

# IDSA

## *Issue Brief*

# Defence Budget 2018-19: Over to the Standing Committee For Scrutiny

*Laxman Kumar Behera*

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## **S***ummary*

The SCoD's examination of the MoD's Demands for Grants for 2018-19 comes at a time when the critical 'teeth' part of the defence budget looks further blunted. The expert committee has two choices to make. Like in the past, it may like to urge the Ministry of Finance to allocate more resources to the MoD, over and above what has already been provided. Alternately, it may like to go along with the difficult choice involving solutions within the MoD's available resources.

With the ongoing budget session of Parliament breaking into a recess for about a month, the Departmentally Related Standing Committees (DRSCs) are all set to scrutinise the detailed 2018-19 budgets of the various ministries and departments. The Standing Committee on Defence (SCoD) – one of the two dozen-odd DRSCs which have been functioning since the 1990s to facilitate greater Parliamentary oversight over the administration – will examine the allocations of the Ministry of Defence (MoD), which are provided under four Demands for Grants – MoD (Miscellaneous), Defence Services (Revenue), Capital Outlays on Defence Services, and Defence Pensions.

This Issue Brief highlights five major issues and concerns that may merit the SCoD's attention while examining the latest Demands for Grants of the Ministry of Defence. Before that, however, a word of appreciation is in order for the yeomen service that the SCoD has rendered over the years.

Since its inception in the early 1990s, the SCoD has done a great service to the nation in bringing otherwise opaque defence issues to the attention of not only Parliament but also of the strategic community and the public at large. Unlike the other oversight agencies, particularly the Parliamentary Finance Committees or the Comptroller and Auditor General of India, the SCoD has wider oversight functions encompassing the whole of MoD and covering all issues ranging from policy, planning, budgeting, and procurement to research and development (R&D), production and force structure. It is mainly due to the SCoD that the country has a much better perspective on military modernisation and the state of defence preparedness. Its periodic reports, especially those on the MoD's Demands for Grants, and the subsequent action taken reports, go a long way in influencing the defence policy making process.

## **1. What is India's Defence Budget?**

In the past, the immediate post-Union Budget focus of the SCoD has been on defence allocation and its inadequacy in meeting the defence requirements of the nation. While commenting on the allocation, the previous Committees have mostly limited their focus to what is loosely defined as the defence budget. What this loosely defined term denotes is only a part of the MoD's larger allocations, which are reflected in the Defence Services Estimates – an annual publication of the finance wing of the defence ministry. In its present form, the DSE includes two out of four Demands for Grants – Defence Services (Revenue) and Capital Outlay on Defence Services. This not only excludes Defence Pensions and MoD (Miscellaneous), which are part of the MoD's larger budget, but also some other items of expenditure that directly impinge upon the country's defence. One such item of expenditure outside the MoD's budget is that of the four Border Guarding Forces (Border Security Force, Indo-Tibetan Border Police, Assam Rifles and Sashastra Seema Bal), which are funded through the budget of the Ministry of Home Affairs (MHA). Their non-inclusion in DSEs or MoD's budget does not, however, hide the substantial amount that the government expends on them every year.

It is worth noting that even the loosely defined defence budget is not consistent in terms of its contents. Suffice it to say that Defence Pension was part of the DSE until the early 1980s, after which it was taken out, reportedly to pacify the international financial agencies that were putting pressure on India to reduce its defence expenditure in order to receive much-needed economic aid. Besides, a few items of expenditure such as that on Military Firms and Ex-Servicemen Contributory Health Scheme (ECHS), which are now reflected as part of the MoD (Miscellaneous) budget, were part of the DSE until a couple of years ago.

What is of greater significance is that the arbitrary nature of the DSE's contents and non-inclusion of several defence-related expenditure in the MoD's overall budget has prevented a holistic understanding of India's defence commitment. As Table 1 shows, what is commonly understood as India's defence expenditure is only about 65 per cent of country's overall security expenditure. Ignoring the remaining 35 per cent of the allocation (which amounts to Rs 1,58,179 crore in 2018-19) from closer scrutiny does not serve any clear purpose. Instead, it gives rise to a misinterpretation of the government's commitment towards defence. Suffice it to say that this larger security expenditure represents some 18 per cent of the total central government expenditure and 2.3 per cent of the estimated GDP for 2018-19, whereas the corresponding figures in respect of the defence budget are 11 per cent and 1.5 per cent, respectively. The issue for the SCoD is, therefore, to consider whether it is ideal to examine the defence budget in isolation or take into account the rest of the allocation provided outside the DSE's purview. From a purely public finance perspective, it is ultimately the same tax payers' money irrespective of where it is allocated. Keeping this in view, the SCoD may like to examine the possibility of bringing at least all of the MoD's expenditures under the DSE's purview.

**Table 1. India's Defence and Security Expenditure**

Year	MoD's Expenditure (Rs in Crore)	Expenditure on BGF (Rs in Crore)*	Total (Rs in Crore)	Defence Expenditure (Rs in Crore)	Defence Expenditure as % of Total Expenditure
2014-15	309251	21684	330935	218694	66
2015-16	293920	24464	318384	201415	63
2016-17	351550	28319	379869	248710	65
2017-18 (RE)	374004	30781	404785	263004	65
2018-19 (BE)	404365	33119	437484	279305	64

**Note:** \*- BGF: Border Guarding Forces. Expenditure on BGF does not include expenses on border infrastructure and management, etc.

## 2. Rising Share of Pay and Allowances in Defence Expenditure

A critical issue for the SCoD is to examine the drivers of the defence budget growth. This assumes significance given the near continuous decline in the share of capital expenditure in the defence budget. Between 2013-14 and 2018-19, the decline is by nine percentage points to 34 per cent. A closer examination of the defence expenditure would show that much of the skewed ratio adversarial to capital expenditure is because of the hefty rise in Pay and Allowances (P&A) of the defence services, owing largely due to implementation of the recommendations of the 7<sup>th</sup> Central Pay Commission. As Table 2 brings out, the share of P&A in defence expenditure has increased and accounts for close to half of the 2017-18 budget. Notably, the rise in share of P&A has come at the cost of not only capital expenditure but also some of the revenue expenditure, particularly the ‘Stores’ budget which is used for upkeep of existing equipment.

In the light of the above, the SCoD may like to examine the recommendations made by various committees, especially the Shekatkar Committee which was tasked to suggest measures to “enhance combat capability and rebalance defence expenditure of the armed forces.”<sup>1</sup> In particular, the SCoD may like to examine whether the MoD has acted upon all the recommendations of the Shekatkar Committee or implemented them only partially. It is believed that the implementation of the Committee’s recommendations would lead to a savings of some Rs 25,000 crore. This is undoubtedly a big sum and, if effected properly, could go a long way in stabilising the current imbalance in the revenue-capital mix.

**Table 2. Percentage Share of P&A, Stores, Capital Expenditure and Others in Defence Expenditure**

	P&A	Stores	Capital Expenditure	Others
2013-14	40	12	39	9
2014-15	42	12	37	9
2015-16	42	14	36	9
2016-17 (RE)	46	13	32	8
2017-18 (BE)	49	10	33	8

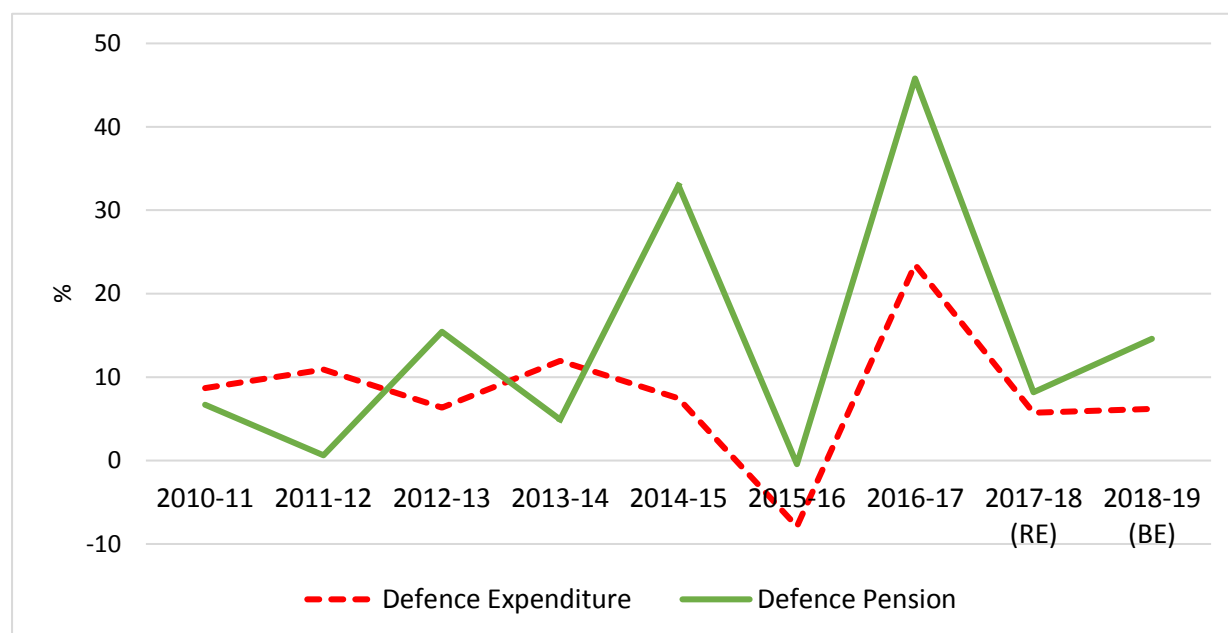
**Note:** Others include transportation and miscellaneous expenditure which are part of revenue expenditure.

<sup>1</sup> Lok Sabha, “Recommendations of Shekatkar Committee”, Unstarred Question No. 2691, Answered on January 03, 2018.

Apart from the cost savings measures, the SCoD would do a great service if it were to map the existing manpower strength of the defence services, particularly the civilian component. This is a decidedly grey area and no composite database is apparently available in the public domain for scrutiny. In particular, the SCoD may like to scrutinize the sanctioned and held strength of Military Engineer Services (MES), Defence Accounts Department (DAD), Defence Research and Development Organisation (DRDO), Ordnance Factory Board (OFB), Naval Dockyards, Base Repair Depots (BRS), Army Base Workshops and such other organisations in which civilian are funded through the MoD's budget.

### 3. Sharp Rise in Defence Pensions

Apart from Pay and Allowances, the SCoD may also like to take note of defence pensions, which has been growing faster than the defence budget in recent years (Figure 1).



**Figure 1. Percentage Growth of Defence Expenditure and Defence Pension**

Accounting for about 27 per cent of the MoD's total budget, and 39 per cent of the defence budget, the allocation for defence pension in 2018-19 is more than double Pakistan's entire official defence budget (of 2017-18). In four years, pensions have increased by 81 per cent to Rs 1,08,853 Crore (see Table 3) that too at a time when defence expenditure grew by 39 per cent. Apart from the 7<sup>th</sup> CPC benefits, the OROP scheme, which was implemented with effect from July 01, 2014, has been the main reason for much of the growth in defence pensions in recent years.

**Table 3. Expenditure on Defence Pension**

	Defence Personnel (Rs in Crore)	Civilian (Rs in Crore)	Total (Rs in Crore)
2012-13	30358	13010	43368
2013-14	33215	12285	45500
2014-15	44733	15717	60450
2015-16	45179	15059	60238
2016-17	70261	17565	87826
2017-18 (RE)	Not Available	Not Available	95000
2018-19 (BE)	Not Available	Not Available	108853

The point for deliberation is not only the current magnitude of defence pensions but also their recurring future impact. It may be noted that the number of defence pensioners is close to 30 lakhs (see Table 4), substantially higher than previously known.<sup>2</sup> Given the rise in life expectancy and the fact that ever year nearly 85,000 personnel retire from the defence services, the pension budget is bound to increase significantly in the future. A modest five to seven per cent annual increase will take the total pension allocation to anywhere around Rs 1,40,000 crore at the end of the next five years. In the light of this, the SCoD may like to examine if the current trend is sustainable in the long run. In this respect, the Committee may revisit its past recommendations, especially the one that talked of absorption of retired services personnel into the paramilitary forces. The SCoD may also like to examine why such a crucial recommendation, which can substantially bring down pensionary liability, has not been implemented.

**Table 4. No. of Pensioners****(As on April 01, 2017)**

<b>Category</b>	<b>Service Pensioners</b>	<b>Family Pensioners</b>	<b>Disability Pensioners</b>	<b>Total</b>
<b>Officers</b>	52681	17367	6562	76610
<b>PBORs</b>	1603898	546626	181264	2331788
<b>Defence Civilians</b>	334324	227661	0	561985
<b>Total*</b>	1990903	791654	187826	2970383

**Note:** \*- Includes 58,640 unclassified pensioners. The total number of pensioners is based on a comprehensive compilation of data obtained from all the pension disbursing agencies. The figure is substantially higher than the previously known

<sup>2</sup> The previously known figure as of 2014-15 is 24,61,651. See Laxman Kumar Behera, "India's Defence Budget 2018-19: The Imperative of Controlling Manpower Cost", *IDSA Issue Brief*, February 02, 2018.

number (of about 24,61,351 as on April 01, 2015) available in the public domain, which was a presumptive one.

#### 4. Dwindling Share of Modernisation in Defence Expenditure

In the past, the SCoD had reserved some of its deepest concerns on the slow progress being made in defence modernisation. These concerns do not seem to have been addressed fully. As Table 5 illustrates, the share of capital procurement in defence expenditure has been on a path of constant decline, indicating the stress on the modernisation front. The SCoD may like to examine this crucial aspect in greater detail. In particular, it may like to examine how much of the capital procurement budget is being devoted towards ‘new schemes’, after meeting all the expenses of the ‘committed liabilities’. This would provide a better picture of the new capabilities being planned each year.

**Table 5. Dwindling Share of Capital Procurement in Defence Expenditure**

	Capital Procurement (Rs in Crore)	Share of Capital Procurement in Defence Expenditure (%)
2013-14	66850	33
2014-15	66152	30
2015-16	62236	31
2016-17	69280	28
2017-18 (RE)*	69401	26
2018-19 (BE)*	74224	27

**Note:** \*: Approximate value

#### 5. Make in India in Defence: Mapping the Progress

Defence industry is not only one of the 25 identified sectors under the Make in India programme, but it is also part of the 10 ‘Champion Sectors’ that have been identified for focused attention because of their “potential to become global champions, drive double digit growth in manufacturing, and generate significant employment opportunities.”<sup>3</sup> Numerous steps have been taken both within and outside the ambit of the Defence Procurement Procedures to incentivise domestic defence production. In his budget speech, Finance Minister Arun Jaitley had promised to bring out an industry-friendly defence production policy, and take “measures to develop two

<sup>3</sup> Ministry of Finance, Government of India, *Economic Survey 2017-18: Vol. II*, p. 125.



defence industrial production corridors in the country.”<sup>4</sup> Subsequent to Jaitley’s budget speech, the Prime Minister, in his address at the Uttar Pradesh Investors’ Summit-2018, announced a plan to set up one such corridor in Bundelkhand, which is expected to attract an investment of Rs 20,000 Crore.<sup>5</sup>

While all the announced measures to promote Make in India in the defence sector are welcome, the crucial aspect for the SCoD to examine is whether they are good enough or some further measures are needed. Industry, particularly the private sector, has long demanded special incentives such as infrastructure status for their investment, and deemed export benefits for certain types of procurement, to incentivize their entry into the defence production sector. It would be worthwhile for the SCoD to examine the feasibility of such incentives.

It is also worthwhile for the SCoD to examine the efficacy of the measures taken so far. Since the proof of the pudding lies in its eating, the SCoD may like to take into account the impact of the measures adopted hitherto on the domestic industry. One way to measure impact is to examine the year wise Acceptance of Necessity (AoN) accorded for weapons procurement under various categories. Table 6 provides a template to evaluate the progress of Indian-industry centric procurement proposals vis-à-vis import-oriented ones. From among the India-centric procurement proposal, the SCoD may also like to see the distribution of AoNs between the Indian private sector and public sector companies. In addition, the Committee may also like to examine why not a single ‘Make’ project has yet been awarded even though more than 10 years have passed since the procedures were first announced.

**Table 6. Procurement Category-wise AoNs**  
(Rs in Crore)

Year	Buy (Indian- IDDM)*	Buy (Indian)	Buy and Make (India)	Buy and Make	Buy (Global)	Total
2013-14	--					
2014-15	--					
2015-16	--					
2016-17						
2017-18						

**Note:** Buy (Indian-IDDM): Buy (Indian-Indigenously Designed, Developed and Manufactured). The Procedure, announced for the first time in Defence Procurement Procedure 2016 (DPP 2016), has been effective from April 01, 2016.

<sup>4</sup> Ministry of Finance, Government of India, “Budget 2018-19: Speech of Arun Jaitley”, February 01, 2018.

<sup>5</sup> “PM Modi announces Rs 20,000 crore defence corridor for Bundelkhand”, *The Economic Times*, February 21, 2018



## **Two Choices: Which One to Choose?**

The SCoD's examination of the MoD's Demands for Grants for 2018-19 comes at a time when the critical 'teeth' part of the defence budget looks further blunted. The expert committee has two choices to make – one is easy but may not be acceptable to the government, while the second is difficult but has the potential to yield dividends in the long-run. Like in the past, the SCoD may like to urge the Ministry of Finance (MoF) to allocate more resources to the MoD, over and above what has already been provided. However, this recommendation would mostly likely fall on deaf ears, since the MoF does not seem to be in a comfortable position to top up the MoD's existing budget, which has already been increased by Rs 40,511 crore over the previous allocation. It is to be noted that, like the SCoD, the other DRSCs also make similar fervent demands to the MoF, which has a difficult task of balancing the government's overall expenditure with fiscal deficit targets, while meeting the vast socio-economic needs of the country.

In the light of this, the SCoD may like to go along with the second choice – a difficult choice involving solutions within the MoD's available resources. There have been plenty of recommendations in the past to save money from within the existing defence budget, without cutting down on combat capability. There is no harm in examining them afresh. If the MoD could save Rs. 25,000 crore, as has been apparently indicated by the Shekatkar Committee, it would really be a game changer.

## About the Authors



**Laxman Kumar Behera** is a Research Fellow at the Institute for Defence Studies & Analyses, New Delhi.

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