



PERSPECTIVES

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India and Israel: Strategic Partners on the Move

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BESA Center Perspectives Paper No. 728, January 30, 2017

EXECUTIVE SUMMARY: India and Israel elevated their bilateral relationship to that of a “strategic partnership” in July 2017. While agriculture and opportunities for cooperation in the innovation economy hogged the limelight during both the prime ministerial visits, the defense/security peg of the partnership continues to have the greatest traction. The two countries hope to take it forward with an ambitious agenda that includes joint manufacturing as well as joint research and development.

The India-Israel relationship is often described as made up of “diamonds and defense.” During 2015-17, for instance, trade in diamond polishing and processing made up over half of imports (from Israel) and one-third of exports (to Israel). The respective figures are \$2.1 billion (out of \$4 billion of total imports) and \$2 billion (out of \$6 billion of total exports over those two years).

These figures are exclusive of defense trade. The defense component of the relationship has been one of the strongest pillars of the bilateral relationship. While there is no official acknowledgement of the exact financial volume of such trade, reports indicate that India buys more than a \$1 billion of equipment every year and that over 40% of Israel’s arms exports in 2012-16 were to India.

Curiously, during the visits of the two prime ministers to one another’s countries over the past six months, not much focus was directed towards the defense aspects of the relationship. To be sure, the sides did explicitly “[raise] the bilateral relationship to that of a strategic partnership” during the historic visit of Prime Minister Narendra Modi to Israel in July 2017. Many view this as proof that both sides are finally acknowledging the defense component of the relationship, an aspect about which they had been reticent till then.

Indian officials argue that since defense cooperation is part of an ongoing process, there was no need for a specific focus on those aspects during the prime ministerial visits. Ahead of Modi's visit, for instance, Israel Aircraft Industries (IAI) announced in April 2017 that it had entered into deals worth more than \$2 billion relating to the supply of Barak-8 air defense systems to the Indian Army and the Indian Navy. Earlier, during the visit of President Reuven Rivlin to India in November 2016, reports indicated that a deal for two additional Phalcon airborne warning and control systems (AWACS) worth over \$1.5 billion had been signed.

India already has three Phalcon AWACS in its inventory, the deal for which dates back to 2004. The 2004 Phalcon deal was touted as the biggest in Israel's defense industry until then. IAI is now touting the April 2017 deal for point defense systems as the biggest ever deal in Israel's history.

On the sidelines of the first meeting of the India-Israel CEO Forum, which was held during Modi's visit, 12 agreements were signed by private companies of the two countries – four related to defense, two to civil aviation, and one each to e-medicine, animal husbandry, infrastructure, water, renewable energy, and innovation. A joint venture that is potentially worth over \$1.5 billion over a period of a decade was set up by Kalyani Strategic Systems Limited (KSSL) and IAI to “address a range of opportunities across air defense systems, radars, [and] anti-ship missiles,” among others.

In August 2017, KSSL and another Israeli company, Rafael Advanced Defense Systems Limited (the manufacturer of the Spike anti-tank guided missile [ATGM]), inaugurated a factory near Hyderabad. The Kalyani Rafael Advanced Systems (KRAS) joint venture was formed primarily to cater to the possibility of the Indian government's awarding the contract for the Spike ATGM, which had been shortlisted by the government in October 2014 to cater to the requirements of the Indian Army.

However, a few weeks ahead of Netanyahu's visit, Rafael was notified that the Indian government was canceling the \$500 million deal to supply 8,000 missiles and 300 launchers. While no contract had been signed, price negotiations were underway. No reasons were provided for the deal's cancelation. Possible points of contention range from the price of the missile to technology transfer, among others.

Though the Spike deal was canceled, other deals, like a \$72 million transaction for more Barak-1 missiles (which the Indian Navy uses to protect frontline ships), were approved weeks ahead of Netanyahu's visit.

The CEO of Rafael was part of the large business delegation that accompanied PM Netanyahu to India. While some Israeli reports suggest that the Spike deal is back on following the visit, there has not yet been any confirmation of this from the Indian side.

No matter what the upshot of the Spike saga might turn out to be, it demonstrates the challenges Israeli companies are going to face in a policy environment in which the Indian government is making concerted efforts to strengthen local manufacturing through its flagship “Make in India” (MII) program.

The Modi government also recently tweaked its policy to allow for 100% foreign direct investment (FDI) in the defense sector. The government believes FDI in the defense sector “could be the most trusted route to technology transfer, which would help in increasing the defense production base and providing the much needed impetus to self-reliance and indigenization in the defense sector.” Despite such policy changes, as of December 2017, no proposal for a JV in the defense sector with FDI beyond 74% had been approved by the government.

Modi made a pitch for MII in the defense sector at the India-Israel Business Summit during Netanyahu’s visit. It remains to be seen if Israeli companies will take the bait, given the huge business opportunities in the defense sector.

In the Joint Statement released at the end of delegation-level talks on January 15, the two prime ministers “call[ed] on the Defense Ministers to hold discussions in 2018 with active involvement of the public and private sectors, in order to create the basis for viable, sustainable and long-term cooperation in the defense industry.” As part of the mandated process, therefore, we could soon witness the first-ever visit of an Indian defense minister to Israel, which would reciprocate Moshe Yaalon’s visit in February 2015.

The Joint Statement also called for “joint ventures and joint manufacturing, including transfer of technology [ToT] as well as joint research and development [R&D] in defense and security fields.” Some aspects of such cooperation are already in motion. The Barak-8 is a pertinent example, wherein India’s Defense Research and Development Organization (DRDO) and Bharat Dynamics Limited (BDL) are active partners with IAI and Rafael in building parts of the missile.

While ToT continues to be a sensitive issue, joint R&D in the defense sector could be down the road. JVs like that between Mahindra Telephonics and Shachaf Engineering (entered into in July 2017) for “design, development and manufacture of strategic electronics” are steps in that direction.

A key Israeli strength is its strong investment in R&D as a percentage of GDP. This figure has averaged more than 4% since 2011, placing it among the highest in the world. Major Israeli defense companies reflect this trend, with IAI, for instance, investing nearly \$40 million in R&D for the quarter ending in September 2017, or 4.6% of its sales for that quarter.

Notably, Indian companies are now emulating such best practices. The aeronautical major Hindustan Aeronautic Limited (HAL), for example, invested close to 7% of its annual turnover on R&D in 2012-15, according to information provided to India's Lower House of Parliament by then Defense Minister Manohar Parrikar in August 2016. Such efforts could pave the way for greater synergies going forward.

The two prime ministers in their respective visits sought to focus attention on areas of cooperation such as agriculture and innovation that could potentially have dramatic benefits affecting the economic wellbeing of millions of Indians. Whereas defense cooperation remains a sensitive subject for public discussion, cooperation in these other sectors can be openly acknowledged and celebrated. Significant strides have been made in areas like agricultural/horticultural cooperation, with more than 25 centers of excellence established in India with Israeli expertise.

India and Israel look to increase their bilateral trade to \$20 billion over the next five years from the current level of around \$5 billion, with a focus on areas like urban infrastructure, digital technologies, and agriculture and water management. They plan to accomplish this by leveraging each other's strengths in the innovation economy. In the meantime, the defense peg of the partnership continues to have the greatest traction, despite intermittent hiccups like the Spike saga. Agreements for cooperation in cyber security (entered into during Netanyahu's visit), along with ongoing cooperation in the arena of homeland security (with a bilateral agreement dating back to early 2014) and counter-terrorism, add further strength to this most crucial peg of the partnership.

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