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STANDING COMMITTEE ON DEFENCE
(2017-18)

(SIXTEENTH LOK SABHA)

MINISTRY OF DEFENCE

[Action Taken by the Government on the Observations/Recommendations contained in the Thirty-First Report (16th Lok Sabha) on 'Demands for Grants of the Ministry of Defence for the year 2017-18 on Capital Outlay on Defence Services, Procurement Policy and Defence Planning (Demand No. 21)']

THIRTY SIXTH REPORT

LOK SABHA SECRETARIAT

NEW DELHI

December, 2017/Agrahayana, 1939 (Saka)

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Presented to Lok Sabha on 19.12.2017

Laid in Rajya Sabha on 19.12.2017

LOK SABHA SECRETARIAT

NEW DELHI

December, 2017/Agrahayana, 1939 (Saka)

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*** Resigned w.e.f. 16.11.2017**

SECRETARIAT

1	Smt Kalpana Sharma	-	Joint Secretary
2	Shri TG Chandrasekhar	-	Director
3	Smt. Jyochnamayi Sinha	-	Additional Director
4	Smt Preeti Negi	-	Committee Assistant

INTRODUCTION

I, the Chairperson of the Standing Committee on Defence (2017-18), having been authorised by the Committee, present this Thirty-sixth report on Action Taken by the Government on the Observations/Recommendations contained in the Thirty-first Report (16th Lok Sabha) on 'Demands for Grants of the Ministry of Defence for the year

2017-18 on Capital Outlay on Defence Services, Procurement Policy and Defence Planning (Demand No. 21)'.

2. The Thirty-first Report was presented to Lok Sabha on 09.03 2017 and laid in Rajya Sabha on 10.3.2017. It contained 50 Observations/Recommendations. The Ministry of Defence furnished Action Taken Replies on all the Observations/Recommendations in September, 2017.

3. The Report was considered and adopted by the Committee at their Sitting held on 29 November, 2017.

4. For facility of reference and convenience, Observations/Recommendations of the Committee have been printed in bold letters in the Report.

5. An analysis of action taken by the Government on the Observations/Recommendations contained in the Thirty-first Report of the Standing Committee on Defence (16th lok Sabha) is given in Appendix II.

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New Delhi;
<u>11 December, 2017</u>
20 Agrahayana, 1939 (Saka)

Maj Gen B C Khanduri, AVSM (Retd),
Chairperson,
Standing Committee on Defence

REPORT

CHAPTER I

This report of the Standing Committee on Defence deals with action taken by the Government on the Observations/Recommendations contained in the Thirty -first Report (16th Lok Sabha) on 'Demands for Grants of the Ministry of Defence for the year 2017-18 on Capital Outlay on Defence Services, Procurement Policy and Defence Planning (Demand No. 21)' which was presented to Lok Sabha on 9 March, 2017 and laid in Rajya Sabha on 10 March, 2017.

2. The Committee's Thirty-first Report (16th Lok Sabha) contained 50 Observations/Recommendations on the following aspects:-

Para No.	Subject
1 - 5	Allocations under Capital Budget Head
6	Ratio of Capital and Revenue Outlay
7-9	Underspending
10 -15	Capital Acquisitions - Creation of 'Roll on' and 'Non-Lapsable Fund'
16 - 20	Committed Liabilities and New Schemes
21	Defence Procurement Procedure 2016
22	Long Gestation Period in Procurement
23	Probity, Accountability and Transparency in Defence Procurement
24 - 25	Dependence on foreign suppliers for military hardware
26 - 27	Import content in equipment produced, and developed by DRDO, Ordnance Factories and DPSUs
28 - 31	Make-in-India policy
32 - 35	Private Sector Participation
36	Strategic Partnership for various platforms of the Private Sector Industry
37- 41	Offset Clause
42- 44	Defence Planning
45 - 46	Long Term Integrated Perspective Plan (LTIPP)
47- 50	Married Accommodation Project

3. **Action Taken Replies have been received from the Government in respect of all the Observations/Recommendations contained in the Report. The replies have been examined and the same have been categorised as follows:-**

(i) (a) Observations/Recommendations which have been accepted by the Government:

Para Nos. 21, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 47, 48, 49 and 50

(27 Recommendations)

These may be included in Chapter II of the Draft Report.

(b) Observations/Recommendations which have been accepted by the Government and to be commented upon:

Para Nos. 16, 17, 18, 19, 20, 22, 45 and 46

(08 Recommendations)

These may be included in Chapter II of the Draft Report.

(ii) Observations/Recommendations which the Committee do not desire to pursue in view of the replies received from the Government:

Para No. 1

(01 Recommendation)

This may be included in Chapter III of the Draft Report.

(iii) Observations/Recommendations in respect of which replies of Government have not been accepted by the Committee and which require reiteration and to be commented upon:

Para Nos. 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14 and 15

(14 Recommendations)

These may be included in Chapter IV of the Draft Report.

(iv) Observations/Recommendations in respect of which Government have furnished interim replies:

Nil-may be shown in Chapter V of the Draft Report **(00 Recommendation)**

4. **The Committee desire that the Ministry's response to the comments made in Chapter I of this Report be furnished to them at the earliest and in any case not later than six months of the presentation of this Report.**

A. <u>Allocations under Capital Budget Head</u>

Recommendation (Para Nos. 2-5)

5. The Committee had recommended as under:
'The trend of Capital Account Budgeting for the three Services is evident from the following figures:

(Rs. in Crore)

Year	Service	BE		RE		Expenditure
		Projected	Allocated	Projected	Allocated	
2010-11	Army	21,633.04	17,250.84	19,177.55	15,641.16	15,856.08
	Navy	15,221.78	12,137.85	17,890.87	15,323.77	17,140.18
	Air Force	31,667.56	25,251.72	25,271.72	24,266.79	23,625.42
2011-12	Army	25,611.68	19,210.69	20,641.69	16,005.69	14,947.82
	Navy	26,882.60	14,657.83	21,482.18	17,459.08	19,211.52
	Air Force	36,186.10	30,282.03	30,282.03	27,734.78	28,841.18
2012-13	Army	28,234.60	19,237.80	18,971.09	15,749.30	14,760.69
	Navy	28,643.19	24,766.42	25,002.85	18,266.42	17,759.88
	Air Force	36,950.52	30,514.45	36,999.62	30,517.95	32,980.11
2013-14	Army	25,528.08	17,883.83	19,271.59	14,967.25	14,433.29
	Navy	33,775.53	24,149.03	27,290.06	20,418.98	20,358.85
	Air Force	64,607.84	39,208.84	65,825.22	37,750.44	38,614.93
2014-15	Army	41,936.15	26,533.60	23,832.67	21,933.54	18,586.73

	Navy	28,253.21	23,832.67	22,903.31	18,507.07	22,269.66
	Air Force	62,408.33	33,710.68	38,948.19	33,710.68	32,796.42
2015-16	Army	31,938.67	27,342.42	27,845.33	24,230.47	20,703.70
	Navy	26,268.13	25,003.24	25,152.20	19,740.06	19,874.69
	Air Force	46,191.96	33,686.75	35,780.78	30,442.15	31,198.32
2016-17	Army#	37,960.18	26,943.08	34,706.12	24,026.86	17,205.64*
	Navy	30,223.31	22,000.09	22,530.04	19,596.28	12,613.87
	Air Force	41,266.41	29,795.42	36,512.95	28,239.86	23,770.25

(Rs. in Crore)

* Expenditure upto end of December 2016

(# includes allotment to NCC, DGQA, Military Farms, Rashtriya Rifles and ECHS which were shifted to modified Grant No. 20-MoD(Miscellaneous) in FY 2016-17, but have been transferred back to Defence Services Estimates in FY 2017-18, with the exception of Military Farms and ECHS, for the purpose of comparison with previous as well as future years.)

The above table depicts the budgetary provision for Capital acquisition for the three Forces from 2010-11 onwards. The Committee observe that the budgetary allocations for Capital acquisition has declined for the three Services not only at the RE stage of 2015-16 in comparison to BE 2015-16 but also for the RE during the year 2016-17 in comparison to BE 2016-17.

Similarly, against a projection of Rs. 1,46,155.54 Crore for Capital Budget in 2017-18, Rs. 86,528.65 crore have been allocated for BE 2017-18 for various Services (Army, Navy, Joint staff, Air Force, DGOF, R&D and DGQA, National Cadet Corps, Military Farms, Rashtriya Rifles and Ex-Servicemen Contributory Health Scheme). For 2017-18, the Army projected an amount of Rs. 42,485.93 crore for Capital Budget but only Rs. 25,246.35 crore has been allocated, which is in line with the trend being witnessed over the years. The same is the case with the Navy and Air Force which projected a requirement of Rs. 27,546.49 crore and Rs. 62,048.85 crore but have been allocated Rs. 18,603.71 crore and Rs. 33,570.17 crore, respectively.

The Committee are highly disappointed to note the persistent trend of decreased allocation of funds compared to the projected amount meant for Capital Expenditure for the Services. This decline in the allocation for Capital acquisition will definitely affect several procurement proposals and contracts relating *inter alia* to Land, Aircraft & Aeroengines, Heavy and Medium Vehicles, Other Equipments, Military Farms, Procurement of Rolling Stock, Ex-Servicemen Contributory Health Scheme, Rashtriya Rifles, National Cadet Corps, Construction Works, National Defence Academy, Married Accommodation Project, North Eastern Projects and Special Projects, etc. which are to be finalised in 2017-18. The budgetary cut at BE 2017-18 against the projection indicate that all the pending procurement projects would not go through unless the Government increases the allocations at the Revised Estimate stage. Therefore, the Committee fervently urge the Ministry to ensure that the allocations to the Services, under the Capital Head, match their demands and the allocation be suitably enhanced at the Revised estimate stage so as to enable our Services to meet the requirements of highest level of operational readiness.'

6. The Ministry in its Action Taken Reply has stated as under:

'There has been persistent trend of less allocation of funds compared to the projected amount under Capital Head. Detail of projections made and fund allocated in Budget Estimate, Revised Estimates, Modified Appropriation and Actual expenditure during the last five years are as under:

(Rs. in crore)

Year	BE Projected	BE allocated	RE	MA (Final Grant)	Actual Exp.
2012-13	101934.61	79578.63	69578.63	69578.63	70499.12
2013-14	134070.26	86740.71	78872.23	78872.23	79125.05
2014-15	145091.29	94587.95	81965.24	81965.24	81886.98
2015-16	117955.42	94588.00	81400.00	79483.28	79958.31
2016-17 #	121929.80	86340.00	79370.29	81747.26	86367.29
2017-	146113.54	86488.01			

18			

(# In the year 2016-17, 7 organisations viz, Ordnance Factories, DRDO, NCC, ECHS, Military Farms, Rashtriya Rifles and DGQA, which were till 2015-16 part of Defence Services Estimates, were shifted to MoD(Miscellaneous) Grant in the rationalized Demands for Grants. In 2017-18, except for ECHS and Military Farms, all other 5 organizations were reverted to Defence Services Estimates. The figures shown against FY 2016-17 included provisions of 7 organizations for comparison purpose only. Figures for 2017-18 do not include provisions of Military Farms and ECHS.)

From the data given above, it may be seen that every year funds allocated under Budget Estimates have been reduced at Revised Estimates stage by Ministry of Finance broadly on the pretext of trend of expenditure at that point of time. Though there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17), there has been either excess expenditure or more than 99.9% utilization when compared to Final Grant.

The recommendations of the Committee are noted and all efforts will be made to obtain additional requirements projected by the Services at RE stage. It may be further added that operational preparedness of the Services will not be compromised.'

7. The Committee, in their original Report, had highlighted the negative effect of persistent trend of decreased allocation of funds as compared to the projected amount meant for Capital Expenditure for the Services on several procurement proposals and contracts. These contracts pertained *inter alia* to Land, Aircraft & Aeroengines, Heavy and Medium Vehicles, other Equipments, Military Farms, Procurement of Rolling Stock, Ex-Servicemen Contributory Health Scheme, Rashtriya Rifles, National Cadet Corps, Construction Works, National Defence Academy, Married Accommodation Project, North Eastern Projects and Special Projects, etc. which were to be finalised in 2017-18. In their reply, the Ministry have submitted that each year funds allocated under the Budget Estimates have been reduced at Revised Estimates stage by Ministry of Finance broadly on the pretext of trend of expenditure at that point of time. Though there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17), there has been either excess expenditure or more than 99.9 percent utilization when compared to Final Grant. While the Committee have always urged

for suitable allocation of funds to the Services, they also wish to point out that underutilization of funds with reference to Budget Estimates allocated (except in 2016-17) in indicative of inefficient budgetary planning by the Ministry of Defence. Therefore, the Committee recommend that the Ministry take concrete measures to exercise prudent and effective budgetary planning.

B. Ratio Capital and Revenue Outlay

Recommendation (Para No. 6)

8. The Committee had recommended as under:

'The Committee observe that from 2012-13 onwards, the 'Capital' component of the budgetary allocation has decreased in comparison to 'Revenue' component of the Budget. The overall 'Revenue' to 'Capital Ratio' of the budgetary allocation stands at 61:39, 61:39, 63:37, 65:35 and 68:32 for 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17 (RE), respectively. The Committee understand that the Revenue component of the Budget caters to salary, other obligatory expenses, requirement of stores (including Ordnance), transportation (of personnel and stores), revenue works and maintenance, etc. and the Capital component provides allocation for Land & Construction Works of the three Services, Capital Expenditure of various Defence Departments and for Capital Acquisitions of the Services, etc. Both components are equally important aspects of the Budget, however, the Committee are deeply anguished to note that with each year, the ratio of Revenue to Capital outlay is skewed as the Budget for Capital acquisitions for the Services is declining in comparison to revenue allocations thereby adversely affecting the modernisation process of our Forces. Therefore, the Committee recommend that the Ministry of Defence should look into this aspect and overhaul their planning and budgeting mechanism to ensure a prudent and equitable distribution of funds to 'Revenue' and 'Capital' Heads.'

9. The Ministry in its Action Taken Reply has stated as under:

'It may be relevant to mention that majority of Revenue outlay includes Salary and expenditure incurred on maintenance of capital assets. The Capital outlay includes ongoing/new projects and expenditure on Land/works etc. While Revenue outlay expenditure follows a pattern due to its inherent characteristics, Capital outlay fluctuates depending on milestone payments, new accruals etc., which may not necessarily increase every year. Some years may see jump in Capital expenditure due to acquisition of new equipments/machinery etc., whereas the following year may see a dip due to lesser Committed Liabilities/New Schemes etc. As such the Revenue Capital ratio may vary from one year to the other, depending mainly upon the variations in Capital expenditure.'

10. The Ministry, in its Action Taken Reply, has submitted that while Revenue outlay expenditure follows a pattern due to its inherent characteristics, Capital outlay fluctuates depending on milestone payments, new accruals etc., which may not necessarily increase every year. Some years may see jump in Capital expenditure due to acquisition of new equipments/machinery etc., whereas the subsequent years may see a dip due to lesser Committed Liabilities/New Schemes etc. As such, the Revenue Capital ratio may vary from one year to the other, depending mainly upon the variations in Capital expenditure. The Committee feel that the Ministry's reply is not corroborated with the facts as 2012-13 onwards, the 'Capital' component of the budgetary allocation has witnessed a persistent decrease in comparison to 'Revenue' component of the Budget. The overall 'Revenue' to 'Capital Ratio' of the budgetary allocation was 61:39, 61:39, 63:37, 65:35 and 68:32 for 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17 (RE), respectively. Therefore, the Committee would reiterate their recommendation that the Ministry of Defence should overhaul their planning and budgeting mechanism to ensure a prudent and equitable distribution of funds to 'Revenue' and 'Capital' Heads. The Committee would also like to have figures for ratio of Revenue to Capital accounts for 2017-18 at the earliest.

C. Underspending

Recommendation (Para Nos. 7-9)

11. The Committee had recommended as under:

'The Committee, while examining the Demands for Grants, have observed that the Capital expenditure has never remained under control and the allocated funds under Capital Head are never fully utilized. During the year 2011-12, at RE stage, Army was allocated Rs. 16, 005.69 crore but was able to utilise only Rs. 14, 947.82 crore. During the year 2012-13, at RE stage, Army was allocated Rs. 15, 749.30 crore, but again it was able to utilise only Rs. 14,760.69 crore. In the same year, Navy was allocated Rs. 23,867.62 crore at BE stage but it could spend only Rs. 16,835.64 crore. During the year 2013-14, the Army was allocated Rs. 14,967.25 crore at RE stage, but it was able to spend only Rs. 14,433.29 crore. Similar was the case with Navy, which was not able to spend in full the allocation made at RE stage. Again, in the year 2014-15, Army was allocated Rs. 21,933.54 crore at RE stage but spent only Rs. 18,586.73 crore and Air Force was able to spend only Rs. 32,796.42 crore against the allocation of Rs. 33, 710.68 crore at RE stage. During the year 2015-16, Army was allocated Rs. 24,230.47 crore at RE stage but was able to spend only Rs. 20,703.70 crore.

In BE 2016-17, under Capital Head, Army was allocated Rs. 26,935.81 crore at BE stage and Rs. 24,017.86 crore at RE stage but was able to spend only Rs. 17,198.92 crore upto December, 2016. The allocation for Capital Acquisition for Navy which was Rs. 21,041.22 crore during BE 2016-17 was reduced to Rs. 18,742.17 crore at RE stage, but expenditure upto December, 2016 was Rs. 12,167.23 crore. The allocation for Capital Acquisition for Air Force which was Rs. 29,795.42 crore during BE 2016-17 was reduced to Rs. 28,239.86 crore at RE stage, but expenditure upto December, 2016 was Rs. 23,770.25 crore.

On being asked to provide reasons for reduction in budget allocation for Revised Estimates 2016-17, the Ministry of Defence submitted that during budget discussion with Ministry of Finance (MoF), the slow pace of expenditure was cited by Ministry of Finance as the reason for reducing allocations/ not granting additional allocations. The Committee are highly disappointed to note the persistent trend of underutilization of funds meant for capital expenditure for the Services even though the amount allocated under this head is always less than the projected one. The underutilization of funds highlights the loopholes in the planning and budgetary exercise undertaken by the Ministry of Defence and consistent failure to utilize the allocated funds has also contributed to reduction in Ministry's budget allocations by the Ministry of Finance. The Committee, therefore, recommend that it is high time the Ministry rectified the deficiencies / anomalies in their budgetary planning and expenditure and took foolproof measures to ensure maximum utilisation of the funds.'

12. The Ministry in its Action Taken Reply has stated as under:

'The details of Budget Estimates, Revised Estimated, Modified Appropriation (Final Grant) and Actual Expenditure under Capital Head during the last five years is as under:

(Rs. in crore)

Year	BE	RE	MA (Final Grant)	Actual Exp.
2012-13	79578.63	69578.63	69578.63	70499.12
2013-14	86740.71	78872.23	78872.23	79125.05
2014-15	94587.95	81965.24	81965.24	81886.98
2015-16	94588.00	81400.00	79483.28	79958.31
2016-17 (Rationalised) #	78586.68	71700.00	74100.00	78731.83
2016-17 (Non-Rationalised)	86340.00	79370.29	81747.26	86367.29

#				

(# In the year 2016-17, 7 organisations viz, Ordnance Factories, DRDO, NCC, ECHS, Military Farms, Rashtriya Rifles and DGQA, which were till 2015-16 part of Defence Services Estimates, were shifted to MoD(Miscellaneous) Grant in the rationalized Demands for Grants. The figures against 'Rationalised' row do not include provision for these 7 organization.For the sake of comparison, provision for all the 7 organizations has been included in figures against 'Non-Rationalised' row.)

From the data given above, it may be seen that though there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17), however there has been either excess expenditure or more than 99.9% utilization when compared to Final Grant. One of the main reason for lesser expenditure than Budget Estimates is reduction in allocation at RE stage. Sometimes cut imposed by Ministry of Finance at RE stage may lead to shifting of large payment to next financial year.

It may also be added that bulk of Capital expenditure comprises of Capital Acquisition which includes Committed Liabilities and New Schemes. Committed Liabilities being milestone payments may not fructify due to slippages in achieving project milestones by the vendor or delay in delivery of product/equipment.'

13. The Ministry, in its Action Taken Reply, has submitted that there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17). However, there has been either excess expenditure or more than 99.9 percent utilization as compared to Final Grant. One of the main reasons for incurring less expenditure as compared to Budget Estimates is the reduction in allocation at Revised Estimates stage which may lead to shifting of large payments to the subsequent financial year. It has further been submitted that bulk of Capital expenditure is intended for Capital Acquisition which includes Committed Liabilities and New Schemes. Committed Liabilities being milestone

payments may not fructify due to slippages in achieving project milestones by the vendor or delay in delivery of product/equipment.

14. The Committee note from the Ministry's reply that it has completely passed the onus of underutilization of funds to either cuts imposed by the Ministry of Finance or delay in delivery of product/equipment by the vendor. There appears to be no self-introspection by the Ministry of Defence in regard to underutilization of funds. In BE 2016-17, under Capital Head, Army was allocated Rs. 26,935.81 crore at BE stage and Rs. 24,017.86 crore at RE stage but was able to spend only Rs. 17,198.92 crore upto December, 2016. The allocation for Capital Acquisition for Navy which was Rs. 21,041.22 crore during BE 2016-17 was reduced to Rs. 18,742.17 crore at RE stage, but expenditure upto December, 2016 was Rs. 12,167.23 crore. The allocation for Capital Acquisition for Air Force which was Rs. 29,795.42 crore during BE 2016-17 was reduced to Rs. 28,239.86 crore at RE stage, but expenditure upto December, 2016 was Rs. 23,770.25 crore. Hence, the Committee would like to reiterate that underutilization of funds highlights the loopholes in the planning and budgetary exercise undertaken by the Ministry of Defence. Also, persistent failure to utilize the allocated funds has contributed to reduction in Ministry's budget allocations by the Ministry of Finance. Therefore, the Committee recommend that the Ministry take urgent and concerted steps in this regard and apprise the Committee of the action taken within two months of presentation of the Report.

D. <u>Capital Acquisitions - Creation of 'Roll on' and 'Non Lapsable Fund</u>

Recommendation (Para Nos. 10-15)

15. The Committee had recommended as under:

'The Committee have, in their reports presented earlier, emphasised on the allocations being of 'Roll on' and 'Non-Lapsable' in nature. However, The Ministry of Defence in the information furnished to the Committee on the subject matter in the past had, in general, not favoured the proposal for constituting a Non-lapsable Defence Capital Fund Account , ostensibly on the plea that there had been no occasion in the last five years where any substantial amounts were available as surplus for rolling over. The intention of the Committee in recommending Non-Lapsable funds for Defence modernization is primarily for ensuring that the money allocated for a particular item is spent on the specified item only, not necessarily in the same financial year.

The Committee are glad to note that the Ministry of Defence has now reviewed its stated position and has admitted that the utility of creation of a non-lapsable, roll over fund for Capital cannot be completely negated as the same would help in eliminating the prevailing uncertainty in providing adequate funds for various defence capability development and infrastructure projects. A proposal for obtaining 'in-principle' approval of Ministry of Finance on creation of Non-lapsable Capital Fund Account has been sent on 9.2.2017 by the Ministry of Defence after obtaining approval of Hon'ble Raksha Mantri and response from the Ministry of Finance is awaited.

The Committee are disappointed to note that the Ministry of Finance is still not in favour of creating 'Non-lapsable Defence Capital Fund Account'. As per the Ministry of Finance, it may not be advantageous in creating a reserve/corpus fund in the Public Account and the requirement of Ministry of Defence for meeting its Capital Modernisation and acquisitions can be addressed through normal budgetary mechanism. The Committee would like to draw attention of the Ministry of Finance to the fact that since last few years, the allocations for the Ministry of Defence under the 'Capital' head are always lesser than its projection not only at BE stage but also at RE stage. To illustrate, against a projection of Rs. 1,46,155.54 crore for Capital Budget in 2017-18, only Rs. 86,528.65 crore have been allocated for BE 2017-18 for various Services (Army, Navy, Joint staff, Air Force, DGOF, R&D and DGQA, National Cadet Corps, Military Farms, Rashtriya Rifles and Ex-Servicemen Contributory Health Scheme). Therefore, the Committee do not agree with the contention of the MoF that the desired objectives of Ministry of Defence towards meeting its contractual liabilities, acquisitions and Defence mordernisation can be achieved through normal budgetary mechanism. The Ministry of Finance should also keep in mind that Defence procurement and acquisition is a complicated process involving long gestation periods and funds allocated for capital acquisition in a particular financial year are not necessarily consumed in that year and ultimately have to be surrendered by the Ministry of Defence. The Committee, in this regard, would like the Ministry of Finance to look at the matter afresh and work out the modalities for creation of 'Non-lapsable Defence Capital Fund Account' in consultation with the Ministry of Defence keeping in mind that our Forces' plans for capacity enhancement and heightened operational preparedness would be negatively affected due to reduced allocation of funds in the Capital head and this would ultimately be detrimental to our National Security.

The Committee find it pertinent to mention in this context that in the Union Budget 1998-99, the Non-lapsable Central Pool of Resources for the North Eastern region was constituted with approval of Parliament. The broad objective of the Non-lapsable Central Pool of Resources scheme was to ensure speedy development of infrastructure in the North Eastern region by increasing the flow of budgetary financing for new infrastructure projects/schemes in the Region.

For identification of projects under Non-Lapsable Central Pool of Resources, States are asked to submit, before the beginning of the financial year, a prioritized list of projects with a short write up on each project. The Committee to administer the Non-Lapsable Central Pool of Resources is headed by Secretary, Ministry of Development of North Eastern Region and has representation from Ministries of Finance and Home Affairs. The priority accorded by the state to the projects in the 'priority list' is only a suggestive and the Committee to administer the Non-Lapsable Central Pool of Resources scrutinizes the projects in the lists in order to identify and finally retain the suitable projects for detailed examination. In examining the priority, the Committee is, inter-alia, guided by considerations such as priority to projects of economic infrastructure, drinking water supply and other health and sanitation projects, the overall utilisation and absorption of funds by a particular state in the past years, past performance of a State in implementing projects in the particular sectors etc. After approval of the Committee, funds are sanctioned and released by the Ministry of Development of North Eastern Region on submission of an implementation schedule. Subsequent releases are made only after receipt of Utilisation Certificate of earlier releases.

The Committee desire that the Ministry of Defence, taking an inspiration from the Non-lapsable Central Pool of Resources for the North Eastern region, should devise streamlined institutional arrangements to administer the ‘Non-Lapsable’ and ‘Roll on’ Capital Budget.'

16. The Ministry in its Action Taken Reply has stated as under:

'In this context, it is intimated that Ministry of Defence has taken up the matter for creation of Non-Lapsable fund specifically for Capital Budget with Ministry of Finance vide letter dated 09th February,2017, and reminder dated 5th May, 2017. The proposal of Ministry of Defence for creation of Non-lapsable Capital Fund Account has not been accepted by Ministry of Finance as conveyed vide Ministry of Finance letter dated 03.07.2017.'

No.F.7(1)-B(AC)/2017
Ministry of Finance
Department of Economic Affairs
(*Budget Division*)

...

New Delhi,
3rd July, 2017.

OFFICE MEMORENDUM

Subject: Creation of 'Non-Lapsable Capital Fund Account' in Public Account for 'Defence Modernisation'.

The undersigned is directed to refer to Defence Secretary's D.O.letter No.3(10)/Bud-I/2016(Pt.)/70/Def.Secy.2017 dated 91.6.2017 on the subject cited above and to state that the proposal of Ministry of Defence for creation of non-lapsable Defence Modernisation Fund has been examined in this Ministry.

2. Considering the following facts against creation of a corpus fund in Public Account, the proposal of Ministry of Defence on 'Defence Modernisation Fund' in Public Account is not agreed to:

(i) Adequate budget provision is made available to Ministry of Defence to finance the capital requirements of Defence Services;

(ii) Balances available in the non-lapsable funds will not be available to Ministry of Defence automatically. It requires Parliament sanction through Demands for Grants of Ministry of Defence for being spent on Defence capital expenditure. Hence, mere creation of non-lapsable fund yields no additional advantage to Ministry of Defence and could rather induce complacency in incurring expenditure;

(iii) Funds in the Public Account are generally created with dedicated receipts for being financed. In this case, there is no such dedicated receipts for financing the corpus of the reserve fund proposed to be created in the Public Account;

(iv) Creating a corpus out of general revenues could lead to unnecessary parking of funds and make them unavailable for other essential expenditure. Thus, non-lapsable funds result in sub-optimal utilisation. Standing Committee on Finance (16th Lok Sabha), in its 2nd Report on Demands for Grants of Ministry of Finance for the year 2014-15, recommended that the unutilized funds/Funds kept idle for more than two years may be transferred

(from pre-page)

(v) Moving general revenues out of Consolidated Fund and parking in corpus fund is against the spirit behind Article 266(1) of the Constitution. Giving go ahead in one case could raise competing demand from other Ministries.

3. This has the approval of Finance Minister.

T. Uthaya Kumar
(T.Uthaya Kumar)
Additional Budget Officer

The Secretary
(Shri Sanjay Mitra)
Ministry of Defence
South Block
New Delhi.

17. The Ministry of Defence, after much emphasis from the Committee, had reviewed its earlier position and admitted that the utility of creation of a Non-lapsable, roll over fund for Capital Acquisition could not be completely negated as the same would help in eliminating the prevailing uncertainty in providing adequate funds for various defence capability development and infrastructure projects. However, the Committee are disappointed to learn that the proposal of Ministry of Defence for creation of Non-lapsable Capital Fund Account has not been accepted by Ministry of Finance as conveyed vide Ministry of Finance letter dated 3 July, 2017.

18. The main reasons as enumerated by the Ministry of Finance in the said letter are non-availability of balances in the non-lapsable funds to the Ministry of Defence automatically as it requires Parliament sanction, unnecessary parking of funds which makes them unavailable for other essential expenditure and possibility of competing demands from other Ministries. However, the Committee are of the opinion that creation of a non-lapsable Defence Capital Fund Account is an imperative need for enhancement and heightened operational preparedness of our Defence Forces. They feel that even if certain financial rules and regulations have to be amended for creation of a 'Non-lapsable Defence Capital Fund Account' to meet the requirements of our Defence forces, it can and should be done in the interest of the nation. They also feel that the Ministry of Finance, in anticipation that creation of non-lapsable fund for Defence might also lead to competing demand for other Ministries, should not have any rigid view in this regard as timely availability of adequate resources for the Ministry of Defence is inextricably linked to national defence and security. Hence, the Committee would like the Ministry of Finance to review the stance taken in this regard in consultation with the Ministry of Defence and apprise the Committee of the progress at the earliest, and not later than three months of the presentation of this Report to Parliament.

E. Committed Liabilities and New Schemes

Recommendation (Para Nos. 16-20)

19. The Committee had recommended as under:

'Committed Liability refers to payments anticipated during a financial year in respect of contracts concluded in previous years. Under the Defence Services Estimates, Committed Liabilities constitute a significant element in respect of the Capital acquisition segment, since one project may span several financial years. As such, it is important to track the element of Committed Liabilities which hold first charge on the budget allocation. Inadequate allocation for Committed Liabilities could lead to default on contractual obligations.

During the year 2015-16, BE allocations for committed liabilities and new schemes were Rs. 15,740.75 crore and Rs 1,541.06 crore, respectively, in case of Army. These figures were reduced to Rs. 9,875.21 crore and Rs. 3,160.07 crore, respectively, in RE 2015-16. The actual expenditure for committed liabilities and new schemes was Rs. 8,705.82 crore and Rs. 1,438.14 crore, respectively. For the Navy, these allocations were Rs. 22,248.12 crore and Rs. 1,112.78 crore for BE 2015-16 and Rs. 17,200 crore and Rs. 1,193.38 crore for RE 2015-16, respectively. The actual expenditure for committed liabilities and new schemes was Rs. 17,788.39 crore and Rs. 591.34 crore, respectively. Air Force was given Rs. 28,246.53 crore for Committed Liabilities and Rs. 3,264.09 crore for New Schemes in BE 2015-16. These figures stood at Rs. 23,942.40 crore and Rs. 4,701 crore, respectively in RE 2015-16. The actual expenditure for committed liabilities and new schemes was Rs. 24,334.17 crore and Rs 4,711.50 crore, respectively.

During the year 2016-17, BE allocations for committed liabilities and new schemes were Rs. 12,492.92 crore and Rs 2,086.08 crore, respectively, in case of Army. These figures were reduced to Rs. 9,928.56 and Rs. 1,986 crore, respectively in RE 2016-17. For the Navy, these allocations were Rs. 18,763.77 crore and Rs. 1600 crore for BE 2016-17 and Rs. 15,300 crore and Rs. 2,838.75 crore for RE 2016-17. Air Force was given Rs. 24,306.02 crore for Committed Liabilities and Rs. 3,250 crore for New Schemes in BE 2016-17.

The Committee have learnt that the additional requirements projected for RE 2016-17 and BE 2017-18 for Committed Liabilities and New Schemes for the three Services were not acceded to by the Ministry of Finance. As per the Ministry of Defence, the reduced allocation will adversely affect the progress of large number of New Schemes which are at Competent Financial Authority (CFA) approval and advanced contract Negotiation Committee (CNC) stages. Delaying these schemes will not only have a cascading effect on the budget of 2017-18, but also result in delays in acquiring capability towards modernisation and bridging existing capability gaps. Further, the reduced allocation will impact cash outgo in committed payments and deferment of these payments will impinge on budgetary allocations in next financial year.

The Committee are unhappy to note that though the Ministry of Defence has blamed budgetary cut for negative effect on committed payments and progress of a large number of New Schemes, the trend of expenditure of the funds for Committed Liabilities and New Schemes belies Ministry's claims. It is evident from the fact that for RE 2014-15, the Outlays for New Schemes were kept at Rs. 2,084.15 crore and Rs. 2,644.99 crore for Army and Air Force, but the actual expenditure was only Rs. 1,443.63 crore and Rs. 1,299.47 crore, respectively. Similarly, in RE 2015-16, against the Committed Liabilities outlay of Rs. 9,875.21 crore, only Rs. 8,705.82 crore was utilized by Army. For RE 2015-16, the allocated funds for New Schemes were Rs. 3,160.07 crore and Rs. 1,193.38 crore for Army and Navy, but the actual expenditure was only Rs. 1,438.14 crore and Rs. 591.34 crore, respectively. The underutilization of funds for Committed Liabilities and New Schemes by the three Services pinpoints to the fact that the institutional mechanisms put in place for financial planning and monitoring utilization of funds is not effective. Though it is earnest desire of the Committee that adequate allocations should be made for Committed Liabilities and New Schemes for enabling modernization of the forces, the Committee cannot help but fervently urge the Ministry of Defence to be more prudent in their budget formulation and expenditure planning.'

20. The Ministry in its Action Taken Reply has stated as under:

'The observations/recommendations of the Committee have been noted and the Ministry of Defence will make efforts to ensure that budget formulation and expenditure planning is more prudent. It may be added that in the year 2015-16, there was no underutilization in Capital Grant with reference to Final Grant (Modified Appropriation). Against final grant of Rs. 79,483.28 crore, actual expenditure was Rs. 79,958.31 crore. In the year 2016-17 also there has been no underutilization of funds under the Capital Grant. For year 2017-18, the expenditure under Capital Grant, till July, 2017, is Rs. 38,913.93 crore against BE of Rs. 86,488.01 crore constituting 45% of the BE; a percentage higher than what attained in previous years.'

21. The Committee note from the Ministry's submission that for year 2017-18, the expenditure under Capital Grant, till July 2017, is Rs. 38,913.93 crore against

the Budget Estimate(BE) of Rs. 86,488.01 crore, which amounts to 45 percent of the BE; a percentage higher than what was attained in previous years. Earlier, the Ministry of Defence had submitted that every year, funds allocated under Budget Estimates have been reduced at Revised Estimates stage by Ministry of Finance, broadly on the pretext of trend of expenditure at the relevant point of time. Therefore, the Committee hope that the Ministry has initiated foolproof measures to ensure maximum utilization of funds so as to avoid lapse of funds, and possibility of further budgetary cuts by the Ministry of Finance.

F. Long Gestation Period in Procurement

Recommendation (Para No. 22)

22. The Committee had recommended as under:

> 'As per the Ministry of Defence's submission, procurement is an ongoing process and the time taken varies from case to case due to inherent complexities and uniqueness. The Committee note that various provisions *viz.* reduction of timelines from 80-117 to 70-94 weeks, reduction in Acceptance of Necessity validity from 1 Year to 6 Months, accompaniment of draft Request for Proposal with Statement of Case for Acceptance of Necessity, conducting of Field Trials in conditions where equipment most likely to be deployed, maximum use of certification and simulations, delegation of powers to Acceptance of Necessity according authorities, Fast Tracking of Procedure for expeditious procurement of urgent operational requirement items in war and peace, exist in Defence Procurement Procedure 2016 for achieving timely, efficient and effective procurement. During oral evidence, the Defence Secretary also briefed the Committee on the steps taken to fasten the process of Defence procurement. The Services are now fully authorised to take up any revenue procurement of ammunition upto a minimum level of 10 (I) war situation. Further, the Cabinet Committee on Security has accepted the proposal of the Ministry for enhancing its capital procurement powers from Rs. 500 crore to Rs. 3,000 crore. The Committee are glad to note that some progress is being made by the Ministry of Defence to correct systemic deficiencies in defence procurement deals but would

like to see concrete and coordinated action so that that the Ministry's various measures do not remain mere ink on paper and our Forces are equipped with state-of-the-art equipments/weapons/platforms.'

23. The Ministry in its Action Taken Reply has stated as under:

'The observations of the Committee have been noted for compliance. Ministry of Defence is taking action to meet the operational requirement of the Armed Forces. During 2016-17 and in the current year, 52 contracts involving Rs. 1,24,465.57 crore have been signed for the capital procurement of defence equipment including aircraft, helicopters, missiles, artillery guns and simulators.

Further, the Ministry of Defence, with a view to reduce time taken in decision making has delegated the number of powers hitherto exercised by it to Service Headquarters/other entities in the Ministry. Such delegation includes powers in respect of post contract management of capital acquisition contracts; items related to post contract management of revenue expenditure; enhanced financial powers to the Director General NCC and Director General Coast Guard. Further, full powers on revenue and capital accounts have been delegated to Service Headquarters with respect to procurement relating to perimeter security. Director General, Border Roads Organisaton(BRO) has been given full powers for inviting tenders, evaluating the same and accepting bids upto Rs.100 crores. Similarly procurement of equipment/transport etc have also been delegated up to Rs. 50 crores. Preparation of DPR has also been delegated to BRO. Projects above Rs. 100 crores will be accepted by a Project Approval Board headed by Defence Secretary.'

24. The Ministry of Defence has detailed several measures aimed at reducing the time taken in decision making, such as delegation of a number of powers hitherto exercised by it to Service Headquarters/other entities in the Ministry. The Committee earnestly desire that the Ministry's efforts are fructified and the long gestation periods in defence procurement are considerably reduced. During 2016-17 and in the current year, 52 contracts involving Rs. 1,24,465.57 crore have been signed for capital procurement of defence equipment including aircraft, helicopters, missiles, artillery guns and simulators. The Committee also wish to

be updated regarding progress of procurement of said defence equipments and budgetary provision for the same.

G. Long Term Integrated Perspective Plan (LTIPP)

Recommendation (Para Nos. 45 - 46)

25. The Committee had recommended as under:

'The Committee note that the Headquarters Integrated Defence Staff (HQIDS), in consultation with the Service Headquarters (SHQs), had evolved the 15 year Long Term Integrated Perspective Plan (LTIPP). Presently, LTIPP 2012-2027 is in vogue and has been approved by the Defence Acquisition Council. Proposals for acquisition of capital Assets flow out from the defence procurement planning process which covers the 15 year LTIPP, 5 year Services Capital Acquisition Plan (SCAP) and Annual Acquisition Plan (AAP). The LTIPP is translated into the SCAP, covering a five year period. The AAP of each service is a two year roll on plan for capital acquisition and consists of the schemes from the approved five year SCAP. Thus, LTIPP gets finally translated to short term plan (AAP) and the cases included in the AAP are progressed for acquisition as per the Defence Procurement Procedure. Progress of procurement cases is regularly reviewed in SHQ and MoD. Amendments are made to the DPP, as and when required, to streamline the acquisition process. DPP-2016 is focused on institutionalising, streamlining and simplifying defence procurement procedure to give a boost to 'Make in India' initiative of the Government of India, by promoting indigenous design, development and manufacturing of defence equipment, platforms, systems and sub-systems.

The Committee note that in the budget on capital acquisition of defence equipment for the period of 2016-17 during the 12th Plan period, an amount of Rs. 53,583.04 crore has been expended till December, 2016 against the BE allocation of Rs. 78,731.32 crore. The Committee would like to know the status of the expenditure at the conclusion of this financial and whether aspects relating to cost escalation due to inflation have been taken into account in allocation of funds for Capital Acquisition for 2017-18.'

26. The Ministry in its Action Taken Reply has stated as under:

'In the year 2016-17, Budget Estimates in respect of Capital Outlay on Defence Services was Rs. 78,586.68 crore against which expenditure of Rs. 53,504.98 crore was incurred upto December, 2016. At the end of financial year 2016-17, the expenditure incurred was Rs. 78,718.52 crore. The projection made by the Services based on the requirements for 2017-18 amounting to Rs. 132872.27(*) crore was sent to Ministry of Finance for favorable consideration. Against the requirements projected, an amount of Rs. 86,488.01 crore has been allocated under Capital Outlay on Defence Services.

* - Rationalized figure in r/o Army, Navy, Joint Staff and Air Force.'

27. The Committee note that an amount of Rs. 86,488.01 crore has been allocated to the Ministry of Defence under Capital Outlay on Defence Services for 2017-18 against the projected amount of Rs. 1,32,872.27 crore. The Committee would like to know how the Ministry has prioritised its expenditure given the reduction in funds for capital acquisition. Further, the Committee would also like to apprised whether additional funds have been sought from the Ministry of Finance to meet the requirements.

CHAPTER II

(A) OBSERVATIONS/RECOMMENDATIONS, WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT

<u>Defence Procurement Procedure 2016</u>

Recommendation (Para No. 21)

The Committee note that the Defence Procurement Procedure (DPP) has been revised in 2005, 2006,2008, 2009, 2011 and 2013, enhancing the scope to include 'Make', 'Buy and Make(Indian)' categories, concept of 'offsets' and Ship Building procedure. In order to achieve enhanced self-reliance in Defence manufacturing and to leverage the economic opportunity present in developing the Indian Defence industry, MoD constituted a Committee of Experts, to recommend suitable amendments to DPP-2013. Based on Government's experience in the Defence Procurement Process and the recommendations of the Committee of Experts, DPP 2016 has been evolved. The main preferred category in the Defence Procurement Procedure is now 'Buy Indian- Indian Designed, Developed and Manufactured (IDDM)' which is a new category. 'Buy (Indian-IDDM)' category refers to the procurement of products from an Indian vendor meeting one of the two conditions: Products that have been indigenously designed, developed and manufactured with a minimum of 40% Indigenous Content (IC) on cost basis of the total contract value or products having 60% IC on cost basis of the total contract value, which may not have been designed and developed indigenously. The Committee appreciate the intentions of the new Defence Procurement procedure to ensure timely procurement of military equipment, systems and platforms as required by the Armed Forces in terms of performance capabilities and quality standards through optimum utilization of allocated budgetary resources, provision for the highest degree of probity, public accountability , transparency , fair competition and level-playing field and pursuance of self-reliance in defence equipment production and acquisition and sincerely hope that the Ministry will leave no stone unturned in realizing the noble objectives of DPP 2016.

Reply of the Government

Ministry of Defence is committed to the objectives of DPP-2016 and will take all steps necessary to realize these objectives.

Probity, Accountability and Transparency in Defence Procurement

Recommendation (Para No. 23)

The Committee have been informed that the Ministry of Defence has given provisions such as formulation of guidelines for penalties in business dealings with entities including Policy on putting on hold, suspension and debarment for corrupt practices, unfair means etc., execution of Pre-contract Integrity Pact (PCIP) for all cases above Rs. 20 crore, complaints regarding violation of PCIP to be looked into by independent monitors, guidelines for handling of complaints being time bound, aligned to Central Vigilance Commission/ Department of Personnel and Training (DoPT) guidelines and in keeping with Government policy , ascertaining vigilance status of L-1 vendor before seeking Competent Financial Authority (CFA) approval, calling off negotiations, cancellation of contract, encashment of bank guarantee and debarment from future procurement due to violation of guidelines etc., for ensuring probity, accountability and transparency in defence procurement cases. While appreciating the Ministry's step to ensure corruption free defence deals, the committee would desire the Ministry to not abstain from stern punitive action against violation of set guidelines for probity, accountability and transparency in procurement cases as this would send a strong message to offenders trying to threaten the security of our Nation.

Reply of the Government

The DPP contains penal provisions in Standard Clauses of Contract for use of undue influence including engagement of Agents unauthorisedly by the Seller. Further, the DPP provides for execution of a Pre Contract Integrity Pact (PCIP) in respect of all procurement above Rs. 20 crore with the objective of ensuring that the procurement process is free of corruption. PCIP is a binding agreement between the bidder and the Government whereby both parties undertake that none of their officials will offer or accept any kind of bribe during the procurement process. The selected vendor is also required to submit an Integrity Pact Bank Guarantee (IPBG). Violation of PCIP can result in calling off the negotiations, cancellation of contracts, encashment of bank guarantees and debarment from future procurement.

Ministry of Defence has also promulgated guidelines for penalties in business dealings with entities, which have come with effect from 21.11.2016. These guidelines have been promulgated to ensure probity, transparency, propriety and compliance in the defence Procurement process. The guidelines are aimed at ensuring fairness, impartiality, rigour and correctness in dealings with entities, keeping in view the overall security interest of the country. All concerned entities are required to ensure compliance with these guidelines. In terms of these guidelines, financial penalties may be levied and/ or business dealings suspended/banned interalia for violation of PCIP and resort to corrupt practices during any stage of bid/contract.

Dependence on Foreign Supplier for Military Hardware

Recommendation (Para Nos. 24 and 25)

Modernisation involves the acquisition of new state-of-the-art platforms, technologies and weapon systems to upgrade and augment defence capabilities and the budget for the same is taken from the Capital segment of the defence budget. However, the Committee are anxious to note that requirement of weapons and equipments for our Forces are being met largely through import. The major defence equipments imported during the last three years include rockets, simulators, Armament Repair facility for EKM, submarines and component level repair facility for Tanks from Russia, Unmanned Aerial Vehicles, Radar, fire control system for tanks and missiles from Israel, aircraft, helicopters and simulators from USA And Bimodular Charge system(BMC) High Zone Modules of Artillery Guns from France. As per the data supplied by the Ministry, the total expenditure for Army for direct payments to foreign vendors for Capital Acquisitions is Rs. 1,659.36 crore, Rs. 800.39 crore, Rs. 424.82 crore, Rs. 884.84 crore, Rs. 1,365.71 crore, Rs. 3,452.61 crore and Rs. 3,004.91 crore in 2009-10, 2010-11, 2011-12, 2012-13, 2013-14, 2014-15 and 2015-16, respectively. Similarly, the Navy spent Rs. 4,576.83 crore, Rs. 4,746.88 crore, Rs. 6,532.37 crore, Rs. 5,968.80 crore, Rs. 12,577.81 crore, Rs. 6,884.00 crore and Rs. 6,939.76 crore in 2009-10, 2010-11, 2011-12, 2012-13, 2013-14, 2014-15 and 2015-16, respectively, for importing military equipment. As for the Air Force, an amount of Rs. 4,226.28 crore, Rs. 4,364.82 crore, Rs. 15,258.11 crore, Rs. 19,220.95 crore, Rs. 20,927.55 crore, Rs. 14,655.75 crore and Rs. 12,477.45 crore in 2009-10, 2010-11, 2011-12, 2012-13, 2013-14, 2014-15 and 2015-16, respectively, was spent on import of weaponry from foreign vendors. The Committee note that in the last seven financial years (2009-10 to 2015-16), total expenditure for the three Services for direct payments to foreign vendors for Capital Acquisitions was Rs. 1,50,950 crore.

The Committee note that Capital procurement of Defence equipment from Indian and foreign vendors is carried out as per provisions of the Defence Procurement Procedure. Defence equipment is being imported from various countries as per the operation requirement of Armed Forces. During the last two financial years (2014-15 and 2015-16), 108 contracts with total value of Rs. 1,12,736.81 crore have been signed for capital procurement of defence equipment, out of which 73 contract involving a value of Rs. 72,303.34 crore were signed with Indian vendors and 35 contracts involving a value of Rs. 40,433.47 crore were signed with foreign vendors. The Committee also note the candid submission of the Defence Secretary where he attributed heavy dependence of Air Force on foreign equipment to the lack of requisite sophisticated equipments in our country. The Committee understand that our Forces need to resort to import arms and equipment to meet current security challenges of the Nation but cannot help noting that heavy reliance on import does not provide long-term solution to our security requirements. Further, import of defence capital acquisition also leads to depletion of valuable forex reserve. Hence, the Committee hope that the Ministry of Defence now armed with Defence Procurement Policy 2016, would take urgent and concerted steps to arrest the import of arms equipment and encourage domestic defence industry base.

Reply of the Government

In accordance with the Defence Procurement Policy, preference is given to indigenous design, development and manufacture of defence equipment and procurement from foreign sources is to be resorted to only in case the Indian industry is not in a position to deliver the equipment as per the Services Qualitative Requirement in the requisite timeframe. The DPP 2016 includes several initiatives to encourage local Research and Development. The 'Make' procedure under DPP-2016 seeks to address the multiple objectives of self-reliance, wider participation of Indian industry, impetus to MSME sector, sound implementation, transparent execution and timely induction of equipment into the India Armed Forces. A new category of procurement i.e. 'Buy (Indian-IDDM)' has been introduced in DPP-2016 and will be the most preferred acquisition category. During 2016-17 and in current financial year(upto 30.04.2017), the Government has accorded approval to 34 capital procurement cases at an estimated cost of Rs. 1,02,338.45 crore out of which 23 AoNs at a estimated cost of Rs. 96,466.25 crore value are under the 'Buy (Indian)', 'Buy Indian-(Indigenously Designed & Developed Manufactured (IDDM))' and 'Make' categories.

<u>Import content in Equipment Produced and Developed by DRDO, Ordnance Factories and Defence Public Sector Undertakings (DPSUs)</u>

Recommendation (Para Nos. 26 and 27)

The Committee are concerned to note that the import component and value of the Defence equipment manufactured and developed by Defence Public Sector Undertakings (DPSUs) is substantial. To illustrate, in case of Hindustan Aeronautics Limited (HAL), the import component is said to range from 44 to 60 per cent; 36 to 44 per cent in case of equipment manufactured by Bharat Electronics Limited (BEL) and almost 20 percent in case of equipment manufactured by Bharat Earth Movers Limited (BEML), from 2013-14 to 2015-16;. Further, the import component of Ships manufactured by Hindustan Shipyard Limited (HSL) is informed to be 21 per cent in 2016-17, 14.51 to 35.50 per cent for ships produced/delivered by Goa Shipyard Limited (GSL) and 28 to 58 per cent in case of Ships manufactured by Mazagon Dock

Shipbuilders Limited (MDL). Ordnance Factory Board's import content during the last three financial years stands at 8.9 per cent to 15.15 per cent.

The Committee note that Defence Public Sector Undertakings (DPSUs) and Ordnance Factories Board (OFB) are main pillar of indigenous development and production of defence arms and equipment. Therefore, they earnestly desire that for increasing our self-reliance in defence production, the DPSUs and the OFB should leave no stone unturned in supplying State-of-the-Art equipments to our Defence personnel within a fixed time framework and reducing the import content in the military equipment manufactured indigenously.

Reply of the Government

HAL: HAL's core activities of design, development, manufacture and maintenance are steps towards reducing the import content as described below.

- HAL has manufactured 14 types of aircraft/helicopters under ToT from foreign OEMs. This has resulted in reduction of import content by avoiding direct import of these aircraft/helicopters from abroad. Currently, SU-30 MKI aircraft is being produced at HAL

- HAL has Designed and Developed 17 types of aircraft indigenously. The indigenous Design and Development has not only reduced the import content but also reduced the dependency on foreign OEMs for ROH, modification and upgrades during the life cycle of an aircraft / helicopters. The following major Indigenous development programs are under way at HAL

  - Light Combat Aircraft (LCA) MK1A - Tejas
  - Intermediate Jet Trainer (IJT)
  - Hindustan Turbo Trainer (HTT-40)
  - Light Combat Helicopter(LCH)
  - Light Utility Helicopter (LUH)
  - Indian Multi-Role Helicopter (IMRH)
  - Fixed and Rotary wing Unmanned Aerial Vehicle (UAV)
  - 25 kN Turbofan Engine (HTFE-25)
  - 1200 KW Turboshaft Engine (HTSE-1200)

- It is pertinent to mention that HAL products, both indigenously developed and manufactured under ToT, are import substitutes as these obviate the need for import of such platforms by the country.
- Concerted efforts are made on indigenisation of components, accessories and systems required for manufacture as well as repair and overhaul of aircraft, engine and associated systems. Every year more than 2000 items are indigenized with

considerable FE Savings. More than 600 types of LRUs (Accessories /Avionics) have been indigenously developed so far for various platforms.

- A portal has been launched on the Company's website-www.hal-india.com and the following have been hosted to encourage participation of private industries.

  - More than 300 Nos of Systems and sub systems of mechanical, electrical, avionics, instrumentation for various HAL projects such as ALH, LCA, Do-228 Hawk and Jaguar, etc for indigenous development.

  - More than 270 nos. of spares/ items required for ROH of SU-30 MKI aircraft. These items are proposed to be manufactured in India by private companies under ToT from Russian OEMs

- Over 85 types of test facilities available at HAL which could be utilised by the Indian industries.
- R & D Corpus has been created with contribution of 10% of operating profit after tax every year and is being utilized both for in-house development and also to encourage R & D by private sector
- HAL has provided necessary impetus to the growth of aviation industry in India. Today, over 2300 vendors are supporting HAL in terms of component manufacturing, tooling, sub-assembly and Design and Development.
- HAL has associated with premier R & D organizations like DRDO labs, NAL and academia like IITs and IISc for Research and Development activities in the field of aerospace.

BEL: BEL generally does not import fully finished Defence equipment. However, for the design, manufacture and supply of Defence products/services, the company resorts to import for some of the special Components/Raw materials, proprietary items/sub-systems etc., (input material) that are not being manufactured in the country.

Self-reliance is one of the objectives of the company to meet the strategic needs of the nation for which indigenization is one of the thrust areas of BEL. Major portion of BEL's turnover (around 85%) is generated from products based on indigenous technology. Over the years, BEL has been providing enhanced thrust to minimize the import content in its equipment/systems. Towards this endeavour, some of the major specific steps taken for self-reliance in design and development and production of equipments are detailed below:

- Product development through:
  - In-house R&D efforts.
  - Joint development by partnering with DRDO, National R&D Labs and Academia.
  - Collaborative R&D partnership with Indian private sector (MSMEs) and

foreign OEMs/Design houses.

- ToT based In-depth manufacturing from foreign OEMs.

- Import substitution of critical sub-systems through in-house/domestic vendor development.

Infrastructure for Promoting Indigenization Efforts:

R&D: BEL has a 3-tier R&D setup comprising of Two Central Research Laboratories (Bengaluru & Ghaziabad), a Centralized D&E centre (Bengaluru) and Unit/SBU wise Development & Engineering Divisions. BEL's software division is SEI CMMI Level 5 certified. BEL has also initiated setting up of a State-of-the-art Product Development Innovation Center (Bengaluru) with larger infrastructure & resources.

Manufacturing: BEL has established state-of-art manufacturing facilities in all its nine Units which are capable of absorbing latest manufacturing technologies.

In order to further minimize the dependency on import of input material, BEL has set a Roadmap & Action plan for next 5 years for decreasing Import Content as a %age of Sales detailed below:

Roadmap for next 5 years					
Financial Year	17-18	18-19	19-20	20-21	21-22
% Import content to Sales	23 %	22 %	21 %	20 %	19 %

BDL: The import content in the products manufactured by Bharat Dynamics Limited during the last three years is 13.73%. BDL is emphasizing on Indigenization so that the country can achieve self-reliance in Defence Production and thereby reduce dependency on foreign suppliers.

BEML: BEML is engaged in manufacturing of Mining & Construction, Defence and Rail & Metro products.

During the year 2016-17, the import content as a % of total turnover was 21.72% (Provn).

It may be noted that, Indigenisation is above 90% in each of Mining & Construction equipment and balance components like bearing, oil seals, valves etc. are being imported because of either not being available in India or not being of desired quality standards to give satisfactory performance.

In respect of Rail & Metro Business, Rail Coaches, AC Electrical Multiple Units (ACEMUs), Diesel-Electric Multiple Unit (DEMU), Mainline Electric Multiple Unit (MEMU), Stainless Steel Electrical Multiple Unit (SSEMUS) and Over Head Equipment inspection Car (OHEs) are fully indigenised.

In respect of Metro Cars indigenisation is around 50%. During the year 2016-17 development order has been placed for Driver & Co-Driver seats and samples are expected shortly. For the year 2017-18, components like Axle box, Saloon Seats are planned to be indigenized.

MDL: Import content (as a percentage of VoP) for the last 5 years as follows:

Year	2012-13	2013-14	2014-15	2015-16	2016-17
Import content (% of VoP)	36.9	37.7	41.5	47.7	49.17

The reason for increase in the import content is due to the procurement of high value items nominated by DCNS, France (collaborator), imported for P75, Scorpene class Submarine project under Transfer of Technology contractual agreement.

MIDHANI: The import content of MIDHANI is showing a decreasing trend and effort will be put to reduce the import content even further. The import content for the last three year is as under:

S. No.	Financial Year	R&D Expenditure (Rs.in Cr.)
(i)	2014-15	32.65%
(ii)	2015-16	37.42%
(iii)	2016-17	30.00% (Prov)

GRSE: The value of direct import content for the ships delivered by GRSE Ltd. in the year 2016-17 is Rs. 66.31 Cr (provisional) which amounts to 7.08% of total VoP of Rs. 936.70 cr.

GSL: GSL has worked over years to increase indigenization content in its projects and has improved indigenization level to 64% in ongoing projects. In new 5 CGOPV project, efforts are to be increase indigenization level to 70% by increasing the local content further. Towards this, company is working with large number of local firms, to develop import substitute equipment/systems. Definitive policy changes have been adopted including purchase preference clause to Indian firms with minimum 40% indigenization content. The company expects new policy measures will have positive impact on increasing indigenization content.

HSL: HSL has put in best possible efforts to bring down the % of import content. For instance, the import content as a % of VoP in the FY 2015-16 was 27% and this has been brought down to 13.94% by the end of FY 2016-17.

Apart from this, yard has endeavored to use indigenous material where ever feasible/ permitted by the customer. Items viz. Shipbuilding Steel (DMR 249A), doors & hatches for ships, welding Rods, welding rectifiers/ inverters, cables, material handling equipment, switch gears, lifting gear and accessories, paints, transformers etc. are generally being procured from indigenous sources only.

OFB: OFB makes continuous endeavour to bring down import content in its products which is evident from the figures of import during last three years and current financial year (Prov) 2016-17:

(Rs. in crore)

Year	Value of Issue	Import Content	% of Import Content
2013-14	11123	1685	15.15
2014-15	11364	1017	8.95
2015-16	13047	1656	12.69
2016-17	14806 (Prov)	1747 (Prov)	11.79

OFB has also directed the factories to further bring down the Import content. Twelve (12) dedicated Task Force have been constituted in the Factories to achieve the objective of Indigenisation in a time bound manner. DGQA has also nominated Officers for associating with the Task Force. Regular meeting on Indigenisation and TOT absorption is held at OFB to review the progress, future action plan & difficulties faced in achieving the same.

Make-in-India policy and Self-reliance in Defence Production

Recommendation (Para Nos. 28 - 31)

The Committee note that 'Defence Manufacturing' is one of the identified sectors under the 'Make in India' programme of the Government of India which aims to facilitate investment, foster innovation, protect intellectual property, and build best-in-class manufacturing infrastructure. Defence Production Policy promulgated in 2011, aimed at achieving substantive self-reliance in the design, development and production of equipment, weapon systems, platforms required for defence in as early a time frame as possible; creating conditions conducive for the private industry to take an active role in this endeavour; enhancing potential of Small and Medium Enterprises (SME) in indigenisation and broadening the defence R&D base of the country.

In pursuance of this policy, the new Defence Procurement Procedure (DPP) 2016 has been promulgated for capital procurements and has come into effect from 1st April, 2016. DPP-2016 has a focus on achieving the 'Make in India' vision by according priority to 'Buy Indian–IDDM' (Indigenously Designed, Developed and Manufactured), ‘Buy (Indian)’ & ‘Buy and Make (Indian)’ categories. It also focuses on enhancement and rationalization of indigenous content. The ‘Make’ Procedure has been simplified with provisions for funding of 90 % of development cost by the Government to Indian industry and reserving projects not exceeding development cost of Rs. 10 crore (Government funded) and Rs. 3 crore (industry funded) for Micro, Small and Medium Enterprises (MSME).

However, admittedly, there is no allocation of budget for 'Make in India' Project as the budget allocation is made for the total acquisition of defence equipment requirements of the Services. The proposals for capital acquisition in DPP are categorised as ‘Buy (Indian-IDDM)’, ‘Buy (Indian)’ & ‘Buy and Make (Indian)’, with preference over ‘Buy (Global)’ category, to make the country self-reliant in Defence production after deliberations in various Committees such as Services Capital Acquisition Categorization Committee (SCAPCC) / Services Capital Acquisition Categorization Higher Committee (SCAPCHC) / Defence Procurement Board (DPB) / Defence Acquisition Council (DAC). There is no ‘Make in India Project’ category for procurement as per DPP, however, the objectives of ‘Make in India’ initiative of the Government are pursued through procurements under ‘Buy (Indian-IDDM)’, ‘Buy (Indian)’, ‘Buy and Make (Indian)’ and ‘Make’ categories of capital procurement.

The Committee appreciate the various policy measures taken by the Government to achieve self-reliance in Defence design and production. For instance, Foreign Direct Investment (FDI) Policy under which Foreign Investment Cap is allowed through automatic route upto 49% and Government route beyond 49% wherever it is likely to result in access to modern technology or for other reasons to be recorded. The Defence Products List for the purpose of issuing Industrial Licenses (ILs) under Industries (Development and Regulation) Act has been revised and most of the components, parts, sub-systems, testing equipment and production equipment have been removed from the List, so as to reduce the entry barriers for the industry, particularly small & medium segment. The list of military stores has been finalised and put in the public domain so as to make the process transparent and unambiguous. The process of receiving applications for NOC for export of military stores and for issuing NOC has been made online to reduce the delay and to remove human interface in the process. The preferential treatment given to Defence Public Sector Undertakings in excise duty / custom duty has been discontinued. As per the revised policy, all Indian industries (public and private) are subject to the same kind of excise and custom duty levies. The Committee would like to see the tangible results of these measures in the form of substantive self-reliance in the design, development and production of equipment, weapon systems, platforms required for defence in reasonable timeframe. In this regard, the Ministry should implement these measures on a war footing to ensure that India does not remain the largest importer of defence equipment in the world.

Reply of the Government

The concerns of the committee have been noted by the Department of Defence Production. However the Department will like to place before the committee tangible results in the form of impact Analysis in the succeeding paragraphs, because of various policy measures taken by the Government to achieve substantive self-reliance in defence design & production.

a. In order to promote indigenous design and development of defence equipment, a new category of procurement 'Buy (Indian-IDDM)' has been introduced in Defence Procurement Procedure-2016 and the same has been accorded top most priority for procurement of capital equipment.

Impact: During the last three financial years (2014-15, 2015-16 and 2016-17) DAC has accorded approval of 145 capital procurement cases at an estimated cost of Rs. 3,99,796 crore, out of which 103 cases involving Rs 2,46,417 crore are under the 'Buy (Indian-IDDM)', 'Buy (Indian)', 'Buy & Make (Indian)' and 'Make' categories.

b. In May 2001, the Defence Industry sector, which was hitherto reserved for the public sector, was opened up to 100% for Indian private sector participation, with Foreign Direct Investment (FDI) upto 26% both subject to licensing. Further, Department of Industrial Policy & Promotion, Ministry of Commerce & Industry vide Press Note No 5 (2016 Series) (Available at *www.dipp.nic.in* under Acts and Rules followed by Press Notes) has notified revised FDI policy under which FDI is allowed under automatic route upto 49% and beyond 49% through Government route wherever it is likely to result in access to modern technology or for other reasons to be recorded.

Impact: 36 FDI proposals/Joint Ventures have been approved in defence sector for manufacture of various defence equipment, both in public and private sector. As upto 49% FDI has been permitted under automatic route, the data related to JVs having FDI upto 49%, which have been formed after the new policy, is not available in the department.

c. Industrial licencing regime for Indian manufacturers has been liberalised and most of the components/ parts/ sub-systems have been taken out from the list of defence products requiring Industrial Licence. This has reduced entry barriers for new entrants in this sector, particularly SMEs.

Impact : Since the opening up of Defence industry sector in May 2001 for 100% manufacturing by Indian Private sector including FDI upto admissible cap both subject to licensing, DIPP has issued 342 licenses to 205 Indian companies. Since the launch of Make in India policy in September 2014, DIPP has issued 116 industrial licenses till June, 2016. Till date, 53 licensed companies covering 92 licenses have reported commencement of production. The list of licenses is available on DIPP's website link (http:/www.dipp.nic.in/English/policy/status_DIL_June 2016. pdf).

d. The List of Military Stores earlier notified *vide* Notification No. 115(RE-2013)/2009-2014 dated 13.3.2015 stands rescinded. The process of receiving applications for Authorisation (earlier NOC) for export of Munitions List (earlier Military Stores) items and for issuing Authorisation has been made online to reduce the delay and to remove human interface in the process. Recognising the need for promotion of defence exports to make the Indian defence industry economically sustainable; Defence Exports Strategy outlining the various steps to be taken, has been formulated and is put up in public domain. In products where there is a capacity constraint, DPSUs have been allowed to export upto 10% of their annual production with a view to explore market opportunities outside the country.

Impact: Exports from OFB, DPSUs and Private sector in the Financial Year 2016-17 increased to 1489.15 crore from Rs 1153.35 crore in FY 2013-14. The number of Authorisations issued for Export of Munitions List Items has increased from 39 in 2013-14 to 254 in Year 2016-17.Time taken to issue authorisation has reduced considerably. Most of the applications have been disposed-off within the time frame as stipulated in the SOP (4 weeks for appendix-II items and 2 Weeks for other than appendix-II items).

e. The offset guidelines have been streamlined wherein the vendor is given flexibility to furnish details of products and IOP at a later stage. In addition a Standard Operating Procedure (SOP) for processing contract amendment proposals relation only to rephasing of offset schedule, change of IOP and change of offset components in respect of all offset contracts has been introduced. Offset obligations can be discharged through listed avenues provided in the guidelines i.e. Direct purchase of Product/Services, FDI, Transfer of Technology/Equipment etc.

Impact: 97% offset claims filed during past three years i.e. 2014-2016 (USD 1.55 Billion against 1.62 Billion) as against 64% during the period 2008-2013 (USD 0.79 Billion against 1.24 Billion)

f. Issues related to level-playing field between Indian & foreign manufacturers, and public sector & private sector have also been addressed. These include Exchange Rate Variation (ERV) protection for Indian vendors, Offset obligations in ‘Buy (Global)’ cases, removing anomalies in taxation in customs/ excise duty etc.

<u>Private Sector Participation</u>

Recommendation (Para Nos. 32- 35)

As per the Ministry of Defence, several policy changes have been made recently to ease the entry of private sector in defence manufacturing. These include liberalisation of FDI policy and Industrial Licensing policy, simplification of export procedures, streamlining of defence offset guidelines and creating level playing field for Indian private and public sector companies. Reportedly, these initiatives of the Government will help encourage private sector participation in defence with special focus on MSMEs, thereby reducing dependence on imports.

Further, the Government has issued 342 Industrial Licenses (ILs) covering 205 companies for manufacture of a wide range of Defence products, to Indian companies till June 2016; 52 licensee companies covering 83 licenses have so far reported commencement of production. Out of 342 ILs, 116 ILs have been issued since the launch of Make in India initiative. DRDO has created infrastructure and a management structure to develop, manage and integrate high-cost and high-technology programmes and projects by pooling national resources and expertise available in academic institutions, R&D centres, public and private industries. It has a strong partnership with approximately 110 academic institutions, 20 national S&T agencies, 50 Public Sector Undertakings (PSUs), 39 Ordnance Factories (OFs) and more than 800 private sector industries.

Government of India has also set up the 'Technology Development Fund (TDF)' which aims at funding the development of Defence and dual use technologies that are currently not available with the Indian Defence industry, or has not been developed so far. The funding is to public and private sector industry especially MSMEs that may work in collaboration with the academia or research institutions to carry out innovation, research and development. The scheme envisages creating an Eco-system for enhancing cutting edge technology capability for Defence application and to inculcate R&D culture in MSMEs. In addition, under the 'Make' Category of Defence Procurement Procedure, there is a provision for collaboration between Government and private Indian Industry where 90% of cost of prototype development shall be borne by Government.

The Committee appreciate the intention of the Ministry in introducing several initiatives to enhance potential of MSMEs and private sector in indigenous Defence production and broaden the defence R&D base of the country. However, they recommend that the Ministry should constantly monitor the performance of such MSMEs and private sector and extend all possible support to them whenever required.

Reply of the Government

The suggestion of the Committee has been noted. The initiatives taken by the Government to enhance potential of Micro, Small and Medium Enterprises (MSMEs) have been brought in succeeding paragraphs.

The preamble to the Defence Procurement Procedure (DPP) – 2016, specifically mentions that enhancing the role of Micro, Small and Medium Enterprises (MSMEs) in the Defence Sector is one of the defining features of DPP. Following specific provisions have been introduced in DPP-2016 that would increase the participation of MSMEs in the Defence sector:

(a) In the 'Make' category of capital acquisition, Government funded projects with estimated cost of prototype development phase not exceeding Rs 10 crore and

Industry funded projects with estimated cost of prototype development phase not exceeding Rs. 3 crore are reserved for MSMEs.

(b) In addition, it has been mandated to involve MSME associations while carrying out feasibility studies for ‘Make’ projects. MSMEs have also been granted relaxation in the registration and profitability criteria for consideration as eligible “Indian Vendor” for participation in the ‘Make’ projects.

(c) In the discharge of offset obligations, a multiplier of 1.50 is permitted where MSMEs are Indian Offset Partners (IOPs).

Government of India has notified the Public Procurement Policy for Micro and Small Enterprises (MSEs) Order, 2012 under which a minimum of 20% of the total annual procurement is made mandatory from Micro & Small Enterprises by Central Ministries / Departments / Public Sector Undertakings w.e.f. 1st April 2015.

(a) The aforesaid policy mandates that all the Micro and Small Enterprises registered with bodies designated/ specified by Ministry of MSME or having the Udyog Aadhaar Memorandum (UAM) will be issued tender set free of cost and exempted from payment of Earnest money, and will also be allowed to bring down their price to L1 level provided it has bid in the price band of L1+15%, by the Central Ministries / Departments / Central Public Sector Undertakings. In addition, 358 items are reserved for exclusive procurement from MSEs.

(b) Additionally, Ministry of MSME has issued a circular dated 10 Mar 2016 which mandated that relaxation may be given by Central Ministries / Departments / Central Public Sector Undertakings in prior experience / prior turnover criteria to MSEs.

The capability and viability of the Defence and aerospace industry is built on the strength of supply chains, in which the MSMEs are intricately intertwined. There are substantially large number of MSMEs across the country supplying components and sub-assemblies and systems to the Defence Public Sector Undertakings, Ordnance Factories, Defence Research and Development Organisation and private industries.

Ministry of Defence regularly conduct conferences and discussions through Annual seminars with an aim to strengthen long term plans and industry capability in Defence procurement. Regular interaction with interested vendors / indigenous developers, including MSME units, through collegiate mechanism of procurement committee and pre-bid meetings are scheduled for clarification on various aspects of the procurement process.

Strategic Partnership for Various Platforms from the Private Sector Industry

Recommendation (Para No. 36)

The Committee note that the Expert Committee under the Chairmanship of Shri Dhirendra Singh recommended a ‘Strategic Partnership’ model for creating capacity in the private sector on a long-term basis in six strategic segments such as aircraft/helicopters, warships/submarines, armoured vehicles, missiles, command control systems and critical materials. It recommends the constitution of a Task Force chaired by Dr. Aatre for laying down the criteria for selection of Strategic Partners in the aforementioned six segments. Strategic Partnerships would not only be long term relationships between an Indian private sector entity and the MoD but would also be critical from the perspective of achieving self reliance in respect of national security and Defence production apparatus of the country. The Task force submitted its Report in January 2016. During oral evidence in connection with examination of Demands for Grants 2017-18, a representative of the Ministry submitted that the policy for 'Strategic Partnership' is under finalization by MoD. The Committee, in this regard, recommend that this policy on 'strategic partnership' should be finalized by the Ministry of Defence at the earliest in consultation with all stakeholders and experts and accordingly apprise the Committee.

Reply of the Government

The policy and criteria for selection of Strategic Partners has been finalized with the approval of the Defence Acquisition Council. The policy and criteria have been encapsulated into Chapter VII of the Defence Procurement Procedure, 2016 which has since been uploaded on MoD's website (www.mod.nic.in).

<u>Offset Clause</u>

Recommendation (Para Nos. 37- 41)

Defence Procurement Procedure (DPP) stipulates provision for the offset clause in 'Buy (Global)' or 'Buy and Make' categories of Defence Acquisition where the indicative cost of acquisition is Rs. 2000 Crore or more on the date of AON. The provision of obligatory Offset discharge in defence acquisitions was included as part of DPP since 2005. Under this scheme, a contractual responsibility is cast upon the foreign vendors in capital acquisition program to mandatorily fulfil offset obligations by opting any one or a combination of methods as given in Defence Offset Guidelines through their selected eligible Indian Offset Partners. The required value of offset obligation is 30% of the estimate cost of acquisition in 'Buy (Global)' and 30% of the foreign exchange component in 'Buy and Make' categories of procurements. The obligations may be discharged with reference to eligible products and eligible services as listed out in the DPP 2016.

As per the information furnished by the Ministry of Defence, as on 31st December 2016, 35 offset contracts (22-IAF, 10-IN and 3-IA) have been signed. The total offset obligations is US$ 10.4 billion approx (contracts with different denominations converted to USD) to be discharged over a period extending upto 2024. The contracted obligations to be discharged as per schedule till December 2016 amounts to US$ 2.7 billion approx. against which the vendors have reported discharge claims worth US $ 2.01 billion approx. These offset contracts are under different stages of implementation by the foreign Original Equipment Manufacturer (OEM).

The Committee note that once executed, it is estimated that the respective contract shall cause, on account of offset provisions, generation of substantial business to Indian industries thus strengthening the defence industrial base. It shall also enable the Indian domestic industry to be a vital part of the supply chain of the major global defence industries by becoming key players in the highly competitive and cost conscious international defence market in their respective areas of expertise. Further, through the banking provisions, the OEMs are likely to invest more in Indian Industries even in absence of any acquisition contract which is expected to spur growth in defence and synergistic sectors.

According to the Ministry of Defence, some notable changes in the existing offset provisions in new DPP are as follows:- The offsets are applicable to capital acquisition categorised as 'Buy Global' and 'Buy and Make'; the threshold for offsets applicability has been enhanced to Rs. 2000 Crore from Rs. 300 Crore ; the vendor has an option of providing Indian Offset Partner (IOP) wise work share, specific products and supporting documents for IOP credentials either at Technical Offset Evaluation Committee (TOEC) or one year prior to discharge or at the time of seeking credits; and any vendor failing to implement the offset obligations will be liable for action under the relevant provisions of DPP.

The Committee, in this context, recommend that the Ministry strictly and continuously monitor discharge of mandatory offset obligations by the foreign vendors and not hesitate in initiating stringent action against the defaulters.

Reply of the Government

The recommendations of the Committee have been noted for compliance.

Defence Planning

Recommendation (Para Nos. 42 - 44)

The Defence Five Year Plans are formulated to chalk out the necessary steps to maintain and augment defence capabilities in line with the Raksha Mantri's Operational Directives, the Long Term Perspective Planning and the current threat perception. These plans help to estimate the outlay required to achieve the planned objective. The plan period of 10th Plan was 2002-07, 11th Plan was 2007-12 and 12th Plan was 2012-17. To the utter surprise of the Committee, these Plans did not receive Government approval. However, the Ministry claimed that activities included in the Plans proceeded during the Plan period within the available budget allocations and projections in respect of annual budgets were made in line with Five Year Plans and available allocations were prioritized accordingly.

As per the Ministry of Defence, while formulating guidelines for the 13th Defence Plan it was decided that the Plan may not be sent to Ministry of Finance for information only and not for its approval. The Ministry of Finance will be kept in loop about the requirements of the Defence Forces in the coming years. It is further submitted by the Ministry that discontinuation of Five year Plans and Plan/Non-Plan Expenditure would have no impact on resource estimation/implementation of projects. Five year Defence Plans are still being prepared in which future requirements of the Services are projected. Activities planned are likely to proceed according to available annual budget allocations. As such, planned projects were implemented to the extent possible with the available allocations.

The Committee feel that the claims of the Ministry of carrying planned activities and projects as per the available budget allocations and projections in respect of annual budgets made in line with Five Year Plans are betrayed by the trends of underspending and imbalanced revenue to capital ratio which have been highlighted in the earlier Recommendations of the Committee. Hence, the Committee desire that the Ministry should adopt measures for foolproof budgetary planning and implementation.

Reply of the Government

This Ministry has noted the suggestion and affirm that all necessary steps will be taken for better planning and implementation.

<u>Married Accommodation Project</u>

Recommendation (Para Nos. 47- 48)

Directorate General of Married Accommodation Project (DG MAP) was raised by Government of India under the aegis of Engineer in Chief to construct married accommodation for the three services, with the aim of eradicating the deficiency of married accommodation for service personnel. The MAP was setup to fulfill the promise made to the Armed Forces by the Government of India. The total deficiency of two lakh dwelling units has been slated for construction in four phases. With the approval of the Cabinet on Security (CCS), three Committees, i.e. Apex Steering Committee (ASC), Vice Chief Committee (VCC) and Command Committee (CC) have been set up with enhanced financial powers for speedy decision making.

The Committee noted that as regards the construction of dwelling units under Phase II of MAP, 80% progress has been achieved so far. Before the launch of the Phase III, Phase I and II were evaluated and a committee headed by Vice Admiral Murugesan submitted the report in this regard. The Committee is disappointed to note that implementation of Phase II was not satisfactory, as admitted by the Defence

Secretary himself. He also submitted that there is no constraint of funds for Phase III of MAP. In this regard, the Committee recommend that in light of recommendations of Vice Admiral Murugesan Committee and dissatisfaction with implementation of Phase II of MAP, timely and effective execution of Phase III must be accorded top priority.

Reply of the Government

Stations where Phase-III is to be commenced have been finalized. Works allocation has also been approved in Apex Steering Committee meeting on 27.07.2017. The MAP Contract Conditions (Buildings) has been revised and orders issued on 12.06.2017. The revision of Detailed Engineering Project Management Consultancy (DEPMC) Contract Conditions for MAP has also been completed. Defence Secretary has reviewed restructuring of MAP, based on the recommendations of Vice Admiral Murugesan Committee on 09.06.2017. After taking action on the restructuring of MAP, CCS will be approached for the commencement of MAP Phase-III and its timely and effective execution will be given top priority.

Recommendation (Para No. 49)

As regards the authorization of Married Accommodation and satisfaction level of the Officers and Other Ranks, the Committee have been apprised that 35 per cent of the jawans are authorized for married accommodation. It was further intimated that after the completion of MAP Phase II, the percentage of satisfaction for the Army would touch 68 per cent, for the Navy about 96 per cent and for the Air Force 82 per cent. The Committee earnestly hope that DG MAP would strive to work in the direction of achieving 100 percent satisfaction in the three Services as the issue of provision of married accommodation is innately connected with welfare of those who serve our Nation.

Reply of the Government

MAP was sanctioned in the 2002. Construction of 57875 Dwelling Units (DUs) in MAP Phase I is completed. Construction of 69904 DUs in MAP Phase II is in progress. 39877 DUs has been completed and the remaining will be completed by December 2019. Planning for constructing 71102 DUs in MAP Phase III has commenced. On completion of MAP Phase III, with reference to sanction of MAP in the year 2002, the satisfaction level of Army will be 68%, Navy 96% and Air Force 82%.

Recommendation (Para No. 50)

The Committee noted that the shear wall and pre-cast technology are being used for construction of dwelling units under MAP. Reportedly, this technology is entirely made in India, is cost effective, less labour intensive, much better at pollution control and earthquake resistance. If there are about 3,000 dwelling units to be constructed, it will be about 10 percent cheaper than the conventional frame structrue. The Committee hope that use of this new technology will result in speedier and efficient construction of dwelling units for authorized personnel.

Reply of the Government

The Committee expectations will be borne in mind while using this technology.

(B) OBSERVATIONS/RECOMMENDATIONS WHICH HAVE BEEN ACCEPTED BY THE GOVERNMENT AND TO BE COMMENTED UPON:

Committed Liabilities and New Schemes

Recommendation (Para Nos. 16-20)

Committed Liability refers to payments anticipated during a financial year in respect of contracts concluded in previous years. Under the Defence Services Estimates, Committed Liabilities constitute a significant element in respect of the Capital acquisition segment, since one project may span several financial years. As such, it is important to track the element of Committed Liabilities which hold first charge on the budget allocation. Inadequate allocation for Committed Liabilities could lead to default on contractual obligations.

During the year 2015-16, BE allocations for committed liabilities and new schemes were Rs. 15,740.75 crore and Rs 1,541.06 crore, respectively, in case of Army. These figures were reduced to Rs. 9,875.21 crore and Rs. 3,160.07 crore, respectively, in RE 2015-16. The actual expenditure for committed liabilities and new schemes was Rs. 8,705.82 crore and Rs. 1,438.14 crore, respectively. For the Navy, these allocations were Rs. 22,248.12 crore and Rs. 1,112.78 crore for BE 2015-16 and Rs. 17,200 crore and Rs. 1,193.38 crore for RE 2015-16, respectively. The actual expenditure for committed liabilities and new schemes was Rs. 17,788.39 crore and Rs. 591.34 crore, respectively. Air Force was given Rs. 28,246.53 crore for Committed Liabilities and Rs. 3,264.09 crore for New Schemes in BE 2015-16. These figures stood at Rs. 23,942.40 crore and Rs. 4,701 crore, respectively in RE 2015-16. The actual expenditure for committed liabilities and new schemes was Rs. 24,334.17 crore and Rs 4,711.50 crore, respectively.

During the year 2016-17, BE allocations for committed liabilities and new schemes were Rs. 12,492.92 crore and Rs 2,086.08 crore, respectively, in case of Army. These figures were reduced to Rs. 9,928.56 and Rs. 1,986 crore, respectively in RE 2016-17. For the Navy, these allocations were Rs. 18,763.77 crore and Rs. 1600 crore for BE 2016-17 and Rs. 15,300 crore and Rs. 2,838.75 crore for RE 2016-17. Air Force was given Rs. 24,306.02 crore for Committed Liabilities and Rs. 3,250 crore for New Schemes in BE 2016-17.

The Committee have learnt that the additional requirements projected for RE 2016-17 and BE 2017-18 for Committed Liabilities and New Schemes for the three Services were not acceded to by the Ministry of Finance. As per the Ministry of Defence, the reduced allocation will adversely affect the progress of large number of New Schemes which are at Competent Financial Authority (CFA) approval and advanced contract Negotiation Committee (CNC) stages. Delaying these schemes will not only have a cascading effect on the budget of 2017-18, but also result in delays in acquiring capability towards modernisation and bridging existing capability gaps. Further, the reduced allocation will impact cash outgo in committed payments and deferment of these payments will impinge on budgetary allocations in next financial year.

The Committee are unhappy to note that though the Ministry of Defence has blamed budgetary cut for negative effect on committed payments and progress of a large number of New Schemes, the trend of expenditure of the funds for Committed Liabilities and New Schemes belies Ministry's claims. It is evident from the fact that for RE 2014-15, the Outlays for New Schemes were kept at Rs. 2,084.15 crore and Rs. 2,644.99 crore for Army and Air Force, but the actual expenditure was only Rs. 1,443.63 crore and Rs. 1,299.47 crore, respectively. Similarly, in RE 2015-16, against the Committed Liabilities outlay of Rs. 9,875.21 crore, only Rs. 8,705.82 crore was utilized by Army. For RE 2015-16, the allocated funds for New Schemes were Rs. 3,160.07 crore and Rs. 1,193.38 crore for Army and Navy, but the actual expenditure was only Rs. 1,438.14 crore and Rs. 591.34 crore, respectively. The underutilization of funds for Committed Liabilities and New Schemes by the three Services pinpoints to the fact that the institutional mechanisms put in place for financial planning and monitoring utilization of funds is not effective. Though it is earnest desire of the Committee that adequate allocations should be made for Committed Liabilities and New Schemes for enabling modernization of the forces, the Committee cannot help but fervently urge the Ministry of Defence to be more prudent in their budget formulation and expenditure planning.

Reply of the Government

The observations/recommendations of the Committee have been noted and the Ministry of Defence will make efforts to ensure that budget formulation and expenditure planning is more prudent. It may be added that in the year 2015-16, there was no underutilization in Capital Grant with reference to Final Grant (Modified Appropriation). Against final grant of Rs. 79,483.28 crore, actual expenditure was Rs. 79,958.31 crore. In the year 2016-17 also there has been no underutilization of funds under the Capital Grant. For year 2017-18, the expenditure under Capital Grant, till July, 2017, is Rs. 38,913.93 crore against BE of Rs. 86,488.01 crore constituting 45% of the BE; a percentage higher than what attained in previous years.

(Please see Para No. 21 of Chapter-I of the Report)

<u>Long Gestation Period in Procurement</u>

Recommendation (Para No. 22)

As per the Ministry of Defence's submission, procurement is an ongoing process and the time taken varies from case to case due to inherent complexities and uniqueness. The Committee note that various provisions viz. reduction of timelines from 80-117 to 70-94 weeks, reduction in Acceptance of Necessity validity from 1 year to 6 Months, accompaniment of draft request for Proposal with Statement of Case for Acceptance of Necessity, conducting of Field Trials in conditions where equipment most likely to be deployed, maximum use of certification and simulations, delegation of powers to Acceptance of Necessity according authorities, Fast Tracking of Procedure for expeditious procurement of urgent operational requirement items in war and peace, exist in Defence Procurement Procedure 2016 for achieving timely, efficient and effective procurement. During oral evidence, the Defence Secretary also briefed the Committee on the steps taken to fasten the process of Defence Procurement. The Services are now fully authorized to take up any revenue procurement of ammunition upto a minimum level of 10(I) war situation. Further, the cabinet Committee on Security has accepted the proposal of the Ministry for enhancing its capital procurement powers from Rs. 500 crore to Rs. 3,000 crore. The Committee are glad to note that some progress is being made by the Ministry of Defence to coordinated action so that the ministry's various measures do not remain mere ink on paper and our Forces are equipped with state-of-the-art equipment/weapons/platforms.

Reply of the Government

The observations of the Committee have been noted for compliance. Ministry of Defence is taking action to meet the operational requirement of the Armed Forces. During 2016-17 and in the current year, 52 contracts involving Rs. 1,24,465.57 crore have been signed for the capital procurement of Defence equipment including aircraft, helicopters, missiles, artillery guns and simulators.

Further, the Ministry of Defence, with a view to reduce time taken in decision making has delegated the number of powers hitherto exercised by it to Service Headquarters/other entities in the Ministry. Such delegation includes powers in respect of post contract management of capital acquisition contracts; items related to post contract management of revenue expenditure; enhanced financial powers to the Director General NCC and Director General Coast Guard. Further, full powers on revenue and capital accounts have been delegated to Service Headquarters with respect to procurement relating to perimeter security. Director General, Border Roads Organisaton(BRO) has been given full powers for inviting tenders, evaluating the same and accepting bids upto Rs.100 crores. Similarly procurement of equipment/transport etc have also been delegated up to Rs. 50 crores. Preparation of DPR has also been delegated to BRO. Projects above Rs. 100 crores will be accepted by a Project Approval Board headed by Defence Secretary.

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

Long Term Integrated Perspective Plan (LTIPP)

Recommendation (Para Nos. 45 and 46)

The Committee note that the Headquarters Integrated Defence Staff (HQIDS), in consultation with the Service Headquarters (SHQs), had evolved the 15 year Long Term Integrated Perspective Plan (LTIPP). Presently, LTIPP 2012-2027 is in vogue and has been approved by the Defence Acquisition Council. Proposals for acquisition of capital Assets flow out from the defence procurement planning process which covers the 15 year LTIPP, 5 year Services Capital Acquisition Plan (SCAP) and Annual Acquisition Plan (AAP). The LTIPP is translated into the SCAP, covering a five year period. The AAP of each service is a two year roll on plan for capital acquisition and consists of the schemes from the approved five year SCAP. Thus, LTIPP gets finally translated to short term plan (AAP) and the cases included in the AAP are progressed for acquisition as per the Defence Procurement Procedure. Progress of procurement cases is regularly reviewed in SHQ and MoD. Amendments are made to the DPP, as and when required, to streamline the acquisition process. DPP-2016 is focused on institutionalising, streamlining and simplifying defence procurement procedure to give a boost to 'Make in India' initiative of the Government of India, by promoting indigenous design, development and manufacturing of defence equipment, platforms, systems and sub-systems.

The Committee note that in the budget on capital acquisition of Defence equipment for the period of 2016-17 during the 12th Plan period, an amount of Rs. 53,583.04 crore has been expended till December, 2016 against the BE allocation of Rs. 78,731.32 crore. The Committee would like to know the status of the expenditure at the conclusion of this financial and whether aspects relating to cost escalation due to inflation have been taken into account in allocation of funds for Capital Acquisition for 2017-18.

Reply of the Government

In the year 2016-17, Budget Estimates in respect of Capital Outlay on Defence Services was Rs. 78586.68 crore against which expenditure of Rs. 53504.98 crore was incurred upto December, 2016. At the end of financial year 2016-17,the expenditure incurred was Rs. 78718.52 crore. The projection made by the Services based on the requirements for 2017-18 amounting to Rs. 132872.27(*) crore was sent to Ministry of Finance for favorable consideration. Against the requirements projected, an amount of Rs. 86488.01 crore has been allocated under Capital Outlay on Defence Services.

* - Rationalized figure in r/o Army, Navy, Joint Staff and Air Force.

(Please see Para No. 27 of Chapter-I of the Report)

CHAPTER III

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

Allocations under Capital Budget Head

Recommendation (Para No. 1)

The Committee note that an amount of Rs. 86,488.01 crore has been allocated to the Ministry of Defence for Capital Outlay on Defence Services in Budget Estimates (BE) 2017-18. The allocation at BE for 2016-17 was Rs. 78,586.68 crore, which was later reduced to Rs. 71,700.00 crore at Revised Estimates (RE) stage. The difference between BE 2017-18 and BE 2016-17 is Rs. 7,901.33 crore. An amount of Rs. 69,473.41 crore has been allocated specifically for Capital (Acquisition) in 2017-18, which is a decrease of Rs. 425.10 crore from Rs. 69,898.51 crore of BE 2016-17. However, for Capital Head (other than Acquisition) which includes expenditure on Land and Works of the three Services, Married Accommodation Projects, Defence Research and Development Organisation (DRDO), Directorate General of Ordnance Factories (DGOF) and other Defence Departments, an amount of Rs. 17,014.60 crore has been allocated in BE 2017-18. This head has witnessed an increase of Rs. 8,326.43 crore from the amount allocated in BE 2016-17. The Committee are surprised to note this huge mismatch between the amounts allocated for Capital (Acquisition) and Capital (other than Acquisition) in BE 2017-18 and would like the Ministry to explain the rationale behind this.

Reply of the Government

In the year 2016-17, the budget of DGOF and DRDO was shifted from Defence Services Estimates (DSE) to MoD (Misc.). In the year 2017-18, these organizations were reverted to DSE. Since provision for DGOF & R&D in the Capital Head comes under Other Than Capital Acquisition (OTCA) budget, there has been comparatively higher increase in OTCA budget than that of Capital Acquisition in 2017-18. In 2016-17, the budget for DGOF and DRDO together was Rs. 7601.41 crore, while for the year 2017-18, it is Rs 8356.00 crore. Hence, the increase in OTCA budget is solely due to the fact that DGOF and DRDO are reverted back to DSE in 2017-18.

CHAPTER IV

OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH REPLIES OF GOVERNMENT HAVE NOT BEEN ACCEPTED BY THE COMMITTEE AND WHICH REQUIRE REITERATION AND TO BE COMMENTED UPON:

Allocations under Capital budget Head

Recommendation (Para Nos. 2-5)

The trend of Capital Account Budgeting for the three Services is evident from the following figures:

(Rs. in Crore)

Year	Service	BE		RE		Expenditure
		Projected	Allocated	Projected	Allocated	
2010-11	Army	21,633.04	17,250.84	19,177.55	15,641.16	15,856.08
	Navy	15,221.78	12,137.85	17,890.87	15,323.77	17,140.18
	Air Force	31,667.56	25,251.72	25,271.72	24,266.79	23,625.42
2011-12	Army	25,611.68	19,210.69	20,641.69	16,005.69	14,947.82
	Navy	26,882.60	14,657.83	21,482.18	17,459.08	19,211.52
	Air Force	36,186.10	30,282.03	30,282.03	27,734.78	28,841.18
2012-13	Army	28,234.60	19,237.80	18,971.09	15,749.30	14,760.69
	Navy	28,643.19	24,766.42	25,002.85	18,266.42	17,759.88
	Air Force	36,950.52	30,514.45	36,999.62	30,517.95	32,980.11
2013-14	Army	25,528.08	17,883.83	19,271.59	14,967.25	14,433.29
	Navy	33,775.53	24,149.03	27,290.06	20,418.98	20,358.85
	Air Force	64,607.84	39,208.84	65,825.22	37,750.44	38,614.93
2014-15	Army	41,936.15	26,533.60	23,832.67	21,933.54	18,586.73
	Navy	28,253.21	23,832.67	22,903.31	18,507.07	22,269.66
	Air Force	62,408.33	33,710.68	38,948.19	33,710.68	32,796.42
2015-16	Army	31,938.67	27,342.42	27,845.33	24,230.47	20,703.70
	Navy	26,268.13	25,003.24	25,152.20	19,740.06	19,874.69
	Air Force	46,191.96	33,686.75	35,780.78	30,442.15	31,198.32
2016-17	Army#	37,960.18	26,943.08	34,706.12	24,026.86	17,205.64*
	Navy	30,223.31	22,000.09	22,530.04	19,596.28	12,613.87
	Air Force	41,266.41	29,795.42	36,512.95	28,239.86	23,770.25

(Rs. in Crore)

* Expenditure upto end of December 2016

(# Includes allotment to NCC, DGQA, Military Farms, Rashtriya Rifles and ECHS which were shifted to modified Grant No. 20-MoD(Miscellaneous) in FY 2016-17, but have been transferred back to Defence Services Estimates in FY 2017-18, with the exception of Military Farms and ECHS, for the purpose of comparison with previous as well as future years).

The above table depicts the budgetary provision for Capital acquisition for the three Forces from 2010-11 onwards. The Committee observe that the budgetary allocations for Capital acquisition has declined for the three Services not only at the RE stage of 2015-16 in comparison to BE 2015-16 but also for the RE during the year 2016-17 in comparison to BE 2016-17.

Similarly, against a projection of Rs. 1,46,155.54 Crore for Capital Budget in 2017-18, Rs. 86,528.65 have been allocated for BE 2017-18 for various Services (Army, Navy, Joint staff, Air Force, DGOF, R&D and DGQA, National Cadet Corps, Military Farms, Rashtriya Rifles and Ex-Servicemen Contributory Health Scheme). For 2017-18, the Army projected an amount of Rs. 42,485.93 crore for Capital Budget but only Rs. 25,246.35 crore has been allocated, which is in line with the trend being witnessed over the years. The same is the case with the Navy and Air Force which projected a requirement of Rs. 27,546.49 crore and Rs. 62,048.85 crore but have been allocated Rs. 18,603.71 crore and Rs. 33,570.17 crore, respectively.

The Committee are highly disappointed to note the persistent trend of decreased allocation of funds compared to the projected amount meant for Capital Expenditure for the Services. This decline in the allocation for Capital acquisition will definitely affect several procurement proposals and contracts relating *inter alia* to Land, Aircraft & Aero engines, Heavy and Medium Vehicles, Other Equipments, Military Farms, Procurement of Rolling Stock, Ex-Servicemen Contributory Health Scheme, Rashtriya Rifles, National Cadet Corps, Construction Works, National Defence Academy, Married Accommodation Project, North Eastern Projects and Special Projects, etc. which are to be finalised in 2017-18. The budgetary cut at BE 2017-18 against the projection indicate that all the pending procurement projects would not go through unless the Government increases the allocations at the Revised Estimate stage. Therefore, the Committee fervently urge the Ministry to ensure that the allocations to the Services, under the Capital Head, match their demands and the allocation be suitably enhanced at the Revised estimate stage so as to enable our Services to meet the requirements of highest level of operational readiness.

Reply of the Government

There has been persistent trend of less allocation of funds compared to the projected amount under Capital Head. Detail of projections made and fund allocated in Budget Estimate, Revised Estimates, Modified Appropriation and Actual expenditure during the last five years are as under:

(Rs. in crore)

Ye ar	BE Projec	BE alloca	RE	MA (Final	Actua l Exp.

	ted	**ted**		**Grant)**	
2012-13	101934.61	79578.63	69578.63	69578.63	70499.12
2013-14	134070.26	86740.71	78872.23	78872.23	79125.05
2014-15	145091.29	94587.95	81965.24	81965.24	81886.98
2015-16	117955.42	94588.00	81400.00	79483.28	79958.31
2016-17 #	121929.80	86340.00	79370.29	81747.26	86367.29
2017-18	146113.54	86488.01			

(# In the year 2016-17, 7 organisations viz, Ordnance Factories, DRDO, NCC, ECHS, Military Farms, Rashtriya Rifles and DGQA, which were till 2015-16 part of Defence Services Estimates, were shifted to MoD(Miscellaneous) Grant in the rationalized Demands for Grants. In 2017-18, except for ECHS and Military Farms, all other 5 organizations were reverted to Defence Services Estimates. The figures shown against FY 2016-17 included provisions of 7 organizations for comparison purpose only. Figures for 2017-18 do not include provisions of Military Farms and ECHS.)

From the data given above, it may be seen that every year funds allocated under Budget Estimates have been reduced at Revised Estimates stage by Ministry of Finance broadly on the pretext of trend of expenditure at that point of time. Though there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17), there has been either excess expenditure or more than 99.9% utilization when compared to Final Grant.

The recommendations of the Committee are noted and all efforts will be made to obtain additional requirements projected by the Services at RE stage. It may be further added that operational preparedness of the Services will not be compromised.

(Please see Para No. 7 of Chapter-I of the Report)

Ratio of Capital and Revenue Outlay

Recommendation (Para No.6)

The Committee observe that from 2012-13 onwards, the 'Capital' component of the budgetary allocation has decreased in comparison to 'Revenue' component of the Budget. The overall 'Revenue' to 'Capital Ratio' of the budgetary allocation stands at 61:39, 61:39, 63:37, 65:35 and68:32 for 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17 (RE), respectively. The Committeeunderstand that the Revenue component of the Budget caters to salary, other obligatory expenses, requirement of stores (including Ordnance), transportation (of personnel and stores),revenue works and maintenance, etc. and the Capital component provides allocation for Land &Construction Works of the three Services, Capital Expenditure of various Defence Departmentsand for Capital Acquisitions of the Services, etc. Both components are equally important aspects of the Budget, however, the Committee are deeply anguished to note that with each year, the ratio of Revenue to Capital outlay is skewed as the Budget for Capital acquisitions for the Services is declining in comparison to revenue allocations thereby adversely affecting the modernization process of our Forces. Therefore, the Committee recommend that the Ministry of Defence should look into this aspect and overhaul their planning and budgeting mechanism to ensure a prudent and equitable distribution of funds to 'Revenue' and 'Capital' Heads.

Reply of the Government

It may be relevant to mention that majority of Revenue outlay includes Salary and expenditure incurred on maintenance of capital assets. The Capital outlay includes ongoing/new projects and expenditure on Land/works etc. While Revenue outlay expenditure follows a pattern due to its inherent characteristics, Capital outlay fluctuates depending on milestone payments, new accruals etc., which may not necessarily increase every year. Some years may see jump in Capital expenditure due to acquisition of new equipments/machinery etc., whereas the following year may see a dip due to lesser Committed Liabilities/New Schemes etc. As such the Revenue Capital ratio may vary from one year to the other, depending mainly upon the variations in Capital expenditure.

(Please see Para No. 10 of Chapter-I of the Report)

Underspending

Recommendation (Para No.7-9)

The Committee, while examining the Demands for Grants, have observed that the Capital expenditure has never remained under control and the allocated funds under Capital Head are never fully utilized. During the year 2011-12, at RE stage, Army was allocated Rs. 16, 005.69 crore but was able to utilise only Rs. 14, 947.82 crore. During the year 2012-13, at RE stage, Army was allocated Rs. 15, 749.30 crore, but again it was able to utilise only Rs. 14,760.69 crore. In the same year, Navy was allocated Rs.

23,867.62 crore at BE stage but it could spend only Rs. 16,835.64 crore. During the year 2013-14, the Army was allocated Rs. 14,967.25 crore at RE stage, but it was able to spend only Rs. 14,433.29 crore. Similar was the case with Navy, which was not able to spend in full the allocation made at RE stage. Again, in the year 2014-15, Army was allocated Rs. 21,933.54 crore at RE stage but spent only Rs. 18,586.73 crore and Air Force was able to spend only Rs. 32,796.42 crore against the allocation of Rs. 33, 710.68 crore at RE stage. During the year 2015-16, Army was allocated Rs. 24,230.47 crore at RE stage but was able to spend only Rs. 20,703.70 crore.

In BE 2016-17, under Capital Head, Army was allocated Rs. 26,935.81 crore at BE stage and Rs. 24,017.86 crore at RE stage but was able to spend only Rs. 17,198.92 crore upto December, 2016. The allocation for Capital Acquisition for Navy which was Rs. 21,041.22 crore during BE 2016-17 was reduced to Rs. 18,742.17 crore at RE stage, but expenditure upto December, 2016 was Rs. 12,167.23 crore. The allocation for Capital Acquisition for Air Force which was Rs. 29,795.42 crore during BE 2016-17 was reduced to Rs. 28,239.86 crore at RE stage, but expenditure upto December, 2016 was Rs. 23,770.25 crore.

On being asked to provide reasons for reduction in budget allocation for Revised Estimates 2016-17, the Ministry of Defence submitted that during budget discussion with Ministry of Finance (MoF), the slow pace of expenditure was cited by Ministry of Finance as the reason for reducing allocations/ not granting additional allocations. The Committee are highly disappointed to note the persistent trend of underutilization of funds meant for capital expenditure for the Services even though the amount allocated under this head is always less than the projected one. The underutilization of funds highlights the loopholes in the planning and budgetary exercise undertaken by the Ministry of Defence and consistent failure to utilize the allocated funds has also contributed to reduction in Ministry's budget allocations by the Ministry of Finance. The Committee, therefore, recommend that it is high time the Ministry rectified the deficiencies / anomalies in their budgetary planning and expenditure and took foolproof measures to ensure maximum utilisation of the funds.

Reply of the Government

The details of Budget Estimates, Revised Estimated, Modified Appropriation (Final Grant) and Actual Expenditure under Capital Head during the last five years is as under:

(Rs. in crore)

Year	BE	RE	MA(Final Grant)	Actual Exp.
2012-13	79578.63	69578.63	69578.63	70499.12
2013-14	86740.71	78872.23	78872.23	79125.05

2014-15	94587.95	81965.24	81965.24	81886.98
2015-16	94588.00	81400.00	79483.28	79958.31
2016-17 (Rationalised)#	78586.68	71700.00	74100.00	78731.83
2016-17 (Non-Rationalised)#	86340.00	79370.29	81747.26	86367.29

(# In the year 2016-17, 7 organisations viz, Ordnance Factories, DRDO, NCC, ECHS, Military Farms, Rashtriya Rifles and DGQA, which were till 2015-16 part of Defence Services Estimates, were shifted to MoD(Miscellaneous) Grant in the rationalized Demands for Grants. The figures against 'Rationalised' row do not include provision for these 7 organizations. For the sake of comparison, provision for all the 7 organizations has been included in figures against 'Non-Rationalised' row.)

From the data given above, it may be seen that though there has been underutilization of capital budget with reference to Budget Estimates (except in 2016-17), however there has been either excess expenditure or more than 99.9% utilization when compared to Final Grant. One of the main reasons for lesser expenditure than Budget Estimates is reduction in allocation at RE stage. Sometimes cut imposed by Ministry of Finance at RE stage may lead to shifting of large payment to next financial year.

It may also be added that bulk of Capital expenditure comprises of Capital Acquisition which includes Committed Liabilities and New Schemes. Committed Liabilities being milestone payments may not fructify due to slippages in achieving project milestones by the vendor or delay in delivery of product/equipment.

(Please see Para Nos. 13-14 of Chapter-I of the Report)

<u>Capital Acquisitions - Creation of 'Roll on' and 'Non Lapsable Fund</u>

Recommendation (Para Nos. 10-15)

The Committee have, in their reports presented earlier, emphasised on the allocations being of 'Roll on' and 'Non-Lapsable' in nature. However, The Ministry of Defence in the information furnished to the Committee on the subject matter in the past had, in general, not favoured the proposal for constituting a Non-lapsable Defence

Capital Fund Account , ostensibly on the plea that there had been no occasion in the last five years where any substantial amounts were available as surplus for rolling over. The intention of the Committee in recommending Non-Lapsable funds for Defence modernization is primarily for ensuring that the money allocated for a particular item is spent on the specified item only, not necessarily in the same Financial year.

The Committee are glad to note that the Ministry of Defence has now reviewed its stated position and has admitted that the utility of creation of a non-lapsable, roll over fund for Capital cannot be completely negated as the same would help in eliminating the prevailing uncertainty in providing adequate funds for various defence capability development and infrastructure projects. A proposal for obtaining 'in-principle' approval of Ministry of Finance on creation of Non-lapsable Capital Fund Account has been sent on 9.2.2017 by the Ministry of Defence after obtaining approval of Hon'ble Raksha Mantri and response from the Ministry of Finance is awaited.

The Committee are disappointed to note that the Ministry of Finance is still not in favour of creating 'Non-lapsable Defence Capital Fund Account'. As per the Ministry of Finance, it may not be advantageous in creating a reserve/corpus fund in the Public Account and the requirement of Ministry of Defence for meeting its Capital Modernisation and acquisitions can be addressed through normal budgetary mechanism. The Committee would like to draw attention of the Ministry of Finance to the fact that since last few years, the allocations for the Ministry of Defence under the 'Capital' head are always lesser than its projection not only at BE stage but also at RE stage. To illustrate, against a projection of Rs. 1,46,155.54 crore for Capital Budget in 2017-18, only Rs. 86,528.65 crore have been allocated for BE 2017-18 for various Services (Army, Navy, Joint staff, Air Force, DGOF, R&D and DGQA, National Cadet Corps, Military Farms, Rashtriya Rifles and Ex-Servicemen Contributory Health Scheme). Therefore, the Committee do not agree with the contention of the MoF that the desired objectives of Ministry of Defence towards meeting its contractual liabilities, acquisitions and Defence mordernisation can be achieved through normal budgetary mechanism. The Ministry of Finance should also keep in mind that Defence procurement and acquisition is a complicated process involving long gestation periods and funds allocated for capital acquisition in a particular financial year are not necessarily consumed in that year and ultimately have to be surrendered by the Ministry of Defence. The Committee, in this regard, would like the Ministry of Finance to look at the matter afresh and work out the modalities for creation of 'Non-lapsable Defence Capital Fund Account' in consultation with the Ministry of Defence keeping in mind that our Forces' plans for capacity enhancement and heightened operational preparedness would be negatively affected due to reduced allocation of funds in the Capital head and this would ultimately be detrimental to our National Security.

The Committee find it pertinent to mention in this context that in the Union Budget 1998-99, the Non-lapsable Central Pool of Resources for the North Eastern region was constituted with approval of Parliament. The broad objective of the Non-lapsable Central Pool of Resources scheme was to ensure speedy development of infrastructure in the North Eastern region by increasing the flow of budgetary financing for new infrastructure projects/schemes in the Region.

For identification of projects under Non-Lapsable Central Pool of Resources, States are asked to submit, before the beginning of the financial year, a prioritized list of projects with a short write up on each project. The Committee to administer the Non-Lapsable Central Pool of Resources is headed by Secretary, Ministry of Development of North Eastern Region and has representation from Ministries of Finance and Home Affairs. The priority accorded by the state to the projects in the 'priority list' is only a suggestive and the Committee to administer the Non-Lapsable Central Pool of Resources scrutinizes the projects in the lists in order to identify and finally retain the suitable projects for detailed examination. In examining the priority, the Committee is, inter-alia, guided by considerations such as priority to projects of economic infrastructure, drinking water supply and other health and sanitation projects, the overall utilisation and absorption of funds by a particular state in the past years, past performance of a State in implementing projects in the particular sectors etc. After approval of the Committee, funds are sanctioned and released by the Ministry of Development of North Eastern Region on submission of an implementation schedule. Subsequent releases are made only after receipt of Utilisation Certificate of earlier releases.

The Committee desire that the Ministry of Defence, taking an inspiration from the Non-lapsable Central Pool of Resources for the North Eastern region, should devise streamlined institutional arrangements to administer the ‘Non-Lapsable’ and ‘Roll on’ Capital Budget.

Reply of the Government

In this context, it is intimated that Ministry of Defence has taken up the matter for creation of Non-Lapsable fund specifically for Capital Budget with Ministry of Finance vide letter dated 09th February,2017, and reminder dated 5th May, 2017. The proposal of Ministry of Defence for creation of Non-lapsable Capital Fund Account has not been accepted by Ministry of Finance as conveyed vide Ministry of Finance letter dated 03.07.2017 (copy enclosed).

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

CHAPTER V

OBSERVATIONS/RECOMMENDATIONS IN RESPECT OF WHICH GOVERNMENT HAVE FURNISHED INTERIM REPLIES/REPLIES AWAITED

-NIL-

New Delhi;
December, 2017
Agrahayana, 1939 (Saka)

Maj Gen B C Khanduri, AVSM (Retd),
Chairperson,
Standing Committee on Defence

APPENDIX I

STANDING COMMITTEE ON DEFENCE (2017-18)

MINUTES OF THE THIRD SITTING OF THE STANDING COMMITTEE ON DEFENCE (2017-18)

The Committee sat on Wednesday, the 29 November, 2017 from 1130 to 1300 hrs. in Committee Room 'C', Parliament House Annexe, New Delhi.

PRESENT

Maj Gen B C Khanduri, AVSM (Retd) - Chairperson

MEMBERS

LOK SABHA

2 Shri Shrirang Appa Barne
3 Col Sonaram Choudhary(Retd)
4 Shri Thupstan Chhewang
5 Shri Dharambir Singh
6 Shri Sher Singh Ghubaya
7 Km Shobha Karandlaje
8 Dr Mriganka Mahato
9 Shri Kalraj Mishra
10 Smt Mala Rajya Lakshmi Shah
11 Smt Pratyusha Rajeshwari Singh

RAJYA SABHA

12. Shri K R Arjunan
13. Shri Harivansh
14. Shri Basawaraj Patil
15. Shri Sanjay Raut
16. Smt Ambika Soni
17. Shri Vivek K Tankha

SECRETARIAT

1	Smt Kalpana Sharma	-	Joint Secretary
2	Shri TG Chandrasekhar	-	Director
3	Smt Jyochnamayi Sinha	-	Additional Director
4	Shri Rahul Singh	-	Under Secretary

LIST OF WITNESSESS
MINISTRY OF DEFENCE

S.NO	NAME OF OFFICER	DESIGNATION
1	Shri Sanjay Mitra	Defence Secretary
2	Lt Gen Sarath Chand	VCOAS
3	Air Marshal S B Deo	VCAS
4	Vice Admiral Ajit Kumar P	VCNS
5	Lt Gen Ashwani Kumar	Adjutant General
6	Shri Jayant Sinha	Joint Secretary
7	Shri Ravikant	Joint Secretary
8	Maj Gen Nav K Khanduri	ADG CAB
9	Maj Gen Yogendra Dimri	ADG D&V
10	Rear Admiral Kishan K Pandey	ACOP (AC)
11	Shri S K Sharma	Director(MIS)
12	Brig K Narayanan	DDG PS (A)
13	Cmde Atul Kumar	PDPS
14	Gp Capt RP Singh	Dy JAG(Air)

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6. The Committee took break for tea and resumed the Sitting for consideration and adoption of the draft Reports on Action Taken by the Government on the Observations/Recommendations contained in Twenty-Ninth Report (16th Lok Sabha) on 'Demands for Grants of the Ministry of Defence for the year 2017-18 on Army, Navy and Air Force (Demand no. 20)' and Thirty-First Report (16th Lok Sabha) on 'Demands for Grants of the Ministry of Defence for the year 2017-18 on Capital Outlay on Defence Services, Procurement Policy and Defence Planning (Demand No. 21)'.

7. After deliberation, the Committee adopted the above Reports and authorized the Chairperson to finalize the Reports in the light of the suggestions as may be received from the Members within three days.

The Committee then adjourned.

8. A copy of verbatim record of the proceedings has been kept.

***Does not pertain to the subject

APPENDIX II

ANALYSIS OF THE ACTION TAKEN BY THE GOVERNMENT ON THE OBSERVATIONS/ RECOMMENDATIONS CONTAINED IN THE THIRTY-FIRST REPORT (16TH LOK SABHA) ON 'DEMANDS FOR GRANTS OF THE MINISTRY OF DEFENCE FOR THE YEAR 2017-18 ON CAPITAL OUTLAY ON DEFENCE SERVICES, PROCUREMENT POLICY AND DEFENCE PLANNING (DEMAND NO. 21)'

1. Total number of recommendations
50

2. Observations/Recommendations which have been accepted by the Government (please see Chapter II A):

Recommendation Nos. 21, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43, 44, 47, 48, 49 and 50

Total : 27
Percentage: 54%

3 Observations/Recommendations which have been accepted by the Government and commented upon (please see Chapter II B):

Recommendation Nos. 16, 17, 18, 19, 20, 22, 45 and 46

Total : 08

Percentage: 16%

4. Observations/Recommendations which the Committee do not desire to pursue in view of the replies received from the Government (please see Chapter III):

Recommendation No. 1

Total : 01
Percentage: 2%

5. Observations/Recommendations in respect of which replies of Government have not been accepted by the Committee and which require reiteration and to be commented upon (please see Chapter IV):
Recommendation Nos. 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14 and 15

Total : 14

Percentage: 28%

6. Observations/Recommendations in respect of which Government have furnished interim replies/replies awaited (please see Chapter V):

Nil

Total : 00
Percentage: 0%