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Issue Brief

India's Defence Budget 2020-21

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S*ummary*

This issue brief assesses the impact of the latest allocations of the MoD, and, in so doing, examines the major components of the said allocations and also situates them in a longer time frame, wherever necessary, to benefit from a trend analysis. The brief, however, begins with a short survey of the Indian economy and the state of government's finance so as to better appreciate the larger context of defence allocations.

Presenting her second and Narendra Modi Government's seventh regular budget on February 1, 2020, Finance Minister Nirmala Sitharaman earmarked Rs. 4,71,378 crore (US\$ 66.9 billion¹) for the Ministry of Defence (MoD), stating that national security is a top priority of the government. Of the MoD's total allocations, Rs. 3,23,053 crore (\$45.8 billion) has been provided under the Defence Services Estimates (DSE), an annual publication of the finance wing of the MoD that primarily deals with the expenses of the three armed forces and the Defence Research and Development Organisation (DRDO), and is popularly considered as India's defence budget. The balance allocation is distributed between defence pensions (Rs. 1,33,825 crore or \$19.0 billion) and MoD (Civil) (Rs. 14,500 crore or \$2.1 billion). Representing a growth of 9.4 per cent, MoD's overall allocation translates into an increase of Rs. 40,367 crore. This raises the question, how would this increase affect India's defence and modernisation in particular?

This issue brief assesses the impact of the latest allocations of the MoD, and, in so doing, examines the major components of the said allocations and also situates them in a longer time frame, wherever necessary, to benefit from a trend analysis. The brief, however, begins with a short survey of the Indian economy and the state of government's finance so as to better appreciate the larger context of defence allocations.

State of the Economy

After registering an impressive growth of 8.2 per cent in 2016-17, the Indian economy has since been on a declining trajectory. The year 2019-20 has particularly been a difficult year. The sharp slowdown of the global economy, increasing trade tensions between the world's two largest economies, and challenges facing the domestic financial sector have put a downward pressure on Indian economy which is expected to grow by 5.0 per cent in 2019-20, the lowest in last eight years. In 2020-21, the economy is, however, expected to rebound with the gross domestic product (GDP) expected to grow in the range of 6.0 to 6.5 per cent.

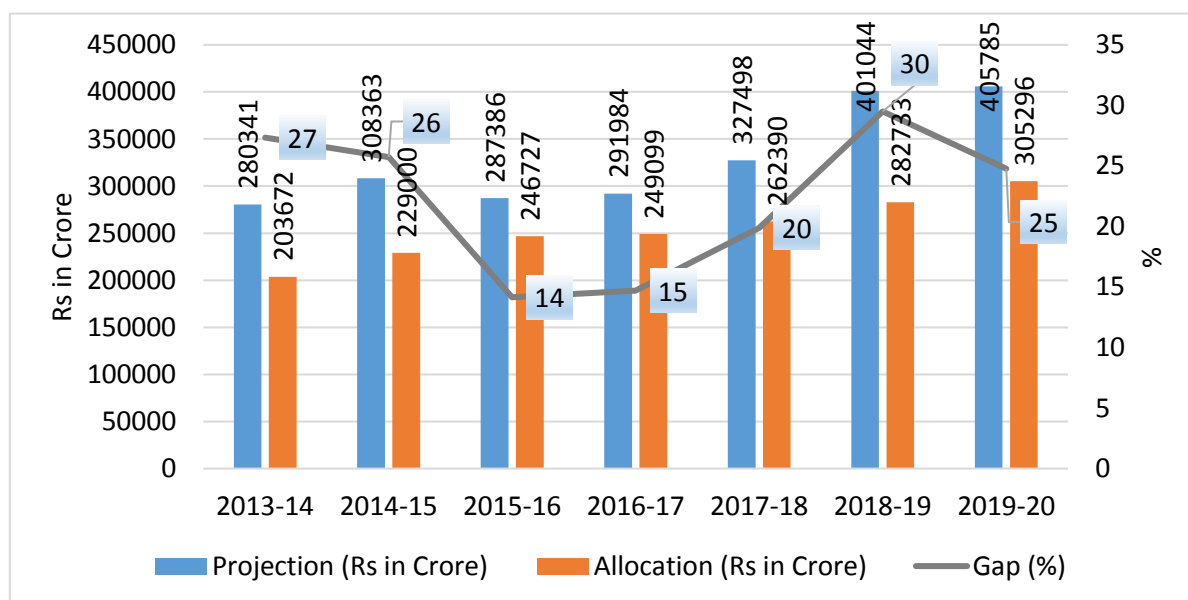
The subdued economic forecast notwithstanding, some of the macro fundamentals of the Indian economy have remained sound. On the external front, the economy has made gains with further narrowing of current account deficit (CAD) and continuous increase in foreign direct investment (FDI), portfolio investment and foreign exchange reserves. On the domestic front, inflation, measured in consumer price index (CPI), has though spiked in the recent past, it has nonetheless remained within the margin of the tolerable zone.

¹ Conversion to US\$ is based on the average exchange rate (\$1.0=Rs 70.48) of first 10 months of 2019-20.

One indicator which has come under great pressure is fiscal deficit that reflects the total borrowing requirements of the government to meet all its expenses.² The government has not only deviated from its own fiscal target set in the previous budget but has also extended the fiscal consolidation roadmap further.³ The expansionary fiscal policy is largely due to government's constraints in restraining its expenditure in view of the shortfall in revenue collection, particularly central government's net tax collection, which has been revised downward by nine per cent from the 2019-20 budget estimate and is projected to decline further by one per cent in the coming fiscal year.

In the given economic and fiscal situation, the growth of 9.4 per cent in MoD's overall allocation looks reasonable, though not sufficient to meet all the shortages it faces. In the past seven years, MoD's gap between resource requirement and allocation, which briefly narrowed from a high of 27 per cent in 2013-14 to 14 per cent in 2015-16, has increased to 30 per cent in 2018-19 and 25 per cent in 2019-20 (see Figure 1). What is of greater importance is that MoD is unlikely to witness a major hike in its budget in the near future that would be enough to mitigate its shortages. The MoD has to perform cut down some of its planned expenditure and reprioritise the rest. This is an uphill task and is expected to be performed by the Chief of Defence Staff (CDS), a post created by the Modi Government to improve efficiency in military matters.

Figure 1: MoD's Resource Projection and Allocation under Defence Services Estimates



² In 2020-21, the fiscal deficit is budgeted at Rs. 7,96,337 crore, or 3.5 per cent of the estimated GDP of Rs. 224,89,420 crore.

³ The revised estimate of fiscal deficit (FD) as a percentage of GDP of 2019-20 is 3.8 per cent as against budget estimate of 3.3 per cent. The budget estimate of FD as a percentage of GDP of 2020-21 is 3.5 per cent as against the earlier target of 3.0 per cent.

MoD's Budget: Defence, Civil and Pension

Among the three major components of the MoD's 2020-21 budget, the DSE constitutes 69 per cent, defence pension 28 per cent and MoD (Civil) three per cent (see Table 1 and also annexure for key defence indicators). It is, however, to be noted that in the three years since 2018-19, the share of DSE, which deals with operating expenses and capital needs of the defence services, has seen a decline while that of the defence pension has increased. Furthermore, the increase in the defence pension accounts for nearly 54 per cent (Rs 21,745 crore) of the total growth in the defence budget. Together with increase in the pay and allowances (P&A) of the three armed forces, its contribution to the overall growth of the MoD's budget amounts to a whopping 78 per cent (Rs. 31,483 crore). In comparison, modernisation budget has contributed to about 23 per of the growth. This means MoD's all other segments combined has witnessed a negative growth, though marginally.

Table 1: MoD's Budget: Defence, Civil and Pension

Year	Defence Services (Rs in Crore)	MoD (Civil) (Rs in Crore)	Pension (Rs in Crore)	Total (Rs in Crore)
2018-19	2,90,802 (72)	10,881 (3)	1,01,775 (25)	4,03,457
2019-20 (BE)	3,05,296 (71)	13,635 (3)	1,12,080 (26)	4,31,011
2019-20 (RE)	3,16,296 (70)	14,714 (3)	1,17,810 (26)	4,48,820
2020-21 (BE)	3,23,053 (69)	14,500 (3)	1,33,825 (28)	4,71,378

Note: Figures in parenthesis represent percentage share in MoD's total expenditure. MoD (Civil) includes MoD Secretariat, Border Roads Organisation, Defence Accounts Department, Coast Guard Organisation, Defence Estate Organisation, Jammu and Kashmir Light Infantry, Armed Forces Tribunal, etc. BE and RE represent Budget Estimate and Revised Estimate, respectively.

Of the MoD's total allocation, revenue expenditure amounts to 75 per cent and capital expenditure 25 per cent. It is important to note that while MoD's revenue segment represents just 13 per cent of the central governments' total revenue budget, its capital expenditure amounts to 29 per cent of the total capital outlays of the union

budget. As explained later, the capital segment, particularly the modernisation front, has greater shortages. However, considering that the defence capital expenditure already accounts for a very high share in the central government's overall capital spend, any substantial hike in the former's share looks less likely. This is more so given the government's priority to spend on infrastructure and other non-defence capital assets to revive the economic growth.

Defence Budget 2020-21: Growth Over Previous Allocation

Though the defence budget 2020-21, as represented by the DSE, has increased by 5.8 per cent, the increase is a mere 2.1 per cent in comparison to the revised estimate of the previous allocation (see Table 2). This means the MoD's 2019-20 allocation has undergone an upward revision, with both revenue and capital expenditures contributing to the growth. It is important to note that DSE's upward revision comes at a time when the central government's overall expenditure has been curtailed due to shortfall in revenue collections.

Table 2: Defence Allocations, 2019-20 and 2020-21

	Revenue (Rs in Crore)	Capital (Rs in Crore)	Total (Rs in Crore)
2019-20 (BE)	2,01,902	1,03,394	3,05,296
2019-20 (RE)	2,05,902	1,10,394	3,16,296
2020-21 (BE)	2,09,319	1,13,734	3,23,053
Increase in 2020-21 (BE) over 2019-20 (BE)	7,417 (3.7)	10,340 (10.0)	17,757 (5.8)
Increase in 2020-21 (BE) over 2019-20 (RE)	3,417 (1.7)	3,340 (3.0)	6,757 (2.1)

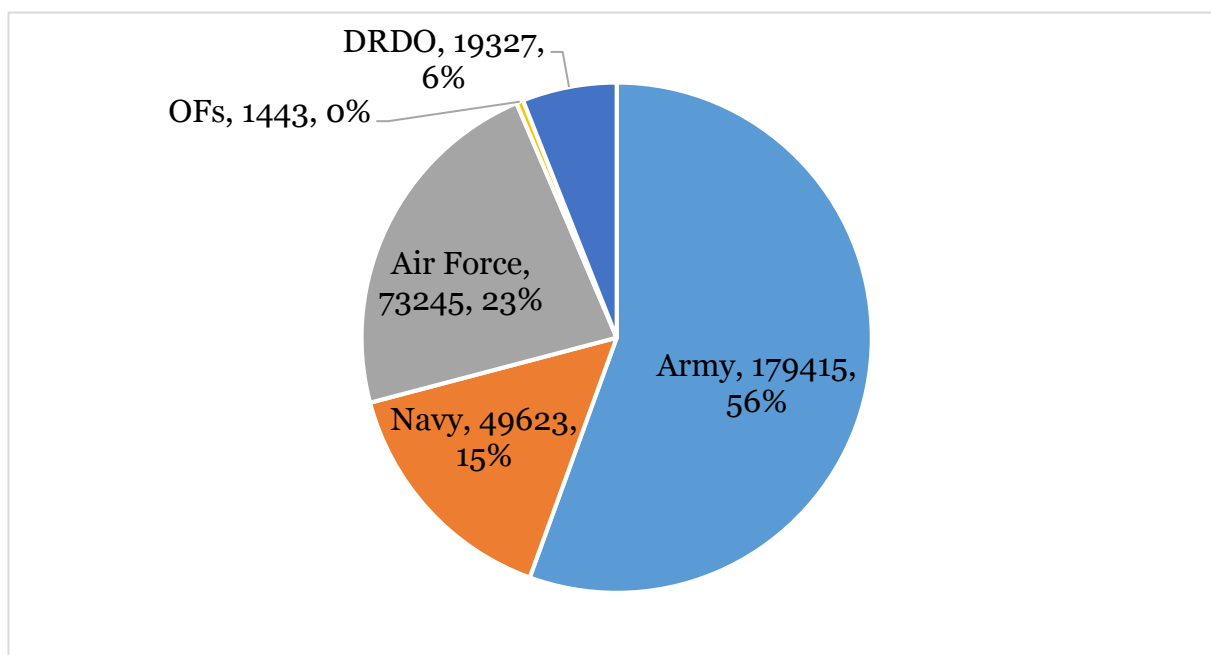
Note: Figures in parentheses represent percentage increase; RE and BE represent revised estimate and budget estimate, respectively.

Share of Defence Services

The Indian Army, given its overwhelming size (see Table 9), continues to be the biggest stakeholder in the defence budget (see Figure 2). Among the three forces, army has, however, the lowest capital share (see Table 3). Furthermore, its capital share has seen a decline, from a high of 26 per cent in 2007-08 to 18 per cent in

2020-21, largely due to increase in P&A, which accounts for 70 per cent of its total revenue expenditure and 57 per cent of the total budget in 2020-21. The army's increase in the revenue share is a cause of concern considering its attempt to shift to the higher side of the technology-driven warfare which requires a much greater spend on capital assets.

Figure 2: Share of Defence Services in Defence Budget 2020-21



Note: Army includes Military Farms, Ex-Servicemen Contributory Health Scheme (ECHS), Directorate General Quality Assurance (DGQA), Rashtriya Rifles, and National Cadet Corps (NCC). Navy includes Joint Staff.

Table 3: Revenue and Capital Expenditure of Army, Navy and Air Force, 2020-21

	Army	Navy	Air Force
Revenue Expenditure (Rs in Crore)	1,46,941	22,935	29,963
Capital Expenditure (Rs in Crore)	32,474	26,688	43,282
Total (Rs in Crore)	1,79,415	49,623	73,245
Revenue Expenditure as % of Total	82	46	41
Capital Expenditure as % of Total	18	54	59

Modernisation

Table 4 summarises armed force-wise modernisation budget, while Tables 5 to 7 present different head-wise modernisation outlays for individual services in respect of budget and revised estimates of 2019-20 and budget estimate of 2020-21. As can be seen, all three services have got a hike in their 2020-21 modernisation budget, with the overall increase being 11 per cent or Rs. 9,227 crore. However, in comparison to the revised budget of 2019-20, the increase is a mere Rs. 255 crore. The meagre increase vis-à-vis revised allocation looks grossly under-provisioned in view of the vast shortages existing in capital procurement.

Table 4: Modernisation Budget of Indian Armed Forces

	2019-20 (BE) (Rs in Crore)	2019-20 (RE) (Rs in Crore)	2020-21 (BE) (Rs in Crore)	% Increase in 2020-21 (BE) over 2019-20 (BE)
Army*	22,951	23,517	25,999	13.3
Navy	22,106	25,155	25,620	15.9
Air Force	36,365	41,722	39,031	7.3
Total	81,422	90,394	90,649	11.3

Note: *: Figures for Army are approximate

Table 5: Modernisation Budget of Indian Army*

Modernisation Head	2019-20 (BE) (Rs in Crore)	2019-20 (RE) (Rs in Crore)	2020-21 (BE) (Rs in Crore)	% Increase in 2020-21 (BE) over 2019-20 (BE)
Aircraft & Aero-Engine	2,115	3,237	4,000	89.1
Heavy & Medium Vehicles	2,128	1,466	1,589	-25.3
Other Equipment	18,562	18,717	20,209	8.9
Rolling Stock	50	3	100	100.0
Rashtriya Rifles	95	95	100	5.3
Total	22,951	23,517	25,999	13.3

Note: *: Figures for Army are approximate

Table 6: Modernisation Budget of Indian Navy

Modernisation Head	2019-20 (BE) (Rs in Crore)	2019-20 (RE) (Rs in Crore)	2020-21 (BE) (Rs in Crore)	% Increase in 2020- 21 (BE) over 2019-20 (BE)
Aircraft & Aero-Engine	2,400	1,150	4,640	93.3
Heavy & Medium Vehicles	45	25	30	-33.3
Other Equipment	3,500	3,600	3,000	-14.3
Joint Staff	929	929	1,022	10.0
Naval Fleet	12,182	15,434	12,746	4.6
Naval Dockyard/Projects	3,050	4,017	4,182	37.1
Total	22,106	25,155	25,620	15.9

Table 7: Modernisation Budget of Indian Air Force

Modernisation Head	2019-20 (BE) (Rs in Crore)	2019-20 (RE) (Rs in Crore)	2020-21 (BE) (Rs in Crore)	% Increase in 2020-21 (BE) over 2019-20 (BE)
Aircraft & Aero-Engine	24,807	21,736	26,910	8.5
Heavy & Medium Vehicles	110	110	120	9.1
Other Equipment	11,448	19,876	12,001	4.8
Total	36,365	41,722	39,031	7.3

It may be mentioned that the India armed forces are in the midst of a major modernisation drive. In the first 10 months of 2019-20, the MoD has signed nearly 14 new contracts that include T-90 Tanks (Rs. 20,000 crore), anti-submarine warfare shallow watercraft (Rs. 12,623 crore) and Akash Missile System (Rs. 5,357 crore). However owing to severe resource crunch, timely payment for these and other ongoing contracts has been a major issue for the MoD. In fact, in past several years, the resource crunch has been so acute that its allocation for modernisation has been

less than even the Committee Liabilities arising from payment outgo for the past contacts (see Table 8). The shortages have also led some of the armed forces to cut down on their planned procurement. The India Navy, for instance, has recently pruned its capital procurement of mine countermeasure vessels, early-warning helicopters, landing platforms docks (LPDs) and maritime reconnaissance aircraft, owing to budget constraints.⁴ However, resorting to such a measure doesn't augur well for the modernisation and defence preparedness of the country, to say the least.

Table 8: Shortages of Modernisation Fund

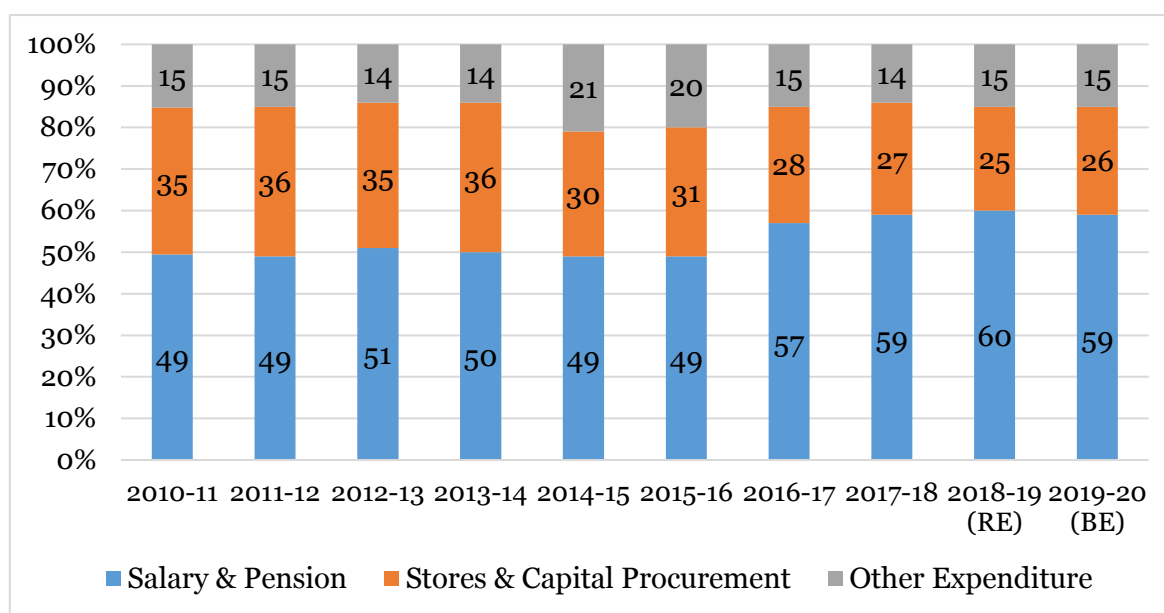
	Committed Liabilities (Rs in Crore)	Modernisation Budget (Rs in Crore)	Shortages (Rs in Crore)	Shortages (%)
2016-17	73,553	62,619	10,934	15
2017-18	91,382	68,965	22,417	25
2018-19	1,10,044	73,883	36,161	33
2019-20	1,13,667	80,959	32,708	29

Manpower Cost

The under provision of the modernisation budget needs to be seen in the larger context of the MoD's changing pattern of expenditure. As shown in Figure 3, the share of manpower cost (salary, pension and other perks) in the MoD's expenditure has drastically increased to account for almost 60 per cent. More significantly almost all the increases in the manpower cost has come at the cost of the stores and modernisation budget, two key components of the DSE that are essential for acquiring and maintaining hard military capability. In other words, the modernisation expenditure has suffered due to the sharp increase in manpower cost.

⁴ Manu Pubby, "Indian Navy cutting down on procurement due to Budget cuts", *The Economic Times*, January 16, 2020.

Figure 3: Changing Pattern of MoD's Expenditure



The hefty increase in the manpower cost is primarily due to the ever-increasing number of people being funded by the MoD and their periodic increase in salary, pension and other benefits. Presently, MoD's budget directly pays to nearly 5.1 million people, of which 1.4 million are uniformed personnel (see Table 9), 3.2 million pensioners (see Table 10) and 3,98,433 defence civilians. In percentage terms, defence pensioners constitute 64 per cent of total MoD-funded people. The Personnel Below Officer Rank (PBOR), the biggest pensioner segment, accounts for 77 per cent of the total pensioners and 49 per cent of total number of people directed funded through the MoD's budget.

Table 9: No. of Uniformed Personnel (As of 2019)

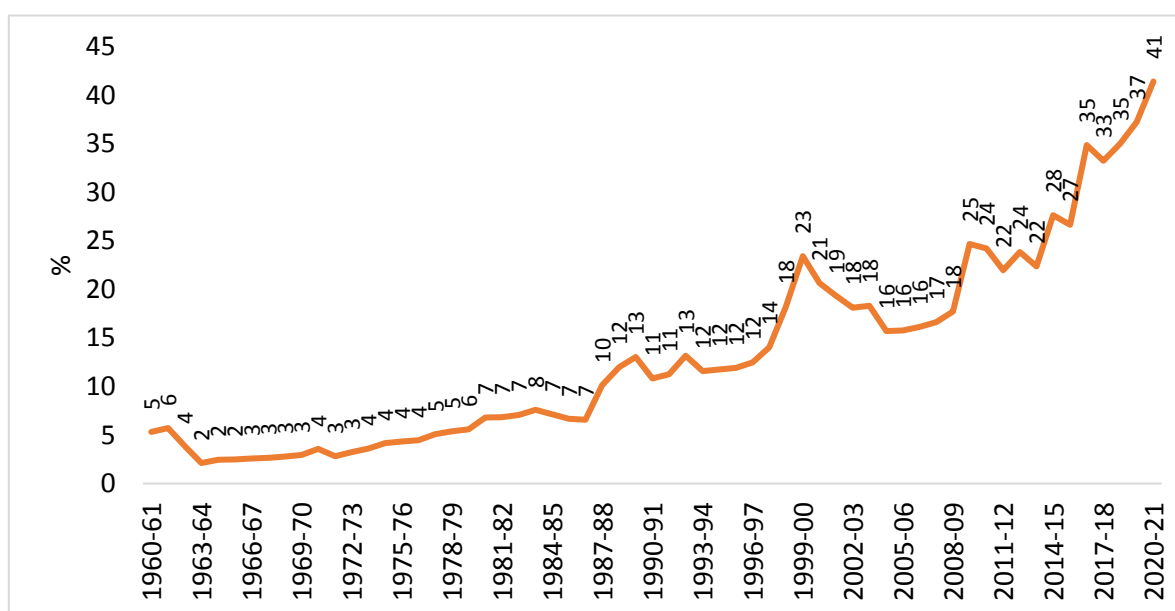
	Officers	Other Ranks	Total
Army	42,913	11,85,146	12,28,059
Navy	10,979	58,073	69,052
Air Force	12,159	1,29,447	1,41,606
Total	66,051	13,72,666	14,38,717

Table 10: No. of Pensioner (As on April 1, 2019)

Category	Service Pensioners	Family Pensioners	Disability Pensioners	Total
Officers	54,825	19,060	9,374	83,259
PBORs	17,05,574	5,93,208	2,05,037	25,03,819
Defence Civilians	3,47,779	2,54,004	---	6,01,783
Unclassified				46,869
Total	21,08,178	8,66,272	2,14,411	32,35,730

The huge manpower strength and its impact on resource allocation has, however, received very little attention of the policymakers, with defence pension receiving the least interest, though it has grown exponentially, from less than 10 per cent of the DSE up to late 1980s to over 40 per cent in 2020-21 (see Figure 4). With the implementation of the One Rank One Pension (OROP) scheme (which requires the government to revise pension of retired defence forces personnel every five years in comparison to every 10 years for the central government civilian employees) and annual addition of nearly 60,000 retirees to the pension club, the exponential growth in the pension budget will continue unhindered unless drastic reform is undertaken to contain it.

Figure 4: Defence Pension as a % of DSE, 1960/61-2020/21



Note: Figures for 2019-20 and 2020-21 are revised and budget estimate, respectively

It is noteworthy to mention that while a part of the increase is due to factors mentioned above, the root cause of the exponential growth in defence pension is the change in the colour service (or minimum engagement period) from earlier seven years to 17 years for a vast segment of PBORs. The change, effected in the 1960s and 1970s, took effect from the late 1980s onwards and has resulted in every retiree being eligible for pension. In comparison, prior to the change in colour service, around 35 per cent of army soldiers, which constitute the bulk of the retirees, were eligible for pension.⁵ The change has also caused the number of military pensioners eligible for pension ballooning from 380,000 in 1950 and 600,000 in 1970⁶ to nearly 2.6 million in 2019. Evidently, funding such a large pool of retirees has come with huge budgetary consequences, with particular impact on the modernisation of defence forces.

An Uphill Task for the Chief of Defence Staff

Given the economic slowdown and shortfall in government's revenue collection, an increase of Rs. 40,367 crore in the MoD's overall allocation looks reasonable, though it falls short of the expectations of the defence establishment, which is facing an acute resource constraint to meet all its expenses including on modernisation front. The worry is that the resource constraints are unlikely to be mitigated in the near future, in view of the state of economy and socio-economic requirements of the country. Given that a substantial hike in allocation is unlikely to be provided in the near future, the MoD has to find a way out for managing its resource problem, particularly that arise out of ballooning manpower cost, which in turn has crowded out resources that could have been devoted to modernisation and other heads of expenditure.

The appointment of the first ever CDS and creation of a new Department of Military Affairs (DMA) under him offer a ray of hope in mitigating some of the problems. The CDS's clearly articulated tasks of promoting jointness and the DMA's charter covering policy matters concerning the armed forces, give him a unique opportunity to drive some of the hard defence reforms in resource allocation, so as to maintain a fine balance between the manpower cost and the modernisation expenditure. The CDS needs to take a hard look at the current strength of uniformed personnel, and importantly the colour service that decide the number of retirees eligible for pension. Needless to say that the current scenario in which there are 2.2 pensioners for every active uniformed personnel is unsustainable for a balanced growth of India's military capability.

⁵ Jasjit Singh, *India's Defence Spending: Assessing Future Needs*, Knowledge World, New Delhi, 2001, p. 105.

⁶ *Ibid.*, p. 108.

Annexure

Key Defence Indicators

Indicator	2019-20	2020-21
Defence Budget (Rs in Crore)	3,05,296	3,23,053
Growth of Defence Budget (%)	9.3	5.8
Revenue Expenditure (Rs in Crore)	2,01,902	2,09,319
Growth of Revenue Expenditure (%)	8.9	3.7
Share of Revenue Expenditure in Defence Budget (%)	66	65
Capital Expenditure (Rs in Crore)	1,03,394	1,13,734
Growth of Capital Expenditure (%)	10.0	10.0
Share of Capital Expenditure in Defence Budget (%)	34	35
Share of Capital Expenditure in Central Government Capital Expenditure (%) #	31	28
Capital Acquisition (Rs in Crore)	80,959	90,649 [^]
Growth of Capital Acquisition (%)	9.2	12.0
Share of Defence Budget in GDP (%) [*]	1.49	1.44
Share of Defence Budget in Central Government Expenditure (%)	11.0	10.6
Defence Pension (Rs in Crore)	1,12,080	1,33,825
Growth of Defence Pension (%)	3.0	19.4
MoD (Civil) (Rs in Crore)	13,635	14,500
Growth in MoD (Civil) (%)	-15.9	6.3
MoD's Budget (Rs in Crore)	4,31,011	4,71,378
Growth in MoD's Budget (%)	6.6	9.4
Share of MoD Budget in GDP (%) [*]	2.1	2.1
Share of MoD Budget in Central Government Expenditure (%)	15.5	15.5

Note: *: Based on GDP's revised estimate for 2019-20 and budget estimate for 2019-20; #: The share is with respect to the capital segment of the DSE. If the MoD's total capital expenditure is taken into account, the share increases to 32 per cent and 29 per cent in 2019-20 and 2020-21, respectively. [^]: Approximate

About the Authors



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