



Prime Minister Manmohan Singh with President Barack Obama at the White House

US-INDIA DEFENCE COOPERATION Towards an Enduring Relationship

Robert S Metzger

Patience and persistence are required for businesses to succeed in the Indian market. The same is true as to the bilateral security relationship, between the US and India. Taking the longer view, the security objectives of India, and the US, in the South Asia region, are characterised more by identity and similarity than by difference or rivalry. If these propositions are correct, such market forces will move both nations towards cooperation and mutual reliance, and existing bilateral barriers will be overcome in time.

AS A RISING POWER, INDIA ALREADY has assumed important responsibilities for regional security. Its role and prominence will grow, as will its defence expenditures. The United States is paying special attention to India. The 2012 US Defence Strategic Guidance explicitly acknowledges the necessity to 'rebalance' US security resources towards the Asia-Pacific region, as the withdrawal of US combat forces from Iraq and Afghanistan proceeds. India is the



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only country that the US specifically identifies as a key strategic partner:

"We will also expand our networks of cooperation with emerging partners throughout the Asia-Pacific to ensure collective capability and capacity for securing common interests. The United States is also investing in a long-term strategic partnership with India to support its ability to serve as a regional economic anchor and provider of security in the broader Indian Ocean Region."

—*Sustaining US Global Leadership: Priorities for 21st Century Defence* (January 2012)

The particulars of the phrasing are important. The US Government speaks to 'investment' in a 'strategic partnership' intended to support India's ability to uphold regional security. A 'partnership' implies a relationship among peers which serves the interest of each.

India has embarked upon a multi-year program to improve its defence capabilities. The metrics are impressive. Since 2001, India's defence spending has risen by more than 60 per cent to \$36 billion in 2011 - 2012. Between the years 2007 and 2011, India signed \$35.6 billion in defence contracts. Some forecasts project \$100 billion in military purchases over the next ten years, of which 50 per cent (or more) may be sourced from foreign vendors. While India has made indigenisation a national priority, that is a long-term proposition. In the near term, India remains a leading market opportunity for US and other foreign suppliers.

For the US government, however, India is more than an arms customer. As is evident from the Strategic Guidance Document, the US looks for a 'partnership' with India to support long-term stability in the region and protect mutual security interests. That partnership proceeds without an alliance relationship but is driven by common interests.

On the surface, great progress has been made in the relationship. The United States is now the largest defence supplier to India. American companies have received \$12 billion in contracts from the Government of India - a 34 per cent share since 2007. Yet when examined more carefully, there are key points of frustration and limitation which need to be better understood and addressed incrementally, to mutual benefit.

THE FOREIGN MILITARY SALES (FMS) PROCESS

By dollar value, most US sales to India have been through the government-to-government (FMS) route. Yet both the US and India are far from satisfied. Among criticisms attributed to India - FMS letters of offer are not fully responsive to the competition sought by India's Defence Procurement Procedure (DPP), India has insufficient contractual leverage over the supplier as an FMS agreement is with the US Government and that the FMS adds costs for functions that India does not desire. The US view is that India may not accurately portray FMS or fairly appreciate its advantages.

The DPP and FMS serve very different purposes. The principal objective of the DPP is to assure that the Government of India can conduct defence acquisition of approved requirements through transparent means which produce the lowest cost, technically compliant bid among at least two qualifying offers. FMS, in contrast, exists to serve the security assistance objectives of the United States and its allies. It employs the US federal acquisition process, developed over many years, and often operates from the very different paradigm of 'best value', where the US regularly performs a 'cost-technical' trade to decide whether superior performance justifies a higher price. The DPP works from an equally legitimate but fundamentally different premise.



Soldiers of Indian Army and the US Army during Exercise Yudh Abhyas

India and the United States

While friction between the FMS and DPP thus is inevitable, both India and the US should continue to make selective use of FMS wherever mutually advantageous. Although it can suffer from lethargic processing in the US bureaucracy, FMS deals get done. FMS benefits from the full faith and credit of the US Government behind FMS agreements, the potential availability of financing where a 'dependable undertaking' is obtained, high confidence in integrity as a consequence of US compliance mechanisms, and the assurance of life cycle system support. By reducing payment risk to the US supplier, there are potentially lower costs to India as a buyer. Although the US Government purchases supplies or services for the benefit of India, it employs many rigorous systems to assure that the price is fair and reasonable. Where more sensitive technologies are implicated, FMS will be the only vehicle as direct commercial sales may not be authorised. Where India's priorities warrant, it also can use FMS to purchase subsystems and hardware (and defence services) from lower tier US suppliers.

Both the US and India can act to improve the match between FMS and India's defence requirements. US agencies with key FMS case responsibilities, including the Defence Security Cooperation Agency (DSCA), Directorate of Defence Trade Controls (DDTC), and Defence Technology Security Administration (DTSA), can give priority to FMS cases for India. The US Government can commit greater resources to support the Office of Defence Cooperation (ODC) at the US Embassy in New Delhi, as the ODC is a key interface between the potential requirements of India and the Letter of Request (LOR), which formally begins an FMS case. These steps would help close a perceived gap between the priority given India in US pronouncements, such as the Strategic Guidance, and actual practice as evidenced in responsiveness, resources committed and timely actions. At the same time, India can be encouraged to make adjustments to the DPP as will better reconcile it to enable US companies to compete with FMS offers.

INDIA'S DEFENCE PROCUREMENT PROCEDURE

Some American companies have complained of fatigue with the DPP process that India

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uses for Direct Commercial Sales (DCS). This 'fatigue factor' is of concern as it may prompt some capable firms not to participate in DPP competition. US firms view the DPP as unwieldy and uncertain. Because of the 'No Cost, No Commitment' trials requirement, vendor participation can be expensive. Award is made to the Lowest Price (L1) bidder who satisfies minimum technical requirements, without

performance discrimination as in US 'best value' determinations. In India, DPP procurements typically take a very long time to fructify. As US companies must answer to corporate directors, even top-tier companies worry about the return on investment in DPP competitions. Should

they withdraw from the market, as is a genuine possibility, India would have fewer and potentially inferior alternatives and solutions for its key operational requirements.

The DPP, however, is a work in progress. India is relatively new to the global defence marketplace, as the DPP was first introduced in 2002 and then subsequently amended in 2003, 2005, 2006, 2008, 2009 and 2011. As India is developing its acquisition workforce, resource limitations help explain why the DPP is rule-driven rather than encouraging exercise of discretion by contracting officials. Discretionary contracting functions are more stressful on a limited base of acquisition professionals. Excess 'play in the joints' risks error and is more susceptible to improper influence, bias or corruption. Thus, there is context and cause for the DPP's particular approach. With time and experience, execution of the DPP procurements is bound to improve. In any event, the DPP exists for India's benefit not for any vendor from any country. US firms would be well counseled to work (as they have) with international organisations to promote best practices in defence acquisition that will help India to get better results from the DPP.

India benefits from full and fair competition and that is promoted by a functional procurement system which encourages vendor participation from multiple qualified vendors. Ultimately, the purpose of any acquisition methodology is to provide a government end user with supplies or services that it requires. Indeed, the DPP's stated aim is to ensure the 'expeditious procurement of

the approved requirements of the Armed Forces.' Unfortunately, the record of recent years is that the DPP has disappointed those who 'own' the requirements and seek supplies and services. As is true of any country, when acquisition practices fail in their purpose, the result is delay or denial of national objectives. India has made many recent, major purchases outside the DPP, through Inter-Governmental Agreement (IGA) such as an FMS purchase. India can reduce its use of IGAs as it further improves the DPP. India can demonstrate the DPP is effective by completing pending selections and awarding contracts long in gestation. India also can improve supplier willingness to bid, and expedite the closure process on contract negotiations, by aligning key contract terms such as financing of performance, payment and limitation of liability to international commercial norms.

EXPORT CONTROLS AND TECHNOLOGY RELEASE

There continues to be a 'trust deficit' that constrains India's willingness to rely on the US for critical defence items. This reflects several historical examples of export sanctions imposed by the US upon India, most recently in 1998. Doubts as to the outcome of the US export control processes persist. At the commercial level, the result favors bidders from countries such as Russia, France or Israel with less restrictive technology transfer rules.

US export controls and technology release policies exist to serve a variety of functions and policies, and US agencies must adhere to statutory mandates and respect Congressional prerogatives. The US must conform to the Arms Export Control Act (AECA), which limits retransfer of munitions and imposes various measures which condition or accompany military sales or other defence transfers. For example, Section 41A of the AECA requires end use monitoring of defence articles and services



Indian Army and the US Army weapons familiarisation before Yudh Abhyas

sold, leased or exported. The US Government has little or no discretion as concern statutory requirements. However advantageous a particular sale might appear to be, rules cannot be bent as a matter of security policy or industrial objective. At the same time, the US should continue export reform initiatives which, if successful, will control fewer items and promote certainty and more speed in licensing decisions.

If the sources of US constraints were better understood, India might re-assess how it approaches the four so-called 'enabling agreements' that remain points of contention. These are the Communications and Information Security Memorandum of Agreement (CISMOA),

the Basic Exchange and Cooperation Agreement for Geospatial Cooperation (BECA), the Logistics Support Agreement (LSA) and the End Use Monitoring (EUM) Agreement. In July 2009, the US and India announced agreement on End Use

Monitoring of US defence articles. This was a pragmatic accommodation that gave the US sufficient assurance that India would respect non-proliferation objectives without the imposition of an unacceptably intrusive inspection regime.

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Boeing P-8I inducted into Indian Navy

Yet to be resolved are issues regarding the CISMOA, BECA and LSA. These agreements assist the US in maintaining compliance with its export control and other national security laws and policies. The CISMOA may be the most difficult because of concerns within India that its proposition of 'interoperability' risks compromise of communications security. As evidenced in the several transactions of the P-8I and C-130J, India has purchased US platforms without the US hardware which would require CISMOA, deciding instead to provide its own communications equipment. Over time, the success of this strategy will be revealed through experience. India may find cause in the future to conclude that it is in its national interest to reach an accommodation on CISMOA in order to have greater access to the performance of US systems otherwise withheld.

BECA and LSA should present less difficulty. There are self-evident bilateral benefits to these agreements, especially in information exchange and logistics support. The positive experience of EUM suggests progress can be made. If India objects to a formal agreement on BECA and LSA, the countries might be able to agree on key principles and make appropriate reference in FMS case or DCS contract documentation.

The US has some flexibility in administration but cannot act at variance with its own laws. In contrast, India can decide how it characterises the agreements. Among nations and in business,

peers in a partnership reach agreements which have mutual benefit and mutual obligations. A case may be made that India concedes nothing as to sovereign authority in the particulars of the enabling agreements. What India would gain from these agreements, in contrast, is tangible. Absence of enabling agreements has

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limited what India can receive in high-tech, high-performance US systems. Progress on the enabling agreements, even if gradual, is important for India to maximise the value of US platforms it has already acquired or may purchase – and for transfer of US technology

as India seeks to energise its domestic aerospace and defence capabilities.

Essentially, India's posture today presents a difficult conundrum for the US. Without the enabling agreements there are insufficient 'contractual' assurances of technology controls. The US does not believe it has adequate visibility into India's internal control regime, as might serve as a surrogate to formal agreement. Today, therefore, the US is asked to rely largely on trust. Considering the statutory basis for and great policy importance of counter-proliferation objectives, as well as Congressional oversight, the US is not wrong in asking India for more.

INDIGENISATION AND OFFSETS

An announced national goal is for India to become self-reliant in defence and, someday, a net exporter. India seeks an indigenous defence capability that will engage its private sector

and generate manufacturing employment. These opportunities are to extend beyond big industrial conglomerates to hundreds, if not thousands of Small and Medium-sized Enterprises (S/ME). To achieve these ambitions, India has looked to two methods. One is the 'Make' component of 'Buy and Make' procurements under the DPP, where foreign sellers are required to facilitate in-country manufacture. The other is through offset requirements.

As regards the 'Make' instrumentality, the record today is mixed. Official government sources report modest involvement on the part of India's private sector as prime contractors at the system level. Domestic manufacture of defence systems, and responsibility for design and development, is the domain of public sector enterprises, that is, the Defence Public Sector Undertakings (DPSUs) and Ordnance Factories (OFs). It cannot be said that, across the board, the DPSUs and OFs have proven capable or have the necessary bandwidth to supply defence systems comparable to those available from original foreign sources. The record of DPSUs in design and development reflects examples of disappointment and delay. Considering its formidable national accomplishments in so many areas of demanding technology, India has great potential in aerospace and defence. It is for the Government of India to resolve how it can enable its private sector and actualise its announced manufacturing and employment objectives. The balance between public sector commitments and private sector opportunity may need change. Design and development work now is contracted to DPSUs outside the DPP competitive mechanism. Should India enlarge the DPP to promote competitive selection of private sector contractors for development, US firms potentially can partner with Indian companies and contribute valuable technology and know-how.

Offsets, the other method for indigenisation, are very big

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business. Signed offset commitments amounted to \$3.3 billion before the recent Medium Multi-Role Combat Aircraft (MMRCA) selection.

After MMRCA and other pending purchases are factored, total offset commitments to India will equal or exceed \$10 billion. Offset requirements apply both to IGAs, such as FMS, as well as to DCS under the DPP. Official US policy is neutral on offsets and the US

Government is not a party to offset contracts between the Government of India and foreign source suppliers. Nonetheless, there are very important bilateral issues presented by offsets which warrant close attention.

India's offset program proceeds from a proposition that a contractual requirement will force foreign sellers to create an Indian aerospace and defence industry. There are many and difficult challenges to achievement of the intended result. India's offset requirements, as presently implemented, impose a cost to India as sellers include the cost and risk of offset obligations in their bids. The means of offset implementation, however, are beset with structural and practical problems that place the intended industrial and employment benefits at risk.

This is not because US companies or other foreign offset obligors lack a good faith intention to create and utilise Indian sources to fulfill offset commitments. A threshold problem is one of industrial capability and competence. As of now, India's offset rules allow credit for purchase, qualifying investment or provision of services in three eligible areas – defence, civil aerospace and homeland security. Particularly taking the



Lockheed Martin's C-130J for IAF

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MMRCA award into account, many US and other foreign vendors perceive that India's existing capabilities, in these eligible areas, are absorbed if not oversubscribed. Yet creation of new ventures in India is widely seen as very difficult, in part due to organisational rules, bureaucratic process, uncertain tax laws and other legal requirements. A particular source of frustration, to commercial enterprises, is the 26 per cent limitation on Foreign Direct Investment in the defence sector.

No one benefits in entering into offset contracts that cannot be fulfilled. Although the US government is not a party to offset contracts, it has a stake in the success of US companies in making good on their offset commitments. Considering the size of offset contracts that accompany large platform sales, one can project adverse international consequences should US companies default or fail in their offset obligations. There are actions for each government to take, for their own benefit, and for mutual gain.

The US Government can help by streamlining its export control process and by giving emphasis and priority to the processing of license applications submitted by US firms seeking to partner with Indian companies. Uncertain outcome and slow processing of applications frustrates formation and operation of joint ventures between US and Indian companies, as are necessary to satisfy offset requirements. The US Government also can help by collecting information from its private sector on offset experience and by offering insight and advocacy on solutions.

India can help itself to make offsets succeed. A most important way is to increase the FDI limit beyond 26 per cent so that the US and other foreign firms will have more incentives to invest in new Indian ventures and so that they will have enough authority over those ventures for confidence in the quality and timeliness of product. This is especially needed if the offset programme is to succeed in bringing aerospace and defence work to companies outside the 'top tier' of India's private sector industrial enterprises. A second action is to allow offset credit to existing foreign-owned firms for new work in eligible areas that they perform in India, even if that company has more than 26 per cent foreign ownership.

This is appropriate and earned recognition for companies who have had the foresight to invest in aerospace in India. It is good business and a 'win-win' for both the investing company and India.

A third action is to extend the 'banking' period for offset credits so that there is enough time for companies to partner and to develop necessary competence. Granting of multipliers for realised technology transfer, for output of new aerospace ventures, and for successful utilization of S/MEs, also would help. Beyond this, India should look realistically at outcomes and be prepared, if justified, to expand the sphere of work eligible for offsets to encompass other worthy national objectives. As a matter of administration, India should be encouraged to give greater resources and authority to the agency charged with offset administration so that it can act expeditiously on offset project applications and to resolve issues as may arise in implementation.

CONSTRUCTIVE ACTIONS

Patience and persistence are required for businesses to succeed in the Indian market. The same is true as to the bilateral security relationship, between the US and India. Taking the longer view, the security objectives of India, and the US, in the South Asia region, are characterised more by identity and similarity than by difference or rivalry. If these propositions are correct, such market forces will move both nations towards cooperation and mutual reliance, and existing bilateral barriers will be overcome in time.

Incremental improvement requires limited ambitions and a pragmatic approach to achieve what is possible rather than to fail in attempting what cannot be reached. Both industry and government can contribute. Each time that a US company delivers a supply or service – whether through DPP or by FMS – there is a positive achievement for the relationship as confidence is gained. Similarly, improvement in the bilateral relationship will promote increased commercial opportunities for US firms. There is a great future for US and India to cooperate to meet common security interests, and this future can embrace long-term industrial cooperation which will serve India's national objectives as well as US interests.

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