CENTRE OF LAND WARFARE STUDIES, NEW DELHI

ANNUAL BUDGET WITH FOCUS ON DEFENCE BUDGET 2015-16

04 March 2015

SEMINAR REPORT

Centre for Land Warfare Studies (CLAWS), New Delhi organised a seminar on Annual Budget with Focus on allocation for Ministry of Defence (MoD) and the Armed Forces on Wednesday 04 March, 2015. Despite allocating huge amount of national resources year after year, India's defence expenditure has not generated the required public debate on the capabilities required and achieved. One of the chief reasons for such inadequate public debate is the lack of awareness on defence related issues in general and Defence Budgets in particular. The objective of the seminar was to discuss the Defence Budget 2015-16 and its efficacy in meeting the necessary capabilities for future challenges, modernization and asset creation.

Ms Richa Misra, the Director of the National Academy of Defence Financial Management, Pune gave the special address.

The discussion was chaired by Mr Amit Cowshish, Distinguished Fellow, IDSA
The panelists for the discussion were:

1. Mr Amit Cowshish
2. Brig Gurmeet Kanwal (Retd.), Former Director, CLAWS
3. Brig Ajay Pal, DDG FP

Introduction

- The Defence Budget for 2015-16 set the allocation for defence services at Rs 2,46,727 crore (US$40.4 billion) which comprises revenue outlay of Rs. 1,52,139 crore and capital outlay of Rs. 94,588 crore. Instead of placing defence allocations on a trajectory towards 2.5-3 per cent of Gross Domestic Product (GDP), which national security experts have argued for, the sum allocated accounts for 1.75% of GDP and 13.88% of total central government expenditure (CGE).

- The modest allocation suggests that the government anticipates a benign security environment in the region, notwithstanding a revisionist Pakistan conducting a proxy war through terrorism, an assertive China flexing its power to fulfil its nationalism claims, the United States and International Security Assistance Force (ISAF) troop drawdown in Afghanistan, and the growth of Islamic State.

- The consequence of this low level of expenditure has been lack of modernization of the armed forces, with reducing combat capabilities and preparedness. The Parliament's Consultative Committee on Defence has found that the military is critically short of combat platforms like artillery guns, tanks, missiles, fighter aircraft, submarines and even basic essentials like boots and bulletproof jackets.

- The Parliamentary Standing Committee on Defence in its recent report tabled in parliament in December castigated the central government for overseeing a decline in the country's military capabilities due to a failure to modernise and "a state of ad hocism in planning and budgeting". The committee presented a dismal picture of inadequate funding, severe equipment shortages in all three services, and continuing delays by the Ministry of Defence (MoD) to rectify the situation.

- India is set to become the fourth biggest military spender in the world by 2020, surpassed only by the U.S., Russia and China. It will be critical for India to have developed an overarching strategy by that time, to avoid excessive spending and give direction to future development.

Structure

The Budgetary allocations of the Ministry of Defence are contained under Eight Demands for Grants. The budgetary requirements for the Civil expenditure of the Ministry of Defence Secretariat, Defence Accounts Department (DAD), Canteen Stores Department, Defence Estates Organisation, Coast Guard Organisation, Jammu & Kashmir Light Infantry(JAKLI), Border Roads Organization(beginning this year they have been moved from the Ministry of Road Transport and Highways to MoD civil branch) etc. and Defence Pensions are provided in two separate Civil Demands for Grants of the Ministry of Defence i.e. Demand No. 20 - Ministry of Defence(Civil) (Rs. 8852.6 crore) and Demand No. 21 - Defence Pensions(Rs. 54,500 crore).

These are not included in the overall defence allocation of Rs. 2,46,727 crore (Rs. 1,52,139 crore Revenue Outlay and Rs. 94,588 crore Capital Outlay) in Budget Estimates(BE) 2015-2016.The budgetary requirements for the Defence Services commonly known as Defence Budget are included in the following six Demands for Grants of the Ministry of Defence presented to Lok Sabha:

- Demand No. 22, Defence Services — Army (including NCC, Sainik Schools & DGQA, Rashtriya Rifles, Military Farms and ECHS).
- Demand No. 23, Defence Services — Navy (including Joint Staff)
- Demand No. 24, Defence Services — Air Force
- Demand No. 25, Defence Ordnance Factories
- Demand No. 26, Defence Services — Research & Development
- Demand No. 27, Capital Outlay on Defence Services, includes all Services and Departments other than those covered by the Demands for Grants of Ministry of Defence (Civil).

The Revenue expenditure includes expenditure on Pay & Allowances, Transportation, Revenue Stores (like Ordnance stores, supplies by Ordnance Factories, Rations, Petrol, Oil and Lubricants, Spares, etc.), Revenue Works (which include maintenance of Buildings, water and electricity charges, rents, rates and taxes, etc.) and other miscellaneous expenditure. The 'running' or 'operating' expenditure of the three Services and other Departments viz. DRDO, DGOF, DGQA, NCC, DGAQA and Directorate of Standardization, are provided under the above five Demands (22 to 26), which cater to the requirement of Revenue expenditure. Apart from that the demand for grant for army also includes significantly the budgetary requirement for National Cadet Corps (NCC), Ex-Servicemen Contributory Health Scheme (ECHS), Rashtriya Rifles, and Military Farms.

The Capital expenditure includes expenditure on Land, Construction Works, Plant and Machinery, Equipment, Tanks, Naval Vessels, Aircraft and Aero-engines, Dockyards, etc. The Capital Outlay on Defence Services caters to requirement of the expenditure incurred on building or acquiring durable assets for all Services and Departments other than those covered by the Demands for Grants of Ministry of Defence (Civil).

The union budget presented to the Parliament on February 28, 2015 set aside Rs. 2,46,727 crore (US$ 40.4 billion) for defence, which amounts to a 7.74 per cent increase over the previous year's allocation(BE). The increase effectively is 10.95 % since the revised estimates for 2014-15 had reduced the figure to 2,22,370 crore. The defence allocation is exclusive of another Rs. 62,852.6 crore provided to the Ministry of Defence (MoD) under the heads of Defence Pensions (Rs. 54,500 crore) and Civil Expenditure of MoD (Rs. 8,852.6 crore), both of which do not form part of India's official defence budget.

The original budget allocation of 2014-15 had been revised downward, to the extent of Rs. 6,630 crore on account of the reduction in capital expenditure by Rs. 12,623 crore. More significantly, nearly 72 per cent (Rs. 9,123 crore) of the total cut in capital expenditure was effected on the capital acquisition budget. On the other hand, the revenue expenditure was revised upward by Rs. 5,993 crore.

The revenue component has jumped from 1,34,412 crore to 1,52,139 crore- an increase of 13.2 %. This is the net allocation under the 5 revenue demands. The revised estimates (RE) for 2014-15 had already brought up the revenue budget by about 6000 crore. So, the increase is effectively 8% on the RE figure of 1,40,405 crore. There is no increase in the allocation for capital budget which is maintained at 94,588 crore. On the capital side because of non-utilization of budget the allocation was reduced at the RE stage this year by about 13000 crore.

Strain on the Revenue Budget

Going by the proposed Budget Estimates (BE) for defence allocation in 2015-16, the revenue-capital ratio stood at 62:38. For army, the ratio is 80:20 because of its huge revenue budget outlay (1,04,159 crore), leaving little for capital acquisition. Navy and Air force fare better with ratios of 38:62(Navy:revenue- 15,525.64 crore, capital-25,003.36 crore) and 41:59(Air Force: revenue-23,000.09 crore, capital-33,657.91 crore) respectively. In the case of ordnance factories, the numbers look very different because of the compulsions of gross budgeting while for DRDO the ratio is 46:54. So, the balance is highly skewed when we look at the demands for grants from army which has serious implications on capacity building.

Services wise, it is legitimate to say that these are very different quantities and it is not possible to have uniform rates because army is more manpower intensive and therefore the revenue-capital ratio is bound to be different but by any yardstick, 80:20 is not a very inspiring number.

Another complication in case of army is the host of organizations such as military farms, Ex-Servicemen Contributory Health Scheme (ECHS), DGQA, Rashtriya Rifles, National Cadet Corps (NCC) etc which are embedded in the demand for grants. The allocation for Military Farms increased by almost 46% from 2013-14 to 2014-15. ECHS got an increase of 32 % last year followed by an unprecedented hike of 86% this year (1420.58 crore in 2014-15 to 2639 crore in 2015-16). Rashtriya Rifles's share increased by 31% last term while in BE 2015-16, the increase is close to 12 %(4874.51 crore to 5453 crore).

Pay and allowances accounted for 67% of the revenue budget in 2014 (BE) and the amount would have gone further up in the RE because another 2000 crore was allotted to the army. Stores and equipment budget stood at 24984.15 crore which is 18.59 % of the total followed by works (7.61%), miscellaneous (4.17%) and transportation (3.06%).

There are further sub heads in pay and allowances for the army- pay and allowances officers, and the auxiliary forces- which together constitute 69% of the budget. The corresponding figure for the navy is 44 % and for the Air force is 47 %. Thus, the implication is that the budgetary increase in other components is not really coming in to that extent. The outside perception is that the army is getting a lot of money. Infact, it is only getting what is left after setting aside the budgetary allocations for these heads.

Reduction in Capital Budget

Capital acquisition budget has been ranging between 75 to 80 % roughly of the capital budget. The RE for the current year has been rejigged by reducing the capital allocation by little less than 13000 crore, part of which has gone to the revenue segment and balance amount has been withdrawn. Practically atleast in 2014-15, the reduction will not create any adverse impact on capital acquisition. After reduction of capital acquisition budget at the end of January, MoD was still left with about 11000-12000 crores under the capital acquisition segment.

In the last 10 years, there has not been a single year in which the MoD was able to incrementally absorb the additional funds. The allocation for Air Force remains stagnant implying that the government has not budgeted for buying the Rafale medium fighter. Any big ticket contract eg. MMRCA could, however, upset the balance. The first payment will have to be made, if and when, the MMRCA is signed and could be to the tune of 15,000 crores roughly. While it is true that this allocation for 2015-16 does not cater for a contingency like this, it will also not come in the way of the contract being signed or payment being made. If the contingency arises, the Ministry of Finance pitches in and that has been the understanding in all these years and there is precedence where extra money has been given under capital budget.

The capital budget is notionally divided into capital acquisition and other-than-capital acquisition budgets. The capital acquisition budget is spent on acquisition of equipment, various platforms, weapon systems and other capabilities required for modernization of the armed forces, the other-than-capital acquisition segment of the capital budget caters for expenditure on acquisition of land, development of civil expenditure and the entire capital expenditure of the defence research and development organization (DRDO) and ordnance factories.

An overwhelming percentage of the capital budget is spent on meeting the committed liabilities and the balance amount is used for paying advances in respect of newly concluded contracts. The Ministry of Defence cannot default on contractual payments. Therefore, this would inevitably have implications for new schemes for which contracts are to be concluded.

Another trend that has been noticed is the steady increase in pay and allowances (not questioning the need to increase allocation for pay and allowances or the need to have more manpower). In 2015-16, once 7th pay commission comes in and its recommendations are implemented, it is going to be quite a challenge to manage the finances. The major disappointment with the budget is that in BE 2015-16, these trends have not been given due cognizance.

It was not expected in the budget for 2015-16 FM would include the likely requirement of funds for implementation of 7th pay commission recommendations. The BE for 2015-16 does not reflect any strategy to deal with the situation as and when it arises. It is business as usual. The thrust towards dealing with the situation which is imminent does not appear to be reflected by this budget.

One Rank One Pension (OROP)

The OROP scheme found no mention in the union budget and seems stuck between the Services and the Defence Ministries. The Finance Minister when asked on the subject later said “the methodology of calculating OROP is pending between the Services and the Defence Ministry”, and added that once formulated, it would be implemented.

Stores Budget

In the revenue segment for army, 70 % of revenue budget (74,000 crore approx. in BE 2015-16) goes into pay and allowances. Of the remaining 30 %, a substantial amount goes into inescapable expenditure-rations, clothing, transportation of goods, maintenance of infrastructure etc. So, the axe actually falls on stores budget head and within stores, on ordnance stores. These payments can be curtailed to some extent but not substantially. This expenditure is inescapable and if not incurred the implication will be very immediate and horrible. So, the tendency is to pass on this scarcity of funds onto certain elements within the stores head which relate to ammunitions and spares and therefore there are voids in the ammunition holding, in the state of repair in the weapons system, and in the serviceability level of equipment.

The GDP Debate

Too much energy is being spent on discussing that the budget is inadequate because it amounts to a certain percentage of Gross Domestic Product. However, this does not give a true indication of the adequacy or otherwise of the defence budget. Japan has 1 % of GDP earmarked for defence but their GDP is so large that even 1 % is a huge amount. Pakistan officially spends 3-4 % of its GDP on defence. It does not automatically imply that Pakistan is better placed from a security perspective than India or Japan.

A better statistic would be to analyse the defence budget in terms of its percentage in central government expenditure. The government's intention and ability to spend must be seen in the context of overall resource generation. In that sense, this budget 2015-16 is marginally better than the position obtained in the last 5 years. This year, of the total central government expenditure, the defence budget's share is 13.88 %. In the non plan expenditure segment, its share is 18.8%. If defence pensions or MoD civil are also included it rises to 23-24 %.

There are limitations to government's ability to raise resources for revenue. In the capital segment of the non-planned budget, the defence capital budget accounts for about 89 % of the budget. It may not be adequate but it is an indication of the fact that managers of India's finances are not totally unmindful of the defence needs.

In the non plan segment in terms of only 5-6 demands for grants which constitute the defence services estimates, the defence budget is the second largest chunk of expenditure after interest payments and ahead of subsidies this year. The point is that allocations for the budget must be looked at in the context of the fiscal realities and the fiscal reality is that there is only so much that the government can provide.

Non Budgetary Constraints

1) Lack of clarity on the policy for defence production and defence procurement

   Defence Production Policy came out in January 2011. One of the last paragraphs in the policy says that the progress made towards indegenisation will be reviewed by the Raksha Mantri every year. However, there has been no review since 2011 about the outcome of the Defence Production Policy. It is not even in sync with Defence Procurement Policy. Technology Perspective and Capability Roadmap (TPCR) did not serve the purpose for which it was made but it has not been reviewed in the last few years. There are huge problems regarding the policy structures. Make procedure for instance is still under review for the last 2 year and the offset policy is also still under review. Services as a valid mode of discharging the offset obligation began in 2013, but more than 2 years later, there is no clarity as to what is the future course of action. The industry or foreign Original Equipment Manufacturers (OEMs) cannot be expected to help when there is lack of clarity about the policy and procedures, which is also the reason for the inability to spend the money allocated.

2) Disjointed and unrealistic defence planning

When the 11th plan was prepared one of the criticisms in the media and public discourse was that there is no indication of the funds that will be made available and therefore it is not possible to plan, which is incorrect. The question is whether we plan according to the likely availability of resources or we are planning irrespective of the likely availability of funds. There is a slack in the planning process and the manifestation of that planning into 5 year plans and annual acquisition plans has left much to be desired. Hence there is no nexus between defence allocation and utilization.

DPP is a procedure not a policy. It is based on 10 stages of procurement (not including 11th-post contract management). Of the 10 stages, it is not clear which of the 10 stages can be done away with. If there is a thought that procedures are coming in the way of utilization of funds, then there must also be concrete suggestions as to what can be done in regard to simplification of procedures. There is nothing drastically wrong with the stages but the problem is that with each stage, there are certain processes that are associated and there is lack of clarity as to how to manage that process.

Eg. The procedure doesn't say that the Contract Negotiation Committee (CNC) should take 3 years. The MMRCA CNC has gone on for 3 years. The idea is to make sure that there are structures within the MoD which promote faster and efficient decision making. The problem in regard to underutilization of capital acquisition budget is not on account of the budget figure .It is on account of these non-budgetary non fiscal issues.

Defence has had its own version of Make in India for a long time. The 'Make' procedure is supposed to be a customized Make in India scheme for defence. In the budget, 150 crores has been allocated under the head but the caveat again is the lack of clarity about the policy of Make in India in defence. Make in india largely depends on the ecosystem and infrastructure which doesn't exist in India. According to the World Bank, India ranks a poor 142 on the Ease of Doing business index.

Outcome budgeting

To move towards a visible and outcome-oriented budgeting, the Ministry of Finance (MoF) since 2005 has issued guidelines, emphasizing the linkage between financial budgets, and actual and targeted performance of outlays. The guidelines task the central Ministries/Departments to articulate, among others, a list of major programmes/schemes and the goals and policy framework guiding them. The main objective of the exercise is to “establish one-to-one correspondence between (financial) budget and Outcome Budget.” The Ministry of Defence (MoD), along with 30 Ministries/Departments has been exempted from preparing outcome budget. The exempted Ministries/Departments are however advised to prepare outcome budget for internal use and voluntarily decide the extent to which the general public can have access to it.

The preparation of an outcome budget necessitates that the outcomes are clearly identified and quantified so that the outcomes can be measured with reference to the pre-determined outcomes. The motive is to ensure accountability, improve resource allocation & management and enhance efficiency of the budgeting process.

As per the Standing Committee on Defence (2012-2013) 15th Lok Sabha, the Ministry has been taking steps to implement the concept of Outcome Budgeting. As a part of this, Outcome Budget documents for the year 2012-13 were prepared by the Naval Dockyards, Directorate General, NCC (DGNCC) and Directorate General, Married Accommodation Project (DGMAP). The Ministry is also making attempts to identify more organisations that can be brought under the ambit of outcome budgeting. The problem is that there are issues in regard to identifying in quantifiable terms the outcome of defence budget. The outcome of defence budget very loosely is defence preparedness of the country. How to convert that outcome into a quantifiable matrix and what yardsticks to employ is the challenge.

Conclusion

Considering the financial situation and resources at the disposal, there is a requirement to prioritize and the prioritization would mean that we have to modernize within the conditions of austerity.

The budget fails to deliver on the following fronts.

1) Lack of a roadmap that details that during the plan period, how to make up the deficiency of ammunition and equipment and increase the serviceability of the equipment and weapons system to the requisite level in a result oriented manner.
2) Clearly defined policy with issues related to taxation, incentives etc. to facilitate ‘Make in India’ policy in defence.
3) The allocation is inadequate to give a boost to military modernization that has been stagnating for over a decade and falls critically short in the overall endeavour of capacity building of our armed forces to cater for envisioned threat perception.

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