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**STANDING COMMITTEE
ON DEFENCE
(2009-2010)**

FIFTEENTH LOK SABHA

MINISTRY OF DEFENCE

[Action Taken by the Government on the Recommendations contained in the Thirty-third Report (Fourteenth Lok Sabha) on 'Indigenisation of Defence Production—Public-Private Partnership']

FIFTH REPORT



**LOK SABHA SECRETARIAT
NEW DELHI**

March, 2010/Phalguna, 1931 (Saka)

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*Presented to Lok Sabha on 4.3.2010
Laid in Rajya Sabha on 4.3.2010*



LOK SABHA SECRETARIAT
NEW DELHI

March, 2010/Phalguna, 1931 (Saka)

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COMPOSITION OF THE STANDING COMMITTEE
ON DEFENCE (2009-10)

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(iv)

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3. Shri N.S. Hooda	—	<i>Additional Director</i>
4. Shri Rahul Singh	—	<i>Committee Officer</i>

INTRODUCTION

I, the Chairman of the Standing Committee on Defence (2009-10), having been authorized by the Committee to submit the Report on their behalf, do present this Fifth Report of the Committee on action taken by the Government on the recommendations/observations contained in the Thirty-third Report of the Committee (Fourteenth Lok Sabha) on 'Indigenisation of Defence Production—Public-Private-Partnership'.

2. The Thirty-third Report was presented to Lok Sabha and laid on the Table of Rajya Sabha on 19 December, 2008. The Report contained 23 recommendations/observations respect of which replies have received from Ministry of Defence on 30 October, 2009.

3. The Draft Action Taken Report was considered and adopted by the Committee at their sitting held on 8 February, 2010.

4. An analysis of action taken by the Government on recommendations/observations contained in the Thirty-third Report of the Standing Committee on Defence (Fourteenth Lok Sabha) is given in the Appendix.

5. For facility of reference and convenience, the recommendations/observations of the Committee have been printed in thick type in Chapter-I of the Report.

NEW DELHI;
25 February, 2010
6 Phalgun, 1931 (Saka)

SATPAL MAHARAJ,
Chairman,
Standing Committee on Defence.

CHAPTER I

REPORT

This Report of the Standing Committee on Defence deals with action taken by the Government on the recommendations/observations contained in their Thirty-third Report (14th Lok Sabha) on 'Indigenisation of Defence Production-Public-Private Partnership', which was presented to Lok Sabha and laid in Rajya Sabha on 19.12.2008.

2. The Committee's Thirty-third Report (Fourteenth Lok Sabha) contained twenty three observations/recommendations on the following aspects:—

Para No.	Subject
1.	Need for taking steps to enhance Indigenisation in Defence Production
2.	Extent of Indigenisation
3, 4 & 5.	Private Sector Participation
6.	Defence Procurement Procedure
7.	Review of 'Make' Category
8.	Filed trials
9.	Foreign Direct Investment (FDI)
10.	Offset Provision
11.	Level Playing Field
12.	Financial Assistance to SMEs
13 & 14.	Indigenisation of Defence equipment
15.	Raksha Udyog Ratnas (RURs)
16 to 21.	Research and Development Efforts
22.	Autonomy to DPSUs and Ordnance Factories
23.	General

3. Action Taken Replies have been received from the Government in respect of all the recommendations/observations contained in the

Report. These replies have been examined and the same have been categorized as follows:—

- (i) Recommendations/observations, which have been accepted by the Government (Please *see* Chapter II):—

Para Nos. 3, 4, 5, 6, 7, 8, 12, 13, 14, 16, 18, 20, 21, 22, & 23

(15 Recommendations)

- (ii) Recommendations/observations, which the Committee do not desire to pursue in view of the replies of the Government (Please *see* Chapter III):—

Para Nos. 1, 9

(02 Recommendations)

- (iii) Recommendations/observations in respect of which replies of the Government have not been accepted by the Committee and which require reiteration (Please *see* Chapter IV):—

Para Nos. 2, 10, 11 & 17

(04 Recommendations)

- (iv) Recommendations/observations in respect of which final replies of the Government are still awaited (Please *see* Chapter V):—

Para Nos. 15 and 19

(02 Recommendations)

4. The Committee desire the Ministry to furnish its response to their comments made in Chapter-I of this Report at the earliest.

5. The Committee will now deal with the action taken by the Government on some of their recommendations in the succeeding paragraphs.

A. Extent of Indigenisation

Recommendation (Para No. 2)

6. The Committee had recommended as under:

"The Committee are constrained to observe that no scientific system has been put in place by the Ministry of Defence to assess the exact level of indigenisation achieved by defence production units

in the country. In fact, the statistical information on extent of Indigenisation furnished to the Committee fail to reflect true picture as some of these figures admittedly, do not include the quantum of import content utilised in products manufactured by public sector units. The Committee find it distressing that while one representative of the Ministry of Defence claimed during evidence that the share of indigenously produced items in defence production was about 77 per cent in 2006-07, the Defence Secretary was candid enough to admit that only 30 to 35 per cent of defence expenditure on equipment was met from domestic manufacturers. Undoubtedly, the quantum of financial outgo to the foreign and indigenous sources for procurement of defence equipment continues to be the primary criterion for evaluating the level of indigenisation in defence sector in the country. The Committee wish to remind the Ministry that the main plank of indigenisation in defence production is to reach higher levels of self reliance in development and production of state-of-the-art equipment and weapon systems and this issue of national importance cannot be viewed in a mere commercial and statistical jargon. The Committee express their strong displeasure over the manner in which this data is being maintained and they desire the Ministry to apply necessary corrections in order to ensure an objective and incisive analysis of the realities of the prevailing situation."

7. The Ministry in its action taken reply has stated as under:

"There are two aspects to the issue viz. developing systems indigenously and the level of indigenisation through the ToT route. As regards indigenous R&D, major systems and deliverable are in place, like Prithvi, MBT Arjuna and EW Systems for Army & Navy. In the field of mission computers also considerable indigenous capability has been built for major platforms. This process has to be further strengthened.

As regards ToT, most of the manufacturing programmes in DPSUs and OFB are under license production. The extent of indigenisation depends on the depth of technology being transferred and stage of transfer. For example in the case of SU-30Mkl, the indigenisation percentage which was 13% during 2004-05 would go up to 43.4% in phase IV of manufacturing this year. Similarly, in case of HAWKAJT, the indigenisation percentage will increase from present level of 12%-15% to 45% in the raw material phase of production. In case of T-90 Tank, the indigenisation percentage in the current

year is 30% is likely to go up 70% by 2010-11. It is also relevant to mention that as per provision of DPP-2008, minimum indigenous content in case of ToT is 60% for Cat-I & II items and this is insisted upon in the RFP for 'Buy & Make' cases."

8. Expressing their strong displeasure over the manner in which data is being maintained about the exact level of indigenisation of defence production, the Committee had desired the Ministry to ensure an objective and incisive analysis of the realities of level of indigenisation. The Committee are not satisfied with the reply of the Ministry as till date they have not done any assessment in this regard. The Ministry has furnished information with regard to indigenization percentage in respect of some of the selected major systems developed through ToT. In the absence of such data on all the systems, sub-systems and spare parts being developed by all production agencies and R&D organisations, it would be inaccurate to quantify the level of indigenization. The Committee, therefore, would like to reiterate their earlier recommendation to maintain scientific data on the level of indigenisation of defence production in the country.

B. Offset Provision

Recommendation (Para No. 10)

9. The Committee had recommended as under:

"The Committee note that an 'off-set' provision applicable to all capital acquisitions effective from July, 2005 has been incorporated in the Defence Procurement Procedures (DPP) which stipulates a minimum required offset of 30 percent of the indicative cost of the acquisitions under 'Buy (Global)' category and 30 percent of the foreign exchange component in 'Buy and Make' category in respect of acquisitions valued at Rs. 3000 crore or more. The Committee have been informed that although offset obligations have to be discharged concurrently with the main contract, any failure on this account attracts a meagre penalty of 5 percent and other action can also be initiated against the defaulting company in case of consistent failure. Strangely enough, extension of time for implementing the offset obligation is also stated to be considered with specific order. The Committee are in no doubt that such options leave limited scope with the Government in strictly enforcing the requirements under offset provision which ultimately proves detrimental to the national interests. While certain changes are stated to have been made in DPP-2008 in view of the

requirement of foreign manufacturers to speed up offset implementation over a period of time, the Committee would like to emphasise that time limit for discharging liabilities under the offset provision have to be made essence of the relevant contracts. They, therefore, desire that stringent and specific clauses should be incorporated in the contracts for imposing heavy financial penalties at the rate of a minimum of 15 per cent per annum in all cases of default and no room is left for any discretion in such matters.”

10. The Ministry in its action taken reply has stated as under:

“The Offset provision included in DPP-2008 has been amended with reference to that included in DPP-2006. Action to revise the penalty clause with reference to non-fulfilment of offset obligation can be taken after some of the offset contracts have been implemented and studied”.

11. The Committee note that the offset provision was initially included in DPP 2006. Even after the passage of almost four years, the Ministry need more time to study the offset contracts to revise the penalty clause as recommended by the Committee. In this context, the Committee may like to refer to Para No. 10 of Part II of first report (15th Lok Sabha) of the Committee on Demands for Grants 2009-10 as reproduced below:

“In placing the order for the acquisition of 40 aircraft ‘M’, costing Rs. 9,036.84 crore, Ministry/IAF failed to go in for the Offset Clause as stipulated in the DPP. This led to the denial of corresponding benefit amounting to Rs. 2,711 crore to Indian Defence Industry and the objective of urgent acquisition has also not been achieved.

In view of the above loss of benefit to Indian Defence industry, the Committee recommend that the Ministry should ensure that the DPP provisions are strictly implemented in all capital acquisition cases.”

12. The aforesaid observation of the CAG reinforces the need for stringent penalty measures. As such the Committee would like to reiterate their earlier recommendation to impose heavy financial penalties @ minimum of 15 per cent per annum in all cases of default. The concrete action in this regard should be taken without any further delay and the Committee informed accordingly.

C. Level Playing Field to private sector

Recommendation (Para No. 11)

13. The Committee had recommended as under:

"The Committee are fully conscious of the role being played by the DPSUs and the Ordnance Factories in meeting the national security requirements. However, they are at the same time of the view that the contribution being made by the private sector in defence production cannot be marginalised by the Ministry of Defence in their capacity as the sole buyer of military equipment. Although the long standing demand of private sector for providing a level playing field *vis-a-vis* foreign suppliers is stated to have since been addressed in DPP-2006, the Committee have been given to understand that there are several areas where distinction is made between the private and public sector while procuring defence equipment. These are, *inter-alia*, (i) nomination for transfer of technology where the foreign suppliers are specifically asked to collaborate with an DPSU; (ii) discrepancy in tax structure for exemption of customs and Central excise duties as well as foreign exchange rate variation; and (iii) non-acceptances of corporate bonds as collateral etc. The Committee consider that these issues need urgent attention with a view to doing away with discriminatory treatment so that the necessary thrust is provided to private sector striving hard to augment indigenous defence production in the country. The Committee are of strong view that level playing field and equal opportunities would not only promote healthy competition between the public and private sector but would also result in cost effectiveness of indigenously produced defence equipments. The Committee expect the Government to move in the right direction expeditiously."

14. The Ministry in its action taken reply has stated as under:

"In the matter of nominating Production Agency for receiving ToT, it needs to be pointed out that certain technical sensitivities, maintenance of equipments for a lifetime, assured spares supports and operation in times of war, have to be factored in while making such nomination. Since Government pays for the ToT and the above issues are paramount, DPSUs/OFB would have to be the primary receivers of such technology to give credible guarantees to the needs of national defence.

In so far as taxes are concerned, the evaluation of L1 is done minus the taxes—so that there is a level playing field. In fact in some cases the PSUs are at a disadvantage as they are not in a position to take CENVAT credit.

ERV is admissible only to Defence PSUs wherever import component is involved. However, in multi-vendor cases, no advantage under ERV is admissible to DPSUs.”

15. While taking note of the fact that distinction is made between the private and public sector at the time of procuring Defence equipments, the Committee had recommended for level playing field for the private sector while nominating Production Agency for transfer of technology where the foreign suppliers are asked to collaborate with DPSU. In this regard DPP 2008 specifically provides that in cases where ToT is being sought, the appropriate Production Agency (PA) could be selected from any of the public/private firms including a joint venture company based on the inputs from DDP and if required from DRDO. In spite of that, the Ministry in the action taken reply has highlighted certain concerns for nominating DPSUs/OFBs as primary receivers. The Committee understand that it would always be safer to nominate DPSUs/OFBs as the primary receiver of such technology. However, the total denial of the opportunities to the private sector in this regard is not justified particularly when the specific provision has been made in the DPP. In view of this, the Committee while reiterating their earlier recommendation would like the Ministry to take concrete step to involve the private sector.

D. Research and Development Efforts—Payment of Royalty to Scientists

Recommendation (Para No. 17)

16. The Committee had recommended as under:

“The Committee also wish to emphasise that innovative schemes for promoting research and development activities in the defence sector have to be devised by the Ministry of Defence to achieve an enhanced level of self-reliance, in this area. The Committee therefore, recommend that a comprehensive plan of action should be formulated to recognize the research and development work undertaken by the defence scientists/the industry by extending them appropriate incentives for different projects and payment of royalty, etc. The industry should also be assured of orders in case of development of product within a given time frame in conformity with the specific qualitative requirements of the users.”

17. The Minister in its action taken reply has stated as under:

"The Defence Acquisition Council (DAC) has accepted in principle the concept of shared development cost. The 80:20 ratio for sharing of development cost with the industry is included in DPP 2008 for promoting research and development activities in the defence sector by Indian Industries. There is no question of giving royalty to defence scientists in the DRDO/PSUs as the entire cost of research, including salary, is met by the Government and the fruits of the research are Government property".

18. The Committee disapprove the way the Ministry has responded to one of the important recommendations of the Committee with regard to providing appropriate incentives/royalty to Defence scientists/industry for different projects. Instead of taking the concrete action, the Ministry has outrightly rejected the recommendation of the Committee by stating that the entire cost of research including salary is met by the Government and the fruits of the research are Government property. The Committee strongly feel that extension of royalty will boost the original research and development in defence production. Therefore, the Committee reiterate their earlier recommendation to consider the payment of royalty to scientists.

E. Research and Development Efforts—Involvement of Private Sector in DRDO projects

Recommendation (Para No. 21)

19. The Committee had recommended as under:

"Since DRDO have a well-established and vast network of laboratories spread over the country, feasibility of extending research facilities to defence industries in private sector in DRDO laboratories should also be examined in the interest of national security. The Committee trust that this issue will be considered by the Ministry of Defence in proper perspective so that the R&D infrastructure created in the country is put to optimum use."

20. The Ministry in its action taken reply has stated as under:

"DRDO has been involving Private Sector in almost all of the DRDO projects. DRDO infrastructure is fully utilised by all these participating industries. Further, DRDO has been extending support to industry by providing its infrastructure and facilities, whenever required by them."

21. Though the Ministry in its reply has stated that DRDO has been involving private sector in almost all of the DRDO projects but it has not submitted any details about the industries which are being benefitted in this regard. The Committee desire that a list containing the names, extent of participation, product development by such participation and benefit accrued by DRDO as well as private sector in physical and intellectual terms may be furnished to the Committee at the earliest.

F. Autonomy to DPSUs and Ordnance Factories

Recommendation (Para No. 22)

22. The Committee had recommended as under:

"The Committee are of strong view that there is also an imperative need to improve the functioning of DPSUs and Ordnance Factories Organisation by giving them more autonomy so that the defence infrastructure created in public sector is exploited to its full potential. In order to achieve this objective, the Committee would like the Ministry of Defence to consider the following suggestions:

- (i) The DPSUs and Ordnance Factories should be given adequate freedom in decision making and to enter in joint ventures with other companies having proven competence in the defence sector.
- (ii) DPSUs should be permitted to raise money through borrowings by way of equity/bond/loan from the market so that they do not face financial crunch for carrying out their expansion plans and for investments in R&D activities.
- (iii) The feasibility of reconstituting the Board of Directors of DPSUs by nominating non-official Directors particularly those having expertise in the area of specialization of respective DPSUs should be examined in consultation with the departments concerned.
- (iv) After meeting their prime responsibility for production of defence equipment, the DPSUs and Ordnance Factories should be permitted to use their spare capacity if any, for diversification in production with a view to optimally utilizing the manpower available".

23. The Ministry in its action taken reply has stated as under:

"The following is submitted with regard to the issues raised above by the Committee:

- (i) & (ii) Among the Defence PSUs, HAL and BEL are Nav Ratna Companies, and bestowed with financial and operational autonomy to facilitate decision making for entering into joint ventures with other companies. As per DPE's guidelines the companies are empowered to raise funds from the domestic market for its investments. HAL has 9 joint Ventures in place, engaged in design and production of aviation related products. Other DPSUs, as Mini Ratna Companies, too have sufficient financial autonomy. Financial powers have also been enhanced for OFB and the individual ordnance factories to facilitate enhanced autonomy in operation. Full financial powers have been delegated for procurement of input material, except in single vendor cases. Substantial powers have also been delegated for R&D work in the factories.
- (iii) The non-official Directors are selected on the basis of their specialized domain knowledge in the product range of DPSU, Finance, Academics and Strategic thinking.
- (iv) DPSUs like BEL, after meeting the requirement of defence fully has been able to achieve 19-20% of its turnover through non-defence segment. HAL also has almost 10% of its order book committed to aerospace structures for Deptt. of Space, besides supplying a few helicopters to MHA, ONGC and State Governments. OFB is also expected to supply products worth Rs. 1298 crores to the non-defence sector during 2009-10 out of a total turnover of Rs. 9661 crores. Similarly, GSL has diversified its activities in construction to GRP boats and dedicated infrastructure facilities have been created at the GSL Unit II and III at Goa. The company has further created facilities for supply of spares and systems for Coast Guard Vessels, as also simulators for ONGC etc.

Note on Autonomy to DPSUs and Ordnance Factories

OFB

Financial powers of OFB and Ordnance Factories have been enhanced for their operational needs. Full financial powers have been delegated for procurement of input materials, except single vendor cases. Substantial powers have been delegated for research

and development activities. In order to exploit installed capacity in full after meeting the annual requirements projected by the Defence forces. Ordnance Factories continuously endeavour to diversify product range and expand customer base within the limitation of available facilities being completely dedicated for manufacture of arms and ammunitions only. This has resulted in development and growth in supply to Non-Defence sector. The organization is poised to supply products worth Rs. 1298.00 cr. to Non-Defence sector during 2009-10 out of total turnover of Rs. 9661 cr. registering a growth of 113.14% from 2000-01 (supply to non-defence sector during 2000-01 was Rs. 609 cr.).

HAL

HAL, as the Navratna Company, has adequate Delegation of Powers and freedom in decision making to enter in Joint Ventures with other companies. HAL now has 9 Joint Ventures in place engaged in design and production of aviation related products. HAL has been financing its expansion plans and R&D requirements through its internal resources and through customer financing for dedicated facilities. HAL has the financial powers to borrow from the market if required. HAL has been maintaining the highest credit rating from CRISIL and ICRA for short term and long term borrowings since last 5 years. HAL has autonomy to utilize its resources and spare capacity for diversification into related areas. With the current order book position, HAL does not envisage any spare capacity during the next 10 years.

BEML

Mini Ratna status has been extended to BEML, thereby giving the undertaking sufficient financial autonomy.

GSL

The company has diversified its activities in construction to GRP boats and dedicated infrastructure facilities have been created at GSL Unit II & III at Sancoale Industrial Estate, Goa. The Government of India, Ministry of Home Affairs has placed orders on the Company for Design, Construction and Supply of 116 Nos. of GRP boats, *i.e.* 54 Nos. 5T and 62 Nos. 12T capacity, to the Coastal Police in the States on the West Coast of India and Union Territory of Lakshadweep. The Company has created facilities for testing, assembly and supply of CPP spares and stern gear system in the yard and presently executing prestigious stern gear supply

orders for Naval and Coast Guard vessels. The Company has also diversified its activities in the manufacture of various raining simulators for ONGC and Navy and is providing training on Survival at Sea to ONGC personnel on their training ship Samudra Shiksha. GSL has received project sanction to undertake on turnkey basis the project of setting up Shore Based Training Facility at INS Hansa, Goa, for Indian Navy's LCA (N) project through Aeronautical Development Authority, Bangalore. The work on the said project has commenced and is being implemented ahead of schedule. The aforesaid general engineering project have been undertaken through outsourcing and optimally utilizing its available manpower.

MDL

Major equipment systems such as indigenous Rocket Launcher (IRL), Indigenous Torpedo Tube Launcher (ITTL), Brahmos Missiles, Hallow Transverse Systems, Steering Gear and Stabilizers, AC Plants etc. are being supplied by private sector such as L&T, KPCL etc. They are just not supplying components and sub-assemblies but the complete system.

BEL

BEL being a Navratna company it is bestowed with better financial and operational autonomy. In view of this, BEL is taking proactive steps to protect and consolidate its leadership positioning the Indian Defence market while at the same time accelerate the efforts to get into new business areas. The company is looking for new growth opportunities in areas aligned with BEL's core strengths either through organic growth in existing/new areas and Inorganic growth through Joint Ventures/Acquisitions. In this direction, BEL is discussing with reputed players for forming joint ventures in the area of Defence Electronics. Some of these proposals are in the advanced stage of finalization. BEL being a Navratna company, sufficient empowerment is available as per the DPE guidelines to raise funds in domestic market for its investments. This will be resorted by BEL whenever it is required. At present it is able to cater fund requirements through its internal accruals. There is no restriction on DPSUs to use spare capacity for diversification activities. During the Annual Roll on Plan meetings, the order availability in each of the Units/SBUs are discussed in detail. In case of low order book position in some of the units/SBUs, the projects are assigned for even distribution of load so as to ensure optimal utilization of the available manpower. Besides fully meeting

the requirement of defence, company is able to achieve 20-25% of its turnover through non-defence segment in our effort to improve utilization of capacities built."

24. The Ministry in its action taken reply has stated that the non-official Directors are selected on the basis of their specialized domain knowledge in the products range of DPSU, Finance, Academics and Strategic thinking. In this regard, the Committee would like the Ministry to furnish the list of Non-Official Directors selected, along with the details of area of specialization of each Director. Besides, the details about the selection procedure and the method of evaluation of performance of the Directors should also be made available to the Committee.

CHAPTER II

RECOMMENDATIONS/OBSERVATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

Recommendation (Para No. 3)

The Committee have been informed that there has been a paradigm shift in the role of private sector in the field of indigenisation consequent upon Government's decision in May, 2001 to open defence industry for Indian private sector participation upto 100 per cent with permissible limit of 26 per cent in Foreign Direct Investment (FDI). Although several new policy initiatives have been taken for promoting public-private partnership in defence production during the recent years, the statistics furnished to the Committee reveal that the share of private sector including small scale industries was a meager 23 per cent of the total purchases made by DPSUs during 2006-07. Undoubtedly, this situation is far from satisfactory particularly when the Government aims at harnessing available expertise and the capabilities of the private sector towards the total defence efforts and search for self-reliance. The Committee are of firm view that there is an imperative need for exploring further ways and means for substantially increasing the indigenous efforts in development and production of defence equipment by active participation of both the public and the private industries so as to achieve greater self-reliance. They feel that this task can be accomplished by taking timely and appropriate initiatives to integrate the private industries of proven capabilities in the defence sector without compromising national security. Efforts are also required to be directed towards earnest implementation of the policy framework envisaged from time to time with a view to achieving the desired objectives.

Reply of the Government

The following provisions in DPP-2008, which *inter-alia* outlines the policy framework of Ministry of Defence, have been made with a view to increasing self-reliance/indigenisation in defence production under the 'Buy' and 'Buy and Make' category:

- (i) Inclusion of Joint Venture Company for absorption of Transfer of Technology.

- (ii) Procurement of Products developed by Army Base Workshops, Naval Dockyards and Air Force Repair Depots.
- (iii) Banking of Offset Credits.
- (iv) A joint venture company has been exempted from offering offsets in case indigenous content in the product is more than 50%.
- (v) Requirement of industrial licence for a private industry to participate in offset programmes for becoming eligible for defence offsets has been dispensed with. Licensing will now be required only if so stipulated under the guidelines/licensing requirements for the defence industry issued by the Department of Industrial Policy and Promotion.
- (vi) A list of defence products have been added in DPP-2008, to facilitate the foreign vendors in implementing their offset obligations.
- (vii) ToT for Maintenance Infrastructure to include Army Base workshops/Naval Dockyards/Base Repair Depots of Air Force in addition to Indian Public/Private firm.

Concerted efforts are being made to enhance self reliance in Defence Products and following measures have been taken to integrate private industries of proven capabilities in the defence sector:—

- (a) Participation of the Indian Private Sector in the 'MAKE' procedure.
- (b) Feasibility studies in respect of 06 projects are underway and Integrated Project Management Teams (IPMTs) have been constituted for two other projects. This is an ongoing process and more feasibility studies and IPMTs are in the pipeline. For these projects both the public and private sector industries are considered.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 4)

The Committee understand that a congenial atmosphere has been created for public-private partnership in defence production as a result of several new policy initiatives taken by the Government in the recent past. They feel that an enhanced participation by the private sector would not only promote healthy competition between public and private sector but would also give an impetus to industrial and

economic growth in the country. While commending the Government's decision to accept a majority of recommendations made by Kelkar Committee for encouraging involvement of private sector in promoting defence capacity building and high technology capabilities in defence sector, the Committee strongly feel that a formal mechanism for sharing information on the futuristic requirements and the perspective plans of the users should be put in place in accordance with the practices adopted by certain advanced countries. The Committee feel convinced that such a mechanism would inspire the confidence of the private industries and enable them to gear up their infrastructure well in advance. The Committee, therefore, desire that the Ministry of Defence should address this issue in the right perspective and apprise them of the precise steps taken in this regard.

Reply of the Government

The following steps have been taken:

- (a) Recommendations of the Committee have been addressed by the HQ IDS document 'Technology Needs to Achieve Joint War-fighting Capability', which has been placed on the MoD website. The technology requirements of the Services over the next 15 years have been spelt out therein.
- (b) HQ IDS is also preparing a capability based revised Long Term Integrated Prospective Plan (LTIPP) document, in conjunction with the Services. Once this is cleared from the "Security" angle, this also will be placed in the MoD website.
- (c) DRDO's 11th Five Year Plan document is being integrated into the Services procurement plan.
- (d) Industry Associations would be allowed to make presentation before the categorisation Committees.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 5)

During their interaction with Dr. Vijay Kelkar, the Committee have been informed that Indian Space Research Organisation (ISRO) embraced the private sector industries in the country to meet their requirements in the high-tech area and their experience has been fruitful both in terms of efficiency and economy. The Committee would, therefore, like the Ministry of Defence to make an indepth study of

the practices and procedures being followed by ISRO with a view to exploring the feasibility of adopting the same in defence sector.

Reply of the Government

An in-depth study of the practices and procedures being followed by ISRO has been done by Kelkar Committee in its Report (Part-I) on strengthening self-reliance in Defence Preparedness and recommendations were accordingly made based on the lessons learnt from ISRO's Experience like need for a long-term approach and hand holding of the private industry during development phase and competitive environment later. The recommendations of the Kelkar Committee have been accepted by the Government for implementation.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 6)

The Committee note that the Ministry of Defence have introduced a revised Defence Procurement Procedure (DPP) in July, 2008. A scrutiny of DPP-2008 reveals that while certain procedural changes have been introduced with a view to strengthening the procurement framework and transparency in operations, the procedure does not specifically mention about the procurement policy of the Government for achieving self-reliance and indigenisation in defence production. The Committee are of strong view that the policy initiatives taken by the Government in the recent past for creating public-private partnership and indigenous development defence procurement procedures by clearly bringing out the specific provisions made therein to facilitate indigenously developed products. The Committee trust that the Ministry of Defence would take appropriate steps in this regard.

Reply of the Government

As brought out in reply to para 3 above, several provision have been made in DPP-2008 *inter-alia* with a view to increasing self-reliance/ indigenisation in defence production under the 'Buy', 'Buy & Make' and 'Make' categories.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 7)

The Committee note that the Kelkar Committee on review of Defence Procurement Procedure had recommended and integrated approach involving Users, Ministry of Defence and the Industry in the

'Make' procedure and the recommendations of the Kelkar Committee have been accepted by the government for implementation. The Committee have been informed that the procurement through indigenous development would now be undertaken under three categories. While strategic and security sensitive systems would be undertaken by DRDO and managed through Defence R&D Board, the projects under high technology complex systems would be undertaken by RURs/Indian Industry/DPSUs/OFB/Consortia on a level playing field and this procedure would also be adopted for all upgrades categorised as 'Make'. The projects under low technology mature system would be categorised as 'Buy Indian' and must have a minimum of 50 per cent indigenous content. Considering the fact that the 'Make' category incorporated in the Defence Procurement Procedure way back in 2006 has not yielded any tangible results despite the private industries in the country having registered a significant growth in indigenous capabilities in development and manufacture in the defence sector, the Committee feel that there is an urgent need to fine tune and rationalise the procurement procedures under 'Make' category so as to achieve the goal of self-reliance in real sense. The Committee therefore, desire that an expert Committee should be constituted at the earliest to review the existing procurement procedures under 'Make' category so that the capabilities and expertise available with the defence industries in the country can be gainfully utilized.

Reply of the Government

DPP-2008 provides for a periodic review of the procurement procedure. The recommendation will be kept in view as a guidance while undertaking the exercise for review of 'Make' procedure.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 8)

The Committee had observed in their Nineteenth Report (Fourteenth Lok Sabha) that long evaluation trials by the Armed Forces even in case of equipment produced indigenously has been one of the major causes for delay in procurement of defence equipment. While acknowledging the need for comprehensive evaluation of the new equipment in different conditions, the Committee wish to point out that the quality of indigenously produced equipment should be conducted expeditiously so that the manufacture can make timely efforts in finding out solutions to the shortcomings noticed during field trials and the goal of self-reliance is achieved within shortest possible time. The Committee, therefore, suggest that the Ministry of

Defence should consider procuring sufficient number of prototypes of the indigenously produced defence equipment so that the field trials can be conducted simultaneously in various terrains of the country and inordinate delay in development and production of such equipment could be avoided. Similar measures should also be contemplated for procurement of defence equipment from abroad.

Reply of the Government

Provision exists in the DPP-2008 to ask for more than one prototype for simultaneous conduct of trials and the same is being done for low-cost equipment as also in those cases where the quantities/financial outlays are sufficiently large. The DPP provides for a time frame of 6/12 months for completion of field trials and approval of staff evaluation. As far as possible efforts are made to adhere to this time line both for the imported systems and indigenously developed platforms, weapons & systems.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 12)

Having recognized the potential of some of the small and medium enterprises (SMEs) in the country, the Government have decided to formulate a scheme for providing financial assistance to these enterprises to take up design and development work in the defence production. The Committee urge the Ministry of Defence to take care that the scheme is finalised and implemented after due consultation with the agencies concerned so that the potential of these enterprises is utilised to its optimum level without any loss of time. The Committee also desire that some institutional arrangement in collaboration with DRDO and other research organisation should be put in place to gainfully utilise the efforts of these enterprises in promoting indigenous defence production.

Reply of the Government

The 'Make' procedure already provides for a sharing of development cost between the Government and the Industry.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 13)

The Committee learn that certain equipment like night vision devices, special clothing and mountaineering kits, etc. are being imported for the use of defence service personnel deployed in high

altitude areas. While expressing their surprise over the continued import of such basic equipment, the Committee feel that the Indian industries have also attained capabilities in developing and manufacturing of such types of items. They, therefore, urge the Ministry to explore the feasibility of procuring such items from the indigenous manufacturers within the country.

Reply of the Government

Efforts are made to source defence items from indigenous manufacturers etc. subject to their meeting qualitative requirements of the users. Often stringent military specifications do not enable procurement commercially off the shelf.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 14)

Considering the fact that armed forces personnel are being increasingly deployed in counter-terrorist and counter-insurgency operations, the Committee strongly feel that there is imperative need to provide body protective gears to soldiers and also to use robots for handling hazardous tasks like laying and retrieving of land mines so as to protect the precious lives of trained soldiers. The Committee, therefore, desire that efforts should be made to encourage indigenous development and manufacture of body protective gears and robots in active participation of defence industries both in public and private sector. The Committee would like to be apprised of the precise steps contemplated in this regard.

Reply of the Government

A few Indian companies are involved in production of body protective gear. Weight wise, they are sometimes heavier than imported equipment for which efforts are on to indigenously develop light weight yet robust body armour. Extensive utilisation of robotics for conventional and (CI-CT) operations are also being planned through a collaborative approach with the industry. Mine Protective Gears are under procurement in 'Make' category. Remotely operated vehicles developed by DRDO for detection, terrain, neutralisation and disposal of IEPs are under use. Besides, boot anti mine engineers and boot anti mine inflating used by soldiers are being procured under 'Make' 'Buy & Make' category respectively.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 16)

The Committee have been given to understand that the new procedures put in place enjoin upon DRDO to undertake research and development in the areas where indigenous technologies may not be available or may be cost exorbitant to develop by the Indian industry because of their high research content. The projects covered under 'Make' category would be undertaken by defence industries in public or private sector or consortia where fundamental research is not required. Keeping in view these policy changes, the Committee would like to stress that appropriate financial support systems must be put in place to promote R&D both in public and private sector particularly for projects relating to development of cutting-edge technologies. The Committee also desire that the Ministry of Defence should themselves take the onus of giving such grants to the defence industries and the role of DRDO in such matters be eliminated to the extent possible.

Reply of the Government

Adequate R&D investment with a view to bolstering our indigenous design capabilities and developing cutting edge technologies is a thrust area of our DPSUs and OFs. A note on their R&D activities is enclosed. DRDO has a separate budget for their strategic programmes. The 'Make' procedure provides for the funding mechanism for development of new systems by the Industry, with the development cost being shared on an 80:20 basis between the Government and the Industry.

Note on Research And Development Efforts by OFB & DPSUs

1. BEL

BEL's forte is its strong R&D base spearheaded by two Central Research Laboratories addressing futuristic technologies and R&D Divisions spread across the 9 Units focusing on product design. Indigenously developed products contributed to 83% of turnover during 2007-08. BEL engineers actively interact with different national design & development centres like DRDO, ISRO, CSIR C-Dot, reputed academic institutions like I.I.Ts. II/Sc etc., and R&D wings of various Indian & Multi-national Companies and contribute significantly to development of large number of state-of-the-art indigenous products & systems, components & devices, core technology modules, embedded software packages, enabling technology modules etc. During the year 2007-08, the company and its engineers received a number of awards/ recognitions for the R&D efforts. 23 scientific papers were presented/ published during 2007-08 in various national/international seminars,

conferences/journals by the scientists of BEL Central Research Laboratories and the R&D Engineers. During the year 2007-08, BEL spent 5.1% of its turnover on R&D and it proposes to invest more on R&D in the coming years. In addition to the two Central Research Laboratories at Bangalore and Ghaziabad, one more Central Research Laboratory is planned to be set up at Hyderabad for focused research work on Electro Optics and Electronic Warfare Systems.

2. HAL

HAL has R&D centres dealing with design & development of aircraft, helicopters, aircraft accessories and avionics. Many important development projects have been launched like ALH, IJT, LUH, LCH, Mission Computer, Display systems, Hydro-mechanical systems etc., which will increase indigenous availability of these categories of aircraft and equipment. HAL is also giving additional thrust to collaboration with DRDO laboratories and private industries in terms of taking up programmes like INGPS with RCI, Servo Actuators with VSSC & Mission Computer with DARE & Display Systems with SAMTEL. Around 7% of its turnover is spent on R&D.

3. BDL

With the technical capabilities available in-house, the Company has proactively developed products to meet the customer's requirements. The Design & Engineering Division of the Company has realised a few products which have been inducted into service, such as:

- (a) Fagot Launcher Adapted to Milan Equipment (FLAME)
- (b) ATGM Out Door Simulator
- (c) FLTE (Field Level Test Equipment for FLAME)
- (d) KLTE & KMTE (Konkurs Launcher & Missile Test Equipment)
- (e) Counter Measure Dispensing System (CMDS)

4. GSL

GSL is in the forefront of design and R&D activities. Some of the initiatives are 35 Knots Fast Patrol Vessels, built with GSL in-house design, currently in service with Indian Coast Guard. Two 105 metres advanced Offshore Patrol Vessels, built with GSL in-house design, have been commissioned in the service of the Indian Coast Guard. Three 90M OPVs for Indian Coast Guard and four 105M Naval Offshore

Patrol Vessels (NOPVs) for Indian Navy, under different stages of construction at GSL, are also indigenously designed by GSL. GSL also proposes to undertake design & development for Patrol Vessels of 55-60 metres in length. As can be seen, most of GSL's new shipbuilding projects are based on its in-house design achieved after extensive R&D efforts.

5. BEML

BEML has established Research & Development facilities in all the three Manufacturing Units located at Bangalore, Mysore, & KGF. BEML has the latest facilities including structural labs, power line labs, fluid power labs, CAD/CAM facilities, etc., for taking up R&D development of various products.

6. OFB

The Ordnance factories have a very high degree of self-reliance (94%). OFB has decided to undertake *ab-initio* development of new products and upgrades for sustained business growth and self-reliance. Limitation of financial power for investment on R&D has been removed and OFB has full power to invest in R&D. During last four years OFB has developed a lot of new products and upgrades and has supplied in-house developed products worth Rs. 714 crore during 2007-08.

[MOD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 18)

The Ministry of Defence should also consider creation of a separate head of account in their budget for grant of funds for R&D activities undertaken by the Defence scientists in the public and private industries in the Defence Sector.

Reply of the Government

The production agencies in the public sector already have a separate budget head for R&D activities. Government meets part of the development cost in the 'Make' procedure. Expenditure on R&D is thus deductible.

[MOD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 20)

The Committee also feel that the changing technological and industrial scenario in defence sector warrant an imperative need for

removal of different kinds of control regimes in the R&D area. They are of firm view that the R&D efforts being made by the private industry, keeping pace with latest technological innovations in defence sector, must be encouraged and supplemented by the Government organisations particularly when infusion of foreign technology in defence areas is leading to huge capital outgo from the country with additional burden of heavy dependency on such sources in future. The Committee would like to be apprised of the precise steps taken in this regard.

Reply of the Government

To encourage the R&D efforts being made by the private industries keeping pace with latest technological innovations in Defence Sector, DRDO is planning to associate the industry partners both in Public and Private Enterprises right from the beginning of the project through the 'Make' Procedure so that they would be able to gain the domain experience in defence technologies.

[MOD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 21)

Since DRDO have a well-established and vast network of laboratories spread over the country, feasibility of extending research facilities to defence industries in private sector in DRDO laboratories should also be examined in the interest of national security. The Committee trust that this issue will be considered by the Ministry of Defence in proper perspective so that the R&D infrastructure created in the country is put to optimum use.

Reply of the Government

DRDO has been involving Private Sector in almost all of the DRDO projects. DRDO infrastructure is fully utilised by all these participating industries. Further, DRDO has been extending support to industry by providing its infrastructure and facilities, whenever required by them.

[MOD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 22)

The Committee are of strong view that there is also an imperative need to improve the functioning of DPSUs and Ordnance Factories Organisation by giving them more autonomy so that the defence infrastructure created in public sector is exploited to its full potential.

In order to achieve this objective, the Committee would like the Ministry of Defence to consider the following suggestions:

- (i) The DPSUs and Ordnance Factories should be given adequate freedom in decision making and to enter in joint ventures with other companies having proven competence in the defence sector.
- (ii) DPSUs should be permitted to raise money through borrowings by way of equity/bond/loan from the market so that they do not face financial crunch for carrying out their expansion plans and for investments in R&D activities.
- (iii) The feasibility of reconstituting the Board of Directors of DPSUs by nominating non-official Directors particularly those having expertise in the area of specialization of respective DPSUs should be examined in consultation with the departments concerned.
- (iv) After meeting their prime responsibility for production of defence equipment, the DPSUs and Ordnance Factories should be permitted to use their spare capacity if any, for diversification in production with a view to optimally utilizing the manpower available.

Reply of the Government

The following is submitted with regard to the issues raised above by the Committee:

- (i) & (ii) Among the Defence PUSs, HAL and BEL are Nav Ratna Companies, and bestowed with financial and operational autonomy to facilitate decision making for entering into joint ventures with other companies. As per DPE's guidelines the companies are empowered to raise funds from the domestic market for its investments. HAL has 9 Joint Ventures in place, engaged in design and production of aviation related products. Other DPSUs, as Mini Ratna Companies, too have sufficient financial autonomy. Financial powers have also been enhanced for OFB and the individual ordnance factories to facilitate enhanced autonomy in operation. Full financial powers have been delegated for procurement of input material, except in single vendor cases. Substantial powers have also been delegated for R&D work in the factories.

- (iii) The non-official Directors are selected on the basis of their specialized domain knowledge in the product range of DPSU, Finance, Academics and Strategic thinking.
- (iv) DPSUs like BEL, after meeting the requirement of defence fully has been able to achieve 19-20% of its turnover through non-defence segment. HAL also has almost 10% of its order book committed to aerospace structures for Deptt. of Space, besides supplying a few helicopters to MHA, ONGC and State Governments. OFB is also expected to supply products worth Rs. 1298 crores to the non-defence sector during 2009-10 out of a total turnover of Rs. 9661 crores. Similarly, GSL has diversified its activities in construction to GRP boats and dedicated infrastructure facilities have been created at the GSL Unit II and III at Goa. The company has further created facilities for supply of spares and systems for Coast Guard Vessels, as also simulators for ONGC etc.

Note on Autonomy to DPSUs and Ordnance Factories

OFB

Financial powers of OFB and Ordnance Factories have been enhanced for their operational needs. Full financial powers have been delegated for procurement of input materials, except single vendor cases. Substantial powers have been delegated for research and development activities. In order to exploit installed capacity in full after meeting the annual requirements projected by the Defence forces. Ordnance Factories continuously endeavour to diversify product range and expand customer base within the limitation of available facilities being completely dedicated for manufacture of arms and ammunitions only. This has resulted in development and growth in supply to Non-Defence sector. The organization is poised to supply products worth Rs.1298.00 cr. to Non-Defence sector during 2009-10 out of total turnover of Rs. 9661 cr. registering a growth of 113.14% from 2000-01 (supply to Non-Defence sector during 2000-01 was Rs. 609 cr.).

HAL

HAL, as the Navratna Company, has adequate Delegation of Powers and freedom in decision making to enter in Joint Ventures with other companies. HAL now has 9 Joint Ventures in place engaged in design and production of aviation related products. HAL has been financing its expansion plans and R&D requirements through its internal resources and through customer financing for dedicated

facilities. HAL has the financial powers to borrow from the market if required. HAL has been maintaining the highest credit rating from CRISIL and ICRA for short-term and long-term borrowings since last 5 years. HAL has autonomy to utilize its resources and spare capacity for diversification into related areas. With the current order book position, HAL does not envisage any spare capacity during the next 10 years.

BEML

Mini Ratna status has been extended to BEML, thereby giving the undertaking sufficient financial autonomy.

GSL

The company has diversified its activities in construction to GRP boats and dedicated infrastructure facilities have been created at GSL Unit II & III at Sancoale Industrial Estate, Goa. The Government of India, Ministry of Home Affairs has placed orders on the Company for Design, Construction and Supply of 116 Nos. of GRP boats, *i.e.* 54 Nos. 5T and 62 Nos. 12T capacity, to the Coastal Police in the States on the West Coast of India and Union Territory of Lakshadweep. The Company has created facilities for testing, assembly and supply of CPP spares and stern gear system in the yard and presently executing prestigious stern gear supply orders for Naval and Coast Guard vessels. The Company has also diversified its activities in the manufacture of various raining Simulators for ONGC and Navy and is providing training on Survival at Sea to ONGC personnel on their training ship Samudra Shiksha. GSL has received project sanction to undertake on turn-key basis the project of setting up Shore Based Training Facility at INS Hansa, Goa, for Indian Navy's LCA (N) project through Aeronautical Development authority, Bangalore. The work on the said project has commenced and is being implemented ahead of schedule. The aforesaid general engineering project have been undertaken through outsourcing and optimally utilizing its available manpower.

MDL

Major equipment systems such as indigenous Rocket Launcher (IRL), Indigenous Torpedo Tube Launcher (ITTL), Brahmos Missiles, Hallow Transverse Systems, Steering Gear & Stabilizers, AC Plants etc. are being supplied by private sector such as L&T, KPCL etc. They are just not supplying components and sub-assemblies but the complete system.

BEL

BEL being a Navratna company it is bestowed with better financial and operational autonomy. In view of this, BEL is taking pro-active steps to protect and consolidate its leadership positioning the Indian Defence market while at the same time accelerate the efforts to get into new business areas. The company is looking for new growth opportunities in areas aligned with BEL's core strengths either through organic growth in existing/new areas and Inorganic growth through Joint Ventures/Acquisitions. In this direction, BEL is discussing with reputed players for forming joint ventures in the area of Defence Electronics. Some of these proposals are in the advanced stage of finalization. BEL being a Navratna company, sufficient empowerment is available as per the DPE guidelines to raise funds in domestic market for its investments. This will be resorted by BEL whenever it is required. At present it is able to cater fund requirements through its internal accruals. There is no restriction on DPSUs to use spare capacity for diversification activities. During the Annual Roll on Plan meetings, the order availability in each of the Units/SBUs are discussed in detail. In case of low order book position in some of the units/SBUs, the projects are assigned for even distribution of load so as to ensure optimal utilization of the available manpower. Besides fully meeting the requirement of defence, company is able to achieve 20-25% of its turnover through non-defence segment in our effort to improve utilization of capacities built.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Comments of the Committee

(Please *see* Para No. 24 of Chapter-I)

CHAPTER III

RECOMMENDATIONS/OBSERVATIONS WHICH THE COMMITTEE DO NOT DESIRE TO PURSUE IN VIEW OF THE GOVERNMENT'S REPLIES

Recommendation (Para No. 1)

The defence requirements of the country are presently met through imports as well as indigenous production both in public and private sector. According to the Ministry of Defence, it is the policy of the Government to encourage indigenisation in the defence production and various initiatives have been taken in the recent past for promoting indigenisation and achieving self-reliance in the defence sector. The Committee's examination of the statistical data furnished to them, however, reveals that the extent of import content in production of various defence equipment by public sector defence production units continues to be substantially high. Undoubtedly, there is still heavy dependence on foreign suppliers and the goal of achieving self-reliance in such an important area as defence remains elusive despite a well-established network of the defence industries in the country. In the light of the rapidly changing global security environment and its implications on the national interests, the Committee strongly feel that the Ministry of Defence should expeditiously conceptualise the realities of the situation and contemplate concrete and result oriented steps from time to time to harness and integrate the vast potential of the increasing technical and manufacturing capabilities of both public and private sector industries in the country so as to minimize the dependence on foreign sources for defence procurement. The Committee have dealt with some of the important aspects related to the subject in succeeding paragraphs of this Report.

Reply of the Government

Govt. agrees with the views of the Committee that we should bolster our indigenous capacity substantially by harnessing and integrating the vast potential available. Government is taking steps to address the concerns expressed by the Committee.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Recommendation (Para No. 9)

During their examination of the subject, the representatives from FICCI and ASSOCHAM have expressed the view that the present limit

of 26 per cent FDI in defence sector needed to be enhanced to attract foreign investors. On the other hand, the Ministry of Defence have put forth the plea that any increase in FDI level beyond 50 per cent would imply management control with foreign investors and such ventures might fail to deliver at critical junctures due to factors such as sanctions imposed by foreign governments etc. While giving due weightage to the numerous benefits that would accrue to the industry and economy as a result of increased in-flow of FDI, the Committee are of the firm view that the possibility of increasing limit of FDI upto 49 per cent in defence sector should be examined by the Government after keeping in view the fact that national interest must reign supreme in defence related matters.

Reply of the Government

The matter has been examined and Ministry is of the view that as defence is a strategic sector the foreign investment in joint ventures in defence sector should be limited to 26%. Any FDI increase beyond 26% would be considered on a case to case basis.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

CHAPTER IV

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH REPLIES OF GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE

Recommendation (Para No. 2)

The Committee are constrained to observe that no scientific system has been put in place by the Ministry of Defence to assess the exact level of indigenisation achieved by defence production units in the country. In fact, the statistical information on extent of indigenisation furnished to the Committee fail to reflect true picture as some of these figures admittedly, do not include the quantum of import content utilised in products manufactured by public sector units. The Committee find it distressing that while one representative of the Ministry of Defence claimed during evidence that the share of indigenously produced items in defence production was about 77 per cent in 2006-07, the Defence Secretary was candid enough to admit that only 30 to 35 per cent of defence expenditure on equipment was met from domestic manufacturers. Undoubtedly, the quantum of financial outgo to the foreign and indigenous sources for procurement of defence equipment continues to be the primary criterion for evaluating the level of indigenisation in defence sector in the country. The Committee wish to remind the Ministry that the main plank of indigenisation in defence production is to reach higher levels of self reliance in development and production of state-of-the-art equipment and weapon systems and this issue of national importance cannot be viewed in a mere commercial and statistical jargon. The Committee express their strong displeasure over the manner in which this data is being maintained and they desire the Ministry to apply necessary corrections in order to ensure an objective and incisive analysis of the realities of the prevailing situation.

Reply of the Government

There are two aspects to the issue *viz.* developing systems indigenously and the level of indigenisation through the ToT route. As regards indigenous R & D, major systems and deliverable are in place, like Prithvi, MBT Arjuna and EW Systems for Army & Navy. In the field of mission computers also considerable indigenous capability has been built for major platforms. This process has to be further

strengthened. As regards ToT, most of the manufacturing programme in DPSUs and OFB are under license production. The extent of indigenisation depends on the depth of technology being transferred and stage of transfer. For example in the case of SU-30MkI, the indigenisation percentage which was 13% during 2004-05 would go up to 43.4% in phase IV of manufacturing this year. Similarly, in case of HAWK AJT, the indigenisation percentage will increase from present level of 12%-15% to 45% in the raw material phase of production. In case of T-90 Tank, the indigenisation percentage in the current year is 30% is likely to go up 70% by 2010-11. It is also relevant to mention that as per provisions of DPP-2008, minimum indigenous content in case of ToT is 60% for Cat-I & II items and this is insisted upon in the RFP for 'Buy & Make' cases.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Comments of the Committee

(Please see Para No. 8 of Chapter-I)

Recommendation (Para No. 10)

The Committee note that an 'off-set' provision applicable to all capital acquisitions effective from July, 2005 has been incorporated in the Defence Procurement Procedures (DPP) which stipulates a minimum required off set of 30 per cent of the indicative cost of the acquisitions under 'Buy (Global)' category and 30 percent of the foreign exchange component in 'Buy and Make' category in respect of acquisitions valued at Rs. 300 crore or more. The Committee have been informed that although offset obligations have to be discharged concurrently with the main contract, any failure on this account attracts a meagre penalty of 5 per cent and other action can also be initiated against the defaulting company in case of consistent failure. Strangely enough, extension of time for implementing the offset obligation is also stated to be considered with specific order. The Committee are in no doubt that such options leave limited scope with the Government in strictly enforcing the requirements under offset provision which ultimately proves detrimental to the national interests. While certain changes are stated to have been made in DPP-2008 in view of the requirement of foreign manufacturers to speed up offset implementation over a period of time, the Committee would like to emphasise that time limit for discharging liabilities under the offset provision have to be made essence of the relevant contracts. They, therefore, desire that stringent and specific clauses should be incorporated in the contracts for imposing heavy financial penalties at the rate of a minimum of 15 per cent annum in all cases of default and no room is left for any discretion in such matters.

Reply of the Government

The off-set provision included in DPP-2008 has been amended with reference to that included in DPP-2006. Action to revise the penalty clause with reference to non-fulfillment of off-set obligation can be taken after some of the off-set contracts have been implemented and studied.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Comments of the Committee

(Please see Para No. 11 & 12 of Chapter-I)

Recommendation (Para No. 11)

The Committee are fully conscious of the role being played by the DPSUs and the Ordnance Factories in meeting the national security requirements. However, they are at the same time of the view that the contribution being made by the private sector in defence production cannot be marginalised by the Ministry of Defence in their capacity as the sole buyer of military equipment. Although the long standing demand of private sector for providing a level playing field *vis-a-vis* foreign suppliers is stated to have since been addressed in DPP-2006, the Committee have been given to understand that there are several areas where distinction is made between the private and public sector while procuring defence equipment. These are, *inter-alia*, (i) nomination for transfer of technology where the foreign suppliers are specifically asked to collaborate with an DPSU; (ii) discrepancy in tax structure for exemption of customs and central excise duties as well as foreign exchange rate variation; and (iii) non-acceptance of corporate bonds as collateral etc. The Committee consider that these issues need urgent attention with a view to doing away with discriminatory treatment so that the necessary thrust is provided to private sector striving hard to augment indigenous defence production in the country. The Committee are of strong view that level playing field and equal opportunities would not only promote healthy competition between the public and private sector but would also result in cost effectiveness of indigenously produced defence equipments. The Committee expect the Government to move in the right direction expeditiously.

Reply of the Government

In the matter of nominating Production Agency for receiving ToT, it needs to be pointed out that certain technical sensitivities, maintenance of equipments for a lifetime, assured spares supports and operation in times of war, have to be factored in while making such nomination. Since Government pays for the ToT and the above issues are paramount, DPSUs/OFB would have to be the primary receivers of such technology to give credible guarantees to the needs of national defence.

In so far as taxes are concerned, the evaluation of L1 is done minus the taxes—so that there is a level playing field. In fact in some cases the PSUs are at a disadvantage as they are not in a position to take Cenvat credit. ERV is admissible only to Defence PSUs wherever import component is involved. However, in multi-vendor cases, no advantage under ERV is admissible to DPSUs.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Comments of the Committee

(Please see Para No. 15 of Chapter-I)

Recommendation (Para No. 17)

The Committee also wish to emphasise that innovative schemes for promoting research and development activities in the defence sector have to be devised by the Ministry of Defence to achieve an enhanced level of self-reliance, in this, area. The Committee therefore, recommend that a comprehensive plan of action should be formulated to recognize the research and development work undertaken by the defence scientists/the industry by extending them appropriate incentives for different projects and payment of royalty, etc. The industry should also be assured of orders in case of development of product within a given time frame in conformity with the specific qualitative requirements of the users.

Reply of the Government

The Defence Acquisition Council (DAC) has accepted in principle the concept of shared development cost. The 80:20 ratio for sharing of development cost with the industry is included in DPP-2008 for promoting research & development activities in the defence sector by Indian Industries. There is no question of giving royalty to defence scientists in the DRDO/PSUs as the entire cost of research, including salary, is met by the Government and the fruits of the research are Government property.

[MoD ID No. 11013/25/2008/D (PARL.), Dated 30.10.2009]

Comments of the Committee

(Please see Para No. 18 of Chapter-I)

CHAPTER V

RECOMMENDATIONS/OBSERVATIONS IN RESPECT OF WHICH FINAL REPLIES OF GOVERNMENT ARE STILL AWAITED

Recommendation (Para No. 15)

In pursuance of the Kelkar Committee's recommendation, the Government constituted a selection committee in May, 2006 for identification of companies of proven excellence in development and production of major weapon systems and platforms for being accorded the status of Raksha Udyog Ratnas (RURs). Although, this selection committee was required to give its recommendations by 31 March, 2007 for acceptance of the Defence Acquisition Council, the issue has been stated to be still under deliberations. In the absence of any plausible explanation emanating from the Ministry of Defence in this regard, the Committee express their displeasure over the manner in which such important issues are being allowed to linger on. The Committee, therefore, strongly desire that the Government should take expeditious steps to select and notify RURs at the earliest so that the misgivings among the defence industries are removed and they gear themselves up for effective participation in the national efforts for self-reliance. The Committee also recommend that the Ministry of Defence should also put in place a scientific system for selection and notification of RURs from time to time in future.

Reply of the Government

The Report of the Selection Committee is under examination with the Government.

[MOD ID No. 11013/25/2008/D (PARL), Dated 30.10.2009]

Recommendation (Para No. 19)

The Committee understand that the Government extend certain tax concessions to the companies for expenditure incurred by them on research activities related to the business. The Committee desire that in order to ensure that such concessions achieve the objectives of indigenisation in the defence areas in a timely manner, the companies availing such benefits should be made to complete their research projects related to business in these areas within a fixed time frame. They therefore, urge the Ministry of Defence to move the right quarters for appropriate action in this regard.

Reply of the Government

The suggestion is noted.

[MOD ID No. 11013/25/2008/D (PARL), Dated 30.10.2009]

NEW DELHI;
25 February, 2010
6 Phalgun, 1931 (Saka)

SATPAL MAHARAJ,
Chairman,
Standing Committee on Defence.

MINUTES OF THE TENTH SITTING OF THE STANDING
COMMITTEE ON DEFENCE (2009-10)

The Committee sat on Monday, the 8th February, 2010 from 1500 to 1530 hrs. in Committee Room 'C', Parliament House Annexe, New Delhi.

PRESENT

Shri Satpal Maharaj — *Chairman*

MEMBERS

Lok Sabha

2. Shri Kamal Kishor 'Commando'
3. Shri H.D. Devegowda
4. Dr. Sucharu Ranjan Haldar
5. Shri Ramesh Jigajinagi
6. Shri Arjun Ram Meghwal
7. Shri A.T. Nana Patil
8. Shri Amarnath Pradhan
9. Shri M. Raja Mohan Reddy
10. Shri Baju Ban Riyan
11. Shri Kalyan Singh
12. Shri Mahabali Singh
13. Rajkumari Ratna Singh

Rajya Sabha

14. Shri R.K. Dhawan
15. Prof. P.J. Kurien
16. Shri Mukut Mithi
17. Shri Prakash Javadekar
18. Shri K.B. Shanappa
19. Shri T.K. Rangarajan
20. Shri M.V. Mysura Reddy
21. Shri Sanjay Raut

SECRETARIAT

1. Shri T.K. Mukherjee	—	<i>Joint Secretary</i>
2. Smt. Sudesh Luthra	—	<i>Director</i>
3. Shri N.S. Hooda	—	<i>Additional Director</i>

2. At the outset, the Hon'ble Chairman welcomed the members to the sitting of the Committee. The Committee then took up for consideration the letter dated 2 February, 2010 of Shri Rangarajan, M.P. and member of the Committee as circulated to the members of the Committee. After deliberations the Committee decided that the suggestions made by the member in the letter should be forwarded to the Ministry separately.

3. The Committee, then, took up for consideration the draft report on action taken by the Government on the recommendations/ observations of the Committee in Thirty-third Report on 'Indigenisation of Defence—Production-Public-Private-Partnership' and adopted the same without any modification.

4. The Committee authorized the Chairman to finalize the report and present the same to the House on a date convenient to him during the Budget Session, 2010.

The Committee then adjourned.

APPENDIX

ANALYSIS OF THE ACTION TAKEN BY THE GOVERNMENT ON THE RECOMMENDATIONS/OBSERVATIONS CONTAINED IN THE THIRTY-THIRD REPORT OF THE STANDING COMMITTEE ON DEFENCE

		Total	Percentage of Total
1.	Total number of recommendations	23	
2.	Recommendations/Observations which have been accepted by Government Para Nos. 3, 4, 5, 6, 7, 8, 12, 13, 14, 16, 18, 20, 21, 22 & 23	15	65
3.	Recommendations/Observations which the Committee do not desire to pursue in view of Government's replies Para Nos. 1 & 9	02	9
4.	Recommendations/Observations in respect of which replies of Government have not been accepted by the Committee Para Nos. 2, 10, 11 & 17	04	17
5.	Recommendations/Observations in respect of which final replies of the Government are still awaited Para No. 15 & 19	02	9