
REVIEW OF THE DEFENCE BUDGET

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Under India's parliamentary system of governance, making of budgets is the exclusive responsibility of the Executive. However, the overall budget is to be approved by the Parliament each year as a Money Bill. The Parliament can approve or reject the budget or any of its demands but cannot modify them. The system, thus, differs significantly from the American one, where Congress has the authority to modify the budget. The parliamentary review of the budget undertaken in India should be seen in this context.

A brief description of the defence budgeting process may be in order.

The defence budgeting process in India starts along with the budgeting process of other Ministries and Departments of the Government of India, on the basis of the Budget Circular issued by the Budget Division of the Ministry of Finance (MoF) in the middle of September each year, containing instructions and guidance for the preparation of the Revised Estimates (RE) of the current year and Budget Estimates (BE) of the next year. The budgets are finalised by the end of December.

The Budget Circular is accompanied by various instructions issued in the past by the Department of Expenditure regarding economy measures, rationalisation of expenditure, and measures for augmentation of revenues,

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for being kept in view while preparing estimates. Particular attention is drawn to the instruction regarding the exchequer control system introduced from April 1, 2006, known as the Modified Cash Management System whose main aim is to obtain greater evenness in budget expenditure and reduce the rush of expenditure in the last quarter of the financial year. Under this, Monthly Expenditure Plans are to be worked out, and in the last quarter, not more than 33 percent of the budgetary provisions can be spent.

On receipt of the Budget Circular, the Budget Division of the Ministry of Defence (Finance), in turn, issues circular to the Service Headquarters (HQ), Defence Research and Development Organisation (DRDO) and Department of Defence Production for their budget projections for the RE for the current year and the BE for the next year, keeping in view various parameters, including trends of expenditure.

The defence budget in India, is mainly composed of the budgets of the three Services, which represent 92 percent of the total budget. Projections are made by the Services on the basis of (i) expenditure pattern of past years and current trend of expenditure; (ii) prevailing inflationary trends; (iii) committed liabilities; (iv) anticipated requirement of stores; (iv) Annual Acquisition Plan; (v) requirements on account of new units/formations/establishments; (vi) Annual Works Programmes, etc. The projections by the Services and Departments are consolidated and estimates are projected to the Ministry of Finance. This is the first stage in budget preparation.

These estimates are discussed in the MoF with the Financial Advisers of Ministries/Departments in October/November. After the pre-budget meetings are over, approved ceilings of expenditure, as finalised in these meetings, are communicated to the Ministries / Departments, on the basis of which Financial Advisers are to prepare the final Budget Estimates.

So, in effect, the budget takes its final shape after the Ministry of Finance imposes its “ceilings” keeping in view competing demands and overall constraint of resources.¹

1. Report of the Standing Committee on Defence, on the Demands for Grants 2008-09, Lok Sabha Secretariat, Para 2.27, p.13, April 2008.

The ceiling indicated by the MoF is not the overall ceiling on the defence budget but is indicated demand-wise.

The entire defence expenditure is treated as non-Plan expenditure, which gives the Ministry of Defence more autonomy in the preparation of the budget than other Ministries/Departments, whose budgets are divided between Plan and non-Plan segments.

The departmentally related Standing Committee system, was inaugurated by the Vice President and Chairman of the Rajya Sabha (Upper House) on March 31, 1993. The Committees were constituted soon thereafter. It was a historical landmark in the evolution of the Committee system in the Indian Parliament.

Each of the Standing Committees consists of not more than 45 members—30 to be nominated by the Speaker from among the members of the Lok Sabha and 15 to be nominated by the Chairman, Rajya Sabha, from among the members of the Rajya Sabha. The term of the members of these committees is not to exceed one year.

After the general discussion on the budget is over, the Lok Sabha (Lower House) adjourns for a fixed period and the Standing Committee consider the Demands for Grants during the recess. The demands are thereafter considered by the Lok Sabha in the light of the reports of the Committee.

As would be seen, the Standing Committee has no role in the preparation of the budget of the department concerned. Its role is confined to undertaking a review of the Demands for Grants for the Ministry/Department concerned. Its recommendations on the basis of review, if they pertain to certain allocations made are, however, given due weightage in the preparation of the next year's budget.

The budgetary requirements for the defence Services are included in the following six Demands for Grants presented to Parliament:

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- Demand No.21, Defence Services – Army
- Demand No.22, Defence Services – Navy
- Demand No.23, Defence Services – Air Force
- Demand No. 24, Defence Services – Defence Ordnance Factories
- Demand No.25, Defence Services – Research and Development Organisation
- Demand No. 26, Capital Outlay on Defence Service

The first five Demands for Grants (Demands 21 to 25) are categorised as Revenue Expenditure of the defence budget. Revenue Expenditure includes expenditure on pay and allowances, transportation, revenue stores like ordnance stores, revenue works, expenditure on petroleum, oil, lubricants (POL), etc.

Requirements for Capital Expenditure are contained in the Capital Outlay (Demand No. 26), which caters to the requirements of capital expenditure of all the Services, ordnance factories, Research and Development (R&D) organisation. It includes expenditure on land, construction works, plants and machinery, equipments, tanks, naval vessels, aircraft and aeroengines, dockyards, etc.

The defence budget is formulated on the basis of the structure mentioned above, making it a totally input oriented budget. Control of expenditure is the main theme of defence budgeting in India, for which an input oriented budget is well suited.

The fundamental rule on which the system of budgetary control may be said to rest is that no item of public expenditure may be incurred, unless provisions exist to meet it in the sanctioned BE of the year concerned. This rule applies to the nature of expenditure as well as the amount.

While analysing various points made by the Standing Committee on Defence while scrutinising defence budgets year after year, it may be worthwhile to look into the perspectives from which the defence budget, as it stands, can be analysed.

The key ingredients of the defence budget can be looked at from the “requirements” as projected by the three Services, going into their reasonableness .

But it can take us only up to a point, for in the final stage of the budgetary process, as per the laid down procedure, there is a “ceiling” which is imposed by the MoF.

Secondly, the “requirements” are projected by the Services on the basis of their respective Perspective Plans and Annual Plans, which are not open to scrutiny. So, for the reasonableness of the “requirements” which form the basis of their respective budget projections, one has to depend to a large extent on the analyses and judgement of the Services which have their financial planning wing and control mechanism.

There is another approach towards scrutiny of the defence budget from the “cost” angle i.e. by treating it as composed of various *costs* that the defence Services have to incur or the *prices* they have to pay, from their respective budgets, to maintain the forces and supporting staff, to achieve an acceptable level of defence preparedness and build up necessary capability.

The basic ingredients of the defence budget, from this point of view, are the *costs* which are to be incurred to meet the *requirements*, and many requirements cannot be met because the costs of other items exhaust the total budgetary resources made available to a Service. Prioritisation is the only answer, but that keeps many requirements unsatisfied.

Thus, the defence budget of India can be scrutinised from two perspectives: from the perspective of requirements and from the perspective of costs. One could also add another perspective, that is, requirements, keeping in view the costs. That would mean the introduction of the programme concept in defence budgeting which would enable both requirements and costs to be seen in the context of specific programmes. That would mean introducing an output orientation in defence budgeting.

But since our defence budget, as explained above, is an input oriented budget and is not formulated in terms of programmes, it is difficult to analyse the budget as at present, simultaneously from the requirement and cost point

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of view, nor is it possible to link the budget to the end objectives of defence spending.

Accepting the present limitation from an analytical point of view of an input oriented budget, the main aim while scrutinising the defence budget from the “cost” point of view is that these costs, which are the ingredients of the defence budget, are not more than what is reasonable and should be reflective of good management practices. Cost consciousness should prevail all along the line so that costs borne by the defence budget in carrying out various defence related activities are not more than what is fair and reasonable.

Some of these costs are controllable and some are not. The manpower costs, infrastructure costs, inventory costs and many other costs are controllable by adopting proper manpower policies and good management practices.

Costs, as reflected in the budget, are to be looked into with a view to economise on them without reducing efficiency, so that public money is not wasted and we get cost-effective defence.

The aim, for example, should be to eliminate inefficiencies in support processes and to ensure that the quality of maintenance does not suffer. Cost effectiveness in support areas also helps in better allocation of resources to maximise military capability available to the front line.

It should be the endeavour of any critical scrutiny of the process of defence budgeting to see whether, among other things, it ensures that the front line receives the logistic support needed within the framework that provides the best balance between operational effectiveness and efficiency. Over-enthusiastic effort to cut down the maintenance expenditure to increase the allocation for capital acquisition should not lead to reduction in operational efficiency and impairing readiness.

In defence budgetary literature in India, most of the costs are often treated as “obligatory,” for which it is held that budgetary provisions, in any case,

are to be made. These are treated as policy related costs, determined by the *“strength and composition of Armed Forces maintained for the defence of the country.”*²

But these costs are also controllable through a periodic review of force structure which should be both strategy driven and resource driven.

Some of the infrastructure costs are controllable in the medium term, by taking effective measures from now on so that future defence budgets are less burdened by these costs. For this, a longer term view regarding cost control is necessary.

This also underlines the need for both medium and long-term planning and linking defence budgeting with it, so that savings can be generated for modernisation efforts. Defence planning and linking it with budgeting is, therefore, not a luxury, but a necessity for evolving an affordable and effective defence. Planning should be regarded as a necessary ingredient of defence, which has often been emphasised by the Standing Committees by expressing their anxiety in timely approval of Defence Plans.

As would be seen from the discussion which follows, of the general approach adopted by India’s Parliamentary Committee on Defence (Standing Committee) on the Defence Budget that they have looked into mainly into the cost aspects in the first few years of their scrutiny of the defence budget, as the general environment for public finance was of expenditure control and economy in expenditure. In the subsequent years, however, with easing of financial stringency and higher rate of economic growth, they have looked into the requirements aspects more intensively.

As per the first report on the Demands for Grants 1993-94, the scrutiny of the demands was conducted on the basis of the following information:

- policy/programmes/activities brought out by the Ministry of Defence (MoD) in the Annual Report;

2. Defence Services Estimates, 2008-2009. Procedure followed in regard to budgetary control over defence expenditure, Appendix C, Para 3.

- past commitments carried over in the current year i.e. 1993-94
- anticipated liabilities for the current year; and
- increase over previous year's estimates.

The above documents were consulted by the Committee while scrutinising the demands for grants for subsequent years also. This reflected the concern regarding the "requirement" aspects of the defence budget.

In the first two years of its review of the Demands for Grants for the Ministry of Defence, the Standing Committee, went into the aspect of "reasonableness" of the increase sought in the Revised Estimates of the previous year's budget as also that for the budget of the current year over the Revised Estimates. It went into the reasons for the increases, and found the increases given as reasonable and modest.

The Committee also looked into allocations which had been provided for modernisation schemes in the budget of 1993-94 in both the Capital and Revenue accounts. It was noted that the term "modernisation" was not a classification for budgetary purposes. The Committee were informed that the budgetary constraints had an impact on the modernisation programmes.

The Committee came to the conclusion, keeping in view the overall constraint in resources, that the best way to generate funds for modernisation of the armed forces was through generating internal savings by taking well considered economy measures.

The Committee took particular interest in various measures of economy being undertaken by the Services and the Ministry. It gave special emphasis to these in its reports on the defence budgets of 1993-94 and 1995-96. Apparently, it succeeded in conveying an effective message to the Ministry of Defence and armed forces to manage defence expenditure in a cost-effective way.

The Standing Committee referred to the earlier recommendations of the Committee on Defence Expenditure (CDE) set up in June 1990 regarding achieving economies in specific areas of defence expenditure. In response, the Ministry of Defence explained that action had already been taken to reduce expenditure relating to manpower, petrol, oil, transportation, inventory management, etc. The Standing Committee expressed the hope

that the economies will be suitably reflected in the Demands for Grants of the future years.

The Committee also went into the specific details relating to the economy measures initiated by the Services. In response, the Ministry explained that in the Army, savings were achieved through reduction in the authorisation of equipment, one-time reduction in the inventory in the Army Ordnance Corps, reduction of land norms, introduction of fuel efficient vehicles, introduction of transportation model, etc. These had resulted in a saving of about Rs. 1,000 crore per annum. These savings were envisaged in the budget and had been observed in practice. Similarly, the economy measures initiated by the Navy were likely to result in an annual savings of Rs. 49.93 crore and economy measures initiated by the Indian Air Force (IAF) were to result in a saving of Rs. 67.19 crore. The Committee recommended that the measures regarding conserving of petroleum products should be undertaken by all organisations under the Ministry of Defence, more vigorously.

The Committee made very significant recommendations for achieving economy in the inventory of ordnance stores. Similarly, personnel requirement of the manpower for non-combat duties, the Committee felt, needed constant review for all the Services.

By emphasising that money saved by a particular Service should be available for modernisation (presumably for the same Service that effected the saving), the Committee was enunciating an important principle. It was : economy achieved by these measures by a particular Service which required efforts and sacrifice should not lead to reduction in their overall allocation of the budget, but should be redistributed to increase the allocation, say under the capital head, for expenditure on modernisation. This is an important principle. If this kind of incentive is not provided, the Services may not be enthusiastic in achieving economy in areas where it is possible.

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The Standing Committee also reiterated the need for the report of the Committee on Defence Expenditure to be made public as early as possible.

The report pertaining to the Demands for Grants 1994-95 also looked into the economy aspects with a lot of attention. Some of the important steps taken and consequent savings per annum, which the Committee was informed about by the Ministry, were: (i) Rationalisation of the non-combatant manpower in the Army (Rs. 200 crore); (ii) rationalisation of authorisation of tanks per regiment (Rs. 60 crore); (iii) modernisation of inventory management and introduction of the Central Inventory Control Point System (Rs. 100 crore); (iv) off-loading of the requirements hitherto met by EME and other units of the Army to the civil market (Rs. 20 crore); (v) introduction of a new transportation model including decentralisation of the supply system (Rs. 12 crore); (vi) use of simulators for training (Rs. 300 crore); and (vii) the rationalisation of plinth area for residential accommodation for officers and men (Rs. 8 crore).

The Committee observed that measures regarding conservation of petroleum products as recommended by its first report has not led to reduction in allocation under the POL head. It noted that the Budget Estimates under these items for 1993-94 was revised at a higher figure and a still higher amount was planned to be spent in 1994-95. It was explained by the Ministry in its Action Taken Note that the increase was due to increase in the prices of POL, and in actual terms, there was no increase in consumption of POL.

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The Committee was of the view "that a little more openness even in the matters relating to the defence will not militate against the national interest. ..."³ This is an important point for a democratic system of government. Reports dealing with the efficacy with which public money is spent and how this could be improved upon should be made public, as also measures taken

3. Report of the Standing Committee on Demands for Grants 1994-95, Para 37 of the report.

by the government to implement the recommendations, as the taxpayers should be satisfied that public money was well spent.

The Committee was concerned at the fact that there had been an increase of 10.87 percent in the Budget Estimates of 1995-96 as compared to that of 1994-95 whereas the rate of inflation during 1994-95 was 11.41 percent, allowing no increase in real terms in the defence budget, 1995-96. The Committee also noted that the Gross Capital Expenditure which was 29.45 percent in 1994-95 (RE) declined in 1995-96 (BE) to 28.84 percent, indicating a deceleration of the modernisation effort.

As per the next report, the increase in the BE for 1996-97 over the previous year's RE worked out to 3.2 percent only as against the existing rate of inflation of about 4.5 percent. In other words, there had been no increase in real terms in the defence budget for 1996-97 at all.

The Committee, in its report for 1996-97, gave a table showing how defence expenditure as a percentage of Central Government Expenditure had fallen from 17.55 percent in 1986-87 to 13.58 percent in 1996-97. It also indicated that defence expenditure as a percentage of Gross Domestic Product (GDP) had fallen from 3.58 percent in 1986-87 to 2.72 percent in 1994-95 .

Referring to the budget provision for 1997-98 which represented 20.75 percent increase over that of the previous year, the Committee observed that if the amount required for implementation of the Fifth Pay Commission was excluded, the actual budgetary hike would only be 8.5 percent over the RE 1996-97 against the existing inflation rate of about 7.8 percent "Thus, in real terms, the hike in the Defence Service estimates for 1997-98 is only notional."⁴

The inadequacy of the increase in the defence budget was again commented upon by the Committee while reviewing the Demands for Grants 1998-99 when it observed that the hike in the defence budget was just about enough to meet the outflow of the Fifth Pay Commission's recommendations and general inflation. The rupee devaluation had further eroded budget capacity. "Thus, in real terms, the provision for items other than salary in the defence

4. Report of the Standing Committee on Demands for Grants 1997-98, Para 23.

Thus, in real terms, the provision for items other than salary in the defence budget remains static, if not reduced. In terms of percentage of GDP also, the defence budget has stagnated at 2.4 percent over the last decade. This low level of funding is totally insufficient to meet crucial requirements, including modernisation of the armed forces.

budget remains static, if not reduced. In terms of percentage of GDP also, the defence budget has stagnated at 2.4 percent over the last decade. This low level of funding is totally insufficient to meet crucial requirements, including modernisation of the Armed Forces," it observed. The Committee emphasised that in the interest of the security of the country, defence spending should be raised at least to the level of 3 percent of the GDP.⁵

The same kind of comments were made while examining the Demands for Grants 1999-2000. In real terms, the hike in defence outlay for the year 1999-2000, appeared to the Committee as "notional."⁶

In a table presented in the report, it was shown that the recommendations made by the MoD for the budget were much lower than the projections made by the Services/Departments and allocations made by the MoF were still less. In effect, the amount allocated by the MoF by imposing a ceiling was about 18 percent less than the amount projected by the Services/Departments.

In scrutinising the Demands for Grants for 2001-02, a similar table was presented, which showed that the amount allocated as per ceiling made by the MoF was about 16 percent less than the amount projected by the Services/Departments.⁷

In the Action Taken Notes, the government, in their replies relating to the Committee's observations on the inadequacy of the increases in the defence budget, have all along stated that the observations had been communicated to the Ministry of Finance for their consideration and necessary action. In one of the replies, the government categorically stated, "As already brought

5. Report of the Standing Committee on Demands for Grants 1998-99, Para 24.

6. Report of the Standing Committee on Demands for Grants 1999-2000, Para 26.

7. Report of the Standing Committee on Demands for Grants 2001-02, Para 23.

to the notice of the Committee, the Ministry of Finance make final allocations for defence taking into consideration all relevant factors.”⁸

The recommendations of the Standing Committee of the presentation of the budget do not result in any increase for defence allocations. As per India’s system of financial administration and governance, this really should be accepted as a final point. Reiteration of this point leads to needless discussions, points and counterpoints, without any tangible result.

Therefore, it is felt that discussing the adequacy or otherwise of the overall defence budget after it is finalised, is not a very productive exercise and the Committee should rather look into other aspects which relate to economy and efficiency of defence expenditure. This point was appreciated by the Committee while scrutinising the Demands for Grants 2001-02 when it stated,” The Committee is of the view that effective security cannot be had by merely presenting a bigger defence budget. It requires effective defence finance procedures which, in turn, needs an integrated defence planning organisation.”⁹ The reason for this observation was that an analysis of the figures showed that an amount of Rs. 4,100 crore of the allocated defence budget remained unspent during the year 2000-01. The Committee felt that the tedious and time consuming procedures that had led to delay in defence spending, particularly that relating to procurement. The Committee desired that the procedure should be streamlined. While scrutinising the Demands for Grants 2002-03, the Committee again took note of unspent funds amounting to Rs. 5,000 crore, the major portion of which related to capital expenditure. This story of surrender of funds from the allotted budget, year after year, has been a recurring one.

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8. Report of Standing Committee 1998-99, Action taken on recommendations on Demands for Grants, MoD 1997-98, p.7.

9. Report of the Standing Committee on Demands for Grants 2001-02, Para 27.

This story of surrender of funds from the allotted budget, year after year, has been a recurring one.

The Committee in its report on the Demands for Grants 2004-05 noted that the Budget Estimates for the defence Services for the year 2004-05 showed an increase of 17.92 percent over the Budget Estimates of the year 2003-04 and an increase of 27.69 percent over the Revised Estimates for the year 2003-04. The increase was mainly in capital expenditure (Para 30 of the Report on Demands for Grants for 2004-05). Notwithstanding the higher allocation, the Committee noted that the MoD might have to seek additional funds from the MoF because almost the entire amount allocated for capital expenditure would be spent on committed liabilities. The Committee suggested that the MoD might approach the MoF after reassessing the situation.¹⁰

The Committee also noted that during the previous five years i.e. from 1999-2000 to 2003-04, substantial funds amounting to Rs. 32,740.26 crore for capital expenditure has lapsed due to non-fructification of modernisation schemes. In their earlier reports, they had recommended creation of a Defence Modernisation Fund (DMF). The Committee noted that the MoF had in principle agreed to the creation of the DMF, which would be available for utilisation during the next three years and that the then Finance Minister, while presenting the Interim Budget, 2004-05, announced the setting up of a non-lapsable Defence Modernisation Fund with a corpus of Rs. 25,000 crore. The Committee was, however, surprised to note that no allocation was made for this fund in the General Budget 2004-05 and was dismayed at the policy reversal.¹¹

In the report on the Demands for Grants for 2006-07, a table has been furnished indicating provisions in the Budget Estimates, Revised Estimates, Actuals and Shortfall. The figures shown in the table indicated that there was reduction of allocation from BE to RE and from RE to actual since 2000-01, except in the year 2004-05. These again indicated shortfall/under-utilisation of budgetary allocations. What bothered the Committee was reduction of

10. Report of the Standing Committee on Demands for Grants, 2004-05, Paras 31 and 33.

11. Report of Standing Committee on Demands for Grants, 2004-05, Paras 40 to 43, pp.19-20.

the amounts allocated at the RE stage compared to BE provisions. It was stated by the Ministry of Defence that the Ministry of Finance reduced the amount at the RE stage based on the progress of expenditure and their assessment of requirements of funds during the remaining part of the financial year.

The MoF also stated that in all these years, during the course of the mid-year review, it was found that the capital expenditure of the MoD was much below the amount provided in the budget. The Revised Estimate was arrived at keeping the pace of expenditure and absorptive capacity of the MoD in the next two months in view. The MoD indicated that streamlining the acquisition procedures through the procurement manual would help reduce the time between various stages of acquisition proceedings. The Committee was not satisfied with the explanation. To quote, “Expressing strong displeasure, the Committee feel that there is a need for better financial planning and management in the Ministry of Defence.”¹²

The Committee, as mentioned above, in its earlier reports had recommended creation of a non-lapsable DMF to ensure timely availability of funds for acquisition of defence equipment.

It was brought out by the MoF, that it would not help matters as parliamentary approval would be required for utilising the money from the fund. But the Standing Committee reiterated its recommendation regarding creation of the DMF for better budgetary management of defence procurement.

But the position taken by the MoF has been that as adequate funds were made available in the beginning of each financial year for meeting the requirements of capital expenditure, there appeared “to be no need for sequestering scarce public resources in a Fund.”¹³

12. Report of the Standing Committee on Demands for Grants, 2006-07, Para 1.43.

13. Report of the Standing Committee on Demands for Grants, 2006-07, Para 1.58 and Demands for Grants, 2008-09, Para 2.33, p.16.

The Committee has all along emphasised in its reports the need for achieving self-reliance in defence acquisitions.

The attention of the Committee while examining the Demands for Grants for 2008-09 was focussed on "Curbing of Wasteful Expenditure." The Committee's attention was drawn to various studies that have been undertaken by the Services "in-house" and by the Integrated Defence Staff (IDS) to identify wasteful expenditure. Reference was also made to findings of the IDS that (1) optimisation of defence resources could be achieved, for example, by amalgamation of assets in several areas through promotion of tri-Service institutes; (2) by a pragmatic review of reserve levels which fall in the realm of over-assurance; (3) effective exploitation of the Information Technology (IT) revolution backed up by a sound networking system and in other ways.

The Committee has all along emphasised in its reports the need for achieving self-reliance in defence acquisitions and in this context, recommended a higher percentage of allocation of the budget to defence R&D which was about 4.5 percent of the defence budget in 1994-95, so that R&D programmes are completed on schedule. Its reports also drew attention to the Ten-Year-Self-Reliance Plan to achieve a self-reliance index of 0.7 percent.

Following the Standing Committee's recommendations, the percentage of allocation of defence R&D is now higher at 6 percent of the defence budget.

For better management of the defence budget, the Committee had desired that the 9th Defence Plan for the period 1997-2002 be finalised on time. It also wanted that a firm commitment be made by the government for allocation of resources for five years rather than year to year.

In the Action Taken Note submitted in 1998, the Ministry of Defence had said that the 9th Defence Plan was approved by the Cabinet Committee on Security in December 1997 for which a firm commitment of funds for five years was given.

In fact, this became possible because of the combined efforts made by MoD, Minister of Finance, Service Chiefs, the Cabinet and the then Principal Secretary to the Prime Minister. The yearly budgetary allocations made

from 1997-98 to 2001 to 2002 to defence i.e. in the 9th Plan period and the expenditure made, broadly conformed to the figures originally approved in the beginning of the Plan period.

But this could not be repeated for the 10th Defence Plan (2002-2007), in spite of the concern shown by the Standing Committee in several of its reports. The same problem continues for the 11th Plan. It only shows that a well formulated Defence Plan can get approved in time only when concerted efforts are made at the higher level of decision making in the government, though Standing Committees could help by repeatedly referring to its need, in their reports.

Although legally and technically, the recommendations of the Standing Committees are not binding, the government generally accepts most of them. For example, in its report on the Demands for Grants 2008-09, in the very first chapter, a reference is made to the Action Taken Report on the recommendations relating to the Demands for Grants 2007-08. It contained 76 observations/recommendations of which 57 were accepted. For reasons put forth by the government, in respect of 10 recommendations, the Committee did not wish to pursue Action Taken replies. One of the recommendations referred to allotment of 3 percent of the GDP for the defence budget, another related to a separate Pay Commission for the armed forces. In the case of four recommendations, it did not accept the replies of the government, one of which related to the need for increasing the budgetary allocation to the Navy. In five cases, the replies of the government were awaited.

One should not forget the limits within which the Parliamentary Committees are required to function. They have to function as per the rules of procedures. The Standing Committee can express its views and make recommendations in the form of a report, but it does not fall within its purview to direct any authority or government to do or not to do any particular act or do it in a certain way. Its main function would be to influence the government for taking such action which it considers desirable.

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The Standing Committee, through its reports, has succeeded in putting defence budgeting in the proper perspective.

The Standing Committee, through its reports, has succeeded in putting defence budgeting in the proper perspective. Today, through the medium of its published reports, there is a wealth of information in the public domain about defence budgeting process, trends in budgetary allocation and various considerations which go into defence budgeting. By inviting representatives of the Finance Ministry in its deliberations and asking them to put their point of view before the Committee regarding budgetary allocations, alternative points of view and putting them on record, the reports have succeeded in making the analysts, decision-makers and the public aware of various issues that are relevant in defence budget making and managing.

The Standing Committees on Defence have gradually expanded the scope of examination of defence related activities to gain better insight into defence expenditure management. They have furnished reports on Defence Public Sector Undertakings, Defence Research and Development—Major Projects, Welfare of Servicemen and Ex-Servicemen, Upgradation and Modernisation of Naval Fleet, Manpower Planning and Management Policy in Defence.

The report rendered in 2001 pertaining to Manpower Planning is of particular importance as 35 percent of defence expenditure is manpower related. The Committee noted that the Army had formulated a plan for effecting under-posting of 50,000 soldiers over a period of financial years till 31.3.1999, covering all types of units and formations. The basic aim was to cut down on manpower cost so as to release resources for more investment in higher technology weaponry. The Committee wanted it to be done in a time-bound manner.¹⁴

The Committee also expressed its unhappiness about the deficiencies in the cadre strength of officers in the Army and advised the government for taking necessary steps to fill up the vacancies. The Committee noted that

14. Twelfth Report, Standing Committee on Defence (2001) Manpower Planning and Management Policy in Defence, Para 13.

about 50,000 Service personnel who constitute a rich source of trained and disciplined manpower, retired or were released from active service every year. The Committee recommended that more ex-armed forces personnel should be retrained and absorbed in the paramilitary forces.¹⁵

In this connection, it supported the recommendation of the Fifth Pay Commission's regarding engagement of one-third of the annual intake into the combat and combat support arms of the Army Personnel Below Officer Rank (PBOR) on a shorter term of seven years, with the provision of their remustering into the other supporting arms and services within the Army. The Committee did not understand the reasons for the government not considering favourably any proposal to reduce the colour service. Reduction in colour service would reduce the pension bill of the Service personnel.¹⁶

The Committee also stressed the need for improving the "teeth to tail" ratio to reduce manpower cost by economising on support staff in the Army.¹⁷ Eminent experts from outside were also invited to present their point of view in this respect. One expert commented that the manning strength in the IAF in certain activities was more than the standard adopted abroad for similar activities. These affected the teeth to tail ratio in the IAF.¹⁸

The Committee, in this context, reviewed the functioning of the Standing Establishment Committees of the three Services which are the expert bodies to examine the staffing strength of various units, with a view to optimise the manpower strength. The Committee expressed unhappiness on the functioning of the one of the Standing Establishment Committee.

By giving a very detailed report on manpower planning in defence, the Committee not only provided very useful information relating to manpower in the Army, Navy and Air Force but also put the issues in proper perspective to enable defence analysts and decision-makers to arrive at the correct conclusions.

The reports of the Standing Committee on Defence have been a great help in focussing attention on important aspects of defence budgeting, on the

15. Ibid., Para 40.

16. Ibid., Para 42.

17. Ibid., Para 88 to 90.

18. Ibid., Para 98.

The problem facing defence budgeting from the late Nineties onwards has been, paradoxically, the inability to spend the allotted amounts, particularly under the capital outlay account.

necessity for cost control and curbing of wasteful expenditure, as also the need for early approval of Defence Plans so that money for defence is spent efficiently for achieving the strategic objectives in a cost-effective way.

Control of defence expenditure is, no doubt, a very important aspect of defence budgeting. But the problem facing defence budgeting from the late Nineties onwards has been, paradoxically, the inability to spend the allotted amounts, particularly under the capital outlay account.

In every report of the Standing Committee in recent years, both the unfulfilled requirements for various schemes and projects of the Services and the extent of surrender of budgetary allotments have been brought out. The Finance Ministry has also been frequently criticised for allotting less than the projected amounts in the Plan and for the annual budget, as also for reduction of the budget at the RE stage.

One wonders, however, what the surrenders would have been like from the budgetary provisions, if the projected amounts had been allotted.

The phenomenon of surrendering funds has become more pronounced since 2000-01. Since then, every year, barring 2004-05, substantial funds have been surrendered at the RE stage and at the end of the financial year, in spite of all the efforts made to spend the allotted amounts by frequent monitoring of expenditure. Up to 2008-09, upwards of Rs. 40,000 crore have been surrendered in this way, because of inability to spend the allotted amount.

The Standing Committee in its several reports has criticised this aspect of defence budgeting and attributed it basically to bad financial management and cumbersome procurement procedure.

The Committee's repeated insistence for the creation of the Defence Modernisation Fund (DMF) emanates from this phenomenon of surrender of

funds under the capital head year after year, though there is huge requirement of funds for modernisation.

The MoF has not agreed to the DMF (as per their deposition before the Standing Committee) because, they say :

- funds have never been denied to defence whenever a scheme has matured for implementation and provision for a supplementary budget is always there;
- every year, the Ministry of Defence has surrendered funds at the RE stage, because of inability to spend the allotted amount on the basis of trends of expenditure;
- even if the DMF is created, for drawing money from it , supplementary budgets would have to be prepared as Parliament's approval has to be there; therefore, there is hardly any benefit.

For these reasons, the MoF feels that there is no necessity to keep aside so much funds for future spending in defence, as there are many competing demands for other activities for which funds are required now. In other words, if money cannot be spent, it should be surrendered.

It is not the question only of somehow spending the allotted amounts by any means, but also securing efficiency in spending the amounts. The Standing Committee itself, in its reports, has drawn attention to wastages and the need for economy and efficiency in defence spending so that more money can be spared for modernisation. This kind of economy cannot be brought about by ad hoc measures, as these economies have to be enduring ones. So control of expenditure has to be emphasised but the "control" has to be defined in a wider context of achieving planned targets within the resources made available.

Economy in defence expenditure should always be the desired goal of expenditure management. But it cannot be achieved by ad hoc measures.

Effective measures for achieving economy in defence spending have to be properly planned for on the basis of specific studies. It takes time to fructify, as it may involve restructuring of support areas, introducing economical models

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of logistic support and even closure of establishments which have lost their utility, and achieving economy in manpower by rationalisation of activities . Achieving this kind of economy requires multi-year focus, with performance measures and clear targets for achieving savings for each year .

Then there is the basic issue of prioritisation of expenditure among competing programmes because of scarcity of resources. We often mention its need without realising that the annual budgetary exercise is hardly conducive to a prioritisation exercise, as it provides for all on-going activities and existing commitments in a routine manner, as the reports of the Standing Committee show.

Expenditure prioritisation is about choices between alternative policies and the fiscal impact of specific policy choices on future budgets.. This cannot be done when attention is confined to one year of the budget, as the fiscal impact of the choice would be in the subsequent budgets. A prioritisation exercise has to be an integral part of the budgetary process.

So, for prioritisation of expenditure decisions, keeping in view the impact of present decisions on future budgets, multi-year budgeting is very essential. As Marc Robinson puts it, international experience proves that for being effective, *“expenditure prioritisation needs to be conducted as a systematic routine integrated with budgetary process”* and that *“expenditure prioritisation tends to work best when the budget is put on a multi-annual basis, either through multi-year allocations or a system of rolling forward expenditure estimates....fiscal impact of specific policy choices can often not be measured in the prospective budget year. This point has long been recognised by performance budgeting advocates, well before the recent resurgence of interest in medium-term budgeting. The original US program budgeting system (PPBS), for example, aimed to plan expenditure over at least a five-year plan horizon.”*¹⁹

19. Marc Robinson, ed. , “Making Performance Budgeting Work,” *Performance Budgeting, Linking Funds and Results* (Palgrave Macmillan, IMF, 2007), p.115.

So when we aim to introduce prioritisation in expenditure decisions which is a must in expenditure management in defence, there is an imperative necessity to introduce multi-year budgeting, for optimal allocation of resources.

The other very important aspect in defence budgeting in India which calls for immediate introduction of multi-year budgeting, is that allotments of funds for capital expenditure, in both absolute and percentage terms, have gone up significantly in the defence budget in recent years. The percentage in recent years has been above 40 percent which is very high by all standards. Only a decade ago, the capital budget used to be 28-29 percent of the defence budget.

Many of the projects/schemes under consideration, are 'big ticket' items where huge expenditure is involved over several years. These are all in the nature of investments for future capability building, where careful analyses of costs/benefits are involved.

These investments should not be made in a hurry, without proper cost-benefit analysis. It may be prudent in some cases to deliberately wait before taking a decision, as various alternatives are required to be assessed and new opportunities continue to arise due to rapid technological changes.

For building of capabilities under the concept of the Revolution in Military Affairs(RMA) which is getting incorporated in the doctrines of the armed forces, investments for items categorised as force-multipliers, have to take place over a period of several years, as considerable R&D activities are involved. Many of these investments are inter-linked.

Planning for such investments also underlines the *need for multi-year budgeting in defence*.

It is also to be remembered that in defence procurement cases, to ensure transparency, fairness, proper evaluation and assessment of all aspects of the proposed investment, the laid down procurement procedure has to be

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There are four aspects in the defence budgeting process which need to be attended to.

followed strictly. It cannot be curtailed to fit a given time-frame. Issues arise which have to be sorted out after due deliberation. In urgent cases, a fast track procedure can always be followed but that should be the exception.

So there are four aspects in the defence budgeting process which need to be attended to:

- ensuring economy and efficiency in defence spending in a planned manner;
- prioritisation of expenditure between competing programmes;
- avoiding surrender of funds under the capital account in the defence budget;
- supporting multi-year investment planning and expenditure planning for optimum allocation of resources.

All the four aspects mentioned above lead to only to one conclusion: that is there is an urgent need for budgetary reform in defence, giving particular attention to budgetary process for optimal utilisation of resources. We have to introduce output oriented budgeting. Defence budgeting has till now avoided performance budgeting. Already, outcome budgeting has been introduced in the civil side.

We have to introduce performance budgeting, with the programme concept in defence budgeting. The programme concept is necessary so that one can meaningfully talk of output or objectives and relating output to relevant costs.

This variant of performance budgeting, we may also call *programme budgeting*.

“Programme budgeting is the performance budgeting mechanism which has had the most enduring influence.”²⁰

Basically, programme budgeting comprises (a) the objective-based (“programme”) classification of expenditure; and (b) use of performance

20. Marc Robinson, “Performance Budgeting Models and Mechanism,” in Robinson (ed.), *Ibid.*, p.4.

information in a systematic way for taking decisions about budgetary priorities between competing programmes.

For defence, keeping in view the heavy investments in weapons and systems where investments have to be spread over a number of years, performance budgeting has to be more in the nature of Planning-Programming-Budgeting System (PPBS) which is aimed at moving “planning from the periphery to the center of budget operations”²¹ rather than its simpler version, where performance budgeting is concerned only with the use of *performance measures* in the budget.

In fact, “*performance information*” that we mentioned above, goes beyond *performance measure* to include performance evaluation and cost/benefit analysis.²² Using performance information, in this sense, makes performance budgeting indistinguishable from programme budgeting.

Without the abovementioned reforms in budgeting, the review of the defence budget by the Standing Committee is not likely to be effective and the Committee is apparently aware of this.

This point can be illustrated by reference to some of the points which have emerged in the Committee’s budget review reports so far.

SHARE BETWEEN REVENUE AND CAPITAL IN DEFENCE BUDGET

While scrutinising the defence budget for 2007-08, the issue of what should be the proper allocation between revenue and capital expenditure in the defence budget, came up for lot of discussion in the deliberations of the Standing Committee.

It was brought out by the representative of the MoD that in the 8th Plan period, overall 70 percent of the budgetary allocation was for revenue spending and 30 percent was for capital expenditure. In the 9th Plan, it was 74 percent for revenue expenditure and 26 percent for capital; while in the 10th Plan period, the percentage of revenue expenditure came down to 64 percent and the percentage for capital expenditure went up to 36 percent. This showed

21. A. Schick, *Budget Innovation in the States* (Brookings Institution, 1971).

22. Robison, n.20.

The revenue spending, which goes into their budget, is very essential for ensuring the readiness level of various weapon platforms that they have.

greater emphasis on modernisation than before. In 2007-08, as per budgetary allocation, 56 percent was for revenue expenditure and 44 percent for capital expenditure.

The Defence Secretary, however, added a word of caution, saying that beyond a certain point, the revenue expenditure cannot be brought down.²³ He also added that keeping in view the inflationary trend, the amounts projected by the Services for revenue expenditure in the 11th Plan period might

be inadequate. "The revenue spending, which goes into their budget, is very essential for ensuring the readiness level of various weapon platforms that they have. If they have to maintain 70, 80 or 85 percent level of serviceability, all those spares are needed. All the ammunition gets funded through the revenue budget. *So, if we have to have enough ammunition to fire from various types of weapons that we have, revenue spending has to remain at a reasonable level.*"²⁴

The Committee stated, "During evidence, the representative of the Ministry of Defence also admitted that beyond a point, revenue expenditure cannot be curtailed as that may hamper defence preparedness and the allocation for revenue expenditure for the year 2007-08 is inadequate." The Committee also felt that "due precaution should be taken in the matter so as not to adversely affect the defence preparedness of the country."²⁵

These depositions raise several points. What is the "reasonable level" of allocation for revenue expenditure in the defence budget? What is the point below which revenue expenditure cannot be allowed to fall, so that defence preparedness is not affected? As is evident from the deposition of the Defence Secretary before the Committee, he was apprehensive that projections made by the Services for revenue expenditure for the 11th Plan were inadequate, indicating that probably more emphasis was being given on allocation

23. Report of the Standing Committee on Demands for Grants 2007-08 para 2.31.

24. Ibid., Para 2.35.

25. Ibid., Para 2.36.

for the capital budget. The same predilection can be there while projecting requirements for the annual budget. In any case, allocation of 44 percent for the capital budget is unsustainable. It could lead to a situation, as in the past, where weapon systems would be acquired but there may not be enough resources to operationalise or maintain them

Secondly, the Committee itself noted that the bulk of the expenditure of the Army was on the revenue account and *“there is a huge gap between the revenue expenditure and capital expenditure of the Army, due to different kind of requirement and work performed by it. The Committee endorse the views of the Ministry of Defence that revenue expenditure cannot be curtailed beyond a certain point and that any reduction in revenue expenditure should not be at the expense of the Army’s readiness/preparedness.”*²⁶

The Committee also expressed its concern about “the declining trend in the share of the Army in the defence budget, which was 57 percent in the year 2002-03 and has now come down to 47 percent in the current year.”²⁷

So, what it makes clear is that behind the issue of allotment of the defence budget between the revenue and capital budget, there is a much bigger issue of the respective roles of the three Services and the tasks they have to perform in ensuring the security of the country.

There is now, of course, the concept of jointness and the doctrine is evolving in this direction. This puts emphasis on mission and task orientation in resource allocation decisions, rather than on Service-wise allocation, though that issue cannot be avoided in taking a macro view of the matter on the basis of technological changes and new concepts of warfare.

In fact, mere division of the defence budget into revenue and capital expenditure may be all right for voting purposes, but hardly adequate for

Mere division of the defence budget into revenue and capital expenditure may be all right for voting purposes, but hardly adequate for rational allocation of resources in defence.

26. Report of the Standing Committee on Demands for Grants, 2007-08, Para 4.10, pp. 40-41.

27. Ibid., Para 4.8.

rational allocation of resources in defence; in fact, it is a means of hiding the real issues.

For rational allocation of resources, we have to introduce programme budgeting, in which all elements of cost would be included in a programme for achieving an approved mission. Whether the allocation for the revenue expenditure is adequate or not has to be ascertained programme by programme and on the basis of its specific requirements. To quote Charles Hitch who was the main architect in introducing programme budgeting in US defence under Robert McNamara, indicating the importance of allocating for operating expenses which is catered for what is categorised as revenue expenditure in our budget, “The operating costs are the annual operating costs required to man, operate, and maintain the capability. Quite often, the cost of operating a system over its expected life is more important than investment costs. For example, it costs as much to operate and maintain an infantry division for one year as it does to equip it in the first place. Thus, operating costs can be crucial to the initial management decision to produce and deploy one weapon system as compared with another.”²⁸

It is not enough to equate the capital budget with modernisation; we must know what the modernisation is composed of, and how it is helping in building capability for meeting the emerging threats, in other words, what is the output of the defence budget, keeping in view both the revenue and capital expenditure.

Only programme budgeting can help in relating resources “inputs”—manpower, material and installations—together with their costs, to military “outputs”—strategic retaliatory forces, general power forces, airlift capabilities, air defence capabilities, surveillance capabilities, protection of maritime interests, etc—which cannot be done by merely distinguishing between revenue and capital expenditure.

OUTCOME BUDGET: HOW TO MOVE TOWARDS IT

In its report on the Demands for Grants 2008-09, the Committee showed

28. Quoted by William W. Kaufmann in *McNamara Strategy* (Harper and Row, 1964), p.176.

its interest in the formulation of an “Outcome Budget” in defence. In this context, it stated, “The Committee desired from the Ministry of Defence, brief particulars of all major schemes/ projects under implementation and project- wise achievement against the targets (both physical and financial) during last two years in the Ministry of Defence. The Ministry of Defence have not furnished any information thereon.”²⁹

If the aim is to examine the outcome, going through the schemes and projects may not be very illuminating, unless one is able to link them with the budgetary allocations, on the one hand, and the objectives they are supposed to serve, on the other. Outcome can be assessed only in relation to the programme, of which the scheme/project under review, is a part.

Output budgeting is the basic step towards outcome budgeting, for which we require a well-conceived programme structure, keeping end objectives in view as also the decision-making mechanism at the apex level for major resource allocation decisions.

Incidentally, the Ministry of Defence is one of those Departments/Ministries that have been exempted from presentation of an Outcome Budget by the MoF. However, even those that have been exempted, have been requested by the MoF to carry out this exercise for internal use and voluntarily decide to place it in the public domain, fully or partially. The desire of the Committee was indicated in this background.

The Defence Secretary clarified during the evidence that the Ministry was trying to develop an infrastructure for this exercise. He also stated, “In the Ministry of Defence, because of the nature of its functioning and the nature of expenditure, we could not produce the outcome budget. But if you feel it should be submitted, we will try to do it for certain areas.”³⁰

There is nothing in the nature of the functioning of defence or in the nature of defence expenditure to prevent it from introducing output budgeting which will help in assessing the outcome.

29. Report of the Standing Committee on Demands for Grants 2008-09, Para 2.40.

30. Ibid., Para 2.43.

There is nothing in the nature of the functioning of defence or in the nature of defence expenditure to prevent it from introducing output budgeting which will help in assessing the outcome. In fact, programme budgeting, which is the other name for output budgeting, was first introduced in the Department of Defence in the USA in 1962 and on its overwhelming success there, it was introduced in the rest of the federal government in 1965 which is referred to as PPB. The basic aim of PPB was to establish a firm linkage between programme planning and budgeting. Without such a linkage, planners can easily lose touch with the constraints imposed by scarce resources, while budgeters can easily be divorced from the contents of plans and programmes.

It was not just as a budgeting technique—it was an aid to higher management decisions. The basic aim was, as McNamara put it, “We must ensure that the Army is balanced to the Air Force, that the Navy is balanced to the requirements of the Army, that the financial budget is balanced to the military force structure required as a foundation for our foreign policy.

“It is this type of decisions that come up to my level, and until we translate this basic policy into a *balanced force structure*, I know of no other way to follow.”³¹ The method which McNamara adopted in assisting him in making these decisions was the planning-programming-budgeting system.

In this context, it is worth recalling that the Group of Ministers on Security Management in their report in 2001 had recommended that steps to be taken toward programme-based budgeting in defence.

The Task Force on Management of Defence (set up by the Group of Ministers) constituted a Study Group on Budgetary Reform in August 2001 to overcome the deficiencies in the existing input-based budgeting.

Among the terms of reference of the Study Group was expansion of classification of expenditure to promote programme budgeting. The Study Group made recommendations in this regard to enable introduction of programme budgeting.

But programme budgeting involves facets other than detailed classification of expenditure. The basic building block of this system is classification of

31. Quoted by Kaufmann, n.28, p.172.

expenditure into programmes i.e. objective oriented classification so that activities with common objectives are considered together, where the objective of each programme is explicitly defined. Therefore, it requires a well conceived framework of programmes/sub-programmes/activities to facilitate allocation of resources keeping in view the intended output.

The primary objective of programme budgeting was improved allocative efficiency and better expenditure prioritisation. To achieve this it requires (a) a decision-making structure in the MoD to decide about priorities in the allocation of resources among programmes, as also reallocation on the basis of evaluation of ongoing programmes and strategic considerations ; (b) a longer time-frame for budgeting than what the annual budget provides as costs and benefits are to be considered in a longer time-frame; and (c) introduction of system analysis for evaluation of alternatives before deciding upon a programme from the cost-effectiveness point of view.

All three elements are essential for the introduction of programme budgeting in defence. So mere introduction of more classification heads of expenditure would not do. In any case, the starting point is introduction of an objective oriented programme structure.

Why do we require a longer time-frame for budgeting under this concept? As McNamara, testifying in 1962, explaining the reasons for a longer time horizon stated, "Sound choices of major weapon systems in relation to military tasks and missions have become the key decisions around which much else of the defense program revolves. But the full cost implications of these decisions cannot be ascertained unless both the programs and their cost are projected over a period of years, ideally over the entire life cycle of the weapon system. Since such a long-term projections are very difficult to make with any degree of accuracy, we have fixed on a 5-year period..."³²

With the introduction of programme budgeting, the introduction of multi-year budgeting becomes necessary.

32. Ibid., p.175.

This requirement puts the need for multi-year budgeting in defence in the proper perspective. With the introduction of programme budgeting, the introduction of multi-year budgeting becomes necessary.

The Study Group that set up the Task Force on the Management of Defence did not recommend introduction of multi-year budgeting as it was not in its terms of reference.

It, however, recommended introduction of Vol II of the Defence Services Estimates (DSE) to show where money is allocated, on what it is spent and by whom.

The DSE Vol II was introduced in 2002-03. While it was the right step, it did not show programme/activity-wise allocation; as such, a framework is still to evolve. But the principle that we have to focus on, in activities and outputs in defence, has been accepted by the introduction of DSE Vol II, whatever be its present limitations.

It also resuscitated the concept of Budget Centres, which was introduced in the early Nineties in defence for better management of resources. The concept was supposed to introduce planning, programming, evaluation and accountability in defence expenditure management. This concept is important as it led to substantial delegation of financial powers to Service Headquarters and subordinate formations. In view these earlier initiatives which involved the introduction of Authority and Responsibility Centres, Accountability Centres, Budget Holders and substantial delegation of powers, the basic structure exists to introduce performance budgeting in defence. What is required is introduction of the programme concept for resource allocation decisions, multi-year budgeting and a higher level institutional mechanism for setting objectives and taking resource allocation decisions keeping in view the objectives.

Outputs in government are services, that is, these are service outputs. Service outputs consist of a bundle of activities for which resources are to be allocated. These constituent activities cannot be considered as outputs in their own right because only when they are combined with other activities that an intended outcome can be potentially achieved. This important distinction has to be kept in view.

Introduction of the concept of capability planning enables easier introduction of the concept of outcome budgeting, as is evident from its fairly successful use in Australian defence budgeting.

Input budgeting has hardly any utility in achieving efficiency and effectiveness in defence expenditure management. It cannot even achieve economy in the real sense of the term, as it is formulated on an incremental basis, without conscious resource allocation decisions.

By properly implementing the Budget Holder and Budget Centre concepts which were introduced in the mid-Nineties in defence for better budgetary management in support of the concept known as the New Management Strategy, it is possible to easily introduce performance orientation in the defence budget.

This is because substantial delegation of powers has been made for implementing the concept of Authority and Responsibility Centres which were introduced as part of the New Management Strategy.

Keeping in view the hierarchical mode of functioning in defence, the concept of Top Level Budget Holder should also be introduced to facilitate introduction of performance budgeting in defence.

The Standing Committee, while reviewing the defence budget, may like to enquire about implementation of the ideas contained in the New Management Strategy or New Financial Strategy as it was called in the Army, and to what extent performance budgeting has been or is being introduced in the context of large delegation of powers for implementing the concepts of authority, responsibility and accountability. It should be remembered that these concepts emanated from Service Headquarters, precisely because they became aware of the limitations of the existing input oriented budgeting and wanted to give defence budget an output orientation by bringing in the concepts of authority and responsibility.

Therefore, with a decade and a half long pioneering background of implementation of these concepts in the defence budget (which were not

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thought of in the civil Ministries/Departments), which have also been formally introduced in Vol II of the DSE, with performance budgeting and outcome budgeting being adopted in the civil Ministries/Departments, there is no reason why performance budgeting should not be introduced in defence without delay.

The review of input-based defence budgets, as at present, cannot reveal much, as it is designed only for control of expenditure. The control aspect

has lost much of its relevance with the inability to spend the allotted amounts year after year.

What is worthwhile to concentrate upon is what is the 'output' of this massive expenditure, for which a programme-based budget is essential, both for rational decision-making in resource allocation as also for review of the defence budget by the Standing Committee of the Parliament.

DEFENCE BUDGETING IN A STRATEGIC FRAMEWORK

We have noted above that under the existing budgeting system, much of the allocations in the defence budget are treated as "obligatory" in nature, which is determined by the "strength and composition" of the armed forces. Most of the defence expenditure falls in this category, being policy driven expenditure, for which allocations have to be automatically made in the defence budget every year.

From time to time, however, restructuring of the armed forces may be required for strategic reasons. Being aware of this fact, the Standing Committee made the following observation while scrutinising the Demands for Grants for Defence, 2006-07, "The Committee are aware of the *rapid technological advancements and changes taking place globally in the warfare technology and feel there is an imperative need to constitute a high level empowered Committee to examine the entire security gamut and suggest reforms including restructuring*

of the armed forces, as may be necessary to meet any eventuality in future."³³

The Committee noted that there has been no thorough review of the structural set-up of the armed forces since independence, especially of the Army whose strength constitutes almost 90 percent of our defence forces. "The need of the hour is to optimally use the available limited resources...*The proposed Committee should be given the mandate to suggest suitable manpower restructuring by trimming the force size (teeth to tail ratio) with corresponding increase in the use of advanced and sophisticated technology in our armed forces; review the authorisation of the peace and war establishments which are existing since the Second World War... It is high time to effect substantial savings within the available defence budget for restructuring and modernising our forces*" (emphasis mine).³⁴

Such a review would have a major impact on the resource allocation decisions and would have helped in developing the right capabilities for future conflicts. In fact, the future conflict scenario has to be clearly visualised in such a review, as force restructuring has to be done on that basis. Another benefit of such a review would have been that it would have to indicate availability of funds on a long-term basis so that capability planning could be done in a meaningful way. Further, if savings are to be generated, it would have to indicate the areas where it was to be done and what should be the extent of savings.

In the next report pertaining to the Demands for Grants 2007-08 , the issue came up in a different way in the context of drawing up the Long-Term Integrated Perspective Plan (LTIPP) 2007- 22. The earlier LTIPP 2002-17 did not get approved as the 10th Plan did not get approved and had to be revised for covering the 11th, 12th and 13th Five-Year Plans. Since the 11th Plan is yet to be approved , though three years have passed, it is clear that the LTIPP would again be revised.

Since the 11th Plan is yet to be approved , though three years have passed, it is clear that the LTIPP would again be revised.

33. Report of the Standing Committee on Demands for Grants 2006-07, Para 1.4, p.2.

34. Ibid.

The Ministry of Defence in a written reply indicated, “The revised LTIPP (2007-22) is being prepared following a deliberate and integrated ‘Top Down’ approach by articulating National Security Strategy, National Military Strategy, National Military Objectives .. and so on. Such an exercise has been undertaken for the first time and is an extremely involved process with inputs from three Services, MoD, NSA and various other agencies. The document is expected to be ready by Dec. 2009.”³⁵

On above basis, the Committee noted “that an integrated Perspective Plan covering three Plan periods from 11th to 13th Plan, i.e. from 2007-2022 will be approved by the Defence Acquisition Council by 31st October 2009.” It is also added that this long-term plan would be different from earlier plans in that there will be a “shift from *equipment-based* approach to *capacity-based* approach.”³⁶

There are a few points here which add to the confusion.

The minor one is about the dates. While the document is expected to be ready by December 2009,³⁷ the Defence Acquisition Council is supposed to approve it by October 31. Secondly, about the sequence of events: since the LTIPP is supposed to be a strategic document following a top-down approach involving a major shift in planning procedure from an equipment-based approach to a capability-based approach, its approval has to precede the preparation of the plans. But the 11th Plan (2007-12) has already been prepared on the usual basis as in the past by taking into account “*committed liabilities, prioritised modernisation schemes, obligatory charges and maintenance requirements of the defence services and departments*”³⁸ and projected to the Ministry of Finance in July 2006.³⁹

There was no indication in the deposition before the Committee whether any strategic thought had been given regarding objectives to be attained in the Plan period, the nature of conflicts for which preparation was being made,

35. Report of the Standing Committee on Demands for Grants 2007-08, Para 3.4.

36. Ibid., Para 3.5.

37. Ibid., Para 3.4.

38. Ibid., Para 3.12.

39. Ibid., Para 3.16.

the capabilities that are required to be developed in view likely threats, etc. It apparently is not derived from the LTIPP 2002-17 which was already available, which was supposed to have articulated a strategy adopting a top-down approach. As is evident, from the way the 11th Plan is stated to be put together, it is not very different from the annual budgetary exercise in which the same inputs are taken into account. In other words, the Five-Year Plan basically boils down to five annual budgets and nothing more than that.

The Five-Year Plan basically boils down to five annual budgets and nothing more than that.

It is no wonder it is treated as such by the MoF as is evident from the following response, as indicated in the report of the Committee.

“The proposals of the Ministry of Defence were examined and the views of the Ministry of Finance were conveyed... indicating therein that it would be realistic to assume year on year increase in defence allocations in the range of 8-10 percent for the purpose of the planning exercise for the 11th Plan as against the annual average growth rate of 12.35 percent per year indicated by the Ministry of Defence.”⁴⁰

Interestingly, the reply of the MoF also refers to certain suggestions being made by it on the 11th Plan regarding “*certain operational aspects having substantial financial implications with the request that the Ministry of Defence review the same with the objective of rationalising expenditure while, at the same time, not compromising on modernisation plans.*”⁴¹

In other words, the MoF is no longer prepared to look at the projected Plans only from the financial affordability point of view, and would be going into the operational and strategic aspects of the Plan. This provides a new challenge to the DoD, which has to go into these aspects independently, so that these aspects are gone into from a system analysis point of view, so that the MoF feels assured that all aspects of “rationalising expenditure,” including from operational and strategic angles, is gone into in the MoD before finalising the plan.

40. Ibid., Para 3.16, p.35.

41. Ibid., Para 3.16, p.35.

As indicated by the MoF, the 11th Plan should be redrawn, keeping in view financial realities, and the entire effort in preparing the Plan has apparently gone waste.

In any case, as indicated by the MoF, the 11th Plan should be redrawn, keeping in view financial realities, and the entire effort in preparing the Plan has apparently gone waste. The position is not different from other Plan periods. So we are back to square one. And the LTIPP is still to be approved.

The third point is: how is the LTIPP supposed to be articulating the National Security Strategy or even for that matter National Military Strategy?

Is it not a matter of political decision-making where National Security Council and Cabinet Committee on Security would deliberate, and the Indian Parliament give its approval? How can the Defence Acquisition Council give approval to such a document without first getting approval for the National Security Strategy?

The Standing Committee did not raise these issues. But what it said is also very relevant. It stated, *"The Committee are of the view in the changing paradigm of the security scenario, threat perception and fast changing scientific and technological field, the long-term plan need a regular and sustained review of its content and thrust. Therefore, the Committee wish to recommend that the long-term plan should be reviewed and updated from time to time well in advance, in order to make it realistic..."*⁴²

This recommendation is in keeping with the earlier recommendation made while scrutinising the 2006-07 budget for review of the structure of the armed forces. Since the LTIPP is prepared on the basis of Perspective Plans of the three Services, this kind of proposal of restructuring cannot emanate from the LTIPP. This point will be evident from the following paragraph in the report of the Committee. Referring to the status of the revision of the Perspective Plan, the Ministry indicated, *"The process of revision has already been completed by the Navy in terms of the Maritime Capability Perspective Plan, which covers the period 2007-22. The other two Services are in the process of completing this exercise, updating the*

42. Ibid., Para 3-7, p.31.

LTIPP from 2002-17 to 2007-22. Once these individual plans are ready, these will be integrated into one Long-Term Perspective Plan and after necessary approvals within the Ministry of Defence, it will be taken up with the Ministry of Finance for approval in principle...⁴³ So much for the Top-Down approach in preparation of the LTIPP 2007-22, deriving it from National Military Strategy, etc.

From the deposition before the Committee, it seems the Navy is pushing ahead in implementing its Perspective Plan. There is stated to be a directive by the Defence Acquisition Council that the total number of ships should not fall below 140 . The Committee noted that “in pursuance of this directive, 10-year (upto 2012) ship building plan was envisaged for induction of 83 vessels of various categories...19 ships are presently under construction (excluding *Admiral Gorshkov*) and cases for acquisition of 24 new ships and 6 submarines and 11 aircraft are being processed.”⁴⁴ The Committee went on to add that it “*earnestly desires that the Ministry should take effective steps in order to strictly adhere to the directives of the Defence Acquisitions Council that the total number of ships does not fall below 140 .*”⁴⁵

The Committee also noted that there have been shortfalls in certain critical areas of the Navy like surveillance , mainly in terms of long range aircraft, and acquisition of submarines, and desired that “immediate steps should be taken to meet the above requirements of the Navy in a time- bound manner.” Sufficient funds should be made available for it.⁴⁶

Elsewhere, the Committee takes note of the manpower shortage in the Navy. “The Navy has also highlighted the shortage of manpower in critical areas. This is a matter of crucial importance.” The Committee recommended that the Navy should be allowed to make additional recruitment.⁴⁷ So the mismatch between capital acquisition and manpower has started in the Navy which will adversely affect its combat capability.

43. Report of the Standing Committee on Demands for Grants, 2007-08, Para 3.2, p.30.

44. Report of the Standing Committee on Demands for Grants 2005-06, Para 4.16 pp. 49-50.

45. Ibid., Para 4.21.

46. Ibid., Para 4.18.

47. Ibid., Para 4.20.

The Ministry of Finance have already stated that the LTIPP should be drawn up assuming an average budgetary increase between 8-10 percent per annum.

In the above context, the Ministry assured the Committee, "In order to ensure that naval preparedness is not adversely affected, the progress of the Navy's expenditure and status of ongoing/new schemes would be constantly reviewed during the fiscal year and Plan period. *If need be, Ministry of Finance would be approached for additional allocation of funds*"⁴⁸

This is the issue. What are the long-term cost implications of the new force structure of the Navy as envisaged in their Perspective Plan? We have to include in it both the acquisition cost and operational cost of the *Admiral Gorshkov* and the other aircraft carrier being built indigenously, not to talk of the third one which is being recommended by the Committee .

What if the Ministry of Finance does not allot additional funds? They have already stated that the LTIPP should be drawn up assuming an average budgetary increase between 8-10 percent per annum.

If the planned naval force structure containing 140 ships with two aircraft carriers is given effect to, and other deficiencies are to be met, can it be contained within 18 percent of the defence budgetary allocation as it is at present? Or would it need to go up to higher percentage of allocation, say 21 to 22 percent of the defence budget? In that case, the percentage of allocation for which Service should go down? The Committee has also expressed its apprehension about the falling percentage share of the Army in the defence budget.

It has also strongly recommended that the government should accord highest priority to "ensure that squadron strength (of the Indian Air Force) at any time should not fall below 39.5 and strive to achieve the ideal requirement of 44 squadrons."⁴⁹

All these requirements, given that unit cost of weapon systems is increasing at a rate approaching 10 percent or so per annum, in other words, a modern

48. Ibid, Para 4.10.

49. Report of the Standing Committee on Demands for Grants , 2006-07, Para 5.12, P.63.

weapons system can double in cost every seven years or so, mean a rate of increase no defence budget can be expected to match.⁵⁰ There has, therefore, to be a trade-off, even within a Service in planning for force structure, keeping in view, very limited growth in the budget in real terms, about which the Standing Committee itself has shown concern from time to time.

With the fiscal deficit being now much higher than was contemplated in the FRBM Act, and the government's attempt to contain the deficits, the chances of substantial increase in the defence budget in future years are not very bright.

In this background, a piecemeal approach to force planning can only lead to an unbalanced force structure which will mean a less capable military than could be achieved with the resources made available. What is required is a strategic defence review by a high level empowered committee, as recommended by the Committee in its report on the Demands for Grants 2006-07, which will "examine the entire security gamut" and go into the whole issue of "restructuring of the armed forces" within the given budget, and make recommendations "to make substantial savings for restructuring and modernising our forces."⁵¹

Such a report, containing recommendations regarding the restructuring of forces, capability to be built, readiness and preparedness to be achieved and resources likely to be made available for the next five years, on being accepted by the government, shall become the basis for defence planning and budgeting for the next five years.

Otherwise, we may land up with an unbalanced force structure and/or inadequate balance between defence preparedness and modernisation.

The Committee has strongly recommended that the government should accord highest priority to "ensure that squadron strength (of the Indian Air Force) at any time should not fall below 39.5, and strive to achieve the ideal requirement of 44 squadrons."

50. David Karpatrick, "Is Defence Inflation Really as High as Claimed ?", *RUSI Defence Systems*, October 2008, pp. 66-71.

51. Report of the Standing Committee on Demands for Grants 2006-07, Para 1.4.

It may be mentioned that the major and medium powers of the world, have all made such strategic reviews during the last decade and half in view of the change in the conflict scenario , rapid advances in technology and the process of innovation brought about by the notion of the RMA.

For example, in the UK, the Strategic Defence Review (SDR) was conducted in 1997-98 and the report came out in July 1998. It was regarded for a long time as a model of defence planning. It aimed at bringing foreign policy and defence policy together in an affordable manner. The major organisational changes as a result of the SDR was the combination of single-Service logistics through the creation of the tri-Service Defence Logistics Organisation (DLO). Since its creation, it has sought to rationalise logistic provisions. This is how a defence review helps in achieving economy and efficiency through organisational changes. Recently, the DLO was combined with the Defence Procurement Agency (DPA) and is now collectively known as Defence Equipment and Support (DE&S), creating the largest Top Level Budget Holder in the Department. Though we have in our budgetary management partially introduced the concept of High Level Budget Holder , we are yet to introduce the concept of Budget Holder, which is essential if we want to introduce performance budgeting in defence where the objectives are set at the very top of the hierarchy and then 'cascaded' down through various levels.

Force structuring issues are addressed though these reviews on the basis of strategic guidance. The experience with these strategic reviews shows that because of limitation of resources, each Service has to accept trade-offs in force structure decisions , otherwise it would lead to an unbalanced force structure. Further, the strategic posture should keep in view the resource position.

For example, the centrepiece in terms of procurement requirements resulting from the SDR was the decision to focus on expeditionary warfare with two large aircraft carriers at the heart of the new capability.

The major casualty in the last decade as per an informed commentator has been the surface fleet of the Royal Navy. It has come down to 26 surface ships and some 16 mine hunters, much below the force level envisaged in the SDR.

This became necessary to protect the funding for the future aircraft carriers.⁵² In the view of many experts, the expeditionary strategy adopted by the UK government was never affordable.

It is reported that the British government may be about to move to a system of regular reviews as in the case of the Quadrennial Defence Review (QDR, the first of which was conducted in 1997.⁵³

The QDR is mandated by the US Congress. It is performed every four years. The process for the Defence Department's 2010 QDR has already started. It may have major restructuring proposals. The US Defence Secretary in April 2009 announced some major moves affecting the US Air Force in the proposed retirement of 250 tactical aircraft. The move is supposed to allow the air force to instead to buy things like modern ammunition, unmanned aircraft and other surveillance and other reconnaissance enablers. They have also decided to reduce purchase of F-22 stealth fighter to 187 as more were not affordable, and cancel a next generation bomber programme.⁵⁴

The aim, in other words, of such reviews is to increase the combat and operational capabilities to meet the strategic requirements, within the likely available resources. This requires the trade-off between squadron strength and gaining overall combat capability.

In making these reviews, the defence planners today have to keep in view the challenges posed by RMA.

Defence planners of important military powers in Asia have acknowledged the potential of RMA, particularly Information Technology (IT) in adopting a more cost-effective force structure. RMA calls for changes in organisational structure, resource allocation, doctrine and strategy.

For the Chinese political and military leaders, RMA is regarded as the major area of great power competition that will determine China's position in the world in the next 20 years. The Chinese military has accorded IT the highest

52. Dr Jeffrey Bradford, "Contrasting Efforts: the British Strategic Defence Review and the United States Quadrennial Defense Review Processes," *RUSI Defence Systems*, October 2008, p. 83.

53. Andrew Chuter, "U.K. Preps 1st Strategic Review in 11 Years," *Defense News*, June 15, 2009.

54. *Defense Daily*, May 15, 2009, The Daily of Aerospace and Defense USA, report by Marina Malenic.

priority in its modernisation programme. Advocates of RMA in the People's Liberation Army (PLA) feel that superiority in information technology leads to superiority in combat operations. Information technology makes possible small-sized battle formations without compromising strength and outcome, if they are suitably equipped with high-tech weapons.⁵⁵ China is stated to be studying "the offensive employment of IW against foreign economic, logistics, and C4I systems..."⁵⁶

Japan has gone in for the IT-RMA with a defensive posture in consonance with its defence policy, "The Japanese Perception of Information Technology-Revolution in Military Affairs"⁵⁷

This brings out the point that RMA concepts would have different applications depending on the defence policy and strategy. It would be different for a country adopting an 'offensive' operation oriented policy from a country adopting RMA for defensive purposes. Countries facing different strategic conditions will choose alternate paths. As Takahashi puts it, "Unless it is strategically relevant, even highly advanced weapon systems will not support national security."⁵⁸

Society is moving from an industrial to an information age. The defence strategists feel that military power would in future flow from information technology and strongly argue for pushing information down to tactical level and for more widely distributed operations. Advances in technology led to the concept of "network-centric warfare". Forces at tactical and operational levels can make use of it and take quick decisions in operational matters. This may call for major restructuring of forces. In the Navy, for example, network-centric operations can allow spreading the capabilities now lodged in big ships among more numerous, faster and stealthier ships.

IT has led to developing a new kind of warfare like cyber warfare. Press reports quote the UK's Security Minister's recent warning on a cyber threat

55. You Ji, "Learning and Catching Up: China's Revolution in Military Affairs," in Emily O. Goldman and Thomas G. Mahnken, eds., *The Information Revolution in Military Affairs in Asia* (Palgrave 2004) pp.97,103.

56. Thomas G. Mahnken, in concluding article, *Ibid.*, p.216.

57. Sugio Takahashi, in Goldman and Mahnken, eds., *Ibid.*, p.85.

58. *Ibid.*, p. 92.

from Al Qaeda, confirming that the UK has already faced cyber attacks from some foreign countries. The UK government has published its new Cyber Security Strategy to combat these threats.⁵⁹ Both China and Pakistan are reported to be bolstering cyber warfare capability at a rapid rate. The Indian Army, as per reports in the Press, has set up some institutions to guard against this kind of warfare.⁶⁰ But these steps may not be enough as the threat can be widespread, affecting financial markets, power grids, air traffic control and other facets of public life. Cyber warfare is yet to become an important component of India's security doctrine.

The challenge is that we have to fit in all these programmes when the allocation for the defence budget is only around 2 percent of the GDP.

Then there are space-based programmes.

The point is that, ultimately, the challenge is that we have to fit in all these programmes when the allocation for the defence budget is only around 2 percent of the GDP. The question is: how to evolve a balanced force structure which would be affordable, keeping in view what would be the strategies of adversaries? What would be the use of each of the high cost systems in the strategic environment we are placed in? What would be the defence policy that would guide the acquisitions ?

It is seen from the experience of other countries that any long-term defence capability plan is soon likely to get outdated because of the change in the security environment. The capability priorities are likely to change every few years.

The threats to national security today are emanating from many sources from state and non-state agencies. The character of the national security environment has changed totally with threats emanating from many sources, particularly terrorist threats and other threats to internal security, which are taking larger dimension in terms of national concern, than threats from external aggression. Various agencies would be engaged in the assessment

59. Report in *Business Standard*, July 5, 2009.

60. *The Times of India* News Report on May 2, 2008.

of threats in their arena of activity, which may vary in approach and quality. What is really required is strategic planning for national security which is inclusive and deliberative in order to come up, among other things, with policy priorities for resource allocation decisions across the agencies to develop different capabilities for meeting the spectrum of threat to national security, in an integrated manner. This calls for capacity for long range planning at the highest level of the government.

For getting a true example of such an inclusive and integrated process of strategic planning, one has to go back to the initiation of "Project Solarium" in the USA under the leadership of President Eisenhower.⁶¹ This kind of inclusive and integrative strategic planning is missing even in the USA today.

What is required today is the conducting of a National Security Review to develop a national security strategy through an inter-agency process, which may be led by the National Security Adviser to the Prime Minister to identify various capabilities required to meet the full spectrum of threats to national security. Such a review should logically precede the Defence Review suggested above.

In the above background, the Standing Committee on Defence can play an important role in influencing the decision-makers in the government through its deliberations and reports:

- in instituting a comprehensive strategic review at the national level to be followed by defence reviews at periodic intervals;
- defence reviews should be the basis of defence plans which in turn should be the basis for defence budgets;
- adopting performance budgeting on the basis of programmes; the programmes to be based on end objectives in view and should be costed on the basis of activities to be performed;
- adopting multi-year budgeting and long-term costing of ongoing programmes to ensure that ongoing programmes are affordable.

61. Michele A. Flournoy and Shawn W. Brimley, "Strategic Planning for National Security, A New Project Solarium," JFQ/ Issue 41, 2nd quarter 2006, pp.80-86.

As explained above, only when the defence budgets become programme based as also performance oriented, would it be possible to review these on the basis of their costs and benefits as also evaluate their progress on the basis of appropriate benchmarks.

Programmes with end objectives in view and criteria of performance, would be the basis for introducing output and outcome budgeting in defence. It cannot simply be done on the basis of input budgeting.

Therefore, immediate efforts should be made to introduce programme budgeting in defence on the basis of the framework mentioned above, reactivating the concepts of Budget Centres and Budget Holders who should be provided with indicative budgets for the next few years, with a view to plan their expenditure. The objectives to be achieved and performance parameters, however, should flow from the top, which would make it necessary to introduce the concept of Top Level Budget Holders. This concept has helped in the introduction of cost-effective expenditure management in defence in the UK.

The defence budget should reflect the defence strategy and decisions of higher management regarding force structure and capability. Today's budgeting process which is summation of the budgetary projections of the three Services and two Departments of defence, subject to imposition of a ceiling by the Ministry of Finance, is a totally inadequate tool for higher level decision-making for optimal allocation of resources in defence. The budgetary process in defence has to be streamlined to incorporate the resource allocation decisions emanating from higher management, for which there has to be required institutional support in the Ministry of Defence. As already stated, a comprehensive Defence Review should provide the basis for defence plans and annual defence budgets.

The defence budget should reflect the defence strategy and decisions of higher management regarding force structure and capability. Today's budgeting process is a totally inadequate tool for higher level decision-making for optimal allocation of resources in defence.

If the defence budget is formulated on the above basis, deriving from a strategic review and showing allocations on programme basis, with performance orientation, it would provide a proper basis for scrutiny by the Standing Committee as to whether it is achieving optimal allocation of resources for effectively meeting the goals and objectives of national security.