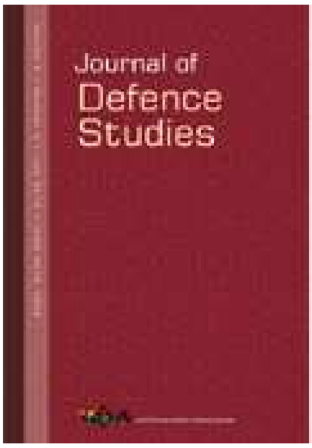

Indian Defence Budget: Challenging Times

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Indian Defence Budget
Challenging Times

Vinay Kaushal *

The past decade, and in particular the Twelfth Plan period, have been challenging times for the Indian defence budget. Strategic foresight demands that India's military strength and capabilities relate to diverse challenges by way of a not unlikely two-front war, the attendant imperatives for a 'Cold Start' capability, non-conventional challenges from non-state actors, counter-terrorism capabilities and unavoidable internal security responsibilities. However, the funds allocated in the annual Union Budget have not been adequate to be able to keep up with the unique inflationary pressure on the defence budget. Among the factors contributing to the limited resource available are the implementation of the FRBM Act and the inability of the defence eco system to fully utilise the allocated resources. This paper addresses some of these issues.

Assesing Threats and Providing Means for National Security

Each country articulates its threat perception, security strategy and the policy to counter perceived threats which identify the ways and means to achieve national security. This is an important long-term goal and must be shared with the citizens of the country so as to mobilise all the resources of the government for the protection of the country's security interests. The periodicity at which these are articulated and issued varies and some choose to call it a 'Defence White Paper' or 'National Security Strategy'.

* The author is a Distinguished Fellow with IDSA, New Delhi.

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In the Indian system, the Ministry of Defence (MoD) and the Ministry of Finance (MoF) work in silos. Both function in full compliance of tasks allotted to them under the Allocation of Business Rules 1961 (as amended from time to time). The task of the Department of Defence (DoD), according to these rules, is:

> Defence of India and every part thereof including preparation for defence and all such acts as may be conducive in times of war to its prosecution and after its termination to effective demobilisation.[1]

The task of the Budget Division of MoF is to provide:

> ways and means; preparation of Central Budget other than Railway Budget including supplementary excess grants and when a proclamation by the President as to failure of Constitutional machinery is in operation in relation to a State or a Union Territory, preparation of the Budget of such State or Union Territory; [and] resources of Five Year and Annual Plans.[2]

Both the ministries have their own procedures in this respect.

MoD Procedure

While no formal document is formulated and/or issued in India by MoD, chapter 1 of its annual report[3] issued every year articulates India's security environment. The defence services periodically carry out an environmental scan with reference to the emerging technologies in the field of military hardware and developments in the military capabilities of potential adversaries. Based on such a scan, the Long Term Integrated Perspective Plan (LTIPP) is prepared, and from this flows the acquisition of weapons systems and equipment for the armed forces. The current LTIPP spells out the capability desired to be achieved by the armed forces over a 15 year period (2012–27). The LTIPP is translated into specific assets that need to be acquired by each service in the form of the Services Capital Acquisition Plan (SCAP), covering a five-year period. From this plan, a list of equipment and weapon systems required to be procured immediately is listed in the form of the Annual Acquisition Plans (AAP). Based on these plans, each service projects its financial requirement for the five-year defence plan as well as its annual budget requirement.

MoF Procedure

For its part, the Budget Division of MoF gets its directions from multiple sources:

1. the approach paper to, and the approved, 'Five Year Plan';
2. the recommendations of the constitutionally mandated 'Finance Commission' which are also for a five year period (the five year period for both these are not, however, concurrent; while the 12th Five Year Plan period runs from 2012 to 2017, the 14th Finance Commission recommendations are for the period 2015–20); and
3. the statement enunciated as part of the annual budget papers presented by the finance minister to the Parliament (the Macro-economic Framework Statement, Medium-term Fiscal Policy Statement and Fiscal Policy Strategy Statement).

The LTIPP 2012–17 was in place well before the date it was to commence. And for the first time, in April 2013, a Technology Perspective and Capability Roadmap (TPCR), which gives out the details of the equipment and technologies required by the armed forces, was put in public domain to provide the industry an overview of the direction in which the armed forces intends to head in terms of capability in future to enable 'Make in India'. For its part, the MoF has steered the economy through a tough period of financial crisis and ensured that challenging 'fiscal deficit' targets set by the Fiscal Responsibility and Budget Management (FRBM) Act are achieved to make India the fastest-growing major economy in the world.[4]

The Result

But this 'picture-perfect' scenario has been disturbed by the findings of the 22nd Report of the Parliament's Standing Committee on Defence of the 16th Lok Sabha. Examining the 'Demand for Grants' for 2016–17, the Committee has noted the following:

1. The decline in the allocation for capital acquisition will definitely affect several procurement contracts.
2. All the pending procurement projects would not go through unless the government increases allocations at the revised estimates (RE) stage.
3. A close examination of previous defence budgets has revealed that the government's ability to spend has come under repeated pressure. In the past four years, the MoD has surrendered over Rs 35,000 crore from its capital allocations.[5]

This state of affairs does not bode well for national security and there is a need to examine, in detail, the causes that have brought the defence budget and the accretion in the capability of the armed forces to such a pass.

Perceived Inadequacy of the Defence Budget

A common narrative that runs through comments and articles on the defence budget every year is inadequate allocation of funds. This narrative is also a recurring feature in the annual reports published by the Parliament's Standing Committee on Defence. The usual observation by the Committee is that the allocations for the three services are less than the projected amount. And, the reports also cite the MoD's reply as to where compromises have been made, or are likely to be made, due to the reduced budgetary allocation as against the projections made by the three services. For instance, the 15th Report of the Standing Committee of the 16th Lok Sabha cites the following response from the MoD in this regard:

> Under the revenue segment, after providing for salary and other obligatory expenses the balance allocation is distributed to meet the requirement of stores (including ordnance), transportation (of personnel and stores), revenue works and maintenance, etc. These areas are likely to be impacted by the reduced allocation. In so far as the capital segment is concerned, the acquisition of land and progress of capital works may get affected. Capital modernisation funds are first set aside to meet the projected Committed Liabilities likely to materialise during the year. The remaining allocation is distributed to meet the projected requirement for other items. Reduced allocation is likely to delay initiation of new projects. The procurement plan for schemes may also have to be reviewed and reprioritized.[6]

The perceived inadequacy of the fund allocation is based on the basis of the gap between the projected requirement of funds and the budget allocated. A tabulation of the annual projections for the 12th Plan period, included in the 21st and 22nd Reports of the Standing Committee on Defence for the 16th Lok Sabha presented in May 2016, and the budget allocated at budget estimates (BE) stage and the actual expenditure during the year is given in Table 1.

As seen from the table, the budget allocation has been less than the projection during the entire 12th Plan period (varies between 72–85 per

Table 1 12th Plan Period Annual Projections (in Rs crore)

	2012–13	*2013–14*	*2014–15*	*2015–16*	*2016–17*
Army#	112096	118883	146774	141697	153522
Navy	44479	52940	47824	44815	51726
Air Force	56838	90530	89482	75824^	66990^
DRDO	14464	16483	18459	19642	18783
OFB*	2197	2150	4142	5323	3862
DGQA	872	814	912	1020	1100
TOTAL	230946	281801	307594	288321	295983
Budget allocated (BE)	193407	203672	229000	246727	249099
Actual expenditure	181783	203508	218703	226045	N.A.
Difference between the projection and actual expenditure	49163	78293	88891	62276	46884

Source: The Defence Services Estimates (DSE) volumes and Controller General of Accounts (CGA) website.

Notes: 1. DRDO: Defence Research and Development Organisation; OFB: Ordnance Factory Board; DGQA: Directorate General Quality Assurance.

2. ^ The Indian Air Force (IAF) projections under capital have come down substantially in 2015–16 and 2016–17 as, in the absence of signing of contracts for major items, the committed liabilities have come down and the request for proposal (RFP) for 126 Medium Multi-Role Combat Aircraft (MMRCA) was retracted.

3. * In the case of OFB, the projections are not available and BE figures have been tabulated.

4. # Includes National Cadet Corps (NCC), Military Farms (MFs), Rashtriya Rifles (RR) and Ex-servicemen Contributory Health Scheme (ECHS).

cent of that projected for the year). Also, the actual expenditure has been less than the BE allocated (varies between 92–99 per cent of the BE for the year) at the beginning of each year.

Current Level of Defence Expenditure

Notwithstanding the perception that the defence budget during the 12th Five Year Plan period is inadequate, a comparison of the defence expenditure between 2006–07 and 2015–16 (Table 2) clearly shows that it has registered a compound annual growth rate of 11.33 per cent and

Table 2 Comparison and Growth Rate between Defence Expenditure in 2006–07 and 2015–16

Defence Expenditure	*2006–07*	*2015–16 (RE)*
Total (Rs crore)	85495	224645
Annual compound growth rate (%)		11.3314
Capital expenditure (Rs crore)	33826	80117
Annual compound growth rate (%)		10.0546
Revenue expenditure (Rs crore)	51669	145928
Annual compound growth rate (%)		12.279

Source: Growth rate worked out by the author based on actual expenditure figures.

growth rates of 10.05 and 12.28 per cent, respectively, with respect to capital and revenue expenditures.

The increase in both the absolute amount of Rs 139,150 crore and the annual compound rate looks impressive. That being so, why do the defence services feel that they are not getting the level of funding they need and project? And it is not just the defence services but also the MoD and MoF that think the same:[7]

> In its submission to the Commission, the Ministry of Defence argued that there has been a decline in the defence expenditure–GDP ratio over the years and defence expenditure allocation in the Union budget needs to be increased to expand the acquisition of arms and improve defence preparedness. The Ministry pointed out that it has not been able to make necessary procurements because of the constraint of funds and large amounts of committed expenditure. The Ministry of Finance has also highlighted the need to increase defence outlays in order to modernise and maintain defence assets and to finance defence acquisitions.[8]

Unique Character and Complexity of Indian Defence Expenditure

Defence expenditure (as seen in Table 1) has continued to increase steadily. However, the defence services, in their presentations to the Standing Committee on Defence—and also the Committee in their reports—have highlighted inadequate allocations and the allocations being much below their projections. This is because of the unique character and complexity of defence expenditure. Maximisation of value of money in defence expenditure involves turning money into maximum military value. Inability of the indigenous defence industrial base to meet the requirement creates import dependence. The expenditure on capital acquisition from foreign vendors and percentage of such expenditure to the total expenditure on capital acquisition during the last three years (2013–14 to 2015–16) varies between 36.3–52.47 per cent.[9] The procurements from Indian vendors are primarily from the defence public sector undertakings (DPSUs), and the DPSUs themselves are significantly dependent on imported parts, components and raw materials.[10] In the case of Hindustan Aeronautics Limited (HAL) and Mazagon Dock Shipbuilders Limited (MDL), for example, the average import dependency in the past five years has been 90 per cent and 67 per cent[11], respectively. This impacts both the acquisition and the maintenance.

It is a fact that, historically, defence industries and markets have been amongst the most protected from competition by hosts governments because of their links to national sovereignty and expenditure of state resources. Defence markets are inherently imperfect because there are few (typically government) customers, served by limited and increasingly consolidated suppliers who are involved in large, long-term programmes. These and some other specific factors result in unique inflationary pressure on the Indian defence budget.

Inflationary Pressure

One of the major factors for the perceived inadequacy of defence allocations is the inflationary pressures on major heads of expenditure. This is evident from a comparison between the budget needed to maintain the purchasing power parity (PPP) specific to Indian defence expenditure and the actual level of defence expenditure during the last 10 years. The review of the total defence budget has been done by dividing it into four major heads of expenditure—modernisation, pay and allowances (P&A), stores and works—and using appropriate indices (see Table 3) to assign weightage to these heads based on their percentage share of total defence expenditure.

The indices used for assigning weightage are as follows:

1. For modernisation expenditure, the wholesale price index (WPI) and the change in the annual average of the US$ as per the Reserve Bank of India (RBI) rates have been used.
2. For P&A, the actual percentage change seen under this head as per DSE, Vol. I, has been used. It includes the period before and

after the 6th Pay Commission was announced, as well as the two years when arrears in this regard were paid.

3. For the stores budget, WPI has been used.
4. For aviation turbine fuel (ATF) and diesel elements, the specific indices of ATF and diesel issued by the Economic Advisor to the Department of Industrial Policy and Promotion (DIPP) have been used.
5. The consumer price index (CPI) has been used for expenditure related to works, services and other expenditure.

The impact of inflation on the Indian defence expenditure, based on the breakdown into major objective heads and their relative weightage (given in Table 3) in the context of our actual defence expenditure using 2006–07 actual defence expenditure as the base, is demonstrated in Table 4 by arriving at the annual Indian defence-specific inflation rate.

Taking 100 as the index for the base year (2006–07), the index over the period indicates that actual expenditure has been lesser than the amount required to sustain the 2006–07 PPP level and the total difference over the period works out to Rs 170,749 crore (see Table 5). The prime drivers influencing the annual inflation rate, as seen in Table 4, are increase in P&A, inflation (both WPI and CPI) and the rupee–US$ exchange rate. Based on the above-mentioned figures, the annual Indian defence-specific inflation (IDSI) as actually experienced has been worked out. Taking the actual expenditure of 2006–07 as the base year, the allocation of funds required to maintain the PPP and the funds actually allotted and spent have been tabulated in Table 5.

Table 3 Major Categories of Expenditure and Weightage Assigned for Indian Defence-specific Inflation

Inflation Applicable	*Weightage (Budget Breakdown %)*	
WPI + US$	35	Modernisation
Actual increase in P&A Budget	40	Pay & Allowances
WPI (12) ATF (3) Diesel (1)	16	Stores (Operations & Maintenance)
CPI	9	Works (Infrastructure)

Source: DSE, Vol. 1, for the years 2011-12 and 2112-13.

Notes: 1. WPI: wholesale price index; ATF: aviation turbine fuel; CPI: consumer price index.

2. The weightage assigned is the average share of these heads as given in the categories of expenditure summarised in DSE, Vol. I, for 2011–12 and 2012–13.

It can be seen that every year (2006–07 being the base), the requirement of funds to maintain the PPP was higher than what was allocated at BE stage or the actual expenditure. Despite the appetite for funds to sustain capability-building momentum, the funds allocated at the BE stage in five of the nine years (the other four years were those when the FRBM Act implementation had been held in abeyance) were not fully utilised and the actual expenditure was comparatively less.

Changes Necessitated in the Pattern of Defence Expenditure

When the funds allocated are not sufficient to meet the requirement, it is not possible to make a uniform proportionate reduction in all the categories of expenditure. Obligatory items of expenditure such as P&A, rations and contractual obligations will have the first charge; the inescapable operations and maintenance (O&M) requirements will have the second charge; and only what is left after meeting these requirements can be spent on the rest and therefore, they will get less than what is actually needed.

Here, it is important to note that defence expenditure can be broadly categorised under four broad heads (for details, see the note below Figure 1):

1. P&A;
2. O&M;
3. infrastructure; and
4. modernisation.

Insufficient funding has resulted in a change in the percentage share of defence expenditure under each of the above-mentioned objective heads. The percentage share of defence expenditure under these four heads over the last 10 years, as estimated earlier, plus the current financial year's allocation is plotted in Figure 1.

The figure indicates that the share of P&A has increased from 27 per cent to 46 per cent of the defence expenditure; the share of modernisation has come down from 36 per cent to 30 per cent; the O&M has come down from 25 per cent to 15 per cent; and that of infrastructure has come down from about 12 per cent to 9 per cent.

Pay and Allowances (P&A)

The spike in the share of P&A is because of payment of arrears of the

Table 4 Inflationary Pressures on the Budget

	2007–08	*2008–09*	*2009–10*	*2010–11*	*2011–12*	*2012–13*	*2013–14*	*2014–15*	*2015–16*
WPI	4.7	8.1	3.8	9.6	8.9	7.6	5.98	2	-2.49
CPI	6.2	9.1	12.4	10.4	8.4	10	9.68	6.29	5.65
US$	11.1	14.2	3.2	-4	5.2	13.7	11.2	1.06	7.06
ATF	3.82	23.61	-29.56	20.35	39.12	12.4	6.26	-12.05	-34.22
Diesel	3.55	8.16	-2.1	14.1	8.45	11.56	18.68	2.49	-16.28
Increase in P&A budget	7.78	61.04	48.16	-3.69	12.81	13.62	12.81	9.71	12.26
Indian defence budget-specific inflation impact	9.91	34.8	22.38	3.32	13.14	15.2	13.1	5.42	5.52
Actual budget increase over previous years	7.24	24.59	24.13	8.7	10.9	6.35	11.95	7.47	2.72

Source: Indices are based on sources cited earlier and weightages as given in Table 3.
Note: All figures indicate annual increase in percentage over previous year as per the indices cited earlier; and in the case of P&A, over the actual expenditure.

Table 5 Comparison between Funds Required Based on IDSI, BE and Actual Expenditure (Rs crore)

FY	*IDSI*	*Actual Defence Expenditure*	*Funds Required for Maintaining PPP Based on IDSI*	*BE*	*Actual Expenditure*	
2006–07	100	100	85495	89000	85495	FRBM
2007–08	109.91	107.24	93971	96000	91684	
2008–09	148.17	133.61	126674	105600	114230	NON FRBM
2009–10	181.32	165.85	155022	141703	141793	
2010–11	187.35	180.28	160174	147344	154129	
2011–12	211.97	199.93	181222	164415	170929	
2012–13	244.19	212.63	208773	193407	181783	FRBM
2013–14	276.18	238.04	236122	203672	203508	
2014–15	291.16	255.81	248927	229000	218703	
2015–16	307.23	262.76	262668	246727	226045	
Total from 2007–08 to 2015–16			1673553		1502804	
Difference between indices-based fund requirement & actual expenditure			170749			

Source: Table formulated by the author based on indices in Table 4, BE & actual expenditure figures as per DSE Vol. I.

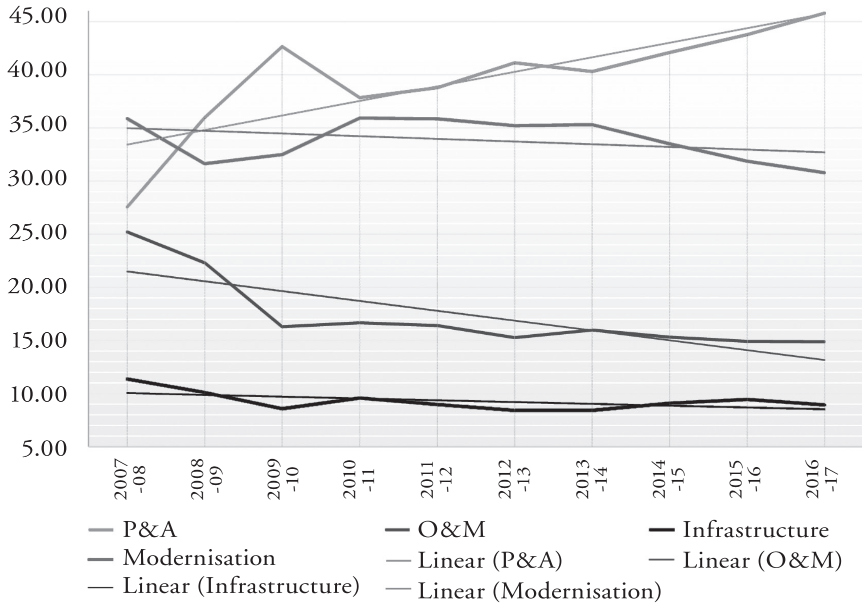

Figure 1 Percentage Share of Major Heads of Defence Expenditure

Source: Actual expenditure figures as summarised in DSE Vol. I and information in note below.

Note: From 2008–09 onwards, DSE, Vol. I, began to publish summarised tabulation of the BE under the heads: 'Pay & Allowances' (does not include salaries and wages of the Military Engineer Services [MES] personnel, etc., which are provided for under the minor head 'Works' and 'Miscellaneous'); 'Stores & Equipment' (includes minor head 'Repair & Refits' of the Indian Navy); 'Transportation, Miscellaneous Charges, Repair Works, Maintenance of Buildings, Installation, etc.'; and 'Capital Expenditure'. This data has been used to classify the expenditure into four broad categories as tabulated in Figure 1. The expenditure under 'Stores & Equipment' and 'Transportation & Miscellaneous Charges' has been added up to form O&M expenditure. The capital works expenditure of army, navy, air force, joint staff, RR, NCC, ECHS, inspection organisation, DRDO and ordnance factories has been reduced from the capital expenditure figure and added to the revenue works expenditure to arrive at infrastructure (acquisition of land, construction of buildings and their maintenance). And the capital expenditure figures, net of the above deductions, is categorised as acquisitions of platform, equipment, upgrades and research and development (capital and ordnance factories, plants and machinery). The figures for 2015–16 are as per RE and for 2016–17, as per BE.

6th Central Pay Commission (CPC) in two instalments during 2008–09 and 2009–10. However, after dropping off in 2010–11, the share of P&A has continued to rise thereafter. To correct the sometimes wrongly articulated perception that only the P&A of service personnel and civilians paid from the defence estimates has gone up, the P&A of all central government employees has been given alongside the P&A expenditure of the three services in Figure 2. It brings out the fact that the increase in P&A expenditure for both categories has followed a similar trend.

Operations and Maintenance (O&M)

Figure 1 seems to suggest that the highest drop in the share of expenditure is under O&M. As per Rule 79 of the General Financial Rules (GFR), expenditure incurred with the object of acquiring tangible assets of a permanent nature or enhancing the utility of existing assets shall broadly

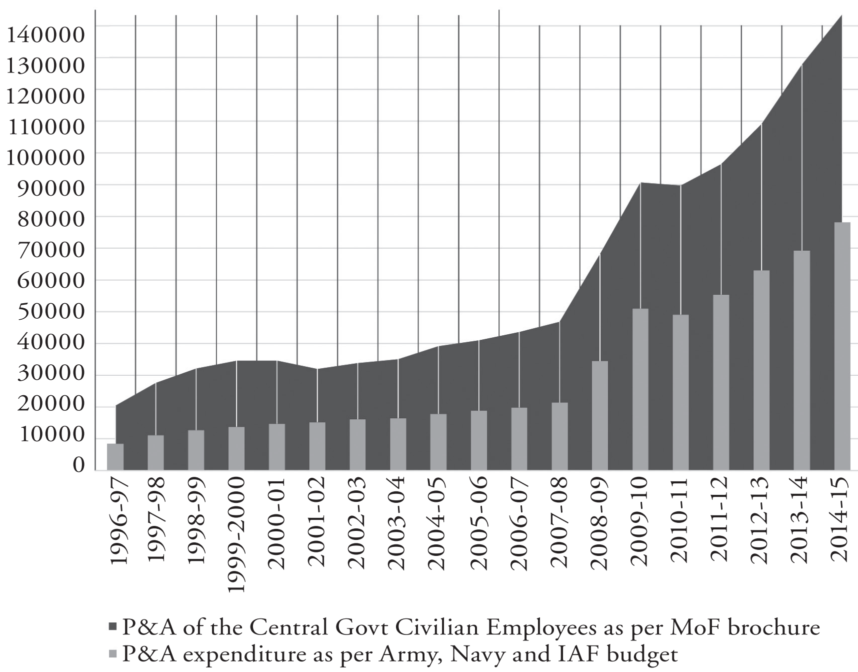

Figure 2 Annual P&A Expenditure of Central Civilian Government Employees and P&A Component of Defence Budget (Rs crore)

Source: Brochure on Pay and Allowances of Central Government Civilian Employees issued by Pay Research Unit of MoF and P & A of the Army, Navy & Air Force as per DSE Vol. I.

be defined as capital expenditure. Subsequent charges on maintenance, repair, upkeep and working expenses, which are required to maintain the assets in running order, shall be classified as revenue expenditure. As per MoD orders of 2003[12], for an expenditure (other than land and medium and heavy vehicles) to be classified as capital expenditure, the life of the item should be seven years or more and the cost criterion should be Rs 10 lakh or more.[13] Accordingly, expenditure on procurement and mid-life upgradation, when undertaken, has been categorised as capital expenditure; and repair/overhaul of aircraft/aero engines and refit of ships and submarines, amongst a host of others, has been treated as revenue expenditure. Here, it is important to understand the difference between overhaul and repair:

1. Overhaul: The time between overhaul (TBO) for air frame/aero engines/rotables is specified by designers. These are prescribed, mandatory, preventive maintenance activities to exploit the prescribed total technical life. It falls in the category of mandatory preventive maintenance.
2. Repair is undertaken in case of failure before the item is due for overhaul (based on TBO). This is curative maintenance.

In 2007, MoD issued a policy letter[14] and identified items of expenditure which, until then booked to the revenue budget, would be met by using the capital budget. To ensure that the elaborate capital acquisition process specified in Defence Procurement Procedure (DPP) does not delay this prescribed activity, the policy letter specified that:

1. The expenditure will be booked to capital budget heads but the procedure to be followed should be as per Defence Procurement Manual (DPM). The list prescribed in 2007 was modified subsequently. This came to be called Capital Budget Revenue Procedure (CBRP).
2. Offsets will not be applicable in respect of such procurements.

The annual expenditure figures under the CBRP category are not available in any document in the public domain. The extent of its usage is illustrated in Table 6 by taking only one minor head for the navy (repair and refits) and one subhead under minor head 'Stores' for the air force, that is, air frame and engines, and comparing the amount allotted at the BE stage in 2005–06 prior to the introduction of CBRP and the current financial year, 2016–17. The expenditure under these heads, which used

Table 6 Comparison of BE Figures for 2005–06 and 2016–17 of Select Heads for Air Force and Navy (Rs crore)

Year	*Air Force*			*Navy*		
	Total Revenue Budget	*Air Frame & Engines**	*% of Revenue Budget*	*Total Revenue Budget*	*Repair & Refits*	*% of Revenue Budget*
2016–17	23656	1251	5.29	17425	865	4.96
2005–06	9005	2011	22.33	6027	1206	20.01

Source: Figures as per DSE Vol. I.

Note: *Air frame and engines is a subhead under minor head 'Stores' in the revenue budget. There is also a minor head under the capital budget, 'Air Craft & Aero Engines'.

to be upwards of 20 per cent of their respective revenue budgets, has come down to 5 per cent because a major part is being booked to the capital budget.

By conservative estimates, the expenditure under CBRP would be of the order of Rs 20,000 crore in 2015–16 (+/–5 per cent). This figure is about 9 per cent of the defence expenditure for 2015–16 (20,000/226,045). Hence, the share of O&M expenditure for 2015–16 would be around 24 per cent (15 per cent as per Figure 1 and +9 per cent on account of CBRP) of the defence expenditure, that is, O&M has dropped by only 1 per cent from 2007–08 to 2015–16.

Modernisation

The actual share of modernisation from the year 2007–08, when the CBRP started, has come down from 36 per cent to 24 per cent (33 per cent as per Figure 1 and 9 per cent on account of CBRP), which is a drop of 12 per cent.

Infrastructure

There is a 3 per cent drop in the share of infrastructure. This expenditure comprises both revenue works (maintenance of existing infrastructure and P&A of MES personnel) and capital works. This revenue element has been maintained at around 5 per cent and the drop in share has entirely been absorbed by capital works (including acquisition of land).

The brunt of budget constraints has therefore been borne by modernisation and capital works (infrastructure), which contribute substantially to capability building.

Defence Budget 2016–17

In line with the rationalisation of demand numbers of the budget of all ministries, the defence budget demands have also been rationalised to reflect the objectives of these demands. Notwithstanding the rationalisation of the demand numbers from the current financial year, defence expenditure as a percentage of gross domestic product (GDP) would continue to be calculated with reference to the old demand numbers 23 to 28, as may be inferred from the contents of paragraph 66 of the Medium-term Fiscal Policy Statement presented as part of the budget papers on 29 February 2016. The DSE, Volume I, for 2016–17 also continues to follow the format of the old demand numbers and only briefly outlines the changes in an explanatory memorandum. This may be due to changes made at a very late stage and DSE for 2017–18 may be aligned to the revised demand numbers.

The marginal increase of 7.8 per cent and 11.05 per cent in the capital and revenue budget allocations for 2016–17[15] over the 2015–16 actual expenditure[16] figures would just about suffice for the foreign exchange (FE) variation in the capital budget. The revenue budget increase would only be able to cater for the impact of the 7th CPC.

Ministry of Finance Perspective: Macro Indicators

Defence expenditure per se was not part of the Five Year Plans prepared by the Planning Commission. However, since it is a major element of the government expenditure, it had to be factored in so as to plan resources available for the plan period. Planning Commission, in its approach paper on the 12th Plan published in October 2011, stated that:

> Defence expenditure is projected to fall from 1.83 per cent of GDP in the base year (2012–13) to 1.56 per cent of GDP in the final year (2016–17). This is based on defence revenue and defence capital expenditure increasing annually, in nominal terms, by about 7.5 per cent and 15.0 per cent respectively.[17]

It also stated that 'since defence expenditure is already very low as a percentage of GDP, this projection may be conservative.'[18]

Resource Allocation

Given the clear indication of allocation of resources in the aforesaid approach paper of the Planning Commission, Table 8 brings out how the actual allocations and expenditure have proceeded.

Table 7 Defence Budget Forecast for 12th Plan Period Based on Assumptions in the 12th Plan Approach Paper

Financial Year	*GDP Projection for 12th Plan*	*Assumption I (Budget as % of GDP)*			*Assumption II (Capital Budget to Increase Annually by 15%, & Revenue Budget by 7.5%)*				
		Assumption I Budget as % of GDP	*Total Defence Budget*	*Defence Budget Growth over Previous year*	*Capital*	*Revenue*	*TOTAL Defence Budge*	*% Share of Capital Budget*	*% Share of Revenue Budget*
2011–12	8980860	1.9	170913		67902	103011	170913	40	60
2012–13	10283085	1.83	188180	10.1	78088	110737	188825	41	59
2013–14	11774132	1.76	207225	10.12	89801	119042	208843	43	57
2014–15	13481381	1.69	227835	9.95	103271	127970	231241	45	55
2015–16	15436181	1.62	250066	9.76	118762	137568	256330	46	54
2016–17	17674428	1.56	275721	10.26	136576	147885	284461	48	52

Source: Prepared by the author based on projection of GDP and assumptions for defence expenditure as per Planning Commission approach paper.

Table 8 Actual Defence Budget Allocations and Expenditure

Year	*GDP*	*BE (Rs crore)*		*BE as a %age of GDP*		*Actual Expenditure* (Rs crore)*			*Actual Expenditure as a %age of GDP**	
		Capital	*Revenue*	*Capital*	*Revenue*	*Capital*	*Revenue*	*Total*	*Capital*	*Revenue*
2012–13	9951344	79579	113829	0.80	1.144	70499	111277	181776	0.708	1.118
2013–14	11272764	86741	116931	0.769	1.037	79125	124374	203499	0.702	1.103
2014–15	12488205	94588	134412	0.757	1.076	81887	136807	218694	0.656	1.095
2015–16	13567192	94588	152139	0.697	1.121	80117	145928	226045	0.591	1.076
2016–17	15065010	86340	162759	0.573	1.08					

Source: Union budget documents from 2012–13 to 2016–17.
Note: * Provisional actual expenditure for 2015–16 as per CGA website on 2 June 2016.

In addition to the clear indication of the resources likely to be available over the five years of the plan period, the budget papers presented by the finance minister give specific indication of the allocation of defence budget in the immediate future as part of the Medium-term Fiscal Policy Statement. The following points of the finance minister's statement are relevant here:

1. 2011–12: As a percentage of GDP, defence revenue expenditure is estimated to reduce from 1.4 per cent in 2009–10 to 1.1 per cent in the BE for 2011–12.
2. 2012–13: As a percentage of GDP, defence revenue expenditure is estimated to reduce from 1.2 per cent in RE for 2011–12 to 1.1 per cent in the BE for 2012–13. And it is further projected to decline to 1.0 per cent of GDP in 2013–14 and 2014–15.
3. 2013–14: During the projection period, defence revenue expenditure is projected to grow at 7 per cent.
4. 2014–15: The total defence expenditure as a ratio of GDP is projected to remain at 1.7 per cent in fiscal years 2015–16 and 2016–17, and the defence services revenue expenditure is projected to grow at 7.2 per cent.
5. 2015–16: Total defence expenditure as a ratio of GDP is projected to remain at 1.8 per cent of GDP in both fiscal years 2016–17 and 2017–18.
6. 2016–17: The revenue component of defence expenditure is estimated at Rs 162,759 crore in BE 2016–17. During the projection period of 2017–18 and 2018–19, it is estimated to increase by 10 per cent over previous years (which would translate to a revenue budget of Rs 179,035 crore for 2017–18 and Rs 196,938 crore for 2018–19).

Meanwhile, the 14th Finance Commission, in its February 2015 report, had stated the following:

> Recognizing that revenue expenditure is critical for defence preparedness and maintenance, we have kept the defence revenue expenditure–GDP ratio constant during our projection period, instead of allowing growth to decelerate as was the case in the past. In other words, the rate of defence revenue expenditure has been allowed to increase at the same rate as the GDP, which is substantially higher than the past growth of defence revenue expenditure.[19]

The deceleration in the revenue expenditure observed by Finance

Commission in the report was because items of revenue expenditure were steadily shifted to capital budget through the CBRP. Given the compound annual growth rate of 12.279 per cent in the revenue expenditure between 2006–07 and 2015–16 (refer Table 2), the above-mentioned recommendation of the Finance Commission will continue to cause distress to the revenue budget. In the face of this, if MoD continues to mitigate this through increasing use of CBRP, it will result in a continuing adverse impact on capability building.

Given the clarity provided in the Medium-term Fiscal Policy Statement, the allocations and the actual expenditure have been aligned with the targets as shown in Table 8.

Figure 3 shows that while the projections based on Planning Commission's approach paper (assumptions as given in Table 7) and budget allocations at BE stage are almost aligned in the first four years, it is only in 2016–17 that the BE is substantially lesser than these projections. The annual projections of all entities whose budgets form part of the defence budget (those of DRDO, OFB, DGQA, NCC, RR and ECHS have, from 2016–17, been shifted to Defence Civil Estimates) are substantially higher.

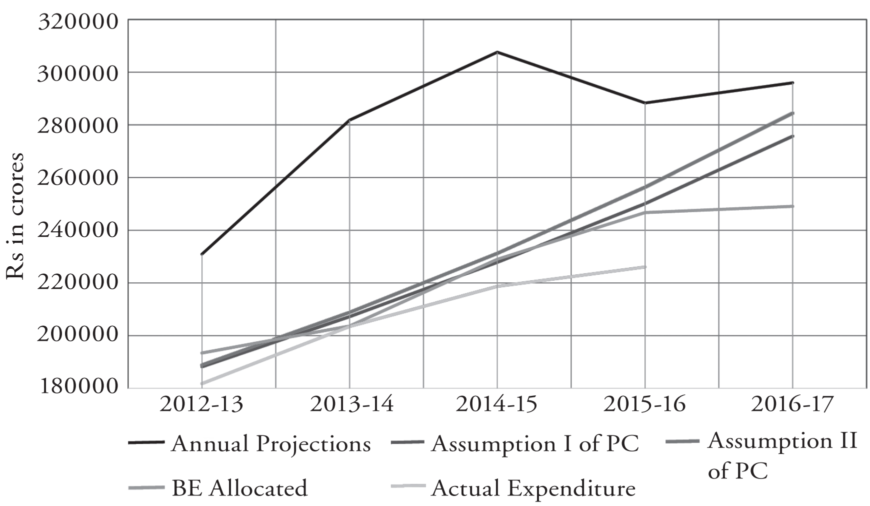

Figure 3 Comparison of Annual projections (figures based on Planning Commission assumption, budget allocated [BE] and actual expenditure)

Source: Annual projections from Table 1; amounts as per Planning Commission projections from Table 7; and the BE and actual expenditure from Table 8.
Note: For dip in projection in 2015–16, refer to the Note 2 (^) of Table 1.

The actual expenditure in all the years has been far less than the allocation. And in the current financial year (2016–17), the BE allocation in the capital head has itself been scaled down. The revenue expenditure has exceeded the BE allocation in two years—2013–14 and 2014–15—and this was met by appropriation of the funds from the capital budget. In all these years, the actual total defence expenditure (capital + revenue) has been less than the funds allocated at the BE stage. The year-wise differential amounts between the years 2012–13 and 2015–16 are: Rs 11,632 crore, Rs 173 crore, Rs 10,306 crore and Rs 22,091 crore. Thus, from the BE allocated in these four years, cumulatively an amount of Rs 44,202 crore could not be utilised.

FRBM Act and Defence Budget and Modernisation

The FRBM Act, 2003 was notified with effect from 5 July 2004. It required a reduction in two ratios, that is, revenue deficit and fiscal deficit as a percentage of GDP, and the target was to wipe out the revenue deficit and bring down the fiscal deficit to 3 per cent by 2007–08, which was later deferred to 2008–09. In the very first year of its implementation, 2004–05, it proved to be a turning point (fiscal deficit, which was 4.5 per cent in 2003–04 and was targeted to be 4.4 per cent in 2004–05, actually came down to 4.01 per cent). In 2007–08, the government had managed to cut the fiscal and revenue deficits to 2.7 per cent and 1.1 per cent of the GDP, respectively. However, given the international financial crisis of 2007, the deadlines for the implementation of the targets in the Act were suspended. As a result, the fiscal deficit rose to 6.2 per cent of GDP in 2008–09 against the target of 3 per cent set by the Act for that year.

Initially, the revival of fiscal prudence was expected in 2010–11 but it was further delayed. While presenting the budget for 2012–13, the finance minister had introduced amendments to the FRBM Act as part of Finance Bill, 2012. As per the amendments in 2012, the government was to take appropriate measures to reduce the fiscal deficit, revenue deficit and effective revenue deficit (effective fiscal deficit excludes from fiscal deficit those revenue expenditures [or transfers] in the form of grants for creation of capital assets) in order to eliminate the effective revenue deficit by 31 March 2015. It was then to build up adequate effective revenue surplus (revenue receipts minus revenue expenditure, excluding expenditures [or transfers] in the form of grants for creation of capital assets). It would then mean that the revenue surplus plus capital receipts and permissible fiscal deficit would be used to create capital assets.

Finance Act, 2015 extended the target dates for achieving the prescribed rates of effective deficit and fiscal deficit. The effective revenue deficit, which had to be eliminated by March 2015, now needed to be eliminated only after three years, that is, by March 2018. The 3 per cent target of fiscal deficit, which was to be achieved by 2016–17, was now shifted by one more year to the end of 2017–18 (see Table 9).

The FRBM Act certainly brought in much-needed fiscal discipline, as can be seen from Figure 4 (for the FRBM period) and Figure 5 (for the period when FRBM Act had either not been promulgated or was suspended). The figures capture the fiscal deficit target as prescribed as per the FRBM Act at the BE stage and the actual deficit based on actual expenditure.

The actual figures for these periods indicate that, in the FRBM period, when the economy did better than expected (2004–05 to 2007–08), the actual total expenditure could exceed the BE figures, yet the fiscal deficit target would be met. But when the economy did not perform as well as expected, the government had to curtail its expenditure below the BE figure. In the non-FRBM period, the government was generally generous and far exceeded its expenditure over the budgeted figures.

Impact on Defence Budget and Modernisation

It can be seen from Table 10 that it was only in 1999–2000 and between 2008–09 and 2011–12 that the actual defence expenditure exceeded the defence budget BE (the 6th CPC arrears were paid in 2008–09 and 2009–10; and to prevent the situation as a result of global financial crisis from worsening further, the government came out with three fiscal stimulus packages[20] to keep up the growth momentum). Also, it was only in 2010–11 that the capital expenditure exceeded the BE figure (see Table 10). In all the other 16 years, the capital expenditure was substantially less than the BE and had to absorb the extra revenue expenditure or contributed to achieving the fiscal deficit target.

The FRBM Act was applicable from 2004–05 onwards (except 2008–09 to 2011–12). Figure 6 brings out that in all the FRBM years, the amount of actual fiscal deficit amount had to be brought below the BE figures to ensure that the fiscal deficit target was met. This reduction as a percentage of the total government expenditure was between 1–3.37 per cent and the average was 1.82 per cent. Because the absolute amount of fiscal deficit had to be brought down, the total defence expenditure had to be reduced and the average percentage by which the actual defence

Table 9 Fiscal Deficit Targets and Achieved Percentage before FRBM Act and Subsequent to its Implementation (Rs crore)

Year	*Budget Estimate (BE)*			*Actual*			*Difference between the Fiscal Deficit Figure at BE Stage and at as per Actual Expenditure of the Union Budget*
	Total Expenditure	*Fiscal Deficit*	*Fiscal Deficit as a % of GDP*	*Total Expenditure*	*Fiscal Deficit*	*Fiscal Deficit as a % of GDP*	
2016–17	1978060	533904	3.5				
2015–16	1777477	555649	3.9	1773269	532351	3.9	23298
2014–15	1794892	531177	4.1	1663673	510817	4.04	20360
2013–14	1665297	542499	4.8	1559447	502863	4.43	39636
2012–13	1490925	513590	5.1	1410372	490190	4.85	23400
2011–12	1257729	412817	4.6	1304365	516269	5.79	–103452
2010–11	1108749	381408	5.5	1197328	373591	4.87	7817
2009–10	1020838	400996	6.8	1024487	418482	6.79	–17486
2008–09	750884	133287	2.5	883956	336992	6.21	–203705
2007–08	680521	150948	3.3	712671	126912	2.69	24036
2006–07	563991	148686	3.8	583387	142573	3.5	6113
2005–06	514344	151144	4.3	506123	146435	4.1	4709
2004–05	477829	137407	4.4	497682	125202	4.01	12205
2003–04	438795	153637	5.6	514344	123272	4.5	30365
2002–03	410309	135524	5.3	399451	131306	5.32	4218
2001–02	375223	116314	3.2	362453	140955	6.14	–24641
2000–01	338487	111275	5.1	325611	118816	5.69	–7541
1999–2000	283882	79955	4	298111	104744	5.35	–24789

Source: BE figures as per union budget and actual expenditure as per 'Accounts at a Glance' issued by CGA, various years (figures for 2015–16 are as per RE in union budget).

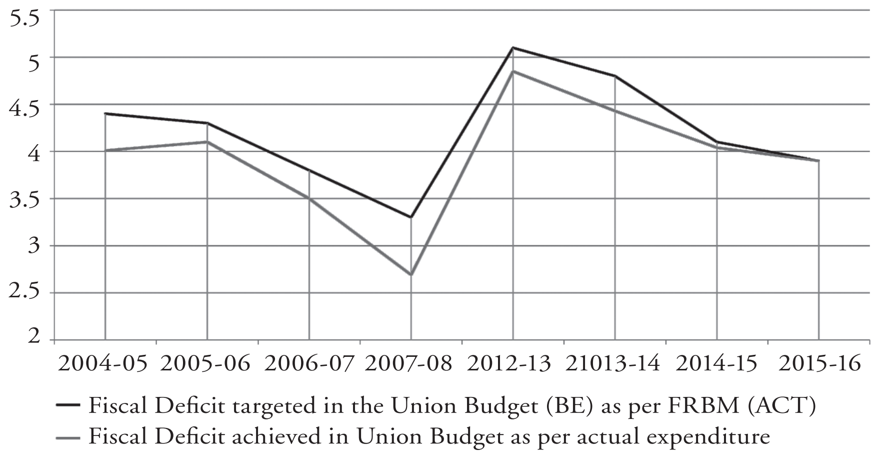

Figure 4 Fiscal Deficit as Percentage of GDP for Years When FRBM Act was Applicable

Source: BE figures as per Union Budget and actual expenditure as per 'Accounts at a Glance' issued by CGA.

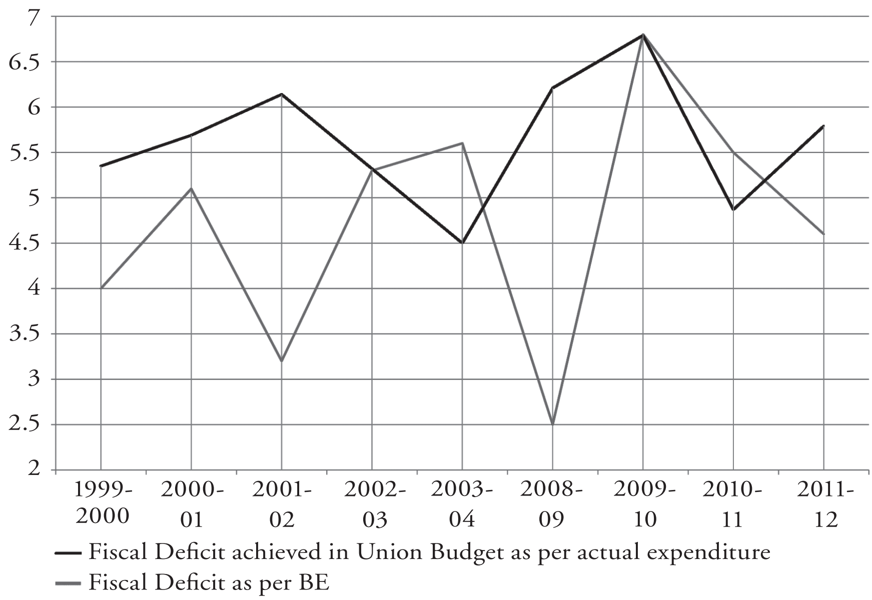

Figure 5 Fiscal Deficit as Percentage of GDP for the Years Preceding the FRBM Act and When Held in Abeyance

Source: BE figures as per Union Budget and actual expenditure as per 'Accounts at a Glance' issued by CGA.

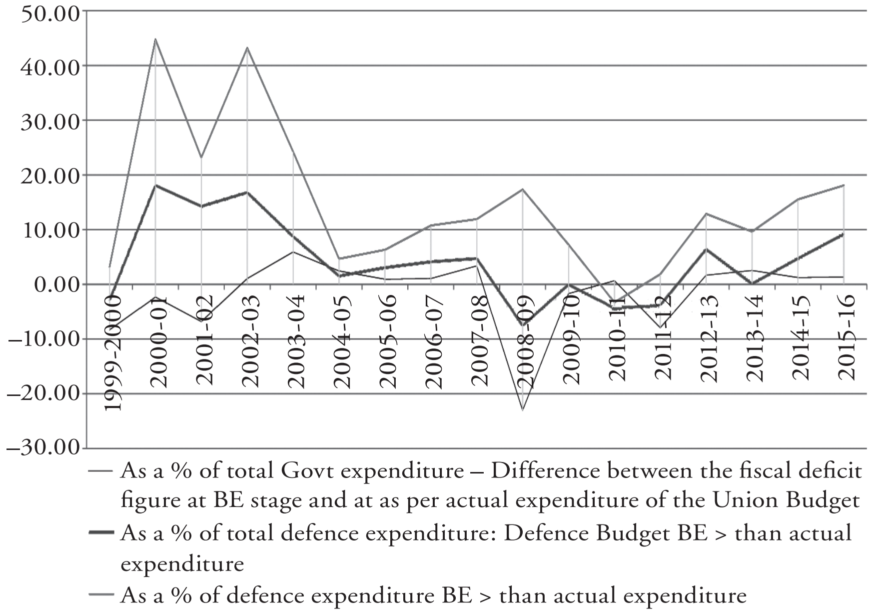

Figure 6 Percentage Variation over the Actual Expenditure between the BE Allocation and Actual Expenditure

Source: BE figures as per Union Budget and actual expenditure as per 'Accounts at a Glance' issued by CGA (various years) and DSE Vol. I figures for defence expenditure.

expenditure was reduced was 4.21 per cent. However, the maximum percentage reduction had to be under defence capital expenditure and the average for the FRBM period was 11.21 per cent. In the non-FRBM period, the actual amount of fiscal deficit was higher than the budgeted figure (except for 2002–03 and 2003–04, the years preceding the coming into effect of FRBM Act). However, it can be seen that the defence capital expenditure exceeded the BE figure only in one of the non-FRBM years.

Implications of Underutilisation of Funds Allocated

As stated earlier, the adverse implications of the underutilisation of funds allocated at the BE stage, as seen in Table 10, have been articulated every year in the report of the Standing Committee on Defence. However, this underutilisation appears to have enabled MoF to achieve the fiscal deficit targets laid down in the union budget and to meet the obligations under the FRBM Act. This has resulted in the underutilisation of the

Table 10 Defence Budget at BE Stage and Actual Expenditure (Rs crore)

Year	*Defence Budget/ Expenditure*		*BE > than Actual*	*Capital Budget/ Expenditure*		*BE > than Actual*
	BE	*Actual*		*BE*	*Actual*	
2015–16	246727	226045	20682	94588	80117	14471
2014–15	229000	218694	10306	94588	81887	12701
2013–14	203672	203499	173	86741	79125	7616
2012–13	193407	181776	11631	79579	70499	9080
2011–12	164415	170913	-6498	69148	67902	1246
2010–11	147344	154117	-6773	60000	62056	-2056
2009–10	141703	141781	-78	54824	51112	3712
2008–09	105600	114223	-8623	48007	40918	7089
2007–08	96000	91680	4320	41922	37462	4460
2006–07	89000	85495	3505	37458	33826	3632
2005–06	83000	80549	2451	34375	32338	2037
2004–05	77000	75856	1144	33483	31994	1489
2003–04	65300	60066	5234	20953	16863	4090
2002–03	65000	55662	9338	21411	14953	6458
2001–02	62000	54266	7734	19959	16207	3752
2000–01	58587	49622	8965	17926	12384	5542
1999–2000	45694	47071	-1377	12230	11855	375

Source: DSE Vol. I.

Note: FRBM Act became effective from Financial year 2004–05. 1999–2000 to 2003–04 represents period prior to FRBM Act. FRBM Act implementation was suspended between 2008–09 to 2011–12.

capital budget funds allocated (BE) for modernisation and infrastructure development. The picture of the last five years has been tabulated in Table 11.

This trend lends credence to the following perception prevalent among the defence services:

> So, even if you reach the end of the procurement cycle and only the CFA sanction is required and goes to the Ministry of Finance, they are well aware of the financial condition, how much money is there in the overall budget and they start applying their checks… So, when these things go to the Ministry of Finance, we find that there is a slowing down and the money would not come.[21]

Table 11 Share of Underutilised Defence Capital Budget in Containing the Fiscal Deficit to the Targeted Percentage

Year	*BE Fiscal Deficit*	*Actual Fiscal Deficit*	*Change in Amount of Fiscal Deficit*	*Capital Budget Amount Underutilised*	*Defence Capital Budget Underutilisation as a %age of the Amount by which Fiscal Deficit Figure had to be Reduced to Meet FRBM Target*
2011–12	412817	516269	(+)103452	1296	Non-FRBM Year
2012–13	513590	490190	23400	9080	38.80
2013–14	542499	502863	39636	7616	19.21
2014–15	531177	510817	20360	12701	62.38
2015–16	555649	532351	23298	14471	62.11

Source: BE & Actual fiscal deficit as per Budget at a glance – a document presented as part of the Union Budget. Also, defence capital budget underutilised as per data given in Table 10.

During the first four years of the 12th Plan beginning with 2012–13, the growth rate of the GDP was less than the figure projected at BE stage. Hence, at RE stage, the government had to reduce the figure of total government expenditure so as to ensure that the actual fiscal deficit was reduced and was contained in the targeted FRBM percentage. This was done by reducing the RE figure for the current financial year under budget heads in which the expenditure had been low till January preceding the budget presentation. Defence capital budget identified itself as such because of low actual expenditure.

The wide gap between projections and allocation is also indicative of differing perceptions between the defence and the finance establishments. Strategic foresight demands that India's military strength and capabilities relate to diverse challenges by way of a not unlikely two-front war, the attendant imperatives for a 'Cold Start' capability, non-conventional challenges from non-state actors, counter-terrorism capabilities and unavoidable internal security responsibilities.[22] Projection of fund requirement by defence establishments has to cater for filling significant capability gaps in terms of weapons platforms, ammunition/armament, sensors, key infrastructure, life cycle sustainment strengths, etc. These need to be bridged urgently before the objective of a strong and dissuasive/deterrent conventional military strength can be said to have been fully met. The situation is rendered even more difficult with the current readiness/serviceability levels of major weapon platforms and low levels of war wastage reserve (WWR) ammunition. The finance establishment, on the other hand, is single-mindedly focused upon managing expenditures within the available resources and is hemmed in by the necessity of complying with the FRBM Act. This is also borne out by an extract of the recommendations of the 22nd Report of the Standing Committee on Defence:

> During the deliberations on Demands for Grants (2016–17), the Defence Secretary very candidly submitted before the Committee that the money allocated for Capital acquisition was not in accordance with the requirements of the Services. The Services get whatever is allocated by the Ministry of Finance. The often repeated explanation of the Ministry in regard to the allocations not being commensurate with the projections is centered on the overall resource constraints of Government of India. Although, assurances are given by the way of stating that additional allocations would be provided as and when required at the supplementary/RE Stage, the matter gets postponed to the subsequent years. Moreover, when the threat perception is on the increase, the Services seem to be falling back. The Committee cannot accept the stance of the Ministry which implies that the Services have to manage with whatever is allocated. Proactive steps need to be taken for effectively countering the threat scenario.[23]

Adverse Impact on Capability Building

The Oxford Dictionary defines the term 'capability' as 'the power or ability to do something'. In the military context, it is defined as 'forces or resources giving a country the ability to undertake a particular kind of military action'. It is said that:

> The notion of military capability as the output level of national power is premised on the understanding that a country's military organisations receive national resources and transform them into specific war fighting capabilities. The war fighting capabilities thus generated are effective to the degree that they enable a country's leaders to impose their will on enemies, existing and potential.[24]

Military capability today involves being able to respond to an increasingly wide range of scenarios, often in extremely short time frames, for example, inter-state wars, peacekeeping, the expanding requirements of security such as rescuing hostages in a terrorist holdout and providing protection from piracy, cyber warfare, biological weapons, etc., to quelling rioters in communal strife to counter-insurgency operations, humanitarian assistance and disaster relief and, last but not the least, being the national instrument of the last resort in any contingency when the designated instruments of the state fail to deliver.[25]

Military effectiveness is the outcome of the resources provided to the military and its ability to transform these resources into effective war-fighting capability. The military knows only one way to transform these resources to effective capability, and that is through training. General George S. Patton's popular adage—'The more you sweat in peace, the less you bleed in war'—dictates the daily life of a soldier, sailor and air warrior till the time s/he is in service. Physical training (PT/parade), classes, weapons training, exercises, sailing and flying are part of the daily routine. Training encompasses all operational situations and it prepares him/her to willingly make the supreme sacrifice in the service of the nation. Training is the nursery where the future leadership is nurtured so to be able to seamlessly take command of a section/unit/ship/squadron even while an operation is underway, should a contingency arise. This activity in equipment-intensive services (platform-based arms of the army, navy and air force) uses expensive resources and the platforms require regular preventive maintenance. Budget constraints lead to two major consequences as follow:

1. The scaling down of training activity has an effect on all that is achieved through it.
2. Old weapon systems and platforms must give way to the new in order to constantly upgrade the capabilities of the equipment, both to match the perceived threats and capabilities of the adversaries and to replace the ageing systems with the latest technology. Budgetary constraints blunt the edge that the military wants to maintain over its adversaries and operating ageing weapon systems/platforms to the limits and beyond their specified technical life is demanding both on the manpower and resources that are required to maintain them.

Defence Budget and GDP

Conventionally, a country's defence expenditure is seen as a percentage of the GDP. The primary reason for using GDP as the denominator is that it has a consistent definition followed by all countries, international financial institutions as well as the United Nations (UN). However, some analysts argue that GDP is not a resource available with the government and it should be seen with reference to the central government expenditure (CGE). This is a valid argument, but it does have a limitation: it cannot be used for comparison with the military expenditures of other countries since the federal structure of each country is different.

Since the focus is on the Indian defence budget, let us first look at the defence expenditure's relationship with CGE. To put it in perspective, defence expenditure along with two other elements (which make the top three categories), that is, interest and subsidy, are plotted in Figure 7.

As can be seen, defence expenditure at 18.76 per cent had the highest share of CGE in 1976–77. Progressively, the government has been spending a lesser percentage of its total expenditure on defence. It has come down to 12.58 per cent in 2015–16, which is a drop of 6.18 percentage points over the years.[26]

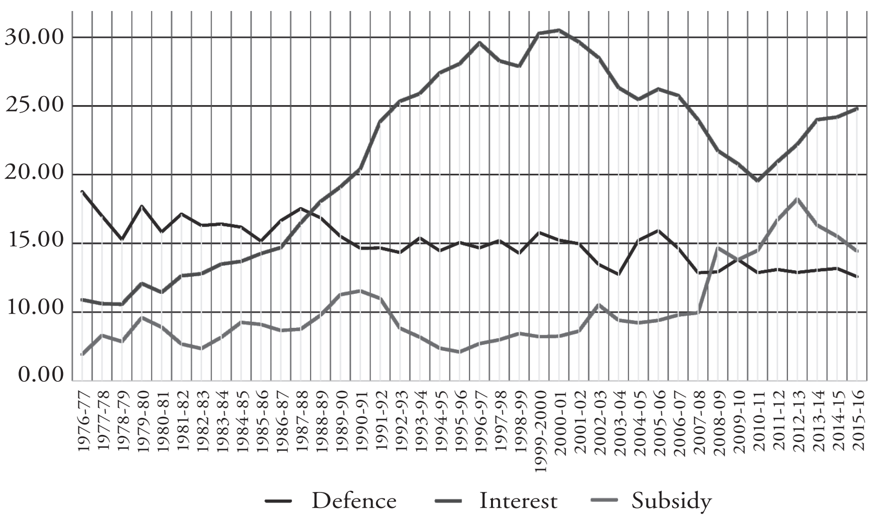

Figure 7 Three Major Items of Expenditure as a Percentage of Central Government Expenditure

Source: 'RBI Table 102: Major Heads of Expenditure of the Central Government'. Data for 2014–15 (actual expenditure) and 2015–16 (RE) has been updated from Union Budget figures. See https://www.rbi.org.in/scripts/PublicationsView.aspx?id=16543, accessed on 1 December 2015.

India's Defence Expenditure as a Percentage of GDP

Indian defence expenditure as a percentage of GDP has been plotted in Figure 8. Defence pensions till 1983–84 were part of the defence budget. However, from the subsequent year's budget, defence pensions were shifted to Demand No. 19 of the defence civil estimates without any reason being assigned to the move. Since then, defence pensions have continued to be a part of the same demand (but are now referred to as Demand No. 21). Hence, for the purpose of uniformity, the pension element included in the defence expenditure up to 1983–84 has been reduced.

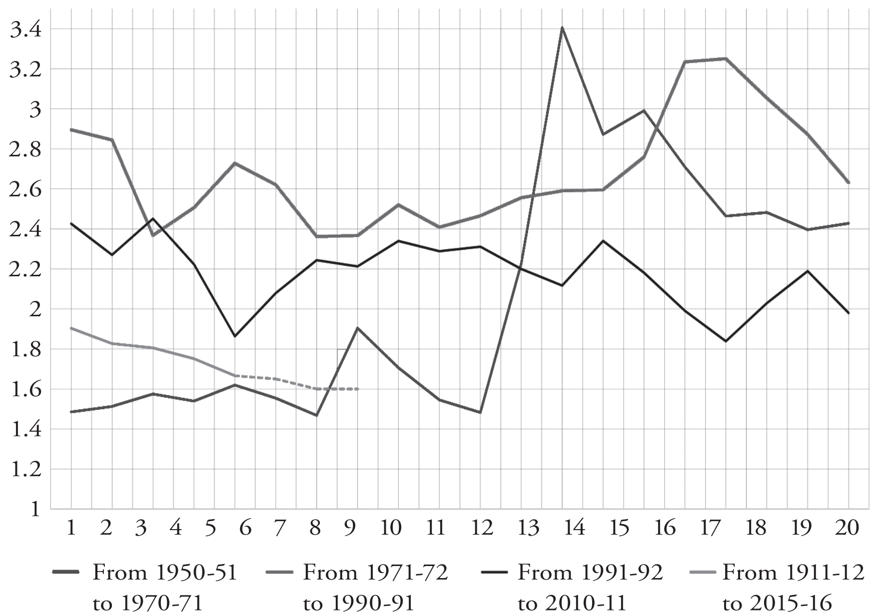

Figure 8 Defence Expenditure as Percentage of GDP

Source: Defence Expenditure figures as per DSE Vol. I and GDP figures as per Economic Survey 2015-16 and Union Budget documents.

Note: Projected percentage based on BE 2016–17 and for 2017–18 and 2018–19. Total defence expenditure (both revenue and the capital heads) is estimated at about 1.6 per cent of GDP in 2017–18 and 2018–19.27 The line based on this indicated that the trend for 2017–18 and 2018–19 will merge with the trend of defence expenditure in relation to GDP in the late 1950s and early 1960s.

Defence Budget as Percentage of GDP: How Much is Needed?

Popular perception articulated by veterans in the recent past and reports of the Standing Committee on Defence suggest that 3 per cent of GDP should be allocated for defence. Although they cite no specific basis for the same, some of the observations that have been offered are:

1. It is generally believed that LTIPP 2012–27 is based on the assumption that the defence budget would be approximately 3 per cent of GDP throughout the 15 year period.[28]
2. It is fervently hoped that the defence allocation gets close to 3 per cent of GDP.[29]
3. In India, though the LTIPP is based on a hypothetical 3 per cent of GDP, defence allocations have never really touched that mark.[30]
4. Apprising the Committee about the major challenges faced by the Indian Army, an army representative recommended a gradual increase in budget allocation from 1.7 per cent to 3 per cent of GDP.[31]
5. 'The Committee are given to understand that Defence expenditure as a percentage share of Gross Domestic Product (GDP) in some of the developed and neighbouring countries is in the range of 2% to 4% and it is growing every year. On the other hand, our Defence expenditure as a percentage to GDP is in reverse mode and declining every year. In 1999–2000; the Defence expenditure was 2.41% of the GDP and it had a continuous slide and since then this financial year, it came down to 1.78% of the GDP. The Committee perceive it to be a grim and unacceptable situation which is affecting all the Services of Defence forces considerably. The Committee desire that the Ministry should raise the bar and gradually increase Defence expenditure at the level of 3% of GDP so that modernization of Armed Forces can become a reality and not remain a mirage.'[32]

These statements probably draw their inference from what former Prime Minister, Manmohan Singh, said in a speech at the Combined Commanders Conference held in October 2005:

> In the Arthashastra, Kautilya wrote that a healthy economy is a sound foundation for well-funded armed forces. 'From the strength of the treasury', he said, 'The army is born'. But it is not only for fiscal reasons that the health of our economy is important for our

> national security. A healthy, growing and stable economy in itself enhances security. New notions of 'Comprehensive National Power' give high weightage to economic, social, scientific, technological, educational and cultural aspects of power. Military strength alone no longer guarantees a nation's security. Knowledge power and economic capabilities are equally important.
>
> Our armed forces have always been assured that our Government will never shy away from finding funds for our defence requirements and I endorse what the Defence Minister has said in his address. It should be obvious, however, that any Government will find it easier to find the required resources if the economy grows faster and generates the incomes and revenues required. *If our economy grows at 8% per annum it will not be difficult for us to allocate about 3% of our GDP for our national defence. This should provide for a handsome defence budget.* Hence, our priority is to pursue policies to generate faster economic growth and mobilize more resources (emphasis added).[33]

While the former prime minister's statement that defence expenditure could be about 3 per cent can be seen as the government's long-term policy, the reality is that the current percentage share of GDP for defence—as specified in the Medium-term Fiscal Policy Statement, Union Budget 2016–17—for 2017–18 and 2018–19, is 1.6 per cent. Given this reality, the defence forces need to engage and discuss with relevant bodies, such as Niti Aayog, Finance Commission and MoF, while vision document, report and allocations are being finalised.

Based on the BE allocated each year and the requirement worked out based on maintaining the purchasing power of 2006–07 actual expenditure figures, the average of GDP (excluding the years 2008–09 and 2009–10 when the 6th CPC arrears were paid) is tabulated in Table 12.

The North Atlantic Treaty Organization (NATO) countries, which, with the exception of new Eastern members like Ukraine, have no physical threat to their territorial integrity, and despite the United States' (US) assurances, feel the need to spend 2 per cent of their GDP on defence. The NATO, at its September 2014 Wales Summit (attended by heads of state and governments), issued a declaration:[34]

1. Allies currently meeting the NATO guideline to spend a minimum of 2% of their Gross Domestic Product (GDP) on defence will aim to continue to do so. Likewise, Allies spending

Table 12 Defence Expenditure as a Percentage of GDP

FY	*GDP*	*Purchasing Power Parity (PPP) Based on Indian Defence-specific Inflation (IDSI)*	*% of GDP*	*BE*	*% of GDP*
2006–07	4294706	85495	1.99	89000	2.07
2007–08	4987090	93971	1.88	96000	1.92
2008–09	5630063	126674	2.25	105600	1.88
2009–10	6477827	155022	2.39	141703	2.19
2010–11	7784115	160174	2.06	147344	1.89
2011–12	8980860	181222	2.02	164415	1.83
2012–13	9951344	208773	2.10	193407	1.94
2013–14	11272764	236122	2.09	203672	1.81
2014–15	12488205	248927	1.99	229000	1.83
2015–16	13567192	262668	1.94	246727	1.82
Annual Average (excluding years 2008–09 and 2009–10 when Pay Commission arrears were paid)			2.009		1.889

Source: GDP and BE figures as per union budget document; PPP-based requirement based on IDSI as worked out by the author.

more than 20% of their defence budgets on major equipment, including related Research & Development, will continue to do so.

2. Allies whose current proportion of GDP spent on defence is below this level will:
   – halt any decline in defence expenditure;
   – aim to increase defence expenditure in real terms as GDP grows;
   – aim to move towards the 2% guideline within a decade with a view to meeting their NATO Capability Targets and filling NATO's capability shortfalls.
3. Allies who currently spend less than 20% of their annual defence spending on major new equipment, including related Research &

> Development, will aim, within a decade, to increase their annual investments to 20% or more of total defence expenditures.

Here, it should be noted that the NATO definition of defence expenditure includes pension payments. For the period 2009–15, average of the total defence expenditure of all members of NATO as a percentage of the total GDP of all members has been between 3.3–2.41 per cent.[35] Therefore, to begin with, India's defence expenditure as defined today should be gradually increased to 2 per cent of GDP in view of the unique security challenges.

It is a fact that India faces unique and formidable external security challenges.[36] In contrast to most other major countries, India's entire northern border with China is unsettled, and there is a Line of Control (LoC) in Jammu and Kashmir (J&K) and not a border with Pakistan. This means that while it is the normal responsibility of any state to protect its frontiers and its territorial integrity, the responsibility of the Indian state in this regard is that much more onerous.

What makes India's security situation particularly tough is the nature of the countries contesting its borders and the capabilities they possess. One of these is China, which not only occupies Indian territory but, in addition, also claims other large parts of Indian territory. China has become a formidable economic power in the last three decades or so, outperforming India decisively. With the massive financial resources at its command, it has developed its military muscle to a degree that now gives it confidence to assert its territorial claims more aggressively than ever before. For its part, Pakistan has actively sought to disturb the status quo through direct military action, infiltration, ceasefire violations, inciting violence across the border, encouraging separatists in J&K to keep the situation continually on the boil and deploying various instruments of terror. India's external security environment is almost unique in that there are two powers on its borders that claim portions of its territory; both are nuclear weapon powers and cooperate with each other against India.

The Way Forward

There has been a steady decline in the share of defence expenditure both as a percentage of the GDP and in the total government expenditure. Personnel-related expenditures, like P&A, ration and clothing, are the first charge on the allocated resources. Only the balance available from the reducing share of defence allocations is available for O&M, infrastructure and modernisation. While this has affected all the three, the reduction of allocation for capital works and modernisation has been substantially higher, which has adversely impacted capability building that is urgently required. The following are the recommendations:

1. As a first step, MoD and the defence services need to augment their capability to spend and avoid recurring underutilisation of allocated budget estimates. Defence capital budget allotted at the BE stage has not been fully utilised since 1999 (except in 2010–11; see Table 10). Most countries have dedicated acquisition workforce. The only way to do that is through 'training'. While a committee has been set up to study the setting up of a 'Defence Procurement Organisation', such restructuring will not be enough. Imparting 'acquisition training' is a must.
2. The MoD also needs to review its policy of CBRP. If for some reasons this cannot be reversed, CBRP expenditure should be introduced as a separate subhead under the capital budget so that the actual amount spent on modernisation is clearly discernible.
3. The Parliament Standing Committee on Defence needs to focus on recurring underutilisation of funds allotted as BE and address the weaknesses in the system.
4. The defence planning process has been historically linked to the national five-year planning process. The 1st Five Year Defence Plan (1964–69) was initiated during the 3rd Five Year Plan, and the Five Year Plan period was synchronised with Five Year Plans of the Planning Commission from the 4th Plan onwards, that is, 1969–74. Service headquarters (HQs) began drawing up the first 15 year perspective plan from 1979 and the concept of LTIPP was introduced in 2001. The existing planning process is based on the 15 year LTIPP, the five year SCAP and the AAP, which is in fact a two-year roll-on plan. The last of the Five Year Plans, the 12th Plan (2012–17), ends next year. Five Year Plans will now make way for a larger and more focused 15 year 'National Development Agenda' that will include internal security and defence as well. Niti Aayog plans to complete the preparation of the 15 year vision document by December 2016, as it wants the next general budget to be guided by the long-term development strategy. It is expected that there will be subsets like a seven year

strategy to convert the vision document into implementable policy and a three year action plan from 2017–18 to 2019–20 as part of the National Development Agenda. In this context, the MoD needs to review its existing planning process and align it with the new process.

5. The yawning gap that exists between 'what is needed to maintain and sustain capability build up' and the funds annually allotted and spent as per budgetary constraints needs to be bridged. Formation of the Strategic Policy Group (SPG) was the first level of the three-tier structure of the National Security Council (NSC). It forms the nucleus of the decision-making apparatus of the NSC. This well-represented group would be the right platform to reconcile this gap. It is also mandated to undertake the 'Strategic Defence Review', a blueprint of short- and long-term security threats, as well as possible policy options on a priority basis. But it has been non-functional for long. The SPG, therefore, needs to be revived and empowered to fulfil its mandate.

Notes

1. See 'Allocation of Business Rules—Second Schedule', available at http://cabsec.nic.in/allocation_secondschedule.php, accessed on 12 September 2016.
2. Available at http://cabsec.nic.in/allocation_secondschedule.php, accessed on 12 September 2016.
3. Available at http://www.mod.nic.in/forms/List.aspx?Id=57&displayListId=57.
4. International Monetary Fund (IMF), *World Economic Outlook: Too Slow for too Long*, Washington, DC: IMF, April 2016, Table 1.1.
5. Para 1.4 of the 22nd Report of the Parliament Standing Committee on Defence, 16th Lok Sabha, available at http://164.100.47.193/lsscommittee/Defence/16_Defence_22.pdf, accessed on 15 July 2016
6. MoD, Government of India, *Fifteenth Report: Demands For Grants (2012–2013)*, Standing Committee on Defence (2011–12), 15th Lok Sabha, April 2012, p. 16, available at http://164.100.47.134/lsscommittee/Defence/FINAL%20DFG%20%20REPORT%20-2012-13.pdf, last accessed 9 January 2017.
7. *Report of the Fourteenth Finance Commission*, Vol. 1, p. 70, chapter 6, para 6.35 presented on 15 December 2014.

8. *Report of the Fourteenth Finance Commission*, Vol. 1, p. 70, chapter 6, para 6.35.
9. Unstarred Question No. 4110, answered in the Lok Sabha on 9 December 2016.
10. Laxman Kumar Behera, *Indian Defence Industry: An Agenda for Making in India*, New Delhi: Pentagon Press, 2016, p. 44.
11. Laxman Kumar Behera, *Indian Defence Industry: An Agenda for Making in India*, New Delhi: Pentagon Press, 2016, p. 44.
12. Ministry of Defence (Finance) ID No 11(9)/B-I/2003 dated 4 December 2003, attached as Appendix to Government of India, MoD letter No. PC-11(1)/Bud1/2007, dated 25 September 2007, available at http://cgda.nic.in/ifa/orders/cir_25_09_07.pdf, accessed on 15 July 2016.
13. *Classification Handbook Defence Services—Receipts & Charges 2014*, issued by The Controller General of Defence Accounts, New Delhi.
14. Government of India, MoD letter No. PC-11(1)/Bud1/2007, dated 25 September 2007, available at http://cgda.nic.in/ifa/orders/cir_25_09_07.pdf, accessed on 15 July 2016.
15. DSE, Vol. I, 2016–17.
16. Provisional figures as per CGA website.
17. Planning Commission, Government of India, 'Faster, Sustainable and More Inclusive Growth: An Approach to the Twelfth Five Year Plan (2012–17)', October 2011, p. 25, available at http://planningcommission.gov.in/plans/planrel/12appdrft/appraoch_12plan.pdf, accessed on 10 April 2013.
18. Ibid.
19. Finance Commission India, *Report of the Fourteenth Finance Commission,* Vol. 1, 2015, p. 70, chapter 6, para 6.36, available at http://finmin.nic.in/14fincomm/14fcreng.pdf, accessed on 15 July 2015.
20. Asian Development Bank Institute, 'Fiscal Policy Issues for India after the Global Financial Crisis (2008–2010)', ADBI Working Paper No. 249, September 2010, available at www.adb.org/sites/default/files/publication/156104/adbi-wp249.pdf, accessed on 27 December 2016.
21. MoD, Government of India, *Seventh Report: Demands for Grants (2015–2016)*, Army (Demand No. 23), Standing Committee on Defence (2014–2015), 16th Lok Sabha, April 2015, p. 15, available at http://164.100.47.134/lsscommittee/Defence/16_Defence_7.pdf,.accessed on 10 June 2015.
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23. Para 6 of the recommendation of 22nd Report of the Standing Committee

on Defence, 16th Lok Sabha. http://164.100.47.193/lsscommittee/Defence/16_Defence_22.pdf accessed on 15 July 2016

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26. One per cent of CGE in 2015–16 represents Rs 17,854 crore. Therefore, had it been maintained at the level of CGE in 1976–77, the defence budget of 2015–16 would have to be higher by over Rs 110,000 crore.
27. 'Medium-Term Fiscal Policy Statement', presented as part of the Union Budget for 2016–17, p. 15, para 66, available at http://indiabudget.nic.in/ub2016-17/frbm/frbm2.
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