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Vinay Kaushal

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Defence Planning and Budget Dilemma

Introduction

The North and South Blocks are situated across each other on the Raisina Hill, New Delhi. Along with numerous other offices, the North Block houses the Ministry of Finance (MoF) and the South Block houses the Ministry of Defence (MoD). As these are two very important cabinet portfolios, the finance portfolio, even in the era of coalition governments, has been always held by senior leaders of the party leading the coalition government and the defence portfolio has been held by senior leaders of the party leading the coalition government/senior-most leader of the coalition partner. In two spells of about one year in the present dispensation, these portfolios have been held by the same incumbent. Yet when it comes to resources needed for or available for defence, it has literally remained a one-way communication. While the government has done away with the Five Year Plan, the MoD has formulated the 13th Five Year Plan and continues to plan without reference to the resources likely to be available.

The 31st Report of the Parliamentary Standing Committee on Defence has observed:

> The Defence Five Year Plans are formulated to chalk out the necessary steps to maintain and augment defence capabilities in line with the Raksha Mantri's Operational Directives, the Long Term Perspective Planning (LTIPP) and the current threat perception. These plans help to estimate the outlay required to achieve the planned objective. The plan period of 10th Plan was 2002-07, 11th Plan was 2007-12 and 12th Plan was 2012-17. To the utter surprise of the Committee, these Plans did not receive Government approval. …As per the Ministry of Defence, while formulating guidelines for the 13th Defence Plan it was decided that the Plan may be sent to Ministry of Finance for information only and not for its approval. The Ministry of Finance will be kept

> in loop about the requirements of the Defence Forces in the coming years….

Peter F. Drucker, the founder of modern-day management, had summarised the above-mentioned situation years ago in his famous quote, "Unless commitment is made, there are only promises and hopes; but no plans." On the other hand, any plan, howsoever good it may be, when made by refusing to see "the writing on the wall" in terms of the resources indicated or likely to be made available is also destined to fail "Plans flounder on the "champagne tastes, beer budget" syndrome.

All reports of the Parliamentary Standing Committee on Defence examining the demands for grants that constitute the defence budget have stated that the funds demanded have not been allotted. In the given context, the aim of the paper is to examine defence expenditure during the 12th Plan period, both from the budget and planning perspective, and the way forward.

Defence Budget

What is Considered "Defence Budget?"

Till 2015-16, the MoD was allotted funds under eight demand numbers (21-28). Of these, Demand Nos 21 and 22 were not included in what is popularly referred to as defence budget. Then, as part of a rationalisation exercise, the total demands for grants were reduced to four. This called for fund requirement of certain demand numbers to be clubbed together. Although the number of demands was retained as four in 2017-18, the demand numbers were changed and fund requirement of certain organisations was reapportioned to another demand number within the MoD demands. The implication, if it settles as per 2017-18 demand numbers, is that Military Farms (MF) and Ex-Servicemen Contributory Health Scheme (ECHS), which were earlier part of defence budget, now move to MoD (Misc.) demand. However, for the sake of comparison of the defence budget, the figures in the tables in this paper have been compiled for what was known as the "defence budget" till 2015-16. Table 1 indicates the original demand numbers till 2015-16 and the changes made in 2016-17 and 2017-18.

Table 1: Demands for Grants in respect of the MoD

2015–16			2016–17			2017–18		
No.		*Also included*	*No.*		*Also included*	*No.*		*Also included*
21	Ministry of Defence (Misc.)	Secretariat including Defence Accounts Department, Border Roads, Coast Guard, Defence Estates, Jammu and Kashmir Light Infantry, Armed Forces Tribunal, Canteen Stores Department.	20	Ministry of Defence (Misc.)	In addition to the organisations already included in Demand No. 21 till 2015–16, the following were added: DGOF, DRDO, DGQA, NCC, RR, ECHS and MF.	19	Ministry of Defence (Misc.)	In addition to the organisations already included till 2015–16, only ECHS and MF were retained under this demand.
22	Defence Pensions	Pension of defence personnel and all civilian personnel whose salary is paid under Demand Nos 21–26.	21	Defence Pensions	Pension of defence personnel and all civilian personnel whose salary is paid under Demand Nos 20, 22–26.	20	Defence Services (Revenue)	In addition to organisations included under Demand No. 22 in 2016–17, the following were added: DGOF, DRDO, DGQA, NCC and RR.
23	Defence Services, Army	MF, ECHS, inspection organisation (DGQA), RR and NCC.	22	Defence Services (Revenue)	Army, Navy (including Joint Staff) and Air Force which were covered under Demand Nos 22–24 were consolidated under one demand.	21	Capital Outlay Defence Services	Capital outlay of all whose revenue budget is under Demand No. 20.
24	Defence Services, Navy	Joint Staff (HQ IDS and formations under HQ IDS).	23	Capital Outlay Defence Services	Capital outlay of all whose revenue budget is under Demand No. 22.	22	Defence Pensions	Pension of defence personnel and all civilian personnel whose salary is paid under Demand Nos 19 and 20.
25	Defence Services, Air Force				Revenue expenditure			
26	Defence Ordnance Factories (DGOF)				Revenue expenditure			
27	Defence Services Research and Development (DRDO)				Revenue expenditure			
28	Capital Outlay Defence Services				Capital outlay for all organisations covered under Demand Nos 22–26.			

Note: DGOF: Director General of Ordnance Factories; DRDO: Defence Research and Development Organisation; DGQA: Directorate General Quality Assurance; NCC: National Cadet Corps; RR: Rashtriya Rifles; HQ IDS: Headquarters Integrated Defence Staff.

Source: Union budget document for the years 2015-16, 2016-17 and 2017-18.

Projections, Allocations and Actual Expenditure

The annual fund requirements are a subset of the Five Year Plans already finalised, submitted and tweaked for changes that come up. The 12th Plan period was from 2012-13 to 2016-17. Table 2 shows the annual projections submitted for the defence budget, the budget allocated at Budget Estimates (BE) stage as approved by the Parliament as part of the annual budget and the actual expenditure. The allocations in all the years have been substantially less than the projections.

Table 2: Defence Budget-Annual Projections, Allocation and Expenditure (Rs in crores)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Army	103740	112968	119697	147686	141707	154622#	196186
Navy	40541	44479	52940	47824	44815	51726	52110
Air Force	56202	56838	90530	89482	75824*	66990*	92496
DRDO	14843	14464	16483	18459	19642	18783	19936
Ordnance Factories Board (OFB)	-310	2197	2150	4142	5323	3862	2767
Total Projections	215015	230946	281800	307593	287311	295983	363495
Budget Allocated (BE)	161665	193407	203672	229000	246727	249099	262390
Actual Expenditure	170913	181776	203499	218694	225895	251781	

Source: Data from 29th and 31st Reports of the Parliamentary Standing Committee on Defence.

Notes: (i) * Air Force projections in 2015-16 and 2016-17 did not include projections for Rafael aircraft as the request for proposal (RFP) for 126 medium multi-role combat aircraft (MMRCA) was retracted.

(ii) # Includes allotment to NCC, MF, RR, DGQA and ECHS, which were shifted to modified Grant No. 20, MoD (Misc.), in fiscal year (FY) 2016-17, but have been transferred back to Defence Services Estimates (DSE) in FY 2017-18, with the exception of MF and ECHS, for the purpose of comparison with previous as well as future years.

In their budget speeches, the finance ministers have sugarcoated the lower allocations by promising more funds if the need arises, highlighting the importance of defence. For example:

1. "In the Budget 2011-12, a provision of Rs 1,64,415 crore has been made for Defence services, which include Rs 69,199 crore for capital expenditure. Needless to say, any further requirement for the country's defence would be met."[1]

2. "In the Budget for 2012-13, a provision of Rs 1,93,407 crore has been made for Defence Services, which include Rs 79,579 crore for capital expenditure. As always, this allocation is based on present needs and any further requirement would be met."[2]

3. "I propose to increase the allocation for Defence to Rs 2,03,672 crore. This will include Rs 86,741 crore for capital expenditure. The Minister of Defence has been most understanding, and I assure him and the House that constraints will not come in the way of providing any additional requirement for the security of the nation."[3]

4. In the budget speech of 2014-15 in July 2014, defence was mentioned at 11 places with reference to allocation, one rank one pension (OROP), modernisation, defence production, foreign direct investment (FDI) and the sugarcoating was, "There can be no compromise with the defence of our country."[4]

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[1] Budget 2011–2012, Speech of Pranab Mukherjee, Minister of Finance, 28 February 2011, para 116.

[2] Budget 2012–13, Speech of Pranab Mukherjee, Minister of Finance, 16 March 2012, para 121.

[3] Budget 2013–14, Speech of P. Chidambaram, Minister of Finance, 28 February 2013, para 101.

[4] Budget 2014–15, Speech of Arun Jaitley, Minister of Finance, 10 July 2014, para 139.

5. The budget speech of 2015-16 had no sugarcoating but stated, "Defence of every square inch of our motherland comes before anything else. …This year too, I have provided adequately for the needs of the armed forces. As against likely expenditure of this year of Rs 2,22,370 crore the budget allocation for 2015-16 is Rs 2,46,727 crore."[5]

Whether sugarcoated in the speech or not, the allocations have been less than requested and the share of defence expenditure as percentage of the gross domestic product (GDP) and the central government expenditure (CGE) has been steadily declining (see Table 3).

Table 3: Defence Expenditure as a Percentage of GDP and CGE (Rs in crores)

Year	Defence Expenditure	GDP	CGE	As a % of GDP	As a % of CGE
2011-12	170913	8736329	1304365	1.96	13.10
2012-13	181776	9944013	1410372	1.83	12.89
2013-14	203499	11233522	1559447	1.81	13.05
2014-15	218694	12467959	1663673	1.75	13.15
2015-16	225895	13764037	1790783	1.64	12.61
2016-17	251781	15253714	1975194	1.65	12.75
2017-18 (RE)	267108	16627585	2217750	1.61	12.04
2018-19 (BE)	282733	18722302	2442213	1.51	11.58

Sources: First Revised Estimates Of National Income, Consumption Expenditure, Saving And Capital Formation For 2016-17 accessed http://pibphoto.nic.in/documents/rlink/2018/jan/p201813101.pdf acessed on

5 Budget 2015–16, Speech of Arun Jaitley, Minister of Finance, 28 February 2015, para 86.

31 Jan 2018. GDP figures for 2018-19 as per Budget at a glance Union Budget 2018-19. CGE figures as per CGE figures and defence Expenditure as per Reserve Bank of India (RBI), 'Table 102: Major Heads of Expenditure of the Central Government', available at https://rbi.org.in/Scripts/PublicationsView.aspx?id=17877 accessed on 15 Dec 2017 and Union Budget, 2018-19

Capability Building and Operational Preparedness

What sets the defence budget apart from the budget of the other government organisations/departments is that while in most organisations and departments the budget is meant to meet the pay and allowances requirement, maintenance and running of an office and some building and works, the defence budget has to ensure operational preparedness of the defence services to meet potential threat and also enhance their capability through replacement of ageing weapon systems with latest technology platforms to match the adversaries.

Defence capability building needs to have a long-term vision and is a continuous process. There is a long-drawn evaluation and selection process. The selected weapon systems/platforms once ordered are produced at a steady rate to the exacting standards demanded. Also, the personnel to operate them have to be trained and have to acquire a degree of proficiency before a composite formation becomes operational as a fighting unit. A life cycle maintenance support system has to be put in place to sustain them through their operational lives, which could be as much as 40 years in the case of major platforms like aircraft, ships and tanks. These are not commercially "available of the shelf" and if adequate funding is not provided, it disrupts this capability-building process. Funds for capability building have to be provided in the capital budget.

Operational preparedness is attained and maintained through continuous rigorous training, which is a man-machine interface, and coordinated single-service or multi-service exercises are a regular feature. Regular training hones and sharpens individual proficiency and teamwork, which is emphasised by the famous adage, "the more you sweat in peace, the less you bleed in war". The funds required for training, preventive and reactive maintenance, fuel, stores and transportation of man and material are met from the revenue budget. Pay and allowances is the largest component of revenue budget.

The implications of inadequate funding, as repeatedly apprised by MoD to the Parliamentary Standing Committee on Defence,[6] is that:

> **Capital**
>
> In so far as the Capital segment, 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. The procurement plan for Capital modernization schemes may have to be reviewed and re-prioritized, based on available funds."
>
> **Revenue**
>
> "Under the revenue segment, provision is first made for salary and other obligatory expenses. The balance allocation available is distributed to meet the requirement of stores (including ordnance), transportation (of personnel and stores), revenue works and maintenance, etc.

Defence Revenue Budget

The foremost charge on revenue budget is for pay and allowances and hence, funds are first allocated for this. The implications of the shortfall in revenue allocation against the projected requirement, based on the approach MoD apprised the Parliamentary Standing Committee on Defence, can be illustrated by taking the live example of allocations under the minor head "Stores". This head caters to what may be called as "operations and maintenance" expenditure for the three defence services. The total allocation for 2016-17 (BE) in respect of stores head for the army, navy and air force was Rs 29,550.23 crores (actual expenditure during 2015-16 was Rs 28,440.77 crores), an increase of 3.9 per cent over 2015-16, and this constituted 20.5 per cent of the total revenue budget for the three services.

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[6] The 31st Report of the Parliamentary Standing Committee on Defence of 16th Lok Sabha, para 1.7.

The total BE for 2017-18 is Rs 29,309.83 crores (Rs 240 crores less than previous year), constituting 17.8 per cent of the total revenue budget for the three services. The figures in respect of navy and air force are same as last year and in the case of army, it is lesser by Rs 240 crores. The 2016-17 Revised Estimates (RE) figures under stores for army and navy are the same as the BE figures, while for the air force, it is higher by about Rs 870 crores. Under the minor head "Stores", a subhead that is the single largest item of expenditure is for petrol, diesel and aviation turbine fuel (ATF), commonly referred to as POL. The ATF and diesel are high-consumption items being the fuel for aircraft, ships and land-based weapon platforms. Flying, sailing and field exercises are regular training activities to attain and maintain operational readiness.

Table 4: POL products Indices and Budget (all budget and expenditure figures in Rs crores)

Petroleum Products							Army		Navy		Air Force	
	Average Index for 2014-15	Average Index for 2015-16	Average Index for 2016-17	Average index Jan 2017 to Dec 2017	% Increase over 2015-16		BE 2016-17	BE 2017-18	BE 2016-17	BE 2017-18	BE 2016-17	BE 2017-18
Petrol	109	75.7	72.4	79.75	5.35	Actual Expenditure	2101	1951	1612	1395	3150	2164
Diesel	115	73.4	74.4	82.94	13.00							
ATF	105	69.5	69.3	75.73	8.97	2015-16	2030		1513		2897	
						2014-15	2575		1844		4117	
						% Change in BE 2017-18 over Actual 2015-16	-3.9		-8.5		-25.3	

Source: Indices figures are from http://eaindustry.nic.in/home.asp; and actual expenditure and BE figures are from DSE (2016-17; 2017-18).

Against a combined expenditure (of the three services) on POL of Rs 8,546 crores in 2014-15, the expenditure in 2015-16 was Rs 6,440 crores because of the fall in international crude oil prices in 2015-16, as seen in the indices of 2014-15 and 2015-16 (Table 4). In 2017-18, the budget allocation for these items is Rs 5,509 crores, which is 14.45 per cent less than the actual expenditure in 2015-16 whilst the indices of petrol, diesel and ATF have gone up by 5.35, 13 and 8.97 per cent respectively. This suggests arbitrary allocation. Since it will be detrimental to scale down training, at the RE stage additional allocation may be made by withdrawing funds from the capital budget, as has been a recurring practice.

The major challenge in defence revenue expenditure is that each service, and entities other than services, has grown in numbers (personnel) over the years, with no major structural or organisational changes. The share of personnel-related expenditure has grown much faster than the growth of the revenue budget thereby impinging upon the availability of funds for other revenue heads, including "operations and maintenance".

Defence Capital Expenditure

Defence capital expenditure is a subset of the capital expenditure of the government. Before focusing specifically on defence capital expenditure, we need to briefly look at government capital expenditure, as some of the issues that affect defence capital expenditure flow are inherent to capital expenditure.

Capital Expenditure

Capital expenditures[7] are those that are incurred with the objective of increasing concrete assets of a material and permanent character. These include expenditures incurred on acquisition of immovable assets, machinery and equipment and government equity investments. Debt operations of the government are also treated as capital expenditures.

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7 Ministry of Finance, Government of India, *Accounts at a Glance, 2006–07*, New Delhi: Controller General of Accounts, p. 10.

Non-Plan expenditure is a generic term, which is used to cover all expenditures of the government which are obligatory in nature, for example, interest payments, pensionary charges and statutory transfers to state and union territory governments. A part of the expenditure relates to essential functions of the state, such as defence, internal security, external affairs and revenue collection. All other expenditure is Plan expenditure. It may be either revenue expenditure or capital expenditure. However, with the planning process having been given a decent burial, there is now (from 2017-18) only capital and revenue expenditure.

Default Bias against Capital

Two recent studies done in India have brought out:

1. The revenue expenditure multiplier in India works only in the short run and is found to be lower than the overall multiplier. In contrast, the output effect of increase in capital outlay is found to be higher and more prolonged than other categories of expenditure.[8]

2. A value of 2.45 for capital expenditure multiplier translates to a strong impact of public investment on economic activity. The revenue expenditure multipliers are below unity. The transfer payments multiplier-which constitutes the effects of subsidies, pensions and other retirement benefits on output-has an impact multiplier of 0.98, while the multiplier constructed on the "other" revenue expenditure components is 0.99.[9]

The politicians, world over, hate cutting revenue (populist) spending. Over the years, successive finance ministers of India have cut fiscal deficit by further slaying capital spending, instead of limiting revenue spending. Capital expenditure of the central government has gone down from 43.08 per

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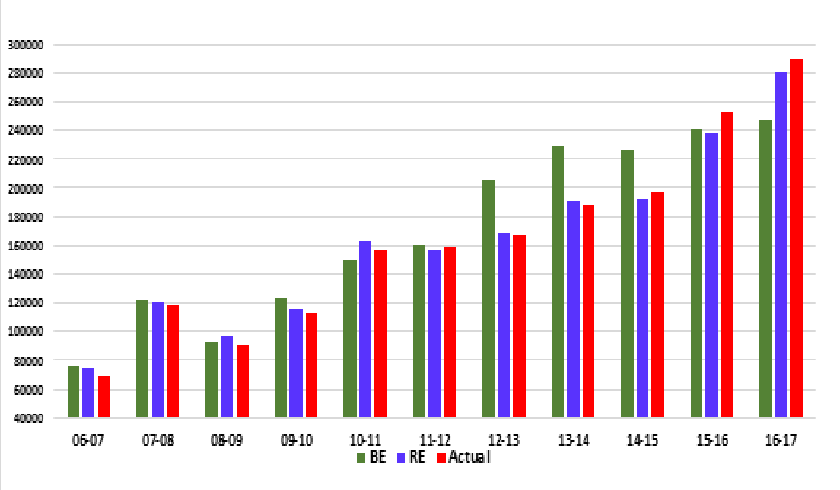
[8] Rajeev Jain and Prabhat Kumar, "Size of Government Expenditure Multipliers in India: A Structural VAR Analysis", RBI Working Paper Series No. 07, September 2013.

[9] Sukanya Bose and N.R. Bhanumurthy, "Fiscal Multipliers for India", Working Paper No. 125, National Institute of Public Finance and Policy, New Delhi, September 2013.

cent of CGE in 1979-80 to 11.82 per cent in 2014-15; and in the last three years, it has inched up to 14.43 per cent as per BE 2017-18.[10] This is not restricted to the political establishment and the temptation is hard to resist, as may be seen from a recent study which states, "To manage the fiscal deficit, the government needs to cut expenditure substantially. We estimate Rs 70,000 crore from the capital expenditure, as there could be a shortfall of Rs 1.1 lakh crore in revenue receipts."[11] Actual capital expenditure has generally been less than the BE except in the last two years (refer to Figure 1).

Figure 1: Total Capital Expenditure: BE, RE and Actual (Rupees in crores)



Source: Reserve Bank of India (RBI), "Table 102: Major Heads of Expenditure of the Central Government", available at https://rbi.org.in/Scripts/PublicationsView.aspx?id=17877, accessed on 15 December 2017.

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[10] As per data in RBI, 'Table 102: Major Heads of Expenditure of the Central Government'.

[11] 'Govt May Meet Fiscal Deficit Targets: SBI', *The Economic Times*, New Delhi, 24 October 2017, available at https://economictimes.indiatimes.com/news/economy/finance/fiscal-deficit-of-3-2-seems-not-difficult-in-fy18-report/articleshow/61180737.cms, accessed on 24 October 2017. This article cites a report by Soumya Kanti Ghosh, chief economist with the SBI group.

Since capital expenditure also includes debt operations of the government, we can disaggregate this expenditure and the capital expenditure after subtracting the government debt operations. The balance may be called capital outlay, that is, the amount utilised for creating assets. The defence capital expenditure forms a part of the capital outlay. As can be seen in Figure 2, from 1978-79, the share of capital expenditure as a percentage of CGE began to gradually decline till 2000-01. Thereafter it steadily increased till 2004-05 and then, again, started to decline (except a blip of 2007-08) till it reached its minimum of 10.2 per cent in 2008-09. After that it began to rise again and reached 14.43 per cent in 2017-18 (BE). The capital outlay share was steady in the range of 10-15 per cent till 1992-93 but went down steadily thereafter, touching the lowest of 7.04 per cent in 2002-03. It came back to double figures in 2004-05 and stayed in the range of 10-11 per cent (except for 2008-09 and 2009-10 when the economic bailout post-global financial crisis was restricted primarily to revenue expenditure). From 2015-16 onwards, it has been above 12 per cent. Defence capital expenditure, which is a part of the capital outlay, had a share between 1-2 per cent till 1986-87. Thereafter, till 2003-04, it ranged between 3.5-4.5 per cent. The blip of 2004-05 and 2005-06 was need based as major contracts were signed, but thereafter it has been steadily declining from 5 per cent in 2012-13 to 3.94 per cent and 4.03 per cent in 2016-17 and 2017-18 respectively.

The allocations for capital outlay (Rs in crores) when it touched its lowest share of CGE in 2002-03 to 2017-18 (BE) and the defence capital expenditure are plotted in Figure 3. The growth rate of defence capital expenditure has been slower in comparison post 2008-09.[12]

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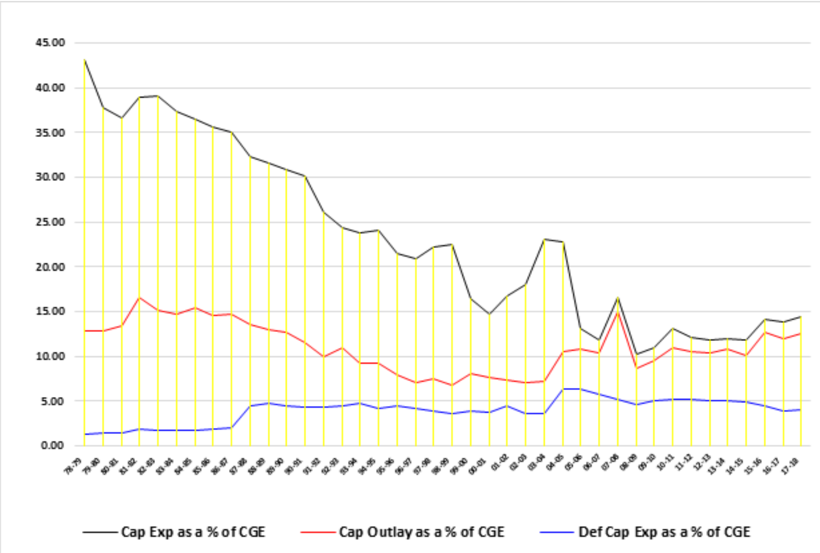
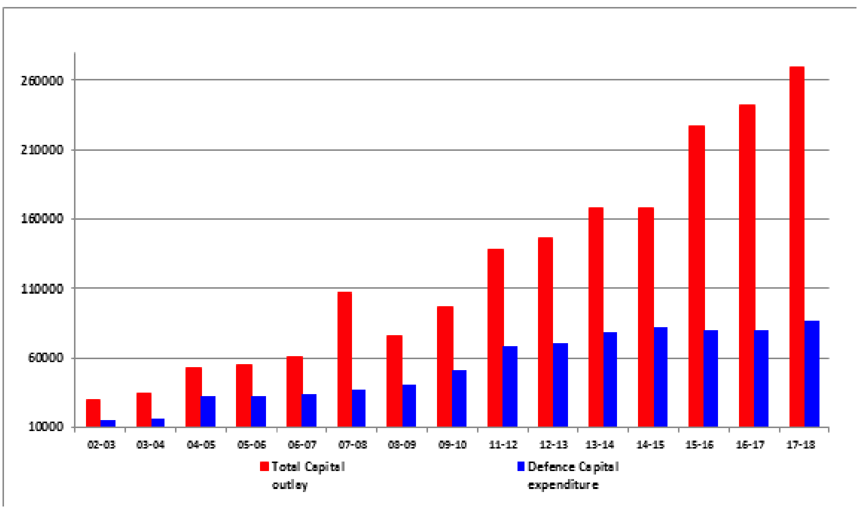
12 Source for data for Figures 3–6 is the union budget documents.

Figure 2: Capital Expenditure, Capital Outlay and Defence Capital Expenditure as a Percentage of CGE



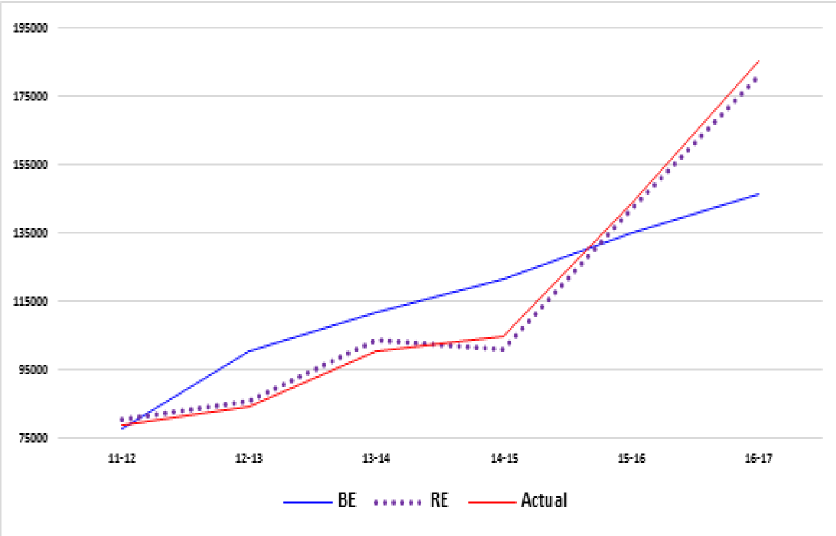
Source: Reserve Bank of India (RBI), 'Table 102: Major Heads of Expenditure of the Central Government', available at https://rbi.org.in/Scripts/PublicationsView.aspx?id=17877, accessed on 15 December 2017.

Figure 3: Total Capital Outlay and Defence Capital Expenditure (Rs in crores)



When we focus on the Plan and Non-Plan capital expenditure during the 12th Plan period (Figure 4), it is evident that BE for Plan capital expenditure shows a steady growth. In the first three years of the 12 Plan, allocations were reduced at the RE stage and the actual expenditure was around the RE. However, the RE in both 2015-16 and 2016-17 was higher than BE and the actual expenditure was even slightly higher than the RE.

Figure 4: Union Budget-Plan Capital Expenditure (Rs in crores)



However, in the Non-Plan capital expenditure, of which the defence capital expenditure is a major component, the RE has been revised substantially lower than the BE and the actual defence expenditure has been close to the RE figure. However, in the Non-Plan expenditure other than defence capital expenditure, the actual expenditure in 2015-16 and 2016-17 has been even higher than BE (see Figure 5).

A Detailed look at Defence Capital Expenditure

Having seen the issues that concern government capital expenditure, let us focus on defence capital expenditure and its implications.

Figure 5: Non-Plan Capital Expenditure and Defence Capital Expenditure (Rs in crores)

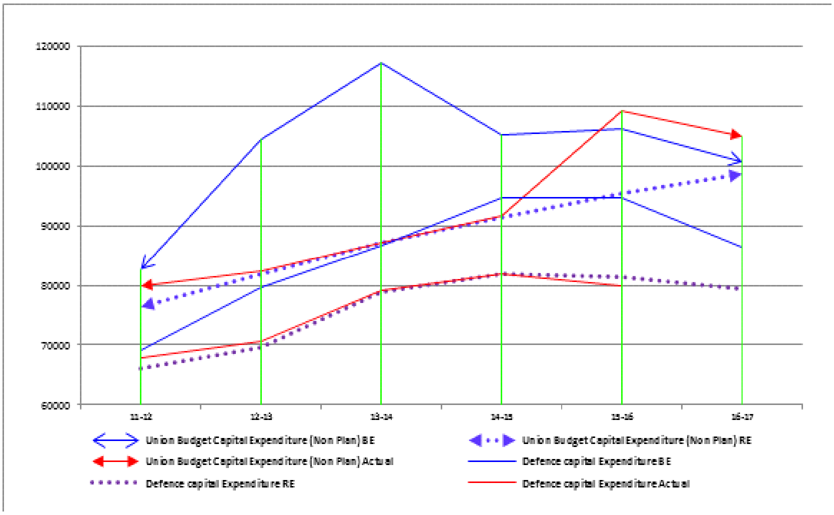
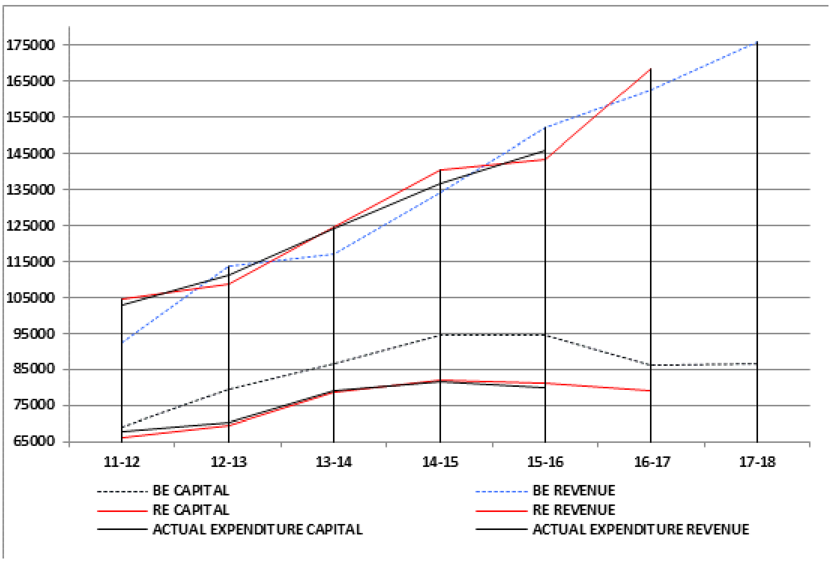


Figure 6: Defence Budget: BE, RE and Actual Expenditure (Rs in crores)

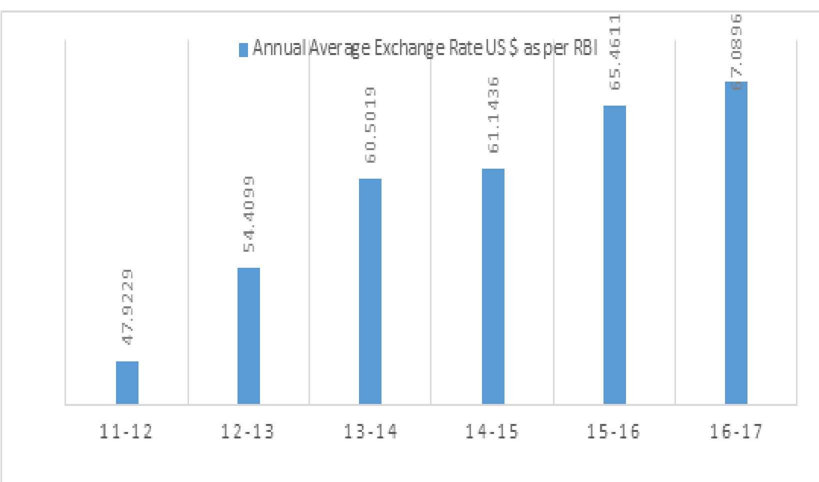


The gap between BE of revenue and capital, which was Rs 23,318 crores in 2011-12, has risen to 89,333 crores in 2017-18 and the ratio of revenue to capital, which was 57.2:42.8, is now 67:33. The allocations, as seen in Figure 6, have been substantially reduced in the capital budget at RE stage. While some of it is used for additional allocation to the defence revenue to make up for the shortfall, the balance reduction is utilised to meet the fiscal deficit target of the union budget. Whether it is the inefficiency of the defence acquisition system to process cases or the MoF which deliberately delays till it is too late for that financial year is an issue that has been debated for long. This adversely impacts capability building and modernisation of defence services.

Modernisation and Defence Capital Expenditure

Funds for modernisation of the defence services are made available out of defence capital expenditure. Figures 2-6 bring out that "capital budget allocation" gets lesser priority in comparison to revenue budget allocation. Within the capital budget allocation, the Non-Plan capital allocation receives a lower priority; and in the last two years of the 12th Plan, defence capital allocation has been worse off. Over and above this, the share and purchasing power of modernisation funds available in defence capital outlays have been further eroded by the following.

Figure 7:



Adverse Exchange Rate

India has been the largest importer of arms, weapon systems and platforms in the period 2012-16.[13] The weapon systems and platforms manufactured in the country have high import content both in terms of raw materials and bought out items. The rupee exchange rate has substantially gone up during the 12th Plan period as shown in Figure 7. This reduces the purchasing power of the capital budget.

Incentivising Domestic Value Addition to Help Make in India

To provide a level playing field to the domestic private sector for competing with the defence public sector units (DPSUs), in 2015-16, the government withdrew the excise duty exemptions available to OFB and DPSUs, as also the exemptions from countervailing duty (CVD) and special additional duty (SAD) for DPSUs, OFB and primary contractors of the MoD.[14] The impact of this was that excise duty at the rate of 12.5 per cent became chargeable on spares parts; and the impact of customs duty was 18.50-29.74 per cent on the material cost component. The exemption from customs duty of direct import by the MoD was also withdrawn through the Finance Bill, 2016-17 and basic customs duty (BCD) of 5-10 per cent, CVD of 12.5 per cent and SAD of 4 per cent was levied from 1 April 2016. The impact of this too would be 18.50-29.74 per cent. The result was that the sale price of supplies ex-DPSUs and OFB went up in 2015-16 and the price of direct imports also went up from 2016-17. This put a substantially additional financial burden on the scarce capital budget. This impacts the revenue budget too. The implementation of Goods and Services Tax (GST) has increased the service tax on defence-related items repaired/overhauled by DPSUs/OFB to 18 per cent rate slab, an increase of 6 per cent over the previous rate.

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13 Available at https://www.sipri.org/commentary/blog/2017/state-major-arms-transfers-8-graphics, accessed on 15 December 2017.

14 Notification No. 29/2015-Customs, dated 30 April 2015; and Notification No. 23/2015-Central Excise, dated 30 April 2015; and MoD I.D. No. 9(46)/2014/Level Playing Field Pvt. Sector (Taxes)/DP (Plg.V), dated 2 May 2015.

Capital Budget Revenue Procedure (CBRP)

The MoD decided, in 2007,[15] that expenditure on specified items listed in the letter (to which more items were added subsequent years), which are considered to be basically capital in nature but expenditure in respect of which was till then being booked to revenue heads, will be booked to capital heads as per the cost-life criteria being met in individual cases. It was also decided that procedure as laid down in Defence Procurement Manual (DPM) as applicable to revenue procurements will be followed for procurement of the items and the competent financial authorities (CFAs) for sanctioning such procurements will be determined with reference to the orders issued concerning delegation of financial powers for revenue procurements. However, offsets will not be applicable in respect of purchases under these orders. The extent to which the capital budget is being used for such purchases has not been disclosed separately-neither in reply to the Parliament questions nor in the reports of the Parliamentary Standing Committee on Defence. In reply to a question in the Parliament, modernisation has been described as follows:

> Modernization of the Armed Forces is a continuous process based on threat perception, operational challenges, technological changes and available resources. The process is based on 15 year Long Term Integrated Perspective Plan, five year Services Capital Acquisition Plan and Annual Acquisition Plan (AAP). Procurement of required equipment and weapon systems is carried out as per the AAP in accordance with the Defence Procurement Procedure.[16]

Going by this definition, CBRP may not be modernisation. Procedurally, it is no doubt a faster procedure and its extent of usage has gone up over the years and is now close to 25 per cent (Table 5).

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15 MoD Letter No. PC-11(1)/Bud. I/2007, dated 25 September 2007.

16 Lok Sabha Unstarred Question No. 2207, answered on 5 December 2014 and Lok Sabha Starred Question No. 364, answered on 11 August 2017.

Table 5: Per cent age share of expenditure through CBRP

Budget Head	BE	Actual Expenditure	Expenditure on Modernisation	CBRP (Estimated)	%
Capital Outlay Defence Services	78587	78732	69280	17000	24.54

Source: The BE and actual expenditure (provisional) as per Controller General of Accounts (CGA); expenditure on modernisation as per Lok Sabha Starred Question No. 364, answered on 11 August 2017; and the CBRP is author's estimate.

This has substantially impacted the resources available for modernisation of the defence services.

Impact on the "Make in India" Initiative

Defence manufacturing was to be the "driver" of the "Make in India" initiative of the government. A vibrant private sector defence industrial base was to be its backbone. The broad goal of this initiative was to encourage Indian companies to participate more in the development and production of platforms and systems in a cost-effective manner that is best suited for specific Indian needs. The private sector participation was expected to make life cycle support systems available in the country, in addition to bringing down ownership costs, improve serviceability of platforms, and gradually enable to close/scale down the organic maintenance-government owned and operated-facilities to optimise the defence expenditure. In this respect, the government initiated a host of policy reforms to encourage private sector participation.

The private sector was enthused by the major policy changes. The policy intent was followed up by the MoD with the requisite action. For example, in the period 2014-15 to 2016-17, MoD accorded acceptance of necessity (AoN) for 145 proposals worth Rs 3,99,800 crore approximately, out of which 103 proposals worth Rs 2,46,400 crore approximately have been approved under "Buy (Indian-Indigenously Designed, Developed and Manufactured [IDDM])", "Buy (Indian)", "Buy and Make (Indian)" and

"Make" categories of capital acquisition.[17] However, the momentum built up appears to be dissipating because the MoD has not been in a position to sign any major contract with the private sector as the meagre budget allocations available are just about enough for paying for the "committed liabilities", that is, stage payments for contracts entered in the past. The opportunity to bring about a paradigm change appears to be slipping away and unless some immediate steps are taken, the private sector may become reluctant in the future.

Defence Budget: Worst Fear

As just shown, the defence budget, both under revenue and capital heads, has not only not met the projected requirements but also seems to have come to a level when even some of the payment obligations may have been carried forward to the next year. Table 6 gives the BE, RE and the actual expenditure (provisional) of 2016-17.

Table 6: BE, RE and Actual Expenditure 2016-17 (Rs in crores)

	BE 2016–17	*RE 2016–17*	*Actual 2016–17*
Revenue	162759	168635	165410
Capital	86340	79370	86371

Source: BE and RE and actual as per the union budget

Table 6 indicates that the capital budget at RE stage was reduced by about Rs 7,100 crores, but the actual expenditure has been higher than the RE figure by Rs 7,200 crores. The only occasion when the Defence Accounts Department, which handles all the payments booked under capital head, would have to release payments despite having exhausted the allocated budget is when these are letter of credit-based stage payment due as per contractual obligation of foreign vendors. Payments, if any, due to Indian vendors both in the public or private sector would be carried forward to ensure that the expenditure does not exceed the allotted budget.

[17] Reply to Lok Sabha Unstarred Question No. 3322, answered on 4 August 2017.

Disaggregated expenditure under each demand is available on the CGA, MoF's website for the year 2017-18 only from June 2017 onwards.

Table 7: Progressive percentage utilisation of BE 2017-18

	BE 2017-18	Actual up to November 2017	% Expenditure up to November 2017	Monthly Average (8 months)	% Expenditure up to June 2017	Monthly Average (April to June)	% of BE Expenditure during the Month					Actual Expenditure up to June 2016
							July	August	September	October	November	
Defence Services (Revenue)	172774	129098	75%	9.34	33%	11	8	9	8	8	8.4	26%
Defence Services (Capital)	86488	65948	76%	9.53	35%	11.67	10	7	7	8	9.6	14%

Source: Expenditure details as per CGA website.

When we analyse the actual expenditure of 2017-18 (Table 7), we observe that:

The expenditure under revenue and capital heads for defence till June 2017 was 33 per cent and 35 per cent of the BE respectively and the corresponding figures for the previous year were 26 per cent and 14 per cent respectively. The average monthly expenditure for the three months, April to June, was 11 per cent and 11.67 per cent respectively. This was much higher than the average monthly expenditure of the first eight months, which was 9.34 per cent and 9.53 per cent respectively, and the monthly expenditure of July to November. Since there were no major contracts sanctioned in the first three months, nor any pay commission arrears paid, the most probable cause of this high expenditure in the first quarter is carry forward of last year obligations and their payment in the current financial year.

DEFENCE PLANNING

The defence planning process is historically linked to the national five year planning process, which began in 1951. 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 (HQ) began drawing up the first 15 year perspective plan from 1979 and the concept of Long Term Integrated Perspective Plan (LTIPP) was introduced in 2001. The existing planning process is based on the 15 years of LTIPP, the 5 year Services Capital Acquisition Plan (SCAP) and the AAP, which is in fact a two-year roll-on plan. The journey of each of the defence plans has been elaborated in detail in a chapter titled, "Defence Planning in India at Crossroads",[18] authored by Amiya Kumar Ghosh. It brings out that perspective planning for defence in India has always been conceived as a "top-down" process, starting from national vital interests and then going by stages to military strategy, forces necessary to carry out the strategy and the budgetary allocation to sustain the forces. It identifies one major pitfall in this approach: it considers budgeting constraints late in the planning process. When the budgeting constraints are applied, the gap between desires and constraints may be so great that major adjustments between ends and means might become necessary. Did this happen in the 12th Plan period?

12th Five Year Defence Plan

Should the resources likely to be available have been known to the MoD?

Although defence expenditure in the planning era was classified as Non-Plan expenditure, yet being one of the major heads of expenditure, it had to be taken into account while estimating resources available to the Planning Commission for Plan schemes. Planning Commission, in the approach paper to the 12th Plan, stated:

> Defence expenditure is projected to fall from 1.83 per cent of GDP in the base year to 1.56 per cent of GDP in the final year. This is based on defence revenue and defence capital expenditure

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[18] Amiya Kumar Ghosh, "Defence Planning in India at Crossroads", in Vinod Misra (ed.), *Core Concerns in Indian Defence and the Imperative for Reforms*, New Delhi: Pentagon Press, 2015, pp. 74–100.

increasing annually, in nominal terms, by about 7.5 per cent and 15.0 per cent respectively.[19]

It also stated that "Since defence expenditure is already very low as a percentage of GDP, this projection may be conservative."[20] The Planning Commission also gave estimates for GDP during the Plan period. Table 8, based on these assumptions, gives us the figures.

Table 8: Defence Budget Indicative Figures as Per 12th Plan Approach Paper (Rs in crores)

Financial Year	GDP Projection for 12th Plan	Assumption I (Budget as % of GDP)		Assumption II (Capital Budget 15%; Revenue Budget 7.5%)		
		Assumption I Budget as % of GDP	Total Defence Budget	Capital	Revenue	Total Defence Budget
2011-12	8980860	1.9	170913	67902	103011	170913
2012-13	10283085	1.83	188180	78088	110737	188825
2013-14	11774132	1.76	207225	89801	119042	208843
2014-15	13481381	1.69	227835	103271	127970	231241
2015-16	15436181	1.62	250066	118762	137568	256330
2016-17	17674428	1.56	275721	136576	147885	284461

Source: 12th Plan Approach paper[21]

[19] Planning Commission, Government of India, *Faster, Sustainable and More Inclusive Growth: An Approach to the Twelfth Five Year Plan (2012–17)*, October 2011, available at http://planningcommission.gov.in/plans/planrel/12appdrft/appraoch_12plan.pdf.acessed on 16 Nov 2017

[20] Ibid.

[21] Planning Commission, Government of India, *Faster, Sustainable and More Inclusive Growth: An Approach to the Twelfth Five Year Plan (2012–17)*, October 2011, available at http://planningcommission.gov.in/plans/planrel/12appdrft/appraoch_12plan.pdf.acessed on 16 Nov 2017

That the MoD was aware of the publication of the 12th Plan approach paper is proven by the fact that the then raksha mantri mentioned it while addressing a gathering to give Raksha Mantri's "Awards for Excellence 2009-10" to DPSUs and ordnance factories.[22] The 12th Five Year Defence Plan was "in principle" approved by Defence Acquisition Council (DAC) only in April 2012.[23] Hence, almost six months before the submission of the 12th Plan to the DAC, the resources likely to be available for defence budget were in public domain.

As has happened in the past Plans, there would be a variation between the targeted growth rate and the actual growth rate (Table 9a).

Table 9a: Targeted and Actual Growth Rates

Plan	Target Growth Rate (%)	Actual Growth Rate (%)
9th Plan	6.5	5.55
10th Plan	8	7.6
11th Plan	9	8
12th Plan	8	6.46*

Source: Available at http://mospi.nic.in/sites/default/files/Statistical_year_book_india_chapters/Five_Year_Plan.pdf. *Based on the GDP numbers at constant prices in the document listed in Table 9b, the rate of growth in the first four years was 5.46, 6.39, 7.51 and 8.01 respectively and in 2016-17, it was 7.1** (** Finance minister's statement as reported by PTI in The Indian Express, New Delhi, 30 December 2017.)

(* provisionally 6.46 for the 12th Plan).

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22 Press Information Bureau (PIB), "Defence Part of Five Year Plan's Industry Outlook for First Time Ever", 14 November 2011, available at http://pib.nic.in/newsite/PrintRelease.aspx?relid=77170 accessed on 17 Nov 2017

23 Huma Siddiqui, "Defence Ministry's 12th Five Year Plans Contines to Wait for Clearance by MoF', *The Indian Express*, New Delhi, 8 March 2013, available at http://archive.indianexpress.com/news/defence-ministrys-12th-five-year-plans-contines-to-wait-for-clearance-by-mof/1085176/.

Table 9b gives the estimated GDP figures at the time of presentation of the budget, the defence budget (BE) and the defence expenditure, as also its percentage share of GDP.

Table 9b: Defence Budget and GDP during the 12th Plan Period

	GDP Projection for 12th Plan	GDP Estimated at the Time of BUDGET	Defence Budget (BE)	BE as a % of Estimated GDP	Actual Expenditure (RE for 2016–17)	Actual Expenditure as a % of the Estimated GDP	GDP Figures*	Actual Expenditure as a % of Latest GDP Figures
2011–12		8980860	170913	1.90	170913	1.90	8736329	1.96
2012–13	10283085	9951344	193408	1.94	181783	1.83	944013	1.83
2013–14	11774132	11272764	203672	1.81	203499	1.81	11233522	1.81
2014–15	13481381	12433885	229000	1.83	218694	1.76	12467959	1.75
2015–16	15436181	13567192	246727	1.82	225895	1.67	13764037	1.64
2016–17	17674428	15065010	249099	1.65	251781	1.67	15253714	1.65
2017–18		16847455	262390	1.56				

Note: *First Revised Estimates Of National Income, Consumption Expenditure, Saving And Capital Formation For 2016-17 accessed http://pibphoto.nic.in/documents/rlink/2018/jan/p201813101.pdf acessed on 31 Jan 2018

Source: BE and actual expenditure figures are as per Union budget documents and GDP figures as stated in column headings

A comparison of the total amount of defence budget estimated based on "assumption I" of the approach paper (Table 8) and defence budget (BE) (Table 9) shows that the BE was very close to the figures based on assumption except in 2016-17. In terms of percentage of GDP, it has steadily declined, as was stated in the approach paper. However, the actual expenditure was much less than the BE in three years, 2012-13, 2014-15 and 2015-16, and the shortfall in expenditure was primarily in the capital budget.

BUDGET INDICATORS AS PER FISCAL RESPONSIBILITY AND BUDGET MANAGEMENT (FRBM) ACT STATEMENTS

The FRBM Act came into force on 5 July 2004. The main objectives of the FRBM Act were to:

- reduce fiscal deficit;
- adopt prudent debt management; and
- generate revenue surplus.

The FRBM Act was amended in 2012, 2015 and 2017. The target dates for achieving the prescribed rates of effective deficit and fiscal deficit (3 per cent) were extended and presently, it is 2018-19. The Act requires the central government to lay in each financial year before both Houses of the Parliament four financial statements, two of which are of specific importance for defence planning:

- Medium-term Fiscal Policy Statement (MTFP); and
- Medium-term Expenditure Framework Statement (MTEF).

The MTFP presented as part of the budget documents specifies the BE in respect of defence revenue expenditure for the year, and also indicates a percentage rate at which it will go up in the next two financial years. It sometimes may also similarly give the defence capital budget figures and the increase in percentage for the next two years, or may prescribe the relationship in percentage terms of the total defence expenditure (capital + revenue) with the GDP.

The details as given in the MTFP in the respective financial year's budget papers laid in the Parliament from 2012-13 are tabulated in Table 10.

Table 10: Medium-term Fiscal Policy Statement: Projections

	MTFP	*2012–13*	*2013–14*	*2014–15*	*2015–16*	*2016–17*	*2017–18*	*2018–19*	*2019–20*
2010–11	Revenue	Revenue expenditure has increased from 1.1% of GDP in 2007–08 to 1.4% of GDP in RE 2009–10 due to the implementation of the recommendations of the 6th Central Pay Commission (CPC). However, with payment of arrears being taken care of, it is estimated to reduce to 1.3% of GDP in BE 2010–11 and come back to the level of 1.1% in 2012–13.							
2011–12		As percentage of GDP, this component (revenue expenditure) is estimated to reduce from 1.4% in 2009–10 to 1.1% in BE 2011–12.							
2012–13	Revenue	113829	*121797*	*130323*	For 2013–14 and 2014–15, it is projected to increase by 7%. As percentage of GDP, this component is estimated to reduce from 1.2% in RE 2011–12 to 1.1% in BE 2012–13. It is further projected to decline to 1.0% of GDP in 2013–14 and 2014–15.				
2013–14	Revenue		117000	*125190*	*133953*	During the projection period, defence revenue expenditure is projected to grow at 7% and defence capital expenditure is projected to grow at 9%.			
	Capital		86741	*94548*	*103057*				
2014–15	Revenue	In FY 2015–16, defence revenue expenditure is projected to grow at 7.2%. However, additional provision has been assumed in FY 2016–17 to accommodate the likely impact of 6th CPC.		134000	*143648*	*153991*	Defence capital has been assumed at nominal growth of 5.7% in FY 2015–16. However, growth of 10% has been projected for FY 2016–17. Total defence expenditure as ratio of GDP is projected to remain at 1.7% in FY 2015–16 and 2016–17.		
	Capital			94588	*99980*	*99980*			
2015–16	Revenue	During projection period, that is, FY 2016–17 and 2017–18, revenue expenditure is expected to grow by 15%, average. Additional provision has been assumed in the FY 2016–17 and 2017–18 to accommodate the likely impact of 6th CPC. Capital has been assumed at nominal growth of 15.9% in FY 2016–17.			152139	*159746*	*183708*	However, growth of 9.1% has been projected for FY 2017–18. Total defence expenditure as ratio of GDP is projected to remain at 1.8% of GDP in FY 2016–17 and 2017–18.	
	Capital				94588	*109627*	*119604*		
2016–17	Revenue	During the projection period of 2017–18 and 2018–19, it is estimated to increase by 10% over previous years. Total defence expenditure, including the capital component, is estimated at about 1.6% of GDP in 2017–18 and 2018–19.				162759	*179035*	*196938*	
2017–18	Revenue	The revenue component of defence services is projected to increase by about 8% and 11% respectively in 2018–19 and 2019–20, over the previous year's estimates.					175861	*189930*	*210822*

Source: Union budget of respective years.

The MTEF is to set forth a three year rolling target for prescribed fiscal indicators with specification of underlying assumptions. According to

World Bank (2013),[24] by the end of 2008, more than 75 per cent of all countries had adopted an MTEF. Most public programmes require resources and generate benefits over several years. Under these circumstances, single-year budgets may not provide adequate information. The MTEFs ensure a multi-year commitment of resources to policies and are, therefore, important for expenditure prioritisation and for fostering government performance over the medium term.

The MTEF contains a statement which provides medium-term expenditure projections. For example, the MTEF placed in the Parliament on 10 August 2017 gives the RE 2016-17, BE 2017-18 and projections for next two years, that is, 2018-19 and 2019-20, for all major revenue and capital expenditure heads. A major difference between the two statements as far as the defence budget is concerned is:

1. The MTFP may or may not give details of the capital budget. The projected figures may be indicated as a percentage increase for the next two years. These figures would reflect what is defined as "defence expenditure". The MTFP has been a part of the budget documents since 2005-06, that is, the financial year after the FRBM Act was implemented.

2. The MTEF is mandated to project absolute figures both for revenue and capital. It follows the generic heading "Defence". Hence, these figures would also include the revenue and capital budget of the Defence (Misc.) but excludes the defence pensions, which are included in the aggregate pensions figure (all government pensions). While revenue expenditure portion details (explaining basis for the projected figures) are given in a dedicated sub-para under the revenue expenditure, defence capital details (including capital portion of Defence [Misc.]) are included as part of the capital expenditure para. The MTEF was mandated through an amendment of the FRBM Act in 2012, and hence was first presented in 2013-14.

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[24] World Bank, *Beyond the Annual Budget: Global Experience with Medium-Term Expenditure Frameworks*, 2013, available at https://openknowledge.worldbank.org /bitstream/handle/10986/11971/735140PUB0Annu00801200date 010031012.pdf?sequence=1&isAllowed=y. accessed on 15 Dec 2017

The details as given in the MTEF in the respective financial years presented in the monsoon session of parliament from 2013-14 are tabulated in Table 11.

Table 11: Medium-term Expenditure Framework Statement (MTEF)

	MTEF	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
2013-14	Revenue	108925	116931	125116	133875				
	Capital	69579	86741	94547	103057				
		RE	BE	Forecast					
2014-15	Revenue		124800	134412	147853	177424			
	Capital		78872	94588	108776	116390			
			RE	BE	Forecast				
2015-16	Revenue			142256	155072	179876	197860		
	Capital			83161	98176	107016	117720		
				RE	BE	Forecast			
2016-17	Revenue				148228	168380	183355	196609	
	Capital				85114	90210	98068	108975	
					RE	BE	Forecast		
2017-18	Revenue					175020	182534	201511	218629
	Capital					84460	91580	101137	111706
						RE	BE	Forecast	

Source: MTEF statement tabled by the Finance Minister in Parliament

14th Finance Commission

The Finance Commission is a constitutionally mandated body whose recommendations also have a five year period. The recommendations of the 14th Finance Commission are for the period 2015-16 to 2019-2020. Primarily focused on distribution of the net proceeds of taxes between the union and the state governments, it is also mandated to deal with

Non-Plan revenue resources. The 14th Finance Commission, in its February 2015 report in respect of defence revenue expenditure, 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.[25]

The share of defence revenue expenditure in the tables annexed (Annexure 6.1 and 6.2) to the report was to be 1.044 per cent of the GDP.[26]

Prior Indications for Availability of Funds during the 12th Plan Period

Thus, it is evident that the funding likely to be available for defence budget was in the public domain as per the approach paper for the 12th Plan prior to the consideration of the 12th Defence Plan by the DAC. The 14th Finance Commission also established a relationship of defence revenue budget as a percentage of GDP; and the statutory obligation of MTFP and MTEF being laid in the Parliament provided advance indication of fund availability in the next two financial years.

Review of Previous Plans

Since the 31st Report of the Parliamentary Standing Committee on Defence has talked about 10th and 11th Plans also, let us briefly take a look at these. Five Year Defence Plans prepared by the MoD have name of schemes with weapon/platform capability details, the numbers needed and the estimated cost. There is no agency outside the defence establishments that

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25 Finance Commission India, *Report of the Fourteenth Finance Commission, Vol. 1*, chapter 6, para 6.36, p. 70, available at http://finmin.nic.in/14fincomm/14fcreng.pdf accessed on 16 Nov 2017

26 Ibid.

has the domain knowledge to review and approve the schemes as part of a plan. The finance establishments in the government can only indicate the amounts that may be made available during the period and it is for the MoD and the Service HQ to prioritise within the indicated funds. We have seen that funds indication was available for the 12th Plan. In the previous Plans too, indicated figures were provided. For example, in the 10th Plan, the MoF had reviewed the projections of MoD made in January 2002 thrice before in-principle agreement to the projections made by the MoD of Rs 4,18,101 crore for the 10th Defence Plan (2002-07) in December 2004.[27] It had clarified that "it was an indicative figure, and that actual allocation for Defence Services would depend largely on resources available with the government at that point of time, capacity to utilize funds, pace of expenditure, contractual agreements and other committed liabilities." Even in the case of the 11th Plan, as informed by MoD to the Parliamentary Standing Committee on Defence, "With regard to the delay in finalization of 11th Plan, the delay was due to difference of opinion between the Ministry of Defence and Ministry of Finance on the plan size."[28] Table 12 gives the projections for the 10th-12th Plans. In the case of the 10th Plan, the specific amount was indicated by the MoF; and in the case of the 11th Plan, there was a difference of opinion about the specific amount.

Budgets have two broad functions: economic and political. Economic, because they are an exercise of planning, controlling and administering activities, intended to balance revenues and expenditures. The dilemmas facing political dispensation in power, decision makers and stakeholders alike are: pressing challenges of homogeneous and inclusive growth to be met through greater financial outlays for rapid infrastructure development; meeting social sector obligations; defence expenditure; subsidy needs of some deserving sections; debt servicing; revenue expenditure on

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27 The 11th Report of the Parliamentary Standing Committee on Defence of the 14th Lok Sabha, paras 2.1, 2.2.

28 The 15th Report of the Parliamentary Standing Committee on Defence of the 15th Lok Sabha, para 1.41.

maintenance and upkeep of the central government's governance apparatus, including pensions; and larger fund devolutions to the states.

Table 12: Projections and Expenditure of 10th-12th Defence Plans

Plan	Projections	Expenditure	Expenditure as a % of Projections
10th Plan	418101	357627	85.54
11th Plan	648750	672715	103.69*
12th Plan	1149027	1077876	93.81

Source: 10th and 11th Plans as given in 31st Report of the Parliamentary Standing Committee on Defence of the 16th Lok Sabha; 12th Plan as per assumption I of Table 8 of this paper (the total of annual projections in Table 2 of this paper is Rs 14,03,633 crores).

Note: * 6th CPC was implemented during this period and arrears were also paid in this period.

The budget establishes which activities will be undertaken (and therefore, the type, quantity and quality of services provided to citizens) and how resources will be obtained and allocated. Funds available with the government for the annual budget are dependent on the resources generated by the government, which is linked to the rate of the growth of the economy (figures of the economic growth rate are given in Table 9a), the resources generated through direct and indirect taxes and the binding constraints imposed on it both by the recommendations of the constitutionally mandated Finance Commission (sharing of revenue with the states) and the targets approved by the Parliament as per the FRBM Act. A challenge that the government and defence establishment of every country faces is how much resources to allocate for management of defence.

The trend of budget allocation and expenditure during the last four Plan periods, covering 9th-12th Defence Five Year Plans, is tabulated in Table 13.

Table 13: Defence Five Year Plans: Trends over Last Four Plans

BE			% Increase over Previous Plan	Capital Budget as % of Defence Budget	Actual (RE for 2016-17)		% Increase over Previous Plan	Capital Budget as % of Total Actual	% of Utilisation of BE Capital	% of Utilisation of BE Revenue
	Capital	Revenue			Capital	Revenue				
12th Plan (2012-17)	441835	680070	72	39.4	390587	687423	60	36.2	88.4	101.1
11th Plan (2007-12)	273901	378411	72	42.0	259450	413264	88	38.6	94.7	109.2
10th Plan (2002-07)	147679	231620	56	38.9	129973	227654	58	36.3	88.0	98.3
9th Plan (1997-2002)	69382	173719		28.5	59586	166549		26.3	85.9	95.9

Source: Defence service Estimates (DSE) Vol I

The increase in capital expenditure in the 10th Plan over the 9th Plan was over 100 per cent and the increase in the capital expenditure during the 11th Plan over the 10th Plan was also almost 100 per cent, but the capital expenditure increase in the 12th Plan has dropped to around only 50 per cent. It is only in the 12th Plan period that the increase in revenue expenditure (66 per cent) has outstripped the capital expenditure increase. However, utilisation of the capital budget has been in the 85-88 per cent range except in the 11th Plan. Revenue expenditure during the 11th and the 12th Plans has been higher than BE and this has been met by reducing capital budget allocation at RE stage. The total expenditure on both defence revenue and capital in the 12th Plan period is Rs 10.78 lakh crores. The last two plans, that is, the 11th and 12th Plans, had to provide for the revision of pay and allowances post the 6th and 7th Central Pay Commissions. The next pay review, if done, may be in 2026, which is beyond the seven year strategy period of 2017-18 to 2023-24 or the 13th Defence Five Year Plan (2017-18 to 2021-22).

Beyond the 12th Plan

Defence Five Year Plans have been historically linked to the Five Year Plans of the Planning Commission. It was decided by the government to discontinue with the Five Year Plans after the end of 12th Plan. On 1 January 2015, the National Institution for Transforming India or NITI Aayog came into existence as the government's premier think tank. The NITI Aayog was tasked to do the following:[29]

1. Formulate a long-term vision of 15 years keeping in mind the social goals set and/or proposed and sustainable development goals.
2. To convert the long-term vision into implementable policy and action, a seven year strategy from 2017-18 to be formulated as a part of "National Development Agenda" with a mid-term review after three years.
3. The three year time frame from 2017-18 to 2019-20 will be aligned to predictability of financial resources during 14th Finance Commission award period. This document is to be called "action plan".

The above-mentioned National Development Agenda was to go beyond the traditional area of "Plan" and cover aspects such as "internal security" and "defence".

Keeping the past historic alignment with the planning process, the defence planning process, which already had three categories of 15 year LTIPP, Five Year Plan and two year roll-on plan, ought to have aligned its planning

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[29] PMO ID No. 360/31/C/38/2014-ES-II, dated 9 May 2016.

process by converting the Five Year Plans to a seven year strategy plan and the two year roll-on plan in to three year action plan as defence and internal security aspects were to be covered in the process. However, to a specific query by the Standing Committee on Defence on this issue, MoD stated:[30]

> Discontinuation of Five year Plans and Plan/Non-Plan Expenditure has no impact on resource estimation/implementation of projects. Five year Defence Plans are still being prepared in which future requirements of the Services are projected. Activities planned are likely to proceed according to available annual budget allocations. As such, planned projects were implemented to the extent possible with the available allocations. Thus, the Plans served as a guide for formulating annual budgetary projections even though formal approval for the Plans could not be obtained.

Three Year Action Agenda: 2017-18 to 2019-20

The NITI Aayog prepared a draft, "Three Year Action Agenda, 2017-18 to 2019-20". This was prepared after seeking inputs from ministries of the central government (as stated in the preface to the action plan agenda) and extensive consultations with experts. With specific reference to defence, besides the MoD which like other ministries would have provided inputs, Dr V.K. Sarswat, former Secretary Research and Development (MoD), who is a full-time member of the Aayog, Admiral Arun Prakash (former Chief of the Naval Staff), who made a written submission, and a defence think tank were consulted by the Aayog. The draft was circulated to the governing council of the NITI Aayog on 23 April 2017 and thereafter hosted on their website. Two specific references to allocations for defence budget were part of this report:

1. Defence Revenue Expenditure: Defence revenue expenditure; police and pensions are expected to grow annually by 6 per cent in 2018-19 and 2019-20.

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[30] The 31st Report of the Parliamentary Standing Committee on Defence of the 16th Lok Sabha, para 3.7.

2. Defence Capital Expenditure: The allocation towards capital expenditure in defence will increase from around Rs 95,000 crore in 2015-16 to about Rs 1,72,000 crore by 2019-20, thereby increasing its share of total expenditure from 5.3 per cent to 6.2 per cent. This is to allow for greater purchase of equipment for the armed forces, keeping in mind the security considerations for the country.

Under the proposed agenda, the share of non-developmental revenue expenditure in total expenditure would decline from 47 per cent in 2015-16 to 41 per cent in 2019-20. At the same time, the share of capital expenditure, which is more likely to promote development, would rise significantly. The proposals imply substantial expansion in expenditures by 2019-20 on education, health, agriculture, rural development, defence, railways, roads and other categories of capital expenditure.

The final document, after receiving feedback, was hosted on their website on 1 August 2017.

Dilemma

Planning involves formulation of one or more detailed plans to achieve optimum balance of needs or demands within the available resources. A news item that appeared on 16 July 2017 stated:

> The armed forces have sought an allocation of Rs 26.84 lakh crore ($416 billion) over the next five years to ensure requisite military modernisation and maintenance to take on the collusive threat from Pakistan and China as well as to safeguard India's expanding geostrategic interests.
>
> Union defence ministry sources said the 13th consolidated defence five-year plan for 2017-2022, which has been pegged at Rs 26,83,924 crore after extensive consultations with all stakeholders, including the DRDO, was presented at the Unified Commanders' Conference here on July 10-11.[31]

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[31] Rajat Pandit| TNN | Updated 16 July 2017. https://timesofindia.indiatimes.com/india/forces-seek-rs-27-lakh-crore-over-next-5-years-for-defence-projects/articleshow/59613786.cms accessed on 16 Nov 2017

It is a surprise because it reaffirms the intent of the MoD not to realign the planning periodicity in sync with the changed government policy.

Against an expenditure of Rs 10.78 lakh crores in the 12th Plan, its projected figure is nearly two-and-a-half times at Rs 26.84 lakh crores, much beyond the increases seen either in allocation or expenditure over the past Plan periods. The MoF, in a circular issued to all ministries on 13 September 2017,[32] has stated that the basis of the final budgetary allocations will be the ceilings indicated in the MTEF. The MTEF was tabled in the Parliament in the monsoon session in August 2017. It has disaggregated the amount under demand numbers and the total amount for Demand Nos 20 and 21 for the first three years of MoD's 13th Five Year Plan is Rs 8.57 lakh crores (see Table 14) against a projection of Rs 26.84 lakh crores for the five year period.

The 13th Five Year Defence Plan, therefore, appears to be an illusion.

Table 14:

	Name	RE 2016-17		BE 2017-18		Projections 2018-19		Projections 2019-20	
		Revenue	Capital	Revenue	Capital	Revenue	Capital	Revenue	Capital
19	Ministry of Defence (Misc.)	25968.89	12759.9	9760.53	5091.69	10587.12	6000	11431.72	6733
20	Defence Services (Revenue)	149051.34		172773.89		190924.26		207196.83	
21	Defence Services (Capital)		71700		86488.01		95136.81		104973
22	Defence Pensions	85625.96		85740		94314		101859.12	

Source: See "Annex - W, Demand wise Medium-term Expenditure Projections", in Government of India, Budget Circular 2018-19, p. 129.

32 Ministry of Finance, Department of Economic Affairs (Budget Division), No.F.2 (30)-B(D)/2017, dated 13 September 2017.

Defence Budget 2017-18 to 2019-20

In fact, 75 per cent of the BE 2017-18 for defence revenue expenditure has been spent till November 2017 (as per CGA website); a clear indication that more funds may be needed. Also, 76 per cent of the BE 2017-18 defence capital expenditure trend up to Nov 2017 (as per CGA website). Based on this trend, the allocations for this year will fall short and if the allocation for the next two years is as per projection in Table 14, it is a dilemma and challenge awaiting the MoD and Service HQ.

The Way Forward

Expenditure Management

The pace of capability building has slowed down considerably in the 12th Plan period both due to inadequacy of allocated resources and the ability to optimally utilise the allocated capital budget, creating an ever-increasing capability void vis-à-vis the threat perception. The NITI Aayog's action plan is suggestive of additional resources to be allocated for capital expenditure. The share of capital budget has been squeezed by 2.5 per cent (see Table 13) in the 12th Plan period and has been going down every year due to the insatiable appetite of defence revenue expenditure. The government has tried to address this issue through a commission and a committee set up by the MoD:

1. The government had constituted, in September 2014,[33] Expenditure Management Commission headed by Dr Bimal Jalan (former Governor of RBI) to review the major areas of CGE and to suggest ways of creating fiscal space required to meet development expenditure needs. The commission identified defence expenditure as one of the areas for study and review, as it constitutes a major part of the CGE. The commission as mandated submitted its final recommendations before Union Budget 2016-17. The report has not yet been presented to the Parliament and is hence not available in the public domain. However, some departmental orders issued by organisations under

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[33] MoF OM No. 7(2)/ E-Coord/2014, dated 4 September 2014.

MoF to implement specific recommendations of the commission, for example, 48, 75, 76, 77, 78, 87 and 89, are available in the public domain.

2. The MoD, in May 2016, had constituted a Committee of Experts under the Chairmanship of Lieutenant General (Retd) (Dr) D.B. Shekatkar with a mandate to recommend measures for enhancing of combat capability and rebalancing defence expenditure of the armed forces with an aim to increase "teeth to tail ratio".[34] The committee submitted its report in December 2016 and as per the official press release dated 30 August 2017, 99 recommendations were sent to the armed forces for making an implementation plan. The defence minister has approved 65 of these recommendations pertaining to the Indian Army for implementation.

The recommendations of the commission and the committee need to be placed in the public domain. The total manpower whose pay and allowances are either directly borne by defence estimates/defence civil estimates or indirectly through product/services cost is a little over 2.2 million. It is certain that besides the army, both these entities would have made recommendations in respect of MoD, higher defence organisations, navy, air force, Army Medical Corps, Army Dental Corps, Engineer-in-Chief's branch, including Military Engineer Services (MES), DRDO, Border Roads Organisation, Coast Guard, Defence Accounts Department, Defence Estates Department, DGQA, Armed Forces HQ cadre, DPSUs and OFB. The imperative for a series of reforms for optimal resource utilisation in all these organisations cannot be overemphasised. These may involve changes of policies and procedures and, as is mandated in "Allocation of Business Rules", these changes will have to be processed in individual case files and approved by MoD. This has the potential to delay the best-intended changes. Regular monitoring at the political leadership level may be needed.

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[34] Available at http://pib.nic.in/newsite/PrintRelease.aspx?relid=170365 accessed on 18 Nov 2017

Planning

The MoD needs to review its decision to continue with the "Five Year Plans" and align with the changed policy. If they still see merit in continuing with the Five Year Plans, then the plans need to be drawn within the indicated resources availability during the period.

Conclusion

While every effort needs to be made by the Service HQ and the MoD to explain the capability voids and threat perceptions to Finance Commission, NITI Aayog and the Parliamentary Standing Committee on Defence, it needs to be appreciated that the annual union budget flows out of the recommendations of the Finance Commission and action, strategy and vision documents of NITI Aayog and FRBM targets set by the Parliament. The 15th Finance Commission[35] has just been constituted by the government. The terms of reference as per the gazette notification[36] include:

> While making its recommendations, the Commission shall have regard, among other considerations, to:
>
> The demand on the resources of the Central Government particularly on account of defence, internal security, infrastructure, railways, climate change, commitments towards administration of UTs without legislature, and other committed expenditure and liabilities;

The plans branches at Service HQ and HQ IDS need to engage with 15th Finance Commission and NITI Aayog regularly and the budget allocation should not to be considered as a constraint but as a challenge to constantly reprioritise both on "inter-service" and "intra-service" basis.

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35 Available at http://pib.nic.in/newsite/PrintRelease.aspx?relid=173905 accessed on 01 Jan 2018

36 Available at http://www.egazette.nic.in/WriteReadData/2017/180483.pdf. accessed on 01 Jan 2018

Since the implementation of the FRBM Act in 2004, the Ministry of Finance (MoF) has, through the union budget document, been indicating the likely defence budget allocation for a further two years. A regular recurring feature of the reports of the Parliament Standing Committee on Defence, while examining the demands for grants of the defence services, is that "funds allocated for both the capital and the revenue budget are much less than the demands projected." Responding to the implications of the shortfall in allocation, the Ministry of Defence (MoD) has always responded that as far as capital budget is concerned, the procurement plan for capital modernization schemes may have to be reviewed and re-prioritized, based on the available funds. In the case of revenue MoD, the standard response is that after meeting the salary and other obligatory expenses the balance allocation available is distributed to meet the requirement of stores (including ordnance), transportation (of personnel and stores), revenue works and maintenance, etc., resulting in an ever shrinking share of funds for operations, maintenance and works. The implications of this recurring shortfall on "capability building" and "operational preparedness' are never mentioned.

It is a similar case with the Defence five year plans. The plans are drawn up and submitted by MoD without taking in to account the likely availability of funds and the Standing Committee in its reports is critical of the defence plans not receiving approval. The government decided to do away with the five year planning process in 2014. Therefore, there is no 13th plan. Despite this, MoD has gone ahead and formulated the 13th five year plan and submitted it to MoF for information only. Thus, the dilemma of defence planning and budget continues.

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