

Is the FMS a Safer Route to Follow?

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Post the Augusta Westland revelations, there has been a growing perception that the Indian arms procurement system, although principally being in a competitive bidding environment, is not immune to malpractices. In such a scenario, the government is bound to put in place increased transparency and accountability controls to guard against recurrence of such embarrassment and hostile public opinion. The state of Indian defence preparedness, on account of ageing and unserviceable equipment, is well known and stated. The slow pace of induction of new weapon systems and platforms, on account of these increased checks and balances, leaves no alternative to make up for the voids of the Indian armed forces but to resort to the presumably safer Government-to-Government (G2G) route.

Military equipment is procured from the US in two distinct modes: Direct Commercial Sales (DCS) and Foreign Military Sales (FMS). Deals under DCS are purely commercial transactions between a buyer government and the US defence industry, where US companies compete with vendors from other countries to sell their defence equipment. As in an open global competitive system, all vendors are invited to field their defence equipment for trail evaluation. Techno-commercial evaluation is undertaken by the buyer country as per the criteria laid down by it. It, thus, implies that in DCS, the US companies are pitted against other global vendors and are required to win contracts in a fair competitive environment.

FMS, on the other hand, is commonly known as a Government-to-Government (G2G) deal. This route is usually followed for items which have already been inducted in the US forces. The buyer nation forwards a Letter of

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Request (LOR) to the US government. If the request is cleared, a Letter of Offer (LOO) is sent to the requesting government. The buying government is required to submit a Letter of Acceptance (LOA) along with the initial advance. Thereafter, a legal contract is signed. The US government may supply the item from its own existing stocks or procure it afresh from the concerned vendor/OEM (Original Equipment Manufacturer). Sale of certain critical items is allowed only through the FMS route and such items are designated as “FMS only” under the provisions of the Security Assistance Management Manual (SAMM) C4.5.9. Such designation may be based on legislation, presidential policy, disclosure policy interoperability or safety concerns. Historically, defence equipment/ platforms like man-portable air defence missiles, certain cryptographic equipment, precise positioning service and airborne warning and control systems have been designated likewise.

The Positives of FMS

There are no middlemen in FMS. The buyer nation saves considerable effort as the US government procures the item as per its well-established acquisition procedure. Quality and performance parameters are also assured. Since the item is already in use with its forces, the US government is in a better position to provide logistic, training and exploitation support. Joint training and development of the exploitation doctrine also gets facilitated. The FMS route is ideally suited for US allies who have a common operational doctrine and where interoperability of equipment is an essential consideration.

One of the major limitations of the FMS route is, however, that a buyer country has to accept the equipment on ‘as it exists’ basis and cannot evolve its own parameters. Unquestionably, the equipment would have been developed specifically for the US forces, keeping in mind their capabilities, doctrine and envisaged operational exploitation. It is essential for a buyer country to be fully convinced of the usefulness of the equipment in its own environmental context prior to initiating a request. No military equipment is ever used in isolation and its optimum exploitation is possible only if it is fully integrated with matching capabilities. Further, the US defence acquisition system, being far more evolved than ours, the evaluation procedure is comparatively more stringent and, therefore, it may be prudent to presume that weapon systems procured through this route, although not trial evaluated for the Indian terrain and operational

conditions, will be the best in the class as far as technology and operational effectiveness are concerned.

Pitfalls of FMS

While the FMS route has the advantages of fixed prices, sovereign guarantees and after sales support, it precludes competition and trials. In other words, it is a take-it-or-leave-it situation for the buyer. Some of the commonly touted advantages of FMS are examined hereunder to clarify common misconceptions about the FMS route.

Cost Effectiveness

- Although the US government offers equipment to foreign governments at the cost at which these items had been purchased for the US forces, it imposes additional handling charges while processing requests under FMS provisions. Except for specific statutory exemptions, the US government charges the buyer government for sales negotiations, case implementation, contract negotiation, contract management, financial management and allied expenses. In other words, the final FMS price includes administrative surcharge and contract administration and services costs.
- The FMS system provides for estimated prices and tentative payment schedules. The final price of equipment under FMS is known only after it is delivered, whereas in competitive bidding, a buyer knows the final price and payment schedule before the contract is signed. Additionally, the Arms Export Control Act (AECA) requires a charge for a proportionate amount of any non-recurring costs of research, development and production of major defence equipment sold through FMS. DCS, on the other hand, is exempt from these costs.
- The US government does not facilitate comparison between FMS and DCS costs for any equipment, thereby denying an opportunity to a buyer to select a financially low-cost (L1) option. No buyer can obtain a DCS price quote after submitting an LOR under the FMS procedure. The LOR is also required to be cancelled prior to making the DCS request. Similarly, all DCS activities have to be terminated/ foreclosed by a buyer prior to submitting an LOR.
- On the other hand, competition and market dynamics of the multi-vendor open bidding system allow a buyer to drive a hard bargain to get the most favourable commercial terms through adroit negotiations. As it is a buyers' market in the world arms trade, even the US companies may be forced to

accept reduced profit margins compared to what the US government allows them under FMS procurements. Therefore, it is a mistaken idea that the FMS route, being a government to government transaction, is always cheaper.

Speed of Delivery

- FMS is a long drawn process. After development, review and acceptance of LOA, assembling of requirements for economic quantity or consolidated purchasing cycles have to be managed. Thereafter, contract negotiations have to be finalised. Production lead times are fairly long, particularly for major equipment. However, deliveries can be much faster in case the US government decides to supply equipment from its stocks or reserve inventory. In an emergency, the US government may, however, allow diversion of items under production for its own use to a needy buyer nation.
- Due to numerous inbuilt safeguards, the FMS process tends to get bogged down in procedural details. On the other hand, defence articles in production can be procured more speedily through open commercial bidding. It is an accepted fact that contractors prepare their proposal much faster than the US government completes the paper work. Moreover, in DCS cases, the buyer country can negotiate delivery schedules as per its requirements with penalties for default.
- End use monitoring is less rigid. With a view to ensure the security of its exported technology, the US government oversees that the equipment sold by it is used strictly as per the initially stated intent in LOR. The US authorities retain the right of ground inspection to check compliance. Elaborate regulations have been framed for End Use Monitoring (EUM), under both the FMS and DCS routes; whereas the Golden Sentry is applicable to FMS deals, the Blue Lantern programme oversees DCS contracts. Criteria and policy for third country transfer are also the same for both routes. Therefore, it is wrong to assume that EUM is less severe in FMS sales.

Transfer of Niche Technology Equipment is Facilitated: It is wrongly believed that transfer of high-end/ niche technologies is easier through the FMS route as deals are negotiated between two governments. As regards considerations for permitting technology release, they are identical for both FMS and DCS sales. For FMS cases, the Defence Security Cooperation Agency (DSCA) seeks the approval of the US State Department before developing new cases. On the other hand, contractors have to obtain an export licence from the State Department

for DCS deals. In other words, both FMS and DCS deals are subject to grant of licence by the Office of Defence Trade Controls of the State Department. Additionally, under AECA (Section 36 (b) and 36 (c) respectively), both types of sales are required to be notified to the US Congress if the proposed sale meets or exceeds the statutory thresholds. Therefore, opting for the FMS route provides no extra benefit with respect to ease of purchase of high-end/niche technology equipment.

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Technical Support is Assured

- There are two facets of the provision of continued technical support for the equipment sold – the initial support package and a solemn assurance of subsequent life-time support. As regards the initial package, the FMS system caters to the development of a total package approach to include all support equipment, spare parts, training and publications by the US government. On the other hand, under DCS sales, the contractors develop support packages as per the requirements projected by the buyer requirement. However, there is no difference in contractor participation in follow-on support and maintenance programmes under FMS and DCS.
- What is of more serious concern is the right reserved by the US government to unilaterally terminate a deal if considered essential in US national interests. This right is equally applicable to FMS and DCS contracts. The US government can terminate a DCS export licence or cancel LOO/LOA in FMS cases. It can also halt deliveries of FMS items or DCS licensed items even if already paid for. Hence, FMS deals provide no guarantee of continued US support, post deliveries.

Offsets

- Even though offsets are applicable to FMS deals as well, the US government follows a hands-off policy with regard to offsets provisions. A buyer country has to negotiate a separate offset agreement directly with the prime contractor. Implementation of such an offset agreement remains a matter between the buyer country and the contractor, while the US government accepts no responsibility for its enforcement.
- As the main contract and offset contracts get delinked, the buyer country has no leverage to ensure fulfillment of offset obligations. In a normal commercial deal, failure to implement an offset programme as per the contracted schedule

can invoke imposition of penalties. In the case of FMS deals, payments are made to the US government and, hence, cannot be withheld.

Conclusion

India has carried out wide ranging reforms in its procurement structures, organisations and procedures. Free competition and transparency are central to the new dispensation. Every government-to-government deal is a testimony to the failure of the present defence procurement regime to deliver. It amounts to a tacit admission by the government of its inability to procure major equipment in an open competitive environment as per its own parameters. Many defence observers fear that a distinct discernible pattern is emerging in recent deals to circumvent competition. No Request for Information (RFI) is issued and no indications are given to possible competitors. Once the Indian decision-makers are convinced, they are prevailed upon to seek equipment through the FMS route, thereby effectively eliminating all competition.

Recent reports reveal that DSCA has notified the US Congress in August 2013 of the possible sale of 145 x M-777 ultra light howitzers at an estimated cost of \$885 million as against its earlier notification of 2010 for \$647 million for the same deal. The other major programme in the pipeline is the case for procurement of 15 x Chinook heavy lift helicopters. According to many knowledgeable observers, the final value of these deals with support systems will far exceed the indicated cost. True to past trends, these are single vendor deals, bereft of all competition.

Finally, it is a misconception that all FMS deals are above board and free from taint. The very fact that decision-makers are prevailed upon to forego open competition (with associated cost, quality and delivery advantages) and opt for the single vendor FMS route, raises questions of propriety.

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