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# RSIS COMMENTARIES

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## **Defence Procurement in India: Implications of Finmeccanica Scandal**

By Manaswini Ramkumar

### **Synopsis**

*India's latest procurement scandal with Italian defence firm Finmeccanica carries serious political and economic ramifications for New Delhi. Apart from stalling Indian defence modernisation, the scandal could also spell electoral defeat for the Congress-led coalition government.*

### **Commentary**

THE RULING Congress government has been hit with yet another corruption scandal, this time in defence procurement. Last month, bribery allegations in a €556 million/US\$743 million deal with a subsidiary of Italian defence firm, Finmeccanica, have surfaced at the most inopportune moment, politically as well as economically, for both India and Italy.

The Indian government issued a show cause notice on 15 February 2013 to Finmeccanica and its UK-based subsidiary, AgustaWestland. It demanded a probe into the alleged kickbacks involved in the sales contract of 12 AW101s – AgustaWestland's Medium/Heavy multi-role helicopter – that were meant to be used as civilian transport aircraft for VVIPs. The Defence Ministry suspended the payment for the remaining delivery of nine choppers, threatened to suspend the contract and blacklist Finmeccanica if the firm did not respond to the notice within a week.

### **Defence relationship revisited – scandal exposé**

India's relationship with Finmeccanica is more than four decades old. It started with AgustaWestland's delivery of 41 Sea King helicopters to the Indian Navy. The Italian defence giant increased its presence in India by developing crucial partnerships with Indian defence firms like Bharat Heavy Electronics Ltd (BHEL), Bharat Dynamics Ltd, Bharat Electronics Ltd (BEL), Hindustan Aeronautics Ltd (HAL) and the Tata Sons group. For India, Finmeccanica provides a wide range of defence products like helicopters, civil/military electronics such as radars, avionics and UAS, training, transport and combat aircrafts, space technologies as well as artillery systems.

According to IHS Jane's Defence Weekly, Finmeccanica's investment portfolio in India is valued at more than US\$12 billion for 2013 alone. If the company is found guilty of financial malpractice in the AW101 deal, it could be blacklisted from operating in India for five to 10 years.

The scandal surfaced when the CEO of Finmeccanica, Giuseppe Orsi, was arrested in January after an Italian court had ordered investigations into the company's affairs of procuring contracts from various countries, including India. Italian police report filed after his arrest indicated that a Swiss middleman was appointed specifically by Orsi to bag the Indian contract for AgustaWestland. The middleman's close relationship with a former Indian air chief was used to set up a meeting for Orsi in early 2009 after which AgustaWestland signed its first contract. The details of the meeting were discovered by the Italian police during a raid from documents found in the middleman's hard drive.

### **Finmeccanica á la Bofors**

The Finmeccanica case brought back memories of the Bofors corruption scandal in 1987 that dealt a major blow to the Congress government in the 1989 elections. In 1986, New Delhi had signed an agreement with AB Bofors of Sweden to purchase 410 155-mm howitzers for the Indian Army to replace the military's ageing artillery. The deal also included an option to license-produce 1000 more guns, with a total value of \$285 million.

By the end of 1987, Swedish police reports indicated that Bofors had paid \$12 million in kickbacks to key Indian politicians and defence officials, implicating the then-Prime Minister of India, Rajiv Gandhi. In complete denial of any wrongdoing, the government was forced to set up a Joint Parliamentary Committee that laid blame on Italian business tycoon, Ottavio Quattrocchi, who had brokered the deal between Bofors and the Indian government.

Owing to several years of legal wrangling and blame games, the case lost steam. Quattrocchi fled India in the early 1990s. As of March 2011, the Argentinian Supreme Court refused to extradite him citing sloppy paperwork by the Indian government. The Delhi High Court, sensing futility, allowed the CBI to drop all charges against the Italian and close the case.

### **Future ramifications**

The scandal carries strong political and economic ramifications for both Italy and India. The Italian public - quite wary of its government's performance over economic stagnation and misuse of public funds - has gotten yet another grouse. Critics retorted that the arrest of Giuseppe Orsi was harming Italy's struggling economy and putting the country at a competitive disadvantage. Finmeccanica is also the country's second largest employer, and if blacklisted by India, it puts \$12 billion investment at risk.

As for India, corruption scandals are becoming commonplace for the Manmohan Singh-government. The current scandal has managed to stall India's much-needed defence modernisation process, with the imminent blacklisting of Finmeccanica. As each defence purchase already takes up to a decade to come to fruition, the scandal will further slow down acquisitions decision-making, with officials becoming overcautious about paperwork, so as to avoid culpability.

Furthermore, with national elections looming in early 2014 and opposition parties clamouring for the government's answer to the high-profile graft cases, the Congress party would be wise to remember its defeat in the 1989 general election that came on the heels of the Bofors scandal.

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