SSPC SPECIAL REPORT

Indian Defence Budget 2016-17: A Curtain Raiser

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SUMMARY

- Defence budget cannot be stretched beyond a point, which means Defence Minister Manohar Parrikar has a tough choice for resources deployment.
- Reducing revenue expenses and more spending for capital purchases pose the biggest challenge for Indian MoD
- National defence budget is all about 'revenue' side of armed forces and their 'capital' requirements. But, is India spending adequately on defence R&D?
- National Defence Budget must be reasonably used to get maximum value for the state and its preparedness.

Once again, it is time to ponder as to what kind of a Union Budget will the Finance Minister present on the floor of the Parliament on 29th February. Most aspects of Indian economy have already been deliberated in public domain, except for the usual suspect – 'national defence'. As a 'non-plan' category, defence budget seldom gets the scrutiny or attention that others receive, although together with budget for homeland security and other categories (like atomic energy and space, which have security dimensions) it accounts for more than a quarter of central government expenditure. Still, it receives least attention.

Should India's national defence budget be discussed and deliberated in public domain? If the answer is to the affirmative, then four fundamental questions pop up: a) how much resources need to be devoted toward national defence?; b) how much should go toward military equipment and services (capital expenditure)?; c) how much should be spent on revenue side (salaries, pensions, welfare for the armed forces, etc.); and d) last but not the least, how much resources should be devoted toward military R&D? Complexities of national military power suggest that definitive amounts cannot be assigned to such questions. However, reasonable assessments can always be arrived at, subject to further debate.

Balancing Resources and Equipment Modernization

An attempt has been made to assess all four intertwined sectors of resources allocations in this series. It examines capital, revenue, and R&D sides of defence budget in the first three parts and then assesses their locations in the national defence budget in the last part. So, 'capital defence expenditure' first.

Capital side of the defence budget essentially consists of military procurement contracts already signed in the previous year/s and factored into the budget. This is called 'committed liabilities', which as indicative trends suggest for the past decade, hovers between 80 and 90 percent of the capital expenditure. This leaves between 10 and 20 percent (depending on the spending pattern) for fresh military equipment acquisitions. In between, at times MoD has to return the money already budgeted for because of its inabilities to spend the allocated money in the same year primarily because of non-fruition of contracts within the same year. This used to be rampant in the past and hence called ‘unspent syndrome’.

Indicative trends again suggest a curious curve in the last decade – while there are years when ‘actual’ capital expenditure has met targets, there are bouts of ‘unspent syndrome’ creeping in as well. For example, the year 2015-16 (budget estimates, announced in FY 2015) may witness ‘unspent syndrome’ of the previous year, to the tune of almost 40% of the capital budget unspent, as reported recently. Latest expenditure data, as claimed by a prominent newspaper, show that over INR 37,000 crore of the defence ministry's modernisation budget remains unutilised as of December-end 2015, with the Army struggling the most, having spent only 45% of its capital allocation. According to the same report, the MoD could not spend 22% of the initially allocated INR 80,545-crore capital budget for the three armed forces during 2014-15. It is assumed that such unspent syndrome could be worse with the MoD could fall short of its target of signing deals worth over Rs 1 lakh crore this year.

Unspent money normally goes back to the centre or some of it adjusted in revenue expenditure. If one looks at acquisition approvals announced by the current government, we are looking at more than INR 3,20,000 crore worth of acquisitions, which need to be budgeted from this year onward, although none of the projects have been factored into thus far. If another set of approvals, as told by the Defence Minister a month back, worth about INR 80,000 crore, cumulatively we are looking at more than INR 4,00,000 crore. Making matters worse, bulk of these project approvals have been pending for years. If new acquisitions are to be planned, then buying cost could escalate further.

Larger acquisition scenario for equipment modernization from a long term perspective (between 2015 and 2027, which marks the end of approved 15 Year Long Term Integrated Perspective Plan) would suggest at least ten time that of what has been approved in the last 18 months. In sum, it will be a gigantic challenge for the government to how to deploy its financial resources for force modernization. Even if revised capital expenditure fall short of budgeted expenditure for last year (INR 95,000 crore), some money could be deployed this year along with an expected 15 percent increase in budget estimates for the coming year. Even if we are looking at an assumed figure of INR 1,10,000 crore or a little more, it may not be enough to meet expectations. It will be a herculean task for the MoD to balance resources for ‘committed liabilities’, approved and new projects with an eye on long term equipment modernization.

Capital purchases thus need to be carefully planned in order to make a fine balance between available resources, which cannot be stretched beyond a point, and necessities. The shopping list looks too big, as all services require, not only replenishing but also enhancing fighting capabilities through advanced systems. From fighters, land-based systems to warships and submarines – you name it, we require dozens of them. It would be really a task for the planners as to how they manage to meet aspirations by committing resources. The forthcoming defence budget could provide us some clues to assess how the Indian military power will look like in time to come.

Balancing Revenue and Capital Allocations

Arguments on capital expenses revolve round three points: a) more weapons acquisitions are necessary, given the imbalanced nature of Indian arsenal heavily tilted toward obsolescence and shortage; b) need for a well planned systems acquisition across services for rationalized allocations; and most importantly, c) given the manpower intensive nature of Indian armed forces and contemporary and futuristic security needs, a balanced approach to resources allocations for national defence must be considered.

It is the third point – balancing 'revenue' and 'capital' allocations – which tops ministerial consideration, a problem grappled with by Indian military planners for decades. The fact is that India cannot devote more resources toward military purposes than it ought to for a variety of reasons. At the most, it can allocate close to 1.8 or 1.9 percent of its GDP for national defence. Realistically, one can not expect more than this for the very simple reason that other national priorities would always precede national defence considerations, although analysts will cite data related to other countries' resources allocations, which itself is a futile exercise. Argument against such analytics would be that Indian national security, which includes resources allocations for national defence (MoD), internal security (MHA), military aspects of atomic energy (DAE) and space (Department of Space), cumulatively consume close to a quarter of central government budgeted expenditure. This is objectively confusing and subjectively debatable.

Given various considerations, revenue side of Indian defence budget does not seem to be coming down, despite noble efforts. Revenue expenditure for national defence refers to resources allocated for salaries, related expenses like military stores, etc. for the 1.3 million strong armed forces, including infrastructure and welfare. Pension (which was about INR 56,000 crore in the last budget) is not included in the defence budget. At times, it also includes revenue expenses for military / revenue infrastructure, which consumes a significant proportion of military budget. This particular category caters to infrastructure spends on various projects like multi billion dollar projects on married accommodation or military infrastructure, etc. Indian Army is the most manpower intensive organ for obvious reasons, while Air Force and Navy, including Indian Coast Guard personnel number less than the Army.

Trends for the past one and half decade suggest that revenue expenses for the Indian armed forces hover between 57 to 63 percent of the defence budget, depending on specific years when either capital budgets have eaten into the budget or unspent money from capital budget have helped the revenue side in percentage terms. In fact, revenue expenditure has as a trend indicator in percentage terms has come down from a high of 78 to 81 percent during 1970s through to early 1990s to the current levels of 57-58 percent in the last three years. This may sound encouraging, but in actual value terms, it still accounts for a large chunk of the budget. If recent projects and announcements are taken into consideration, this year's budget could be somewhere near INR 1,70,000 crore, primarily because of implementation of seventh pay commission compensation, one rank one pay (OROP) advances (in installments) and ex-servicemen health scheme (ECHS), to name a few. Only OROP advances could be as high as INR 12,000 crore alone, according to one recent report. Although pension is not a part of defence expenditure, such commitments could raise the overall budget further. And if such items are included in the budget, the defence budget could account for nearly 2.3 or 2.4 percent of GDP. Even is some unspent capital expenditure from last year is adjusted in some of revenue categories in revised estimates for 2015-16, the total defence budget is still likely to be heavily tilted toward 'revenue' vis-à-vis 'capital' expenditure. The projected figure would have been even greater, if creation of two mountain divisions were approved, which could have necessitated additional phased expenses to the tune of INR 80,000 crore in the next three to five years. In sum, against an ideal modern fighting machine for India that is lean and mean with advanced system support to undertake any conventional or emerging assignments, which should have a balanced ratio of 50:50 in its resources for soldiers and weapons, it appears to be struggling for a well crafted and balanced budget. Revenue expenditure could account for nearly 70 percent of the total expenditure.

Apart from the need for fine tuning the revenue budget, which itself is a gigantic task and which has not yet been warranted by any quarter within the MoD simply because of lack of interest from either civil or military side, there are other constraints as well. Chief of the Army Staff General Dalbir Singh Suhag, in a recent interview to a major news paper, vehemently defended the manpower intensive nature of Indian Army and explained that due to the prevailing security scenario the number of soldiers should actually grow. His argument and a strong sentiment among serving and retired military personnel effectively put a blanket ban on any debate on right-sizing the armed forces. Even though there is no interest among members of strategic community to deliberate on this subject, there is no evidence of it being discussed even within relevant government agencies.

Rightsizing, one should understand, does not necessarily mean reduction of numbers for larger security forces, a small step can begin by demobilization of identified sections into other security agencies for specific roles for which necessary training and demobilization related necessities can be undertaken on a pilot basis. China has in the past exercised this option by demobilizing an estimated 2,50,000 soldiers to People's Armed Police (PAP). Some European countries during the post-Cold War period in the 1990s have also attempted rightsizing through demobilization with varying degree of success. In India's case, modernized soldiers as systems require costly weapons and support, which otherwise means highly trained soldiers for specialized responsibilities at the core of the structure and support from other categories for conventional responsibilities. Military planners, it is high time, should contemplate on this aspect.

Indian defence budget can not be stretched beyond an acceptable level and in a time of economic sluggishness world over with impacts on Indian economy, it would be interesting to examine larger nuances of defence budget this year.

Spending on defence R&D must be adequate

It must be understood that deployment of resources by the state can be objectively identified, but results are subjectively interpreted. This is more complicated in the field of national defence, where general data is available, but specifics elude analytical interpretations. To cite, India spends slightly more than USD 40 billion for national defence (1/12th of what the US spends or 1/4th of what China spends). It spends less than 1.8 percent of its GDP (US spends 4 plus percent, while China spends close to 6 percent). Interpreted thus, India is actually under spending on its national defence. However, if India spends close to 2 percent (or even 3 percent as suggested by the 13th Finance Commission in 2013), its defence expenditure has to touch nearly one and half times of what it has spent last year. This is highly unlikely under current circumstances, even though India has witnessed a GDP growth of 7.3 percent in a turbulent global economic conditions.

Indian defence budget is conventionally usual about 'revenue' or 'capital' allocations. We talk about how much money should armed forces spend for their salaries, pensions, infrastructure, weapons, services, etc. But it is high time that we must contemplate on investments into real military capability development. This can only happen when the State allocates adequate resources for military R&D and industrial capacity development. If great powers invariably possess great arms industries, as history has repeatedly demonstrated, it is high time that India allocates a significant portion of its resources toward military R&D and industries. Has it done the needful? An in-depth examination shows to the contrary.

Technically, defence R&D budget is a part of Indian defence budget, so are budgets for defence industries, specifically the Ordnance Factories (OFs). The latter is always in negative territory, suggesting that state-owned defence industries seldom receive central grants, rather they contribute to national exchequer by providing dividends through profits as they claim. However, a recent study by Josy Joseph of The Hindu, demonstrates that bulk of Indian defence PSUs have shown profits, not through selling of products but through interest accruals from their advanced receipts collected from their customers – Army, Navy and Air Force! As a recent entrant, private sector's contribution to national resources minimization has not yet begun. In sum, domestic industrial capacity has yet to show desirable results.

Indian military R&D budget goes to DRDO, the organization responsible for design, development and innovation in military systems and technologies. Its budget has been hovering between INR 8,000 to INR 12,000 crore in the last five years, which roughly accounts for less than 6 percent of the defence budget. Imagine, a country, which devotes less than 6 percent of its meager budget and expects its premier military scientific establishment to design fifth generation systems!

Bulk of the DRDO funding goes into existing or on-going design and development programmes, leaving very little for new projects. This trend almost remind us of deployment of capital expenditure, where 'committed liabilities' far outnumber 'fresh acquisitions'. Almost all specialized domains, which are directed by Director General (seven in number) and Chief Controllers (six in number) with ten technology clusters (spread across 51 laboratories) are now responsible for execution of projects and accountable to the Defence Ministry.

Beyond resources for DRDO, which appears unable to spend bigger budget, there are issues that require attention. India is the only major country in the world, where military R&D (DRDO) and production (Defence PSUs and Ordnance Factories) are distinct organizations, horizontal and seamless institutional interactions are almost non-existent. As like other organs, DRDO is also vertically structured, with representation at the top decision making bodies. Chief of DRDO used to wear three hats, which has now been reduced to two. Efforts to reform DRDO (implementation of P Rama Rao Committee recommendations) have not yielded desirable results. Sacking of the previous DRDO chief and appointment of two scientists as head of DRDO and scientific advisor to the defence minister are instances in recent times, which may pave the organization to some structural changes in future.

A comparative assessment of military R&D budgets of major countries suggest that while India spends around USD 2 billion, the US spends close to USD 90 billion, China has significantly raised its budget to USD 40 billion (almost equivalent of India's defence budget!), so has Russia, whose R&D budget is close to USD 18 billion. China's spectacular record in accounting for nearly 13 percent of the global military expenditure is indicative of its growing military prowess and its decision to invest heavily in R&D speaks volumes of its super power intent. The US has consistently increased its investment in R&D. Consider this: post-Cold War American military resources allocations plummeted by 40 percent between 1989 and 1996, where most of the organs witnessed massive cuts, but R&D budget was untouched. Major powers understand the importance of innovation and quality R&D in military sector, which along with industrial capacity make them powerful. India should understand this and deploy at least 10 percent of its budget for R&D.

Time Ripe for a Hard Look

Indian Defence Minister Manohar Parrikar has made the following important points in the current session of the Parliament and elsewhere in the last one month. Consider these: a) if pensions for forces are included in the defence budget, it could account for 2.2 percent of GDP; b) eight squadrons of light combat aircraft in the next eight years; c) world's highest battlefield in Siachen Glaciers would not be vacated; d) all service chiefs should review and cancel old and irrelevant defence purchase proposals; e) India is seriously considering fighter plane purchase under 'Make in India' category; and f) transparent defence procurement will save money.

Security considerations aside, most of these statements have one thing in common – how to rationalize resources for maximization of India's national defence interests. None of his predecessors have touched upon so many important points in such aplomb in a relatively short time, which otherwise suggests that he is firmly settled in his position and is not afraid of opining on contentious issues.

What kind of a defence budget is the government likely to propose this year? Will it witness a substantive increase beyond an average increase of 12 percent from previous year's revised estimates to be somewhere between INR 2,80,000 and 3,00,000 crore (last year's budget was INR 2, 46, 727 crore)? How will a modest increase, say for example, increase of 7-8 percent, be viewed at by the country in general and armed forces in particular? Most importantly, how much should India ideally allocate for its national defence purposes? Such questions need in-depth examination.

Resources allocations on national defence can be broadly analyzed based on facts and figures (although minor details on specifics still elude research based interpretations), but relating them to results on ground is always a subjective interpretation. This is the reason as to why, in the absence of detailed data and when blended with aspirations of armed forces, Indian defence budget is always perceived to be deficient, especially by retired military officers, bureaucrats and journalists. As analyses on defence budget seldom get into fundamentals, deficient resources allocations overwhelm our collective imagination.

A set of four perceptions needs to be deconstructed. First, India is spending much less in comparison to its known adversaries as well as (known) major powers. This is largely true in terms of military expenditure in both current and constant prices. In both terms, the percentage of US military expenditure has come down from 53 to percent in the last five years, while the same has graduated from 8 to 12 percent in the same period for China. Many such data based inferences can be drawn. India's share is slightly below 2 percent of global military expenditure, an improvement from 1.4 percent from 2010. Such figures are confusing for the very simple reason that bulk of military expenses, as provided by countries on a yearly basis, disclose little of their resources allocations and hide some details.

Second, at a national level, India is supposedly spending less on national defence. Parrikar deconstructed this notion in his statement in the Parliament, unprecedented in the history of budgetary estimates in India. As repeatedly argued in my previous pieces on resources allocations for national defence over a period of time, India's spending on national defence has been reasonable, keeping in mind our cumulative national resources and priorities. India's declared devotion to national defence stands roughly at 14 percent of central government expenditure (CGE) and about 1.7 percent of GDP, which excludes pensions and a few other items. Insights from responsible quarters suggest, items like 'military stores' contain items that should actually be in 'capital' side. Taken together, as Parrikar said, India's defence budget would account for 2.2 percent of GDP. Please note that last years defence pensions was close to INR 56,000 crore. You have to factor in OROP (INR 12,000 crore), ex-welfare health insurance (close to INR 2000 crore) and 7th pay commission liabilities (exact figure yet to be in public domain) in time to come. Such expenses, if included in 'revenue' side of expenditure, could actually radically deconstruct our earlier assumptions about a 55 (revenue) : 45 (capital) ratio, in favour of revenue expenditure – a horrendously imbalanced national defence budget. Parrikar must be applauded for bringing this anomaly in defence budget calculations.

Third, Parrikar's statements on eight squadrons of fighters, emphases on fighter aircraft production through indigenous means, transparent procurement procedures for pruning of capital expenses and abandoning of long-pending and irrelevant purchases, point to one simple point with three connotations – tighten your belt, be ready for collaborative approach but make products and systems here, and most importantly, be ready for a pruned budget. He has already given a hind that against an import bill of INR 35,000 crore in 2014-15, a INR 1,000 crore reduction has already been witnessed in 2015-16. This indicative trend is likely to continue till he is at the helm of affairs.

Last but certainly not the least, Parrikar, a minister who seems to ask basic questions and has demonstrated a habit of shaking rank and file of organs he heads (sacking of head of DRDO without much murmur in public, branding armed forces as 'erratic buyers', instructing armed forces to review their defence procurement plans, to cite a few), must have advised his colleague Arun Jaitley on what kind of a budget he wants.

Indian defence budget 2016-17 is thus going to be a defining development, to say the least. Each aspect of the budget needs to be deconstructed further.

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