipp.nic.in/english/Discuss_paper/DiscussionPapers_17May2010.pdf.
- 7 "Antony opposes proposal to hike FDI in defence to 49 per cent", *Indian Express*, July 4, 2013. (ISID Online Press Clippings database)
- 8 "An offset agreement is a type of side deal, sometimes best described as a sweetener. This is an agreement between two or more parties that provides additional benefits and is ancillary to another negotiated contract... A company's offset obligation is usually worth 50-100 per cent of the value of the contract and can be direct or indirect. Direct offsets are linked to the original defence contract. Companies often agree to transfer relevant technological knowhow or use local suppliers to build the equipment they are selling to the government", Definition of offset agreement, [ft.com/lexicon](http://lexicon.ft.com/lexicon), accessed from: <http://lexicon.ft.com/Term?term=offset-agreement>.
- 9 At present, offsets come into play for contracts of Rs. 300 crore or more. For a discussion on India's offset policy see: Thomas Mathew, "Essential Elements of India's Defence Offset Policy - A Critique", *Journal of Defence Studies*, Vol. 3, Issue 1, 2009 accessed at http://www.idsa.in/jds/3_1_2009_EssentialElementsofIndiaDefenceOffsetPolicy_TMathew.html. Analysis does point out that offsets are not violative of WTO rules. See: Sandeep Verma, "Offset Contracts under Defence Procurement Regulations in India: Evolution, Challenges and Prospects", *Journal of Contract Management*, Summer 2009, pp. 17-32. Accessed at <https://www.ncmahq.org/files/Articles/JCM09%20-%2017-32.pdf>.
- 10 Defence related imports during the past three years are reported to have amounted to Rs. 83,458 crore. See reply to Rajya Sabha Starred Question No. 496, replied on August 12, 2014.
- 11 The government clarified that original equipment manufacturers, design establishments, and companies having a good track record of past supplies to armed forces, etc. would be preferred. It also reserved the right to verify the antecedents of the foreign collaborators and domestic promoters. See: Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, "Consolidated FDI Policy", Circular 1 of April 2013.

the level of foreign participation in the defence sector could, therefore, be interpreted as demands for relaxing these conditions.

The first signs of a re-think on FDI in defence sector came in the form of the Discussion Paper (DP) issued in May 2010 by the DIPP, referred to earlier. The DP, which provided detailed justification for permitting higher shares of FDI, remains, till date, the only such document available in the public domain. It recommended that up to 74% foreign shareholding should be allowed in defence enterprises (but did not specifically rule out 100% foreign share). The main justification offered was that “[M]anufacturing within the country, through foreign capital, with full transfer of state-of-the-art technology will be a better option than importing the equipment from abroad”. While arguing in favour of liberalising the FDI policy, the DP observed that the global defence manufacturing base has become more dispersed, implying thereby that India can take advantage of the competition among defence equipment manufacturers. More importantly, it underlined that since the ownership structure of defence companies is in constant ‘flux’ there would be no risk of coming under the influence of any country. A few relevant observations and propositions of the DP are listed in Box-A. The DP’s assumptions need to be looked into as they will have an important bearing on the success of the policy.

The new approach to foreign participation in the defence sector was announced by the Finance Minister in the Budget Speech 2014-15. He stated that the cap of foreign participation in companies producing defence equipment would be raised to a composite 49% with full Indian management and control, through the FIPB route.¹² While the earlier policy stated that FDI beyond 26% would be considered by the Cabinet Committee on Security, the Finance Minister’s statement reflected a rethinking on allowing non-FDI forms as well, as it referred to the cap being a composite one. The follow up Press Note issued by the DIPP on August 26, 2014 confirmed this change in policy. It stated that “FDI limit of 49% is composite and includes all kinds of foreign investments i.e. Foreign Direct Investment (FDI), Foreign Institutional Investors (FIIs), Foreign Portfolio Investors (FPIs), Non-Resident Indians (NRIs), Foreign Venture Capital Investors (FVCI) and Qualified Foreign Investors (QFIs) ...”.¹³

While permitting foreign investment up to 49% some important departures were made from the extant policy with regard to representation on the Board and nationality of the Chief Executives. In June 2014, just a few days after the new Union government was formed, the requirement for obtaining specific industrial license (IL) was indirectly withdrawn by specifying the products for which an IL would be required.¹⁴

¹² Budget 2014-2015: Speech of Arun Jaitley, Minister of Finance, paragraph 18. The Finance Minister informed about this change in policy in Rajya Sabha in response to Unstarred Question No.1406 on 22.7.2014.

¹³ Press Note No. 7, 26 August 2014, p. 4.

¹⁴ “India Reworks Defense Licensing Categories, Confusion Remains on FDI Limits”, available at <http://www.defensenews.com/article/20140706/DEFREG03/307060008/India-Reworks-Defense-Licensing-Categories>. See also DIPP Press Note. No. 3 (2014 Series) dated June 26, 2014.

Box-A: Discussion Paper of the DIPP

Foreign Direct Investment (FDI) in Defence Sector: Some Observations

- The indigenous R&D has not kept pace with the requirements and manufacture through transfer of technology (ToT) to Public Sector Units (PSUs)/Ordnance Factories (OFs) has proved to be ineffective and slow. ToT was often not complete, as the suppliers were more keen to push their own products, rather than indigenizing the production in India.
- Since it may take some time for domestic companies to acquire a technical edge in the defence industry which is highly capital and technology intensive, it is necessary to access the technology through FDI.
- The general perception is that the present minority FDI cap of 26% discourages original equipment manufacturers (OEMs) from bringing in proprietary technology, as OEMs are reluctant to license their proprietary technology.
- A higher FDI limit would ... provide a significant incentive for transfer of know-how/technology to the country, leading to higher levels of technological expertise.
- Increase of cap from 26% to 49% will not give any additional say to the foreign investor in the affairs of the company as per the provisions of the Company Law.
- By merely increasing the limit from 26% to 49% we may be accused by posterity of doing too little and too late. Therefore, in case we really want to have the state of the art technology, we have to permit anything above 50% if not 100%. It may be, therefore, desirable to allow either 100% or 74% as in the case of telecom sector.
- FDI provides the necessary supplemental funds and higher levels of foreign investment would reduce the corresponding fund requirements of the Indian partners.
- Defence manufacture is much more dispersed among larger number of countries today than in the past. Also, the ownership structure of many of the important defence production companies is in a state of continuous flux. Therefore, there is no risk of exclusive dependence on a particular country for investment and technology.
- Further, any such threat can be addressed with Government having a right to expropriate a manufacturing facility if the situation warrants.
- A large share of Indian foreign exchange goes towards defence purchases. Allowing more FDI in defence would result in significant savings in foreign exchange, as more foreign companies will establish defense industries in India.
- Liberalisation of the FDI regime would strengthen India's export potential by way of exports of defense products to other countries.
- Production of military equipment within the country will provide impetus to the manufacturing sector through large scale ancillarization as in the case of major industrialized nations like USA, France and Germany.
- A large number of manufacturers of defence and dual use products are finding it difficult to manage their production in western countries due to increasing costs of labour and other inputs. This is the right time for India to project itself as a new hub for manufacturing.
- A number of global defence majors are waiting to set up an alternative/additional manufacturing base in India. *It is, therefore, not at all necessary for us to underwrite production. The FDI policy will not interfere with the prerogative of the Armed Forces to choose an equipment of their choice.*
- *There need not be any commitment on procurement and foreign investors will have to participate in the RFP [Requests for Proposals (RFPs) for sourcing of defence equipment] to technically qualify and also compete in the financial bid.*
- For future RFP's by MoD, a condition may be imposed that the successful bidder would have to set up the system integration facility in India with a certain minimum percentage of value addition in India. The successful bidder should be allowed to bring equity upto the proposed sectoral cap.

Source: Based on DIPP Discussion Paper, "Foreign Direct Investment (FDI) in Defence Sector", May 2010.

Is this change in policy expected to result in the inflow of requisite amount of foreign investment and transfer of 'state-of-art' technology so as to develop a strong and viable defence sector in India? This question can be reasonably answered in our view by examining the nature of global defence industry and the role that foreign investment has played in the development of the industry in countries other than the major powers on two sides of the Atlantic. We would first analyse the global market for defence equipment and the place that the large equipment producers have in the global market for defence equipment. In Section 3, we would present the cases of a few countries that were able to establish domestic production capacities in the defence sector, in particular, their dependence on foreign investors. In this context, we would also examine the role of offset policy and strategic military cooperation in the evolution of new entrants. Section 4 deals with the central question of the paper, *viz.* the possibility or otherwise of foreign investors showing interest in the development of India's defence sector. Section 5 describes a development that has been in the making for some years now and which is acquiring increasing significance *i.e.*, the cooperation between US and India in the defence sector, an important component of which is the Defence Trade and Technology Initiative (DTTI). This Section also discusses the position of US and Indian private sector interests and global greenfield investments in aerospace and defence sectors. Section 6 examines the revised policy on FDI in defence sector. The final section sums up the discussion.

Section 2

Concentration and National Affiliation of Defence Manufacturers

Concentration in Global Arms Sales

The starting point for our analysis is an argument made in the DP, which says that global defence manufacturing base has become more dispersed today than it was earlier, implying thereby that India can take advantage of this competitive marketplace to scout for suppliers of suitable advanced technologies. The pertinent question in this context is whether the present day market for defence technologies provides sufficient basis for this optimism of the government that it will get easy access to the 'state-of-the-art' technologies. Following the end of cold war, global arms business underwent considerable restructuring through mergers and acquisitions (M&As).¹⁵ In 2003 the ten largest defence companies accounted for 61.3% of the sales of the top 100, while in 1990; the corresponding share was 37%. Six of the top 10 in 2003 were US companies while the UK, France, Italy and the Netherlands had one company each in the top 10 list.¹⁶ In 2010, 7 of the top 10 companies were from the US, there was one each from the UK and Italy, and the remaining one was a trans-European company. Since the consolidation witnessed in the industry has strong national/regional dimension, company-wise

¹⁵ It is also relevant to note that the M&As have strong national/regional dimension. See for instance The Defence Industry in the 21st Century Thinking Global ... or Thinking American?, accessed at www.pwc.pl/en/publikacje/defence_industry_ads.pdf

¹⁶ Also see: <http://www.theaustralian.com.au/national-affairs/policy/subs-divide-tale-of-two-companies/story-e6fgr8yo-1226936449970?nk=ec1aeb16e15e34fbaf02d916f2529095>

concentration may be less relevant than country/region-wise concentration. M&As among the US companies are shown in Box-B. The European case was a little complex as it involved consolidation within the region. According to the data released by Stockholm International Peace Research Institute (SIPRI), parent companies headquartered in the US & Canada and their subsidiaries in other countries had 58% share of the sales of the top 100 such companies globally (excluding China) in 2012.¹⁷ The corresponding share for EU was 27%; for the erstwhile socialist bloc it was 5%. The share of the remaining countries was nearly 9%. In fact, members of NATO accounted for nearly 82% of the total sales. Thus, the reality is that global arms sales remain highly concentrated in the developed countries, with the US alone accounting for about 58% of the sales of the top 100 companies in 2012. (Table-1)

National Affiliations Remain Important

The DP's comment about the ownership structure being in constant 'flux' also requires careful examination. The paper seems to suggest that country affiliations do not matter and since ownership is country neutral, individual countries cannot exercise influence over these companies. Hence, India should not be concerned about the influence by a country or group of countries. However, as was noted above, the end result of many M&As cannot be described as 'flux'; there is a definite pattern. From the available information, it does appear that institutional investors and families belonging to the US, and to a lesser extent Canada, dominate the shareholding of leading companies of North America. For instance, institutional holdings, dominated by the US and Canadian investors, hold about three-fourths of the share capital of Boeing. In case of Lockheed Martin, the share of the North American investors is even higher at 86%. In General Dynamics, Honeywell International, Raytheon, L-3 Communications and Huntington Ingalls Industries Inc, all the top 10 shareholders are American financial investors. In case of Oshkosh, nine of the top ten shareholders are American financial investors, the remaining being a financial investor from the UK. Booz Allen Hamilton is a subsidiary of the private equity firm Carlyle. Bombardier is majority-owned by the Bombardier family of Canada, which also holds shares that give them much greater voting power. The two largest shareholders of Magellan Aerospace are Canadian individuals holding 74% and nearly 4% of the company's shares. Except for three American financial investors, all the remaining top 10 shareholders in this company are Canadian.

The largest shareholders of Airbus are the governments of France and Germany, each holding about 11% of the shares. Another government shareholder among the top 10 is Sociedad Estatal de Participaciones Industriales of Spain. In case of Finmeccanica, the Italian government holds 32.5% shares. It has five American financial investors among the top 10, led by Fidelity Management & Research Company with 2.1%. Norwegian sovereign wealth fund is the fifth largest shareholder. Interestingly, Libyan Investment Authority stands at the third place with 2% share.

¹⁷ See 'Measuring arms production' at http://www.sipri.org/research/armaments/production/researchissues/measuring_aprod

Box-B: Mergers and Acquisitions in American Defence Manufacturing Industry (1985-2005)

<i>Existing/Surviving Company</i>	<i>Merged Companies</i>
Lockheed Martin	Lockheed
	GD fort worth
	Sanders
	Martin Marietta
	Gould Ocean Systems
	GD space
	GE Aerospace ←----- RCA
	Loral
	Goodyear Aerospace
	Fairchild Weston
	Honeywell -ED
	Ford Aerospace
	Libra scope
	LTV Missiles
	IBM federal System
Unisys Defence	
Northrop Grumman	Comsat
	Northrop
	Grumman
	Vought
	Westinghouse Electronics Sysp ←----- UTC Norden Systems
	Ryan Aeronautical
	Complek
	Newport News
	DPC Technologies
	Federal Data Corp.
	Complek
	Newport News
DPC Technologies	
Raytheon Corp	Hughes Aircraft
	Magna Vox
	CAE Link
	GD Missiles
	Raytheon
	E - Systems
	CTAS
Texas Instruments	
Boeing Co	Hughes Electronics
	Agro Systems
	Rockwell Aerospace
	McDonnell Douglas ←----- Hughes Helicopters
General Dynamics	Motorola Inc.
	Primex
	Ceridian
	Bath Iron Works
	GTE Government Systems
	NASSCO
	Galaxy Aerospace

Source: Based on PricewaterhouseCoopers, *The Defence Industry in the 21st Century Thinking Global ... or Thinking American?* (undated), accessed at www.pwc.pl/en/publikacje/defence_industry_ads.pdf

Table-1: Country-wise Distribution of Top 100 Arms Sellers in 2012

Country	No. of Companies	Arms Sales 2012 (US \$ mn.)	Share in Top 100 (%)	Cumulative Share (%)
USA	42	230,010	58.19	58.19
UK	10	44,386	11.23	69.42
France	6	22,330	5.65	75.07
Russia	6	19,550	4.95	80.01
Trans-European	1	15,400	3.90	83.91
Italy	3	14,628	3.70	87.61
Japan	6	10,944	2.77	90.38
Israel	3	6,980	1.77	92.15
Germany	4	6,703	1.70	93.84
India	3	5,310	1.34	95.18
South Korea	4	4,207	1.06	96.25
Sweden	1	2,910	0.74	96.98
Singapore	1	1,890	0.48	97.46
Ukraine	1	1,439	0.36	97.83
Norway	1	1,294	0.33	98.15
Spain	1	1,130	0.29	98.44
Brazil	1	1,060	0.27	98.71
Switzerland	1	930	0.24	98.94
Finland	1	890	0.23	99.17
Turkey	1	870	0.22	99.39
Canada	1	840	0.21	99.60
Poland	1	820	0.21	99.81
Australia	1	760	0.19	100.00
Total	100	395,281	100.00	

Source: SIPRI. <http://www.sipri.org/research/armaments/production/Top100>

Dassault Aviation is majority owned by the Dassault family-controlled holding company. Another major shareholder in the company is European Aeronautic Defence and Space Company (reorganised as the Airbus Group in 2014), France which holds 46.3%.¹⁸

A few stock exchange listed leading manufacturers do have financial investors as dominant shareholders. This is not surprising because being listed on the bourses; some stock churning will take place regularly. While such shareholdings may change, the companies cannot escape home governments' regulations and influence.¹⁹ Lockheed Martin, Boeing and Northrop Grumman cannot be considered as non-American while Bombardier and Magellan are clearly identified as Canadian. Whichever way one looks at, it would be difficult to dispute the supremacy of the US in defence production and technology. This fact was also acknowledged by Dr. Tarun Das, the then Chief Mentor of CII. Congratulating the DIPP for bringing out the DP, Dr. Das said, "[W]hether we like it or not, USA is now the Leader in Defence Technology globally. For its own national security interest to be preserved, India needs to access such High Technology".²⁰

¹⁸ Based on the latest shareholding particulars available in the ownership module of thomsonone.com

¹⁹ Companies are also controlled by home governments in a variety of ways: limiting the maximum share that could be held by a foreign investor; mandating the nationality of board members and senior executives; taking up golden shares; and imposing sector-wise controls. For an elaboration and examples, see: Sandeep Verma, "FDI in Defence: Lessons for Developing Countries", IDSA Comment, May 7, 2013, available at http://www.idsa.in/idsacomments/FDIinDefence_sverma_070513.html#footnoteref12_7qgjbq5.

²⁰ Feedback to the Discussion Paper, http://dipp.nic.in/English/Discuss_paper/AspenInstitute_16June2010.pdf

Section 3

Some Features of Major Manufacturers of Emerging Countries

The DP mentioned the cases of Israel and South Korea which have import to export ratios of 1.3:1 and 8.8:1 respectively, as compared to India's very high 194:1. In this context, it is worth referring to the ownership structure of the largest arms companies in these two countries. As can be seen from Table-2, these companies either belong to the local business groups or are majority owned by their respective Governments. More importantly, FDI does not have a direct role in any of these companies. Additionally, South Korea took advantage of its military alliance with the US due to which the country could get technology from its partner and was thus able to follow an "assertive offset policy".²¹

Table-2: Ownership Details of Some Major Non-US, Non-European Arms Sellers

Rank 2012	Name of the Company	Country	Ownership
34	Elbit Systems [listed]	Israel	Shareholders with more than 1% shareholding: Federman Enterprises group of Israel (45.9%); Israeli financial services companies -- Migdal Investments Management (5.5%), Excellence Nessuah (5.1%), Psagot Investment House Ltd. (5.0%), Clal Insurance Enterprises Holdings (4.7%); and an arm of Alliaz SE, a financial services company of Germany (1.2%)
36	Israel Aerospace Industries	Israel	Government Owned
52	Rafael	Israel	Government Owned
54	Samsung Techwin	South Korea	Samsung Group of South Korea
67	Korea Aerospace Industries [listed]	South Korea	Korea Development Bank 26.41%; Hyundai Motors and Samsung Techwin 10% each; Odin Holdings 5%; DIP Holdings 5%; National Pension 6.32%; Employee Share Options 3.33%; and Institutional investors 33.94%
84	LIG Nex1	South Korea	LG Group of South Korea
100	Hanwha (formerly Korea Explosives Inc) [listed]	South Korea	Hanwha Group of South Korea
50	ST Engineering (Temasek) [listed]	Singapore	Majority owned by Temasek, Singapore government's investment arm. Remaining shares are held by major institutions and funds worldwide, and retail investors.
66	Embraer [listed]	Brazil	Privatised government company in which Brazilian government holds a 'Golden Share'. A wholly owned subsidiary of BNDES is a major shareholder with 5.37% share. It is listed on NYSE also. Global institutional investors led by Oppenheimer Funds with 10.38% of the total, are prominent investors in the company.@

@ <http://quote.morningstar.com/stock-filing/Annual-Report/2013/12/31/t.aspx?t=XNYS:ERJ&ft=20-F&d=df183ef55b3562145296fb9745c06143>

²¹ "South Korea aims to become defence powerhouse", *Financial Times*, November 6, 2013, <http://www.ft.com/cms/s/0/87728d1e-197a-11e3-afc2-00144feab7de.html#axzz34yt0eICP>

See also Juan Carlos Ortiz Torrenova, "Global Defence Industry and the Asia-Pacific Region", a thesis presented in partial fulfilment of the requirements for the degree of Master of Defence Studies at Massey University, New Zealand. The scholar also noted how the strong U.S. support to South Korea during the 1950s and 1960s helped its defence industry. (p. 121). He identified strong government support and the offset programme valued at 50% of the defence import contract's value as the other important contributors. (p. 125) Accessed from http://muir.massey.ac.nz/bitstream/handle/10179/4704/02_whole.pdf?sequence=1.

Two other companies which figure in the list of top 100 companies are also worth considering. ST Engineering of Singapore is majority owned by Temasek, Singapore government's investment arm. Brazil's Embraer was privatised in 1994, but BNDES, Brazil's development financial institution has an indirect shareholding and the Brazilian Government has a "Golden Share". The "Golden Share" gives the Brazilian Government veto powers on certain critical matters in the running of Embraer, which include:

- Change of name of the Company or its bylaws;
- Amendment and / or application of the Company logo;
- Creation and / or alteration of military programs, whether or not involving the Federative Republic of Brazil;
- Training of others in technology for military programs;
- Interruption of the supply of spare parts and replacement parts for military aircraft; and
- Transfer of control of the Company.

In November 1999, the European companies EADS, Dassault Aviation, Thales and Safran (collectively referred to as European Aerospace and Defense Group) did take up a strategic share of 20% in Embraer. Following the expiry of the shareholder agreement the foreign investors exited the company, either partly or fully. As of March 31, 2009, Dassault and Safran, held 0.9% and 1.1% of the company's total capital stock, respectively. Earlier, Thales sold all of its shares in October 2006 and EADS exited through a secondary offering in February 2007.²² It can be seen that the strategic share of the foreign investors was only for a limited period and, moreover, they did not have a dominant position. Additionally, the Brazilian Government maintained control over the company through the "Golden Share".

As regard global arms trade, between 2000 and 2012, there have been some changes. While Israel (5), Turkey (12), China (15) and Croatia (20) have entered the top 20 exporters category, Slovakia, Portugal, Sweden and Iran, who were in this list in the year 2000, went out. (Table-3) The rise of Israel can probably be best understood from "Israel Science & Technology: Defense Industry" from which it emerges that military cooperation played a much greater role rather than FDI.²³ Turkey is a member of NATO.²⁴ The Turkish defence industry grew through a combination of tough offset

²² [http://www.wikinvest.com/stock/Embraer-Empresa_Brasileira_de_Aeronautica_\(ER\)/Strategic_Alliance_European_Aerospace_Defense_Group](http://www.wikinvest.com/stock/Embraer-Empresa_Brasileira_de_Aeronautica_(ER)/Strategic_Alliance_European_Aerospace_Defense_Group)

²³ <https://www.jewishvirtuallibrary.org/jsource/Economy/eco1.html>

²⁴ It was in fact said that:

The most crucial ingredient that shaped Turkey's evolution as a **nascent arms exporter** is its NATO membership. This allowed it to buy weapons in bulk, then develop state-controlled industries with the help of member-countries, and later on branch out on its own.

For example, its favorable ties with Germany resulted in an early predisposition for German arms. As a matter of fact, the Turkish Navy's submarines are all German made.

Being a staunch ally of the United States allowed its defense firms to prosper too. Such is the case with **Turkish Aerospace Industries, Inc.** or TAI, the state-owned corporation that built the world's largest number of licensed F-16s for the Turkish Air Force.

policy and joint venture strategy.²⁵ TUSAS Aerospace Industries, Inc. (TAI), the leading Turkish company, was established in 1984 as a 25-year joint venture of General Dynamics (42%), GE (7%) and Turkish Interests (51%). The American partners exited the JV just before the expiry of the JV agreement and after the “joint venture met Turkey's goal of establishing an indigenous aerospace manufacturing capability and that TAI has matured to operations as a stand-alone company”.²⁶ The company was merged with Turkish Aircraft Industries Corporation (TUSAS) and the major shareholders of the combined entity are the Turkish Armed Forces Foundation (54.5%) and Undersecretariat for Defence Industries (45.5%).²⁷

Table-3: Top 20 Arms Exporting Countries: 2000 & 2012

Rank	2000		2012	
	Country	Share (%)	Country	Share (%)
1	USA	52.01	USA	42.47
2	Russian Federation	9.04	Canada	10.09
3	Italy	5.20	Italy	5.16
4	France	4.81	Germany	4.90
5	Japan	4.59	Israel	3.92
6	Germany	3.34	Norway	3.68
7	Canada	3.01	Rep. of Korea	3.31
8	Czech Rep.	1.85	Brazil	2.63
9	United Kingdom	1.72	Russian Federation	2.57
10	Spain	1.48	Czech Rep.	2.09
11	Brazil	1.32	Switzerland	2.04
12	Slovakia	1.31	Turkey	1.53
13	Belgium	1.13	France	1.43
14	Switzerland	1.06	Spain	1.31
15	Norway	1.00	China	1.18
16	Portugal	0.93	Finland	1.15
17	Finland	0.71	United Kingdom	1.07
18	Rep. of Korea	0.68	Japan	0.88
19	Sweden	0.62	Belgium	0.82
20	Iran	0.52	Croatia	0.78
	Top 20 Total	96.32		92.99

Source: Based on UN Comtrade data obtained from <http://comtrade.un.org/data/>. The classification follows SITC Rev.3 and covers 891: Arms and Ammunition.

Though it is not a new entrant, the Australia-headquartered company ASC (Australia Submarine Corp) in the top 100 arms sellers, was established in 1985 as a joint venture between Swedish ship designer Kockums, Chicago Bridge & Iron (CBI), Wormald and the Australian Industry Development Corporation (AIDC).²⁸ Following the buyout of the 49% foreign shareholding by the Australian government in 2000 by

See: <http://21stcenturyasianarmsrace.com/2013/08/05/additional-glimpses-into-the-turkish-defense-industry/>

²⁵ <http://www.ft.com/cms/s/0/837ef75a-1980-11e3-afc2-00144feab7de.html#axzz35dFhb3TB>

²⁶ <http://www.prnewswire.com/news-releases/lockheed-martin-sells-its-share-of-turkish-joint-venture-to-turkish-aircraft-industries-inc-tusas-54022322.html>

²⁷ <https://www.tai.com.tr/en/about-us/company-profile>

²⁸ http://www.anao.gov.au/~media/Files/Audit%20Reports/2013%202014/Audit%20Report%2022/AuditReport_2013-2014_22.pdf

using AIDC's right of first refusal *to prevent HDW getting into the company*, ASC became a fully government owned enterprise.

The above narration reflects the limited role that FDI has played in the leading companies of emerging arms producers. Use of offset policy emerges as a prominent factor. The companies are characterised by different ownership patterns comprising of both public and private sectors and listed companies having international portfolio investors. Brazil also illustrates the use of Golden Shares. This does point to the options that India could choose instead of solely focusing on FDI especially in the context of huge capital requirements that the Discussion Paper had pointed out.

Section 4 Foreign Shares, Inflows and Transfer of Technology

Another important justification offered by the DP for raising the cap was that since the sector is capital intensive, it would be difficult for the indigenous defence industry to develop without the supplementary funds available through FDI. But, is there any certainty that by merely raising the foreign investment cap India will be able to attract substantial investible funds to the country? Experience in other sectors in which the government has allowed even higher levels of foreign participation, does not necessarily support this line of thinking. Further, it would be naïve to imagine that the policy change will facilitate inflow of advanced technologies, particularly at a time when the technology owners are using all means to further their control over the market for technology, especially through strengthening of intellectual property rights (IPRs). It may be pointed out in this context that technology transfer is a major issue even within the developed world which has in the past undermined the special relation between the US and the UK. This was reflected in a statement made by the then Foreign Secretary Jack Straw of the UK in January 2005. He said:

... We were greatly disappointed that the Congress deleted the provisions for an ITAR²⁹ exemption from the Defence Authorisation Act ... it has been a constant source of discussion between the Prime Minister and President Bush, Secretary Powell and myself and our officials. It is disappointing... particularly given what a reliable ally we have been for the United States through thick and thin.³⁰

Subsequently, the US did introduce some changes in its policy towards the UK and Australia.³¹ The exemptions to US International Traffic in Arms Regulations

²⁹ US International Traffic in Arms Regulations

³⁰ It is also relevant to note that the M&As have strong national/regional dimension. See for instance *The Defence Industry in the 21st Century Thinking Global ... or Thinking American?*, accessed at www.pwc.pl/en/publikacje/defence_industry_ads.pdf

³¹ "New US ITAR Regulations Formulate Favored Defense Partners", accessed at http://defense-update.com/20120221_itar_formulates_trusted_partners.html#.U6gVc_mSwWI

(ITAR) can be exercised only through a bilateral agreement with foreign countries other than Canada, UK and Australia.³²

Number of companies, including leading companies like Lockheed Martin and Boeing, were indeed penalised for ITAR violations. These and a few more cases can be seen in Table-4.

Table-4: ITAR Administrative Enforcement Cases

<i>Year</i>	<i>Respondent/ Summary</i>	<i>Description of the Accusation</i>	<i>Total Penalty (\$)</i>
2012	United Technologies Corp	Exportation of helicopter engine software and other defence articles and technical data, and making false statements in voluntary self-disclosures	Civil 55 mn Criminal 20 mn
	Alpine Aerospace Corp	Exportation of missile system components	30,000
	TS Trade Tech Inc	Exportation of missile system components	20,000
2011	BAE Systems plc	Brokering and associated activities, unreported commissions, and recordkeeping violations	79 mn
2010	Xe Services LLC	Making proposals to a proscribed country, exportation of technical data and defence articles, providing defence services to unauthorized foreign persons, record- keeping violations, and false statements	42 mn
	AAR International, Inc.	Exportation of military helicopter, communications, and countermeasure equipment	
	Interturbine Aviation Logistics GmbH/LLC	Exportation/retransfer of ablative materials	1 mn
2009	Air Shunt Instruments, Inc.	Exportation of military aircraft parts	100,000
	Analytical Methods, Inc.	Computational dynamic fluid simulation software, and associated technical data and defence services	500,000
2008	Qioptiq	Exportation of night vision hardware and technology	25 mn
	Lockheed Martin	Exportation of classified and unclassified technical data, and failure to follow proposal notification requirements	4 mn
	Boeing		3 mn
	Northrop Grumman	Aircraft inertial navigation systems, and associated technical data and defence services	15 mn
2007	ITT Corp	Exportation of night vision hardware and technology and omissions of material fact	Civil 28 mn Criminal 100 mn
2006	Lockheed Martin Sippican	Violated TAA provisos, exports after TAA lapsed, unauthorized recipients, failure to establish Technology Control Plan, transfer of classified data	3 mn
	Security Assistance International, Inc. and Henry L. Lavery III	Omission of facts in license application, aiding and abetting unauthorized company to obtain export license, recordkeeping, violating license terms	75,000 (suspended)
	L-3/Titan	Unreported commissions	1.5 mn
	Boeing	Aircraft guidance component (QRS-11) exports	15 mn
	Goodrich/L-3	Material omission in commodity jurisdiction request related to QRS- 11 and unauthorized exports of same	7 mn

³² Clinton Long, "An Imperfect Balance: ITAR Exemptions, National Security, and U.S. Competitiveness", *National Security Law Journal*, Vol. 2:1, 2013, p. 56. Accessed at https://www.nslj.org/pdfs/2_NatlSecLJ_43-64_Long.pdf. UK and Australia have indeed been termed as two of U.S.'s "closest allies" by Secretary Clinton. See: http://www.pmdtc.state.gov/treaties/documents/S_Statement_on_Defense_Trade_Treaties.pdf

<i>Year</i>	<i>Respondent/ Summary</i>	<i>Description of the Accusation</i>	<i>Total Penalty (\$)</i>
2005	Orbit/FR Inc.	Radome measurement system exports and related defence services	500,000 (200,000 suspended)
	DirecTV/Hughes Network Systems	Satellite technology transfers	5 mn
2004	ITT Industries	Night vision and space remote sensing exports and technology transfers	8 mn
	General Motors / General Dynamics	Light armored vehicle technology transfers	20 mn
2003	EDO	Radar technology transfers	2.5 mn
	Multigen-Paradigm	Visual sensor simulation software exports and related technology transfers	2 mn
	Agilent Technologies	Signal processing equipment exports	225,000
	Hughes Electronics/Boeing Satellite Systems	Satellite technology transfers	32 mn
	Raytheon	Troposcatter system exports and related technology transfers	25 mn
2002	Dr. Wah Lim	Satellite technology transfers	100,000 (50,000 suspended)
	Space Systems/Loral	Satellite technology transfers	20 mn
2001	Motorola	Satellite technology transfers	750,000
	Boeing	Airborne early warning system technology (business proposals)	4.2 mn

Source: Fried Frank, "ITAR Enforcement Digest", July 2012, accessed from <http://friedfrank.com/siteFiles/Publications/ITAR%20Enforcement%20Digest.pdf>

In 2013, another American company, Aeroflex, a supplier of radiation-hardened electronics for space and defence applications, was made to pay a fine and had to adopt remedial measures for failing to obtain relevant export licenses for hardware which was used in the satellites launched from China and India.³³ Another company Intersil, also of US, was fined \$10 mn. in connection with the export of radiation tolerant and hardened integrated circuits, which Intersil was under the impression that they were regulated by Export Administration Regulations rather than ITAR.³⁴ It is also relevant to refer to the case of a Chinese national (and a permanent resident of US) who was sentenced to 70 months imprisonment for lying to federal agents and violating ITAR.³⁵

The Export Control Reform (ECR) Working Group of the Defense Trade Advisory Group (DTAG) noted as recently as in January 2014 that one of the objectives of the ECR is to strengthen "the U.S. defense industrial base by reducing incentives for foreign manufacturers to design out and avoid using U.S. parts and components".³⁶ The duties of DTAG are to

³³ <http://www.spacenews.com/article/satellite-telecom/37071us-satellite-component-maker-fined-8-million-for-itar-violations>.

See also: http://www.defence.gov.au/strategy/deco/docs/ITAR_Industry.pdf

³⁴ <http://www.janes.com/article/39808/intersil-corporation-fined-for-itar-violations>

³⁵ <http://www.exportsolutionsinc.com/blog/former-l-3-employee-sentenced-to-70-months-for-export-violations/>

³⁶ http://www.pmdtc.state.gov/dtag/documents/plenary_Jan2014_Tasking1_whitepaper.pdf

... advise the Department [of State] on its support for and regulation of defense trade to help ensure that the *foreign policy and national security interests of the United States* continue to be protected and advanced while helping to reduce unnecessary impediments to legitimate exports in order to support defense requirements of *U.S. friends and allies*.³⁷ (*emphasis added*)

The U.S. Government views

... the sale, export, and re-transfer of defense articles and defense services as an integral part of safeguarding U.S. national security and furthering U.S. foreign policy objectives.³⁸

The Defense Technology Security Administration (DTSA) of the U.S. administers the development and implementation of Department of Defense technology security policies on international transfers of defence-related goods, services and technologies. It seeks to ensure that

- critical U.S. military technological advantages are preserved;
- transfers that could prove detrimental to U.S. security interests are controlled and limited;
- proliferation of weapons of mass destruction and their means of delivery is prevented;
- diversion of defence-related goods to terrorists is prevented;
- military interoperability with foreign allies and friends is supported; and
- the health of the U.S. defence industrial base is assured.

In the context of offsets hurting American interests it was stated clearly in December 2013 that

... anecdotal information obtained from industry suggests that "cutting edge" or nascent technologies under development in the United States are less likely to be transferred to foreign companies in fulfillment of offset obligations than are mature technologies. Regardless, any transfer of export-controlled technology must be approved through the U.S. Government's export licensing processes. The existence of an offset agreement does not allow companies to circumvent the established licensing processes managed by the Departments of Commerce and State, in consultation with DOD.³⁹

It is obvious that the US, the world leader in defence technology and production, will do everything to retain its edge in this sector. Exceptions, if any, would depend on strategic considerations; commercial compulsions would play a secondary role. The above discussion only goes to show the extent of close scrutiny to which US companies in the arms business are subjected to by the government. In the light of the above, the expectation that higher foreign shares would make a compelling commercial case for transfer of advanced defence technologies from countries like the US sounds too simplistic.

³⁷ http://www.pmdtc.state.gov/dtag/documents/Charter_2012.pdf

³⁸ <http://www.pmdtc.state.gov/>

³⁹ US Department of Commerce, Bureau of Industry and Security, *Offsets in Defense Trade*, Eighteenth Study, December 2013, pp. 15-16.

Section 5 Emerging Expectations from DTTI and Approach of Foreign & Indian Private Sectors

The DP's reference to diversifying the sources for defence equipment could be interpreted as reducing the dependence on Russia which has been India's major source of imported armaments. The latest figures indicate that during 2009-2013 India procured 75% of its defence imports from the country. Incidentally, India was the leading importer during this period followed at a distance by China. It was the other way round during 2004-2008. China also emerged as the fourth largest exporter.⁴⁰ An interesting and parallel relevant development has been that supplies from the US to India started picking up over the past few years and the country is reported to have inched to the second spot.⁴¹ The progress of imports from US can probably be traced back to 2005 when the two countries entered into a 'New Framework for the U.S.-India Defense Relationship' (NFDR). The NFDR itself was a follow up of the 'Agreed Minute on Defense Relations between the United States and India' of January 1995. The NFDR inter alia provided for expanded trade between the two countries and "in the context of defense trade and a framework of technology safeguards, increase opportunities for technology transfer, collaboration, co-production, and research and development". The Defense Trade Initiative (DTI), mooted in 2012, provided a thrust to the NFDR by seeking to streamline bureaucratic processes in both the countries. DTI has since been also referred to as DTTI (Defense Trade and Technology Initiative).⁴² The DTTI moved further in September 2013, following the visit of the then Indian Prime Minister to the US. The joint declaration on defence co-operation issued on September 27 2013 referred to both the countries placing each other at the same level as their closest partners.⁴³ Interestingly, the US clarified to India that certain laws related to their exports, such as end use monitoring, which India believed that was applied only to them, were used "even with our [US] closest partners and allies." It was also said that the process was "subject to case-by-case review and there will always be some technologies that we [US] will keep to ourselves".⁴⁴ Obviously, parity with closest partners does not exempt India from certain restrictions and obligations.

The joint statement issued during the Indian Prime Minister's visit to the US in September 2014 proposed to renew the NFDR for a further period of 10 years. The

⁴⁰ "Trends in International Arms Transfers, 2013", *SIPRI Fact Sheet*, March 2014.

⁴¹ *ibid.*

⁴² It was evident that the DTI, which raised a lot of expectations, was probably perceived by both the sides differently; as Trade Initiative by the US and as Technology Initiative by India. [<http://www.defense.gov/transcripts/transcript.aspx?transcriptid=5313>] Though ultimately it started to be referred to as DTTI, the US has not completely abandoned calling it DTI.

⁴³ <http://www.whitehouse.gov/the-press-office/2013/09/27/us-india-joint-declaration-defense-cooperation>. The main elements of the defense and security cooperation between the two countries are: Defense Trade; Joint Military Training; Peace Keeping Operation; Non-proliferation Cooperation; Nuclear Security, Indo-U.S. Policing Conference and Global Health Security.

⁴⁴ <http://www.defense.gov/transcripts/transcript.aspx?transcriptid=5313>

Indian Prime Minister's visit was preceded by the visits to India by the US Secretaries of State and Defense. The latter reiterated the DTTI and also offered some proposals under it, including co-production and co-development of the next upgrade of the Javelin anti-tank missile. Last year too, US was reported to have offered ten technologies, the specifics of which are not known. It was, however, projected that the onus was on India to respond to the offer.⁴⁵ This time around, the US offer was more concrete but an analysis of the proposals pointed out the possible negatives for India if the offer was accepted. It could, for example, lead to abandonment of some of the work already done by Indian public sector entities.⁴⁶ It was also reported that critical components such as algorithms for guidance would not be part of the Javelin deal thus rendering the technology transfer incomplete.⁴⁷ And Javelin collaboration was projected as a special favour as it was "being offered to no other country but India".⁴⁸

US is viewing the defence partnership with India as a part of its Asia Pacific rebalance, an important element of which is "a just international order that emphasizes rights and responsibilities of nations and fidelity to the rule of law, open access by all to the shared domains of sea, air, space, and now cyberspace, and the principle of resolving conflict without the use of force."⁴⁹ The joint statement issued following Indian Prime Minister's visit to the US in September 2014 too had a reference to the disputes in the South China Sea.⁵⁰

In the context of these developments which raised many hopes as also apprehensions, and the US official position described in Section 4, it would be relevant to discuss the views of US government, American companies and organisations representing their interests at various fora to understand the possibility of India being able to develop a manufacturing base with transfer of 'state-of-art technology' through DTTI. Primarily, the position of US is a combination of strategic and commercial interests. The Committee on Armed Forces of the United States Senate noted that "[D]efense trade with India supports both countries and highlights the significance of U.S.-India cooperation in the Asia-Pacific region". It also underlined that the objective

⁴⁵ "Ball in Indian court on co-development projects: Top US official", October 1, 2013, http://articles.economictimes.indiatimes.com/2013-10-01/news/42576187_1_defence-ashton-carter-top-us-official-proposals

⁴⁶ Group Captain Vivek Kapur, "Cooperation in Defence Offers from USA: Boon or Bane", In Focus, Centre for Air power Studies, August 28, 2014. The author raised the question of whether the co-production of Javelin anti-tank missile would help or hinder India's own programme of building upon the successes achieved in developing Nag. Similarly, inducting Hawk XXI missile system, which by no means a state of art surface to air missile (SAM), could clash with the indigenously developed Akash which has "an engagement envelope and capability similar to Hawk XXI".

⁴⁷ "US defence secretary Hagel arrives in India", *Hindustan Times*, August, 7, 2014, <http://www.hindustantimes.com/india-news/pmmodiinus/arms-deal-what-hagel-will-have-to-offer-during-his-india-visit/article1-1249428.aspx>

⁴⁸ Ajai Shukla, "US anti-tank missile Javelin in face-off with Israel's Spike", *Business Standard*, December 17, 2013, available at http://www.business-standard.com/article/economy-policy/us-anti-tank-missile-javelin-in-face-off-with-israel-s-spike-113121700038_1.html

⁴⁹ Remarks by Deputy Secretary Carter on the U.S.-India Defense Partnership at the Center for American Progress on September 30, 2014 available at <http://www.defense.gov/transcripts/transcript.aspx?transcriptid=5313>

⁵⁰ <http://www.whitehouse.gov/the-press-office/2014/09/30/us-india-joint-statement>

of 'Defence Trade Initiative' was "to nurture increased U.S. defense exports to India". The committee noted that the experience with DTI has been mixed and suggested that the Department of Defense should "continue its efforts to streamline business processes to make U.S.-India defense trade and collaboration simpler, responsive, and effective".⁵¹ The Committee directed the Secretary of Defence

... to provide the congressional defence and foreign affairs committees a *classified briefing*, no later than October 1, 2014, on the technologies that are currently being considered or may be considered for export to India, including pending or completed reforms of export controls to facilitate DTI.⁵² (emphasis added)

Earlier, the *National Defense Authorization Act, 2013*, obligated the Secretary of Defence to conduct a comprehensive policy review, in coordination with the Secretary of State -

- (1) to examine the feasibility of engaging in co-production and co-development defense projects with India; and
- (2) to consider potential areas of cooperation to engage in co-production and co-development defense projects with India *that are aligned with United States national security objectives*. (emphasis added)⁵³

This tends to indicate that while export of defense items could move faster, technology transfer would be subjected to filtering at multiple levels by the administration.

Pressure to Dilute Offsets

As noted above, imposing offsets is an important measure to develop manufacturing base for the importing countries. The US, however, disapproves offsets and has openly declared that it would not extend any support to their manufacturers who enter into such arrangements. The US considers that certain offsets for military exports are economically inefficient and market distorting. It also recognises the need to not to adversely affect the country's firms to compete for military exports. For instance, the Defense Production Act Amendments of 1992 *inter alia* state that

- No agency of the United States Government shall encourage, enter directly into, or commit United States firms to any offset arrangement in connection with the sale of defense goods or services to foreign governments.
- United States Government funds shall not be used to finance offsets in security assistance transactions, except in accordance with policies and procedures that were in existence on March 1, 1992.
- The decision whether to engage in offsets, and the responsibility for negotiating and implementing offset arrangements, reside with the companies involved.
- It is the policy of the Congress that the President shall designate the Secretary

⁵¹ <http://www.gpo.gov/fdsys/pkg/CRPT-113srpt176/html/CRPT-113srpt176.htm>

⁵² <http://www.gpo.gov/fdsys/pkg/CRPT-113srpt176/html/CRPT-113srpt176.htm>

⁵³ <http://www.gpo.gov/fdsys/pkg/BILLS-112hr4310enr/pdf/BILLS-112hr4310enr.pdf>

of Defense to lead, in coordination with the Secretary of State, an interagency team to consult with foreign nations on limiting the adverse effects of offsets in defense procurement.⁵⁴

It would thus be in the interest of foreign companies to dilute India's offset policy by increasing its scope to include more non-defence related products and services. For instance, arguing for allowing a broader scope of eligible projects under the offset policy it was explained in 2010 that

The Defense Procurement Procedure (DPP) contains an evolving national defense offset policy first introduced in 2006. As originally conceived, India's offset policy was *highly restrictive in scope*. We welcome the Government's efforts to move forward with further offset policy revisions in the upcoming release of DPP 2010.

...

Presently, only direct offsets – the export of defense-related goods and services – and FDI in defense industry are eligible for offset credit under the policy. The latter is presently limited to 26percent in most cases. We are on record as recommending that the FDI limit be increased and that *eligible offset projects be expanded to include adjacent areas, such as homeland security, energy security, and civilian aerospace*. Such an expansion will greatly increase the amount of technology that will flow to India under offset projects.⁵⁵ (emphasis added)

On its part the United States Senate inter alia resolved on July 24, 2014 after noting that the defense and security ties have led to nearly \$10 bn in defense trade with India, that

The United States Government should urge the Government of India to *modify its offset regime so funds can flow to a second tier of Indian priorities such as education, skills development, or manufacturing*. (emphasis added)

The US Government was also told to urge India to

... continue with its economic liberalization reforms, including *lifting the caps on foreign direct investment and taking steps to enhance protections for intellectual property*... (emphasis added)⁵⁶

The US industry is also making further attempts to push manufacturing into the background and bring services to the fore. In the context of the meeting of 'Avenues 2014: Industry Government Interface' organised by the *Economic Times* and Amcham India in June 2014, the Chairman of Amcham Defense Committee and President of Aerospace Honeywell HGR has said:

Government should focus on making services an important part of the Defense Industry Employment growth program. Services account for a larger share of

⁵⁴ http://www.bis.doc.gov/index.php/forms-documents/doc_download/133-1990-presidential-policy-on-offsets

⁵⁵ *The Indo-U.S. Dynamics: Anchoring Change through Collaboration*, Deloitte and American Chamber of Commerce in India, November 2010 pp. 20-21, accessed at http://www.amchamindia.com/AMCHAM_publication_new.pdf

⁵⁶ 113th Congress, S. RES. 523 accessed at <http://thomas.loc.gov/cgi-bin/query/z?c113:S.RES.523>:

employees than manufacturing in large OEM organizations. Services can generate employment easier and quicker in 3-6 months, than manufacturing jobs which can take 2-4 years to develop. New jobs in Defense Services should be encouraged via offset and tax policies to become the foundation to add manufacturing jobs as a second step.⁵⁷

Interestingly, the Defence Collaboration group met 'behind closed doors' with the Editor - Opinion, *Economic Times* and the panellists included: President, Honeywell Aerospace HGR (also Chairman, Amcham Defence Committee); Chief Executive of Lockheed Martin India Pvt Ltd (also Co-Chairman, Amcham Defence Committee); and a Partner of KPMG India (also a Co-Chairman of Amcham Defence Committee). Incidentally, Deloitte and KPMG, members of Amcham are described as its Knowledge Partners by the Chamber. As member of Amcham Defence Committee, KPMG was closely involved in the negotiations with the government on offset related matters.⁵⁸

The USIBC also expressed its displeasure with India's offset policy. Its priorities include

With current offset policy being challenging to execute on the verge of prohibitive, USIBC encourages offset contracts to include areas such as civil infrastructure, power and energy, and human resources (to include services and training) with an efficient and transparent approvals process in place.⁵⁹

The USIBC also favours the raise of FDI cap to 74% and *appropriate commercial valuation* of "state of the art" technology.

Obviously, there is great divergence between what the foreign corporations wish to offer and what the Indian government expects from FDI and offset policies.

The failure of India's offset policy has been widely acknowledged. Even the Amcham has said in a recent document that

... it [India's Defence Offset Policy] has been simplified several times after being introduced in 2005 as part of the Defence Procurement Procedure.

When the offset policy was considered it was predicted that there would be rapid indigenization in defence and the industry would benefit immediately. However, since its inception the policy is still evolving and the pace of indigenization through offsets is far away from expectations of the stakeholders. The major barriers in offsets procedures relate to conflicting government policies, bureaucratic procedures, inefficient managing body, and execution problems.⁶⁰

⁵⁷ <http://www.amchamindia.com/avenues-2014-ET-amcham-industry.html>

⁵⁸ *Amcham Update*, April 2014, Vol III, Issue 2.

⁵⁹ <http://www.usibc.com/advocacy/committees/aerospace>

⁶⁰ *Addressing Key Challenges: U.S.-India Economic Engagement*, Deloitte and Amcham, April 2014, pp. 30. http://www.deloitte.com/assets/Dcom-India/Local%20Assets/Documents/Thoughtware/2014/US-India_Economic_Engagement.pdf

Among the problems identified by the Comptroller and Auditor General of India, the Amcham cited the following.

... non-adherence to DPP guidelines, waivers given by the MoD to foreign vendors, use of Direct Foreign Investment (DFI) in kind to discharge offset obligations, invalid Indian Offset Partners (IOPs), and unfulfilled penalty charges.⁶¹

Further, in the words of Co-Chairman of CII's National Committee on Defence (also Whole time Director and President, Heavy Engineering Group of L&T)

The ... dilution of Offset norms since the release of the Offset Policy has rendered the whole policy as non-progressive.

...

The offset policy need to be regulated strictly. Dilution of offsets resulted in high end technology not being inducted in the Indian defence industry.⁶²

While foreign companies welcome the dilution (termed as simplification by them) and widening of the gamut of eligible projects, the same are viewed as the causes of its failure by Indian analysts.

Amcham India had expressed its unhappiness over the 26% cap, even while acknowledging the possibility of higher stakes on a case-by-case basis for state-of-the-art technology. It said that "[N]o vendor will contribute technology without control and can't justify business case without export volume". Without specifying any upper limit it merely said that "India will see more investments from American companies once it decides to raise the FDI level in the defence sector."⁶³ In spite of higher FDI shares, which also give foreign companies unambiguous control, being permitted for transfer of 'state-of-art' technologies, though on a case-by-case basis, the Chamber argued that technology would not be brought in without control. It does appear that the main objection is against the 'case-by-case' approvals (in which the foreign investors have to commit themselves) and the insistence on the Indians constituting majority on the boards and the chief executives being Indians. On its part Lockheed Martin is reported to have expressed its dissatisfaction with the new base FDI cap of 49%. A senior functionary of the company is reported to have said: "[W]ith those items where we have a lot of intellectual property and investment in a particular product, we are not necessarily going to want to send it to India and then not have control over that

⁶¹ *Ibid.*, p. 30-31.

⁶² M.V. Kotwal, "Indigenisation in Defence Industry - Current Status and Future Prospects", Sixteenth Colonel Pyara Lal Memorial Lecture 2012, <http://www.usiofindia.org/Article/?pub=Journal&pubno=589&ano=953> see also: Karanpreet Kaur, "Defence Offsets in India: Perceptions and Reality", wherein she refers to the prevailing view that "The opinion is that, we are shifting our focus from indigenisation to appeasing foreign vendors." See: <http://www.claws.in/Defence-Offsets-in-India-Perceptions-and-Reality-Karanpreet-Kaur.html>. See also: Ajai Shukla, "MoD flouts offset rules, favours foreign vendors", *Business Standard*, September 1, 2011 and Ajai Shukla, "Indian industry wary of new defense offset policy: New policy likely to dilute offset requirements, bowing to sustained lobbying from foreign vendors", *Business Standard*, September 2, 2011 and Major Genral Mrinal Suman (AVSM, VSM, Ph.D.), "Defence Offsets: Army's Belied Expectations and Trepidations", *Global Defence Offset Review*, December 2012, accessed at <http://mrinalsuman.blogspot.in/2013/01/defence-offsets-armys-belied.html>

⁶³ *Supra Note 57.*

particular technology.... Over 50 percent is the key where you are able to control the business a little bit more than at 26 or 49 per cent”.⁶⁴

With full control and freedom of entry, the foreign companies can decide on the nature and extent of technology transfer and what to hold back. It is not as if the foreign investors are unaware of the possibility of India allowing FDI up to 100% for high technology items. An official of the USIBC indeed said that it was an “untested option”.⁶⁵ Obviously it was for the foreign companies to test India’s preparedness. Had they been prepared to transfer advanced technologies and interested in local production, they would have definitely tested the option. The foregoing discussion, especially in Section 4, does not make one optimistic about the prospects of transfer of advanced technologies. Evidence provided in Section 6 will further demonstrate that even with 26% share in equity how the foreign investors managed to enjoy equal management rights and secured their technologies; with greater control the situation could be worse.

Indian Industry’s Stand

With the defence industry being removed from the exclusive preserve of the public sector, the Indian private sector has been given a great responsibility. However, the sector seems to be unsure of its position regarding the role that FDI can play. For instance, a section of the Indian industry changed its stand within the past few years. CII and FICCI responded similarly to the DP in 2010. While asking for the retention of 26% limit, FICCI told the government that “[s]tudies show that there is no well-defined proportional relationship between quantity of FDI and Transfer of technology”. In its response to the DP, CII also forcefully argued for the limit to be retained at 26% and said “[I]n any case, the FDI limit should not exceed 49 percent”. Some of the additional conditions suggested by CII were:

- the collaborator should bring in a high level of specialized technologies into the country which are at present not available in India.
- the JV should undertake to set up full-fledged R&D facilities in India and the IPR for all new technologies developed should vest with the Indian company.
- the foreign collaborator should, ..., permit products manufactured by the JV to be exported to global markets, and such exports should start within three years of commercial production.

In June 2014, the CII altered its stance completely and said:

In order to attract investments in the defence sector, higher FDI cap, wherein the foreign investor having majority equity, will act as a catalyst. Higher FDI will definitely help in creating a vibrant domestic defence industrial base in the country. We congratulate the Government of India for initiating forward looking policy measures.⁶⁶

⁶⁴ “Narendra Modi’s offer to defence companies not enough for Lockheed” http://beta.livemint.com/Politics/Xw30CqHNaxwiagB5FGCgyO/Narendra-Modis-offer-to-defense-companies-not-enough-for-Lo.html?utm_source=copy

⁶⁵ *Ibid.*

⁶⁶ CII on FDI in Defence, CII Media Releases, June 10, 2014, <http://www.cii.in/PressreleasesDetail.aspx?enc=1RMPukRTV2pevMnGnXnqbfKAOjRjCWcyC+df+BDsq4=>

Does it mean that its efforts during the intervening period failed to forge joint ventures and it has resigned to the fact that the foreign companies are not willing to share space with Indian entities and the organisation now hopes to get opportunities as suppliers of sub-assemblies while the foreign companies set up integrating establishments in India?

FICCI's reported position was that since defence technology developed by foreign OEMs is controlled by their governments, transfer of technology will be based on strategic considerations rather than on ownership patterns.⁶⁷ CII, however, seems to have changed its stand again showing its preference for 49% cap and higher shares of FDI to be allowed only on case-by-case basis.⁶⁸ It is a fact that international consulting firms work closely with foreign chambers of commerce. Leading Indian Chambers of industry and even the Indian government also rely heavily on such firms for advice and guidance. There is a possibility of conflict of interest as the firms would be leaning heavily towards the international Chambers. The Indian Chambers' interaction with foreign consultancy firms might, therefore, be coming into conflict with the interests of some of the Indian players aspiring to make their mark in defence manufacturing. It is a matter of concern that the Indian associations are in such a dilemma and are not in a position to put forward a coherent view on such an important sector.

Cross-border Greenfield Investments

In the context of the expectation of attracting large amount of FDI by permitting higher stakes for foreign investors in defence industries, a look at the global situation over the past decade or so could be worthwhile. The investment referred to here is not FDI *per se* but the total investment in a project from all sources. It is evident from Table-5 that cross-border Greenfield investments in 'Space and Defence' sector at \$3.41 billion over a period of 11 years are quite small whether seen in relation to all Greenfield investments or on their own. The number of manufacturing projects within 'Space and Defence' is quite small. These figures are from a database which forms the basis for international bodies, including UNCTAD, for reporting global cross-border Greenfield investments. These figures indicate that defence manufacturers engage in overseas production only to a limited extent. Even this is concentrated in developed countries. As can be seen from Table-6, much of the investment in manufacturing projects is concentrated in North America and Western Europe. On the other hand, sales and marketing establishments have better representation in Asia-Pacific and the Middle East. Further, it is evident from Table-7 that most of the investment originates and gets located in North America and Western Europe.

⁶⁷ "CII & FICCI disagree on raising FDI in defence", *Business Standard*, June 12, 2014. (ISID Online Press Clippings database)

⁶⁸ "Industry chambers flip-flop on 100% FDI in defence sector", June 30, 2014., <http://timesofindia.indiatimes.com/business/india-business/Industry-chambers-flip-flop-on-100-FDI-in-defence-sector/articleshow/37491612.cms>

Table-5: Trends in Global Cross-border Greenfield Projects in Space and Defence Sector: 2003-2013

Year	No. of projects	Capital Investment (US \$ mn.)	Of which Manufacturing Projects		
			No. of Projects	Capital Investment (US \$ mn.)	Average Capital Investment (US \$ mn.)
2003	8	185.5	6	139.7	23.28
2004	13	142.2	10	121.3	12.13
2005	5	246.2	3	29.8	9.93
2006	12	185.7	4	81.0	20.25
2007	17	201.4	9	108.0	12.00
2008	24	646.2	10	367.3	36.73
2009	34	400.0	8	100.9	12.61
2010	23	350.1	7	107.3	15.33
2011	32	427.3	10	213.3	21.33
2012	20	345.9	5	158.3	31.66
2013	20	275.9	1	25.5	25.50
A. Total of the above	208	3,406.30	73	1452.4	19.8
B. All Cross-border Greenfield Projects 2003-2013	1,48,323	9,071,344	33,838	3,476,888	102.8
C. % Share of Space & Defence (A/B)	0.14	0.04	0.21	0.04	

Source: Based on the information provided in fDi Markets, a service of the Financial Times Limited. All Rights Reserved.

Table-6: Location of Cross-border Greenfield Manufacturing and Sales & Marketing Projects in Space and Defence Sector: 2003-2013

Location	No. of Projects		Total Investment (US \$ mn.)	
	Manufacturing	Sales & Marketing	Manufacturing	Sales & Marketing
North America	28	18	425.6	162.0
Western Europe	21	19	420.7	76.2
Rest of Europe	3	1	76.5	19.9
Asia-Pacific	11	19	251.0	127.6
Middle East	6	7	129.5	158.7
Latin America & Caribbean	2	6	72.1	16.8
Africa	2	3	77.0	23.7
Total	73	73	1452.4	584.9

Source: Based on the information provided in fDi Markets, a service of the Financial Times Limited. All Rights Reserved.

Table-7: Sources and Destination-wise Distribution of Investments involved in Cross-border Greenfield Manufacturing Projects in Space and Defence Sector: 2003-2013
(Amount in US \$ mn.)

Source	Destination							
	North America	Western Europe	Rest of Europe	Middle East	Africa	Asia-Pacific	Latin America	Total
Western Europe	385.4	262.1	51.0		42.0	118.5	72.1	931.1
North America	40.2	117.6	25.5	53.0		81.3		317.6
Rest of Europe				25.5				25.5
Middle East		41.0			35.0	51.0		127.0
Africa				25.5				25.5
Asia-Pacific				25.5		0.2		25.7
Total	425.6	420.7	76.5	129.5	77.0	251.0	72.1	1452.4

Source: Based on the information provided in fDi Markets, a service of the Financial Times Limited. All Rights Reserved.

Further evidence to the limited spread of defence manufacturing through FDI can be seen from the investments by some of the leading companies selling defence equipment.

- Lockheed Martin (USA, Global No. 1 seller) has significant subsidiaries outside of USA only in UK, Canada and Australia.
- Boeing (USA, Global No.2) has significant subsidiaries besides in USA only in Bermuda, Australia, Canada, Germany and the UK.
- BAE Systems (UK, Global No. 3), has significant subsidiaries only in USA.
- Northrop Grumman (USA, global No. 6) does not have any major subsidiary outside USA.
- Finmeccanica's (Italy, global No. 9) investments are concentrated in Europe and its investment in Brazil and Libya are nominal.
- Thales' (France, Global No. 11) foreign manufacturing sites are in UK, Netherlands, Australia and Germany.⁶⁹

This does not, however, mean that the companies do not have subsidiaries and joint ventures in other countries. On the contrary, it suggests that in the overall consolidated operations of the respective groups, foreign subsidiaries play a very minor role especially because the companies explained in terms such as "[W]e have additional operating subsidiaries that, if considered in the aggregate as a single subsidiary, do not constitute a significant subsidiary".⁷⁰ It also suggests the possibility of the companies participating in joint ventures with minority shares.

While some developed country defence corporations do get involved in developing countries, one needs to analyse fully the nature of such manufacturing projects to gain a better understanding of whether (advanced) technologies were transferred and under what circumstances such investments were made. Saab's investment in South Africa is a case in point. India too has some joint ventures about which we shall discuss briefly in the next Section. India cannot make its FDI policy in isolation and blame herself for its failure and find justification to attract FDI by relaxing the essential performance requirements. The policy has to be rooted in global realities.

Given the above scenario too, it is difficult to foresee sizeable FDI inflows into India's defence manufacturing, following further relaxation of the extant policy. The lukewarm response to India's opening up to defence FDI till now may not be entirely due to the insistence on technology transfer and local control but because of the fact that defence manufacturing is concentrated in a few countries, which are guided more by strategic rather than commercial considerations. In fact, the database listed only one Greenfield manufacturing project for China against six for India. This is significant in the context of China transforming itself from a major importer to an exporter. In case of China's acquisition of technological capabilities in the aerospace industry it was indeed said that

⁶⁹ Based on the Annual Reports of the respective companies accessed in July/August 2014, from their websites or their filings with the Securities and Exchange Commission, USA. The ranking is based on <http://www.sipri.org/research/armaments/production/Top100>.

⁷⁰ This one is from the annual report of Lockheed Martin.

For much of the period since the 1950s, China has depended on a mixture of, “buying, building or stealing” to acquire a military aerospace capability. The balance between the three approaches has depended on the degree of co-operation with other states, ..., generalised access to western technology, and growing indigenous competence, which itself follows China’s economic development and overall technological standing. The latter is also a vital aspect of the country’s ability to absorb technology either legitimately or illicitly obtained....

Reverse engineering at this level itself implies a high degree of technical competence; China has invested heavily in the research and technological infrastructure that is the precondition of acquiring a world class aerospace industry. ...⁷¹

Section 6 **The Revised FDI Policy**

As mentioned at the outset, the 2013 policy guiding FDI in India’s defence sector did not place an upper limit on foreign shareholding. It included certain conditions in cases of foreign equity above 26% and specifically disallowed foreign portfolio investments. What the revised policy did was to not just raise the cap from 26% to 49%, it has also allowed all forms of foreign investment to participate in India’s defence sector. While this aspect of the revised policy received much attention, changes in the accompanying conditions, to the best of our knowledge, have not been discussed in detail. Similar is the case with the aspects of management being in Indian’s hands. In the following we make an attempt to address these issues in some detail. The affected/new conditions applicable to companies having foreign equity up to 49% and to those opting for higher levels are listed in Table- 8.

The relaxation with regard to portfolio investments, in a way, addresses the concern expressed earlier by FICCI.⁷² Probably in the context of permitting portfolio investments the earlier condition of three-year lock-in for foreign investors has been dispensed with. Foreign portfolio investments cannot, however, exceed 24%. It is a fact that global financial investors invest in leading listed defence manufacturers, not necessarily belonging to the US and the UK. They even figure among the topmost shareholders. While the main objective of the financial investors is to maximise returns on their investment, a concern could be that they might be used as a means of influence by home governments. Also, since they could be significant shareholders of other defence companies, they might influence the functioning of companies in India to their overall advantage.

⁷¹ Royal Aeronautical Society, “The Chinese Aerospace Industry – A Background Paper”, July 2013, available at <http://aerosociety.com/Assets/Docs/Publications/DiscussionPapers/ChineseAerospaceIndustryDiscussionPaper.pdf>

⁷² FICCI explained that it would be impractical for listed companies having some defence related businesses to avoid foreign portfolio investors, especially the FIIs. “Regressive FDI norms hurting defence industry: FICCI”, available at <http://www.dnaindia.com/india/report-regressive-fdi-norms-hurting-defence-industry-ficci-1987236>.

Table-8: Some Salient Provisions of the Revised Policy

<i>Up to 49%</i>	<i>Beyond 49%</i>
Mode of Entry: Government Route	Government Route: Cabinet Committee on Security (CCS) decides on case to case basis, wherever it is likely to result in access to modern and 'state-of-art' technology.
The limit is a composite one covering investments by foreign institutional investors (FIIs), foreign portfolio investors (FPIs), non-resident Indians (NRIs), foreign venture capital investors (FVCI) and qualified foreign investors (QFIs).	Not relevant
Portfolio investment by the above categories of investors should not exceed 24% of the investee/JV company and it could, unlike FDI, come through the automatic route. That means while any FDI up to 49% needs government's permission, portfolio investment up to 24% is free from such obligation.	Silent. Possibly applicable by default.
The applicant should be an Indian company owned and controlled by resident Indian citizens.	The applicant should be Indian company/foreign investor.
The management of the applicant company should be in Indian hands with majority representation on the Board as well as the Chief Executives of the company/partnership firm being resident Indians.	Categorically states that this condition is not applicable.
Chief Security Officer (CSO) of the investee/joint venture company should be resident Indian.	Applicable by default.
The Investee/ joint venture company should be structured to be self-sufficient in areas of product design and development.	Applicable by default.

While the condition that management of the investee company should be in Indian hands with majority of the Board and the Chief Executive Officer being Indians for foreign investments up to 49% has been retained, it has been withdrawn for higher levels of foreign equity. In such cases the condition of 'owned' by Indians would obviously not hold good as the majority ownership shifts to foreigners and with majority foreign share it would be illogical to expect the foreign shareholder not to exercise control. On the other extreme, it opens up the possibility of not even a single Indian being on the Board. Interestingly, the condition with regard to the Chief Security Officer being an Indian has been retained even in such cases.

Since the application for investing in India can be made by a foreign company directly also, it would *de facto* permit 100% foreign subsidiaries and obviates the need to form joint ventures with Indian companies, though it does not rule them out completely. In case of foreign equity up to 49% the conditions imply formation of JVs. While in case of such JVs the policy objective is to strengthen the bargaining power of Indian partners, no such provision is there if the foreign equity exceeds 49%. In any case, because of the past experience which shows that even while the JVs meet the condition with regard to foreign share and the proportion of Indian directors, in practice they tend to operate as 50:50 joint ventures. The way the agreements are structured it amounts to joint control at the best and subordination of the Indian

partner at the worst. Such a phenomenon was noted in case of the insurance sector.⁷³ So was the case with Cedar Support Services Ltd in which Walmart did not hold even a single *equity share*.⁷⁴ In view of this, an examination of the operational aspects of the JVs that came up in the defence sector would be in order.

Tata Lockheed Martin Aerostructures Ltd (TLM) is a 26:74 JV between Lockheed Martin Aerostructure Corporation of US (LMAC) and Tatas, formed to provide “Public Services in the Union Government including Defence Services”. The company’s Articles of Association (AoA) provide clear indications of joint control in practically every matter of importance. Tata and LMAC will have equal rights whether it is the shareholder meetings, or of the Board of Directors, especially with regard to ‘Reserved Matters’ which encompass business plans, technology, appointment of senior managerial personnel and Code of Conduct. While the MD/CEO shall be nominated by Tatas his appointment needs a Board decision which itself cannot be taken without the consent of at least one Director nominated by LMAC and one nominated by Tata. On its part, LMAC reserved the right to nominate the Head of Operations/Chief Operating Officer. It is pertinent to note that notwithstanding the fact that the COO will be reporting to the CEO, a nominee of Tatas, as necessitated by the FDI policy, he will be an appointee of the LMAC. Since LMAC has kept the options open of doing business in India in other forms as well and the JV would not own any of the technologies used, save those that get developed during the course of operation, the JV will be even more dependent on LMAC than on Tatas. The JV also has to conform to all relevant US regulations. Interestingly, LMAC is entitled to increase its shareholding beyond 26% but not exceeding 49% pursuant to changes in Indian regulations governing foreign direct investment. (See the Annexure for some freely worded extracts from the TLM’s Articles of Association)

The case of Defence Land Systems India Pvt Ltd (DLS), a 26:74 JV between BAE Systems Plc. UK and the Mahindras, though it is disbanded now, is particularly interesting. The JV had also written into the articles BAE’s right to acquire 49% stake whenever India’s FDI laws permit. In this case, however, instead of the hike happening through expansion of capital, it was sought to be achieved through acquisition of requisite shares from the Indian partner. Thus there was to be no net addition to the resources available to the JV. Some of the more distinguishing provisions of the AoA were as follows. The JV’s Chairman was to be nominated by BAE leaving the choice of Vice-Chairman who “will stand in for the Chairman when the Chairman is not available” to Mahindras. While the CEO was to be nominated by Mahindra’s, the Deputy CEO would be a person chosen by BAE.⁷⁵ Similar was the case with CFO and Deputy CFO. On the other hand, the Chief Technical Officer (CTO) who was to be

⁷³ See: K.S. Chalapati Rao and Biswajit Dhar, “Foreign Direct Investment Caps in India and Corporate Control Mechanisms”, *Economic and Political Weekly*, Vol - XLVI No. 14, April 02, 2011, pp. 66-70.

⁷⁴ See: K.S. Chalapati Rao and Biswajit Dhar, “Vaulting Over India’s Retail FDI Policy Wall”, *Economic and Political Weekly*, Vol - XLVII No. 46, November 17, 2012, pp. 10-13.

⁷⁵ Another interesting feature of DLS is that against the capital contribution of Rs. 19.65 crore received from the foreign partners the JV had paid Rs. 8.60 crore as salary to the expatriate Deputy CEO during the 2011-2013, the three years that it operated as a JV.

responsible for technical affairs of the JV including research and development and technology licensing, was to be a person of BAE's choice. But there was no provision for a Deputy CTO. Further, the Deputy CEO will be responsible for the specific areas: (i) Product Development; (ii) Supply Chain Management; and (iii) Operations. Thus the operations would have been under the direct control of the foreign investor.⁷⁶ The JV was to have a Compliance Officer, a joint nominee of the two partners, whose responsibilities, inter alia, were to:

Lead the establishment of the Company's internal policies to ensure compliance with Indian ethics, export/import and other Indian laws and regulations, as well as applicable laws and regulations of *other countries, e.g. U.S. ethics, export control laws, and regulations (such as FCPA, the International Traffic in Arms Regulations; the Export Administration Regulations; the Federal Firearms Regulations, and the various sanctions programs administered by the Treasury Department's Office of Foreign Assets Control)*. (emphasis added).⁷⁷

Incidentally, BAE has a subsidiary in the US, BAE Systems Inc. It needs to be underlined that BAE settled charges of US ITAR violations by paying a penalty. (see Table-4) It is no surprise that TLM in which LMAC, an American company, is the foreign partner has a similar condition of compliance. It is thus evident that US regulations may affect defence technology transfer and trade for *even some non-American* companies.

The Articles of Association (AoA) of TLM and DLS also suggest that the technology would remain with the respective parties and the JVs would not have the right to use it in case the foreign partner withdraws from it. The AoA of DLS had the following provision.

Intellectual Property provided, licensed, and, or otherwise transferred to the Company by BAE Systems or any Affiliate of BAE Systems *will always remain the property of BAE Systems* or the respective Affiliate of BAE Systems (as the case may be) and the Company [JV] will: (i) use such Intellectual Property in accordance with the terms of the BAE Systems Technology Licence and Consultancy Agreements; and (ii) will not claim any rights or title to or in such Intellectual Property except as may be set out in the BAE Systems Technology Licence and Consultancy Agreements.⁷⁸ (emphasis added)

Even though a similar condition was applicable for technology provided by the Mahindras it would not have had any practical significance. Similar covenants exist in

⁷⁶ In case of Tara Aerospace Systems Ltd (Sikorsky), a 26:74 JV between the United Technologies group and Tatas, the foreign partner reserved the right to appoint the Vice President of Operations and the Chief Financial Officer. The JV manufactures parts for Sikorsky's S92 helicopter cabins.

⁷⁷ Articles of Association of Defence Land Systems India Pvt Ltd.

⁷⁸ As per the AoA, BAE Systems Technology Licence and Consultancy Agreement(s) means the BAE Systems IP Licence Agreement and the BAE Systems Domain Knowledge Agreement in the forms attached as Part A and Part B of Schedule 5 of the Framework Agreement provided that Clauses 9, 10 and 13 of the IP Licence Agreement (Part A) and at Clauses 2.7, 7 and 8 of the Domain Knowledge Agreement (Part B) shall be identical.

case of (i) Samtel Thales Avionics Ltd.⁷⁹, a JV between Samtel group of India (74%) and Thales of France (26%) and (ii) HELA Systems Pvt Ltd, a JV of Tatas (74%) and ELTA Systems (26)%, a subsidiary of the Israel Aerospace Industries group. Thales reserved the right to appoint the CFO and the CTO of the JV with Samtel. The French group also reserved the right to nominate Chief Technology Officer and Senior Executive Vice President (CTO) of its other JV namely Rolta Thales Ltd.⁸⁰ An interesting feature of the AoA of HELA Systems is that while Tatas and ELTA would have equal representation of 3 directors each on the company's Board, at least one of the directors designated by ELTA should have Indian citizenship and residency. Further, for taking decisions relating to certain actions, including those which are generally listed under 'Reserved matters', at the shareholder meetings, 85% of the shareholding would be necessary. Obviously, Tatas with 74% shareholding cannot decide on these matters without the support of ELTA.

The above instances suggest the manner in which the foreign partners (belonging to different countries) could dominate the operations and hold strict control over technology in spite of the Indian partners having majority ownership, majority in the Board and the CTOs/CEOs being their nominees. In essence, the agreements make shareholder meetings and AGMs a mere formality to be followed for statutory purposes. A scrutiny of the agreements may reveal even more restrictive conditions to which the Indian partners might have agreed to. These, however, are not available at the Ministry of Corporate Affairs website.

The AoAs of JVs generally refer to Shareholder Agreements and other agreements entered into between the partners. One does not know how far the AoAs fully reflect the contents of such agreements. However, insertion of references to the agreements in the AoAs provides legitimacy to them so that the agreements cannot be challenged later on keeping in view the supremacy of AoAs over Shareholder Agreements.⁸¹ In fact, the AoA of DLS categorically stated that

The Business shall be managed by the Board and the Executive Officers who shall at all times act for and on behalf of the Company. *Subject to the provisions of the Shareholders' Agreement and these Articles*, the Board shall exercise all powers, ...

In respect of matters not covered by the Act, Rules made thereunder, the Transaction Documents, and these Articles, and *subject always to these Articles and the Shareholders' Agreement* and Articles 106 through 109 (Reserved Matters), the Board is fully empowered to lay down both policy and procedures.

The matters listed at Article 109 [Reserved Matters] may be *varied only by amending the Shareholders' Agreement* and these Articles. (emphasis added)

⁷⁹ The JV was set up manufacture and maintain indigenous helmet-mounted sight and displaysSystems and modern avionics systems. The operations also enable Thales to meet its offset obligations.

⁸⁰ The share of Rolta is 51% while the remaining is held by Thales.

⁸¹ See: Supreme Court of India, V.B. Rangaraj vs. V.B. Gopalakrishnan and Others on 28 November 1991 accessed at <http://indiankanoon.org/doc/140212/>.

The AoA of Tara Aerospace Systems Ltd (Sikorsky), a 26:74 JV between the United Technologies group and Tatas, is even more forthright.⁸²

Inconsistency between provisions of the Agreement and Articles:

In case of any inconsistency or ambiguity between the provisions of these Articles and the Agreement, the Agreement shall be referenced in interpreting such inconsistency or ambiguity.

In case of any inconsistency or ambiguity between the Articles and the Agreement, the Shareholders and the Company shall take all such steps and do all such acts, deeds and things as may be deemed necessary to suitably amend the Articles to ensure that the Articles are consistent with the terms of the Agreement and that the Articles correctly embody the understanding of the Parties and the Company as per the Agreement, as varied or amended.⁸³

The AoA of Rolta Thales Ltd, a JV between the Rolta group and Thales of France without revealing any contents of the Shareholders Agreement, merely state that

37. The provisions relating to *Reserved Matters* are those as are specified under Article V of the Shareholders Agreement and are incorporated herein by reference.

102. The provisions relating to *Intellectual Property Rights* are those as are specified under Article XIII of the Shareholders Agreement and are incorporated herein by reference. (emphasis added)

The case of recently formed BEL-Thales Systems Ltd, a JV between the public enterprise Bharat Electronics Ltd – BEL (74%) and the Thales group (26%) is also relevant the AoA of the JV states that

The terms and conditions of the [JV] Agreement are binding on the Parties and the Company. The Company fully adopts, ratifies and consents to be fully bound by the Agreement and neither the Company nor the Board, nor any officer of the Company shall take a decision which violates the Agreement. In the event of any conflict between the provisions of the Agreement and the Memorandum and/or these Articles or other constitutional document of the Company, the Agreement shall prevail and the Parties shall, subject to the provisions of the Act and of the Agreement, exercise all voting and other rights and powers available to them so as to give effect to the provisions of the Agreement.⁸⁴

It needs to be underlined that while the AoA vests the Vice Chief Operating Officer (Vice CEO) considerable powers, it does not specify which of the JV partners have the right to nominate him/her. Since the MD&CEO will be a nominee of BEL, it is quite possible that Thales retains the right to appoint the Vice CEO. Though the

⁸² It is also relevant to note that Tara Aerospace Systems Ltd, provided for (i) increase in the foreign equity from 26% to 49% once India's FDI policy changes, (ii) need to get approvals from US Departments of State and Commerce with regard to export licensing matters, (iii) right to nominate Chief Financial Officer and Vice-President of Operations, (iv) a list of reserved matters.

⁸³ Article 46 of the company's AoA.

⁸⁴ The Articles of Association of the JV filed with the Ministry of Corporate Affairs on August 28, 2014.

MD&CEO will decide on certain actions, “prior written agreement on the file by the Vice CEO” is mandatory. The matters include (i) presentation of annual budget, inclusive of the Business Plan or Yearly Revised Business Plan and (ii) decisions on new products and technologies including selection, investment and development.⁸⁵ It is relevant to note that the “Guidelines for Establishing Joint Venture Companies by Defence Public Sector Undertakings” specify that the Boards of the collaborating Defence PSUs should retain the right of prior approval of the key decisions of the JV companies inter alia the Annual Business Plan and any material changes there to and the Annual Budget.⁸⁶ It is obvious that the Vice CEO of the BEL-Thales JV holds veto powers on these very matters. Incidentally, BEL is obliged to sell its stake to enable Thales increase its holding consequent to change in India’s FDI policy. Once again, there might not be any addition to the risk capital available to the JV.⁸⁷

There is a possibility of the Shareholder Agreements and technology agreements containing more restrictive covenants than what the AoAs reveal as reference to Shareholders’ Agreement would be redundant had the covenants of the agreement been fully captured by the AoA. The way the Agreements/AoAs are structured they defeat the policy intention of vesting control in the hands of Indians. It is further apparent that they reflect perpetual dependence on foreign investors for technology and markets. It is time that the collaboration agreements submitted to the administrative ministries, FIPB and the DSIR are analysed in detail to underline the factors that inhibit technology transfer and other restrictive covenants not only in defence but also other sectors. Obviously, the DP by merely going by the company law provisions did not factor in the reality of joint venture structures and special rights enjoyed by certain investors. By having Chief Operating/Technical Officers nominated the foreign collaborators would have better control over technology and operations. If this was the case with JVs, it could be worse in case foreign investors hold majority stakes. In this context, the new provision regarding self-sufficiency in product design and development acquires significance. (See Table-8 above).

The Nationality Issue

As mentioned above, in case of foreign investment up to 49% the revised policy retains the stipulation that Indians should constitute majority on the Board and the Chief Executive Officer should also be an Indian. This, however, raises a critical issue of whether resident Indian status is sufficient to serve the purpose of safeguarding national interest. With the internationalisation of many Indian business families, nationality and national allegiance are tending to become weakly related.⁸⁸ This could

⁸⁵ *Ibid.* Article 103(B).

⁸⁶ Rajya Sabha Unstarred Question No.4385, answered On May 16, 2012.

⁸⁷ On the other hand, there may not be any fresh inflow of funds from abroad if a local subsidiary of Thales takes up the equity offloaded by BEL. Thales had a similar arrangement with Samtel. Incidentally, Thales India Ltd is expected to contribute to 21% of the equity capital of the JV while Thales Air Systems SAS, France is expected to take up the remaining 5% foreign share.

⁸⁸ Conversely, there could be situations where the apex company of the group may be headed by a foreign national as in the case of Tata Sons. In fact, some foreigners were among the persons considered to succeed Mr. Ratan Tata.

have a reflection on the nature of the domestic shareholding companies as well.⁸⁹ Further, in the context of the structuring of agreements described above, the condition that management 'should be in Indian hands' would not have any significance. The rights of foreign shareholders described above render a director's nationality and majority on the board inconsequential. There is a need to look at the AoAs and Shareholder Agreements in addition to the nationality of the persons involved if the objective was to ensure control in resident Indians' hands. Or, alternative instruments like Golden Share may have to be deployed.

There are many issues with technology transfer through FDI. A group of experts constituted by the former Prime Minister of India under the auspices of the National Manufacturing Competitiveness Council (NMCC) had expressed its dissatisfaction with technology transfer and diffusion in the post-1991 period when the foreign investors had a much greater freedom to operate as wholly-owned subsidiaries and thus the need to set up JVs with local entrepreneurs no longer existed. Among the many pertinent observations of the group the one most relevant in the present context is the following.

... many of the technologies in the fields of Defence, Aero Space, IT, Atomic Energy and other high technology areas are not available either through the liberalized FDI route or for buying them outright. Clearly for a major country like India, in the long term, it is necessary to have the state of the art technologies and also a programme to develop the next generation technologies internally through vigorous R & D effort. Many developing countries including China have worked towards this end by putting in place appropriate FDI and Industrial policies.⁹⁰

Interestingly and pertinently, a reflection of this observation could be found in China's "National Medium- and Long-Term Program for Science and Technology Development (2006-2020)"

... one should be clearly aware that importation of technology without emphasizing assimilation, absorption, and re-innovation is bound to weaken the nation's indigenous R&D capability, which in turn widens the gap with world advanced levels. Facts have proved that, in areas critical to the national economy and security, core technologies cannot be purchased. If our country wants to take the initiative in the fierce international competition, it has to enhance its indigenous innovation capability, master core technologies in some critical areas, own proprietary intellectual property rights, and build a number of internationally competitive enterprises. In a word, the improvement of indigenous innovation capability must be made a national strategy that is

⁸⁹ In instances like Airasia, (one of) the Indian investors may be closely linked to the foreign investor thereby making the 49% cap a misnomer.

⁹⁰ National Manufacturing Competitiveness Council, *Report of the Prime Minister's Group: Measures for Ensuring Sustained Growth of the Indian Manufacturing Sector*, September 2008.

implemented in all sectors, industries, and regions so as to drastically enhance the nation's competitiveness.⁹¹

The **message** that gets conveyed is that in situations as these other measures including domestic efforts should be given priority instead of waiting (in vain) for FDI to deliver.

Post-2014 Developments in Brief

In November 2015, the requirement for seeking government's permission for foreign equity up to 49% was done away with and foreign investment was allowed to come through the automatic route. Higher foreign equity, as earlier, would be permitted on a case-to-case basis for cases involving access to modern and 'state-of-art' technology. The reference to foreign portfolio and NRI investments was removed. What is probably more important is the anticipated change in defence procurement policy wherein a new category "Indian Designed, Developed and Manufactured (IDDM)" is expected to be introduced. Equipment designed indigenously would be required to have minimum indigenous content of 40%. If the design is not indigenous, the content should be at least 60 per cent indigenous. Another proposed change is reported to be that under 'buy (Indian)' category the minimum level of indigenous content would be raised from 30% to 40%.⁹²

Section 7 Summing Up

Concentration in global defence manufacturing and sales is an undeniable fact. The pattern of restructuring of the industry, particularly after the cold war, clearly demonstrates that national/regional affiliations of large manufacturers are significant factors. The official Discussion Paper's assertion that since the ownership structure of many of the important defence production companies is in a state of 'continuous flux', there was no risk of 'exclusive dependence on a particular country' is difficult to sustain. It has also to be understood that the developed countries would neither slacken their hold on 'state-of-art' technologies nor would weaken their defence industrial base.⁹³ International experience shows that newly emerged countries relied on domestic

⁹¹ The State Council Peoples Republic of China, *The National Medium- and Long-Term Program for Science and Technology Development (2006-2020): An Outline, non-official translation available at [http://www.etiea.cn/data/attachment/123\(6\).pdf](http://www.etiea.cn/data/attachment/123(6).pdf).*

⁹² See: Amit Cowshish', "New Defence Procurement Procedure: A Stimulating Preview", IDSA Comment, January 20, 2016. Accessed at http://www.idsa.in/idsacomments/india-new-defence-procurement-procedure_acowshish_200116.

⁹³ This was put forthrightly by Admiral Vishnu Bhagwat, India's former Chief of Naval Staff, when he said ... just the fact that an OEM wishes to invest in India, attracted by the business proposition that 49 percent or even higher stakes will enable it to control the facility, production run, operating environment, provide monopoly opportunities and influence in the arms business is not adequate enough because the final decision will remain with the parent country controlling the technology.

See: Vishnu Bhagwat, "FDI in Defence: Missing the Reality", August 21, 2014 accessed at <http://www.madhyam.org.in/fdi-defence-missing-reality/>

sources, both in public and private sectors, coupled with a strong offset policy. Favourable international (strategic and military) alignments and circumstances further explain their ascendancy. FDI played only a limited role. Data on global cross-border Greenfield projects and the declarations of some of the large manufacturers further demonstrate the limited quantum of FDI flows in aerospace and defence sectors, particularly to developing countries. In fact, it suggests the possibility of minority participation in JVs rather than in subsidiaries.

This study made an attempt to provide evidence to show that some emerging **economies** that have focused on the development of their domestic armaments industry have done so with considerable support from state-owned enterprises. Even in some developed countries, the government holds strategic ownership in leading defence manufacturers. This is an area where India has an edge, for it still has considerable capacities left in the public sector enterprises. Evidence from other countries suggests that this advantage can be leveraged to implement an offset policy, which, as we have argued, forms a critical element in the building of the domestic defence sector. Far from pillorying the public sector, the problems and constraints have to be identified and action plans drawn up. What is required is strong political will.

One argument put forward for the failure of offset policy is that India does not have the capabilities to take advantage of the offsets. But that is precisely the reason why India needs to harness offsets. A tendency is now emerging to offer service sector employment as a carrot to wean India away from broadening and deepening its defence industrial base. What is required is a FDI policy that is dovetailed to a stringent offset policy because on its own FDI is not going to deliver. Also, FDI is only a means to get technology and as the global Greenfield investments data showed one cannot expect huge investments. Priority should be on outright transfer of technology. On its part, implementation of the FDI policy should provide space for joint ventures with strict performance requirements. The cases cited above indicate that the foreign partners of the JVs retained the ownership of technologies and the likelihood of the JVs carrying on without their support, in the event of foreign partners' withdrawal, is minimal. Also, the structure of the JVs is such that the power sharing relationships defeat the edge that was sought to be given to the Indian partners through caps. If this is the situation with JVs, including those with some of India's largest business houses, it would be worse with wholly foreign owned enterprises.⁹⁴ The repeated criticism of India's weak IPR regime which is further highlighted by the Out of Cycle Review initiated by the USTR recently is another reflection of the intention to keep the technologies with their owners.

The general arguments in favour of raising the FDI cap for the defence sector simply assume that higher caps are necessary to give the foreign investors control (and

⁹⁴ One may refer to another observation of the Prime Minister's Group when it said: "The Multinational Companies are also permitted to open 100 percent owned subsidiaries in India. In other words, in those areas the technology would continue to remain with the Multinational Companies themselves." The Group also said: "This would in turn mean that under the 100 per cent subsidiary regime technology transfer would be slow and the gap would persist if not widen unless suitable policies to compress the same are put in place by the country." *Supra* note 90.

comfort) as otherwise they will not risk bringing in advanced technologies. The arguments tend to ignore the role of home governments, the critical factor in defence industry which aspect is nowhere better demonstrated than with the development of India-US defence cooperation. Strategic interests of retaining technological superiority and global dominance score over commercial interests. In fact, the former is also related to protecting long term commercial interests as well. The possibility of India moving closer to the US and the offers on DTTI front have raised some expectations. In practice, however, the gains for India could be limited and even these could be obtained at some political cost. In any case, the parity with 'closest partners' does not ensure transfer of 'state-of-art' technologies. Even the much publicised offer of Javelin anti-tank missile has its downside. As the cases described in the foregoing show, co-development could mean that the Indian partners would have the right to use only that part of the technology which is developed jointly. The base technology will remain with the foreign investors.

The game plan seems to be like this. Secure control through higher FDI cap, protect technology through further tightening the IPR regime and make dependence perpetual by holding back key components of the technology. The perpetual dependence renders the threat of appropriation of the facilities by India, as suggested by the DP, meaningless. Also, validity of the DP's assumption that due to increasing costs of labour and other inputs western defence companies could be attracted to new manufacturing hubs like India is open to empirical verification. But what is more likely is that they will look to increasing sales abroad to shore up their own manufacturing bases due to slow down and shrinking budgets.

While allowing foreign portfolio investments, which are expected to meet the financing needs at least, one should try to avoid the type of investor disputes that had cropped up during the recent past.⁹⁵ One could even consider offering them non-voting shares. Interestingly, the new policy dispensed with the requirement of control by Indians for cases involving FDI beyond 49%. On the other hand, it introduced the condition that the investee/joint venture company "should be structured to be self-sufficient in areas of product design and development". This should be used to prohibit the restrictions on technology transfer. But given the narration in the foregoing sections, strict implementation of the condition would deter many foreign investors and it might appear that India's defence FDI policy had failed giving scope for criticism and demands to relax the policy. The defence FDI policy should only be seen as an enabling measure and its success should not be measured in terms of the quantum of FDI. It would be a folly to expect FDI in defence to behave in the same manner as it does on case of other manufacturing sectors. Specifically, the policymakers should refrain from progressively diluting the policy in order to attract more FDI and make the policy a 'success' as in the process its very justification could be compromised.

⁹⁵ For an elaboration, see: Biswajit Dhar, Reji Joseph and T.C. James, "India's Bilateral Investment Agreements: Time to Review", *Economic & Political Weekly*, December 29, 2012, Vol XLVII, no 52, pp. 113-122.

Annexure

Some Salient Features of the Articles of Association of Tata Lockheed Martin Aerostructures Ltd⁹⁶

Shareholder Meetings: ... all meetings of the shareholders of the company shall require a quorum of at least five (5) Shareholders provided, however, that such quorum must include (a) a designated representative of Tata: and (b) a designated representative of LMAC.

Number and Composition: The total number of Directors on the Board of Directors of the Company shall be live (5) of which (a) three (3) directors shall be nominated for appointment by Tata ("Tata Directors") and (b) two (2) directors shall be nominated for appointment by LMAC ("LMAC Directors"). ... The composition of the Board shall be consistent with Applicable Laws, including (if applicable) Press Note 2 (2002) Series issued by the Ministry of Commerce, Government of India (as amended from time to time).

Quorum: The quorum of a committee of the Board must include at least (i) one Director who is a Tata Director so long as Tata and/or its Affiliates together own such number of Shares which are at least equal to Threshold limit and (ii) one Director who is a LMAC Director so long as LMAC and/or its Affiliates together own such number of Shares which are at least equal to Threshold Limit.

Affirmative Voting Matters: ... no action shall be taken by the company, whether at the meetings of the board of Directors, committees thereof, or by way of circulation or at the meetings of the shareholders or otherwise, in respect of the matters set forth below in Article 37 (4) without the prior affirmative vote, of both Tata and LMAC, in case of shareholder meetings, and at least one (1) Tata Director and at least one (1) LMAC Director, in case of Board resolutions (at a meeting or by way of circulation), in favor of such matter.

Article 37(4) contains Reserved Matters which *inter alia* include:

- i) A resolution to adopt, approve or amend the Annual Operating Plan and/or the Business Plan;
- ii) Entering into a licensing or other agreement involving the acquisition or disposal or granting or receiving rights to technical knowhow; other than an agreement anticipated by the Business Plan;
- iii) Entering into, amending or terminating any of die Definitive Agreements
- iv) Appointment, removal or varying the terms of appointment of the Chief Executive Officer or Chief Financial Officer and other members of senior management directly reporting to the Chief Executive Officer or the Board;
- v) Any increase or decrease in the number of members of the Board of Directors or appointing a committee of Directors or delegating powers of Directors to a committee, (provided that no delegation to a committee shall occur which would supersede or contravene the affirmative rights provisions under the Joint Venture Agreement);
- vi) Delegation and identification of rights, obligations and duties of all or any of the managers, officers and employees etc. of the Company;
- vii) Amendment to the Company's Code of Conduct or Compliance Procedure as provided in Schedule X and XI of the Joint Venture Agreement or appointment or discharge of the Compliance Officer or the compliance auditor;

Officers: (i) The Managing Director/Chief Executive Officer shall be nominated by Tata and *approved and appointed* by the Board.

(ii) The Head of Operations/Chief Operating Officer shall be nominated by LMAC and approved and appointed by the board and shall report to the Managing Director/Chief Executive Officer.

Compliance Officer shall oversee the implementation and maintenance of the Code of Conduct of the Company, compliance procedures, and generally the compliance of the Company with Applicable Law with respect to which, non-compliance would subject a Shareholder, the

⁹⁶ A general condition is that Tata and LMAC should be holding the respective 'Threshold Shares' to be able to exercise the respective rights.

Company or its directors or officers to liability, including without limitation the U.S. Foreign Corrupt Practices Act and U.S laws and regulations relating to export control. The Compliance Officer shall report directly to the Board.

Compliance Procedure: The Company, including, without limitation, all managers, officers, directors, employees and other Company personnel shall strictly observe the Company's Compliance Procedure, as set out in Schedule XI of the Joint Venture Agreement, as it may be amended from time to time (its amendment remaining a Reserved Matter). That Compliance Procedure shall be approved by the Board at the meeting of the Board held on the Closing Date. The Company's Compliance Procedure establishes policies and procedure designed to ensure that the Company will comply with the Applicable Laws and that the Company's actions shall not cause a Party to violate or be penalized under laws by which such Party is bound including without limitation, *the U.S. Foreign Corrupt Practices Act, the U.S.A. Patriot Act, U.S. export control laws and regulations including the International Traffic in Arms Regulations, U.S. Anti-Boycott Laws, and the U.S. office of Foreign Asset Control Regulations.* (emphasis added)

Export Laws and Re-Export: Each of Tata and LMAC shall comply, and shall *cause its Related Parties who are Shareholders or otherwise engaging in activity connected with the Company* and the Company to comply, with all Applicable Laws and regulations, *including U.S.A export control laws (including the U.S.A. International Traffic in Arms Regulation)* and Indian export control laws, pertaining to the export or re-export of any information or goods received by it or its Affiliates from the Company. The Company shall establish export control procedures and an accompanying compliance program which shall include periodic training to ensure compliance with Applicable Laws.

Retention of Intellectual Property Ownership: Each of LMAC and Tata shall retain ownership of all trademarks, copyrights, patent, trade secrets, and other intellectual property rights and information it may now possess or own or has made application for with respect to its business. All title, ownership rights, and all intellectual property rights in any system, soft-ware, processes, methodology or information/content provided by Tata or LMAC, as the case may be, to the Company shall remain the sole and exclusive property of Tata or LMAC, as the case may be. Neither of the Parties shall acquire any right, title, interest, or license in any Intellectual Property belonging to the other as result of the execution of the JV Agreement.

Non-Exclusivity: ... Tata expressly agrees and acknowledges that LMAC and/or its Affiliates shall be free to undertake, by itself, activities in the 'same field' as understood as per Applicable Law and/ or the Business, in India, and/ or to invest in any Person engaged in or proposing to undertake activities in the 'same field' as understood as per Applicable Law and/ or the Business, in India, and/ or enter into any other joint ventures, tie up or collaboration with Third Parties in the Same field' as understood as per Applicable Law and/ or the Business, in India.

Offset Recognition: The Parties will determine the investment of LMAC consisting of equity contribution, royalty-free technical data license, and provision of tooling appropriate for purposes of offset credit recognition and document their determination of the amount of such investment for such purpose. LMAC may claim offset credit for investments based on the said amount and such additional amounts, as the Parties may determine based on any additional investment creditable for offset purposes.

LMAC's Option to Increase Shareholding: In pursuance to any change in the then applicable Indian regulations governing foreign direct investment ("FDI Policy") ..., LMAC becomes entitled to increase its shareholding in the company beyond twenty six per cent (26%) (whether under the automatic or approval route), LMAC shall ... have the right and option (but not the obligation) to increase its percentage shareholding in the Company up to the maximum limit permissible by the FDI Policy... LMAC shall not have a right to increase its shareholding ... beyond forty nine percent (49%)...