

# Defence Budgeting System: Need for Change

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## Abstract

*In India, the defence budgeting system is incremental and input-based. Yearly allocations of funds are made without reference to the defence plans. In effect, the budget does not get linked to any established goals or outputs. Resource planning beyond a one-year period is not carried out. Some have even called it an archaic system. The five-year defence plans have lost their utility for resource planning. This article brings out the shortcomings in the present budgeting system and recommends some options for a goal-oriented budgeting system.*

Strategy, programmes and budget are all aspects of the same basic decisions.

*Harry S Truman*

## Introduction

Defence is costly. An annual expenditure of Rs 83,000 crore (\$19.02 billion) in financial year 2005-06 means that the government has to make difficult choices in a world of uncertainty. Choices about the size of the defence budget involve social welfare spending. Similarly, within the defence budget, choices are needed between equipment and personnel, and among the Army, Navy and the Air Force. Uncertainty means that today's armed forces and equipment have to be capable of responding to unknown and unknowable future threats over the next 20-30 years.

Defence budgets can be presented in a variety of ways, depending on such factors as the needs of the Government, the Ministry of Defence, the services, secrecy and constitutional requirements. Our approach to budgeting for defence focuses on inputs, showing annual expenditure by

defence primarily on personnel, stores, infrastructure and acquisition of equipment. Input budgets are limited as a means of assessing the efficiency of resource allocation decisions in defence. Input budgets are also limited by focusing on the use of resources for a one-year budgeting period and for showing only money outlays rather than real resource costs.

The defence budgeting system in India has not changed since independence. It has remained incremental in nature and does not indicate any outputs. As a result, performance measurement and accountability are not built in. Numerous models of budgeting have been prevalent in defence forces of other countries but reforms in India's case have been half-hearted and slow. There is a need to vigorously reform the defence budgeting in India. In this paper an attempt has been made to analyse the existing defence budgeting system in India, to visit reforms proposed in the past and to discuss measures for goal-oriented defence budgeting. It argues that in the absence of a clearly articulated defence policy, it is difficult to draw up strategic doctrines, size of armed forces, force postures, arms procurement, and therefore, appropriate levels of defence expenditure.

### **The Existing System**

As per Paragraph 89 of Financial Regulations (FR) Part I, in framing the budget estimates an intelligent discretion and utmost foresight must be exercised with reference to the effect that events, occurring or impending at the time the estimates are under preparation, are likely to have on the receipts or expenditure. In all cases, account should be taken of factors such as the expenditure in previous years, changes of policy and the probable trend of prices, etc.<sup>1</sup> At no stage in the budget formulation process do the FR mention Defence Plans.

#### *The Existing Budget Structure*

The Defence budget is presently allocated under the following:

- Major Head 2076 – Revenue Expenditure: Army (Demand No 23).
- Major Head 2077 – Revenue Expenditure: Navy (Demand No 24).
- Major Head 2078 – Revenue Expenditure: Air Force (Demand No 25).
- Major Head 2079 – Revenue Expenditure: Defence Ordnance Factories (Demand No 26).

- Major Head 2080 – Revenue Expenditure: Defence Services, Research and Development (Demand No 27).
- Major Head 4076 – Capital Expenditure: Defence Services (Demand No 28).

The revenue expenditures of the Directorate General of Quality Assurance (DGQA) and the National Cadet Corps (NCC) form part of the Army's revenue budget. The Army budget also accounts for the Ex-servicemen Contributory Health Scheme (ECHS), which covers the medical expenses of ex-servicemen of all the three services. The revenue expenditure of Joint Staff, which takes care of Headquarters Integrated Defence Staff, The Andaman and Nicobar Tri-service Command and the Strategic Forces Command, is under the Navy's budget. It is interesting to note that the entire Capital expenditure of the defence services is covered under one major head.

The following allocations that are also made to the Ministry of Defence under separate demands do not form part of the defence budget:

- Civil Estimates of the Ministry: These cover the expenditure of the Secretariat and other civil departments of the ministry, Coast Guard, The Regiment of Jammu and Kashmir Light Infantry and the Canteen Services.
- Defence Pensions: These have been segregated from the defence budget since financial year 1985-86.

The existing budget is divided into Revenue and Capital Expenditure. The Revenue Expenditure comprises Pay and Allowances, Transportation, Stores, Revenue Works and Miscellaneous Expenditure. The Capital Expenditure covers Land, Works and Acquisition of Equipment (including aircraft and vehicles). While allocations in 'Revenue' are based primarily on the trend of expenditure in the past, capital budget is limited by allocations made by the Government. A review of the budgetary system during the last six decades shows that the process of budget formulation has remained unchanged till date. A form used for Budget Estimates (BE) in financial year 1939-40 contained the following:

- Actual expenditure of the previous financial year.
- Sanctioned estimates of the current financial year.
- Revised estimates of the current financial year.

- Budget estimates for the next financial year.<sup>2</sup>

This system of estimation of the budget has not changed till today. The budgeting therefore, does not get linked to a plan for the financial year, but is merely incremental. Moreover, the budget caters for requirements of one financial year without a time-frame. It implies that commitments for the future, arising out of a deal or a contract in a particular financial year are made without reference to the likely availability of funds in future years.<sup>3</sup> These commitments then become obligatory in the ensuing financial years and sometimes result in a situation where the limited budget does not allow new projects or schemes to be undertaken. For example, in financial year 2004-05, the capital budget of the Air Force had to be increased by Rs 467 crore at the Revised Estimates (RE) stage, to meet their contractual obligations, which had come up primarily due to the signing of the contract with British Aerospace for supply of 66 Hawk Advance Jet Trainers. Since no additional funds were allotted in the defence budget, this amount had to be cut from the allocations of the other services depriving them of their capital acquisitions.

Today no service knows what its allocation for capital expenditure is likely to be next year or the year after next, since it is a common head catering to everybody's requirement. So, if a service can somehow get a major project started with low cash outgo in the initial years, then it has automatically assured for itself a larger share of the capital budget in later years, starving projects of the other services, which may be equal or more important.<sup>4</sup> This is also called 'the Three Wheeler Phenomenon'.<sup>5</sup>

### *The Budgeting Process*

The budgeting for the ensuing financial year starts with the Forecast Estimates (FE), which are submitted to the Ministry of Defence by each service HQ in the month of November of the previous year. FE is indicative projections of requirements of funds by the services for the forthcoming financial year. The FE is followed by projections for the Budget Estimates (BE) in December. There is expected to be more fine tuned requirement of funds for the ensuing financial year. A number of proposals or schemes forwarded by the service headquarters remain pending with the Government at this time. There are no clear indications from the Ministry about the final outcome of these proposals and the related cash out go in the current financial year. Since, the requirement of funds for the ensuing

financial year also depends on the schemes cleared in the current financial year, service headquarters are not in a position to project the BE accurately. Additionally, the government is also known to surprise the services at the Revised Estimates (RE) stage (around mid-February) by withdrawing sizeable amount of funds from the initial allocations. In financial years 2001-02, 02-03 and 03-04, Rs 5,000 crore (8.06 per cent), Rs 9,000 crore (13.85 per cent) and Rs 5000 crore (7.66 per cent), respectively were withdrawn from the defence budget at the RE stage. Interestingly, in the budget for financial year 1995-96, against a projection of Rs 26,000 crore, the allotment of Rs 25,500 crore at the BE stage was enhanced by Rs 1,397 crore over the initial projections. Amiya Kumar Ghosh calls this a 'soft budget'. He states that availability of funds in a particular year appears to be an elastic concept.<sup>6</sup>

### *Defence Planning*

Defence planning mostly focuses on threat assessments. And in this regard, we are no different from other countries. But what is more critical is the assessment of resources, whether they are related to manpower, technology and equipment or money. Our problem is that resource assessment beyond the current year is rarely carried out in defence planning. Even this is undertaken in the last days of a financial year; and we happily accept the concept that defence could be given more funds above the budget "if required". Revision of the budget halfway down the year has become routine. The five-year Defence Plans have lost their utility for resource planning. In reality resource allocation is a government function and cannot be undertaken by the service headquarters without the Government indicating the basis of what might be available.<sup>7</sup> India's defence planning has suffered adversely from the consequences of inability or unwillingness to commit to long-term allocation of resources in defence.<sup>8</sup> Weapon systems and military equipment normally have a life of 15-25 years before they are due for replacement. Similarly, manpower is inducted in our case for 17-30 years. But our funding for defence is carried out on an annual basis with a mid-year review to revise estimates of expenditure.<sup>9</sup>

The Ministry of Defence has burdened itself with house-keeping functions of the armed forces which are best left to them, and has not been conditioned and trained to think through long-term international and national security issues. Therefore, there is not sufficient awareness in

the government that the country is not equipped to plan a long-term national security policy.<sup>10</sup> There is no point in just listing our various security challenges if the country continues to lack the mechanism to assess the long-term implications of each one of those and to plan our response to them.<sup>11</sup> The Cabinet Committee on National Security (CCNS) sanctions tendering for 126 top class multi-role combat aircraft not because it is presented with a comprehensive air threat analysis, but because the Air Chief has pointed out that a shortage is likely to occur on account of obsolescence and accidents. If the CCNS does not bother to obtain a comprehensive threat assessment on the basis of intelligence available, each service chief is left with no choice but to formulate his own threat assessment and demands for equipment.<sup>12</sup>

In August 2004, the Standing Committee on Defence, while examining the Demands for Grants 2004-05, expressed serious concern that half of the period having already elapsed, the 10<sup>th</sup> Defence Plan (2002-07) has not yet been finalised. The Ministry of Defence replied that the reason for delay was lack of firm commitment from the Ministry of Finance. The Committee remarked that they are not convinced with the sketchy reasons advanced by the Ministry of Defence for delays. It felt that the Ministry had neither shown any urgency nor followed up with the Ministry of Finance to get the firm commitment of funds to finalise the plan. The Committee also expressed its unhappiness with the planning mechanism in the Ministry which has moved at a snail's pace and consequently with no result even after the lapse of one more year, precipitating a situation with no approved defence plan to speak of even in the third year of the plan period. The Committee has recommended that the 10<sup>th</sup> Defence Plan along with committed allocations be taken up at the highest level with the Ministry of Finance so that the process of restructuring, upgradation and modernisation of the armed forces in the areas of infrastructure as well as equipment is carried forward, thereby enhancing the defence capabilities at the desired pace. The Committee has also recommended that the Ministry of Defence should prepare a 15-year roadmap with long-term strategic vision to be updated periodically for modernisation and acquisition plans for the defence services indicating the budgetary support required there for, as to enable the Ministry of Finance to appreciate the long-term objectives concerning defence preparedness.<sup>13</sup>

### *Planning Period*

In the US the planning horizon is a 6-year period called the Future Years Defence Plan (FYDP). The UK has a Strategic Defence Review (SDR), which was presented to the Parliament in 1998. The SDR sets out the Government's plans for modernising and reshaping defence to meet the challenges of the 21<sup>st</sup> century. A New Chapter to SDR, consequent upon the September 2001 attacks in US was issued in 2002. In a White Paper issued in December 2003, budgetary provisions up to 2008 have been forecast. Even a country like China, where most matters are secretive, issues White Papers periodically, the last one having been issued in December 2004. The White Paper issued in December 2004 is more comprehensive than the previous one released in 2002. The new document outlines Beijing's national security concerns covering a wide range of defence activities, from military modernisation, arms control and civil-military relations, to the overall international security situation.<sup>14</sup> In 2002, France announced its six-year defence plan for 2003-08. In May 2003, a document titled *Defence Policy Guidelines* was issued. It provides a future capability profile of the armed forces to meet new requirements. In January 2004, the Defence Minister presented the new concept in a document called *Milestones for the New Direction*. The concept marries the armed forces' missions with capabilities and financial reality.<sup>15</sup> Several other countries regularly issue defence White Papers clearly indicating future force structures, financial commitments etc.

In our case the budget planning is limited to the next financial year, which too is primarily based on the expenditure pattern of the current financial year. Presently, the time for signing a contract from the time of issue of Request for Proposal (RFP), as set by the Acquisition Wing for itself, is 255-300 days. This does not include the time required for finalisation of Service Qualitative Requirements etc. If the likely budgetary allocations are made known to the Services for at least the next three years, then the programmes can be drawn up within the likely funds to be available. This will also give the services and the Government adequate time to start their initial processes in advance so that in the relevant financial year, the proposals reach their finality as planned.

### *Inter-Service Priorities*

The apportionment of the defence funds between the services and

amongst the various arms/capabilities within the individual service was invariably according to dated rationales, to ratios established long ago. This rigid pattern of military spending has resulted in lopsided expenditures and in the building up of certain specific capabilities at the expense of other equally, if not more important, missions. Also, an inflexible budget together with the fixation of each service to acquire evermore sophisticated weapons platforms meant that cost-effective solutions based on a more rational, combined arms approach, and a policy of incremental augmentation of capability (rather than of wholesale modernisation by replacement) of the current inventory using force multiplier technologies and retrofitting advanced technology systems and subsystems on existing hardware, was eschewed.<sup>16</sup>

To set a crude financial ceiling and leave the selection of strategy and design of forces wholly to bargaining among the Services is frequently regarded as an invitation to aimlessness.<sup>17</sup> Each Service guards its own share of the defence budget carefully, and tends, unless it receives strong directions to the contrary from the Ministry of Defence, to spend funds on those items that each considers important, regardless of overall defence policy and the needs of the other Services. This process leads to sub-optimisation.

#### *Defence Services Estimates (DSE)*

A very noticeable feature pertaining to presentation of defence budget in the Parliament is the absence of any supporting documents along with the DSE.<sup>18</sup> The DSE, which is presented in the Parliament during the budget session, lists out the allocation of funds for the relevant financial year. Also listed are the allocations for the previous financial year and the expenditure of the financial year prior. One can compare the allocations and expenditure merely in arithmetical terms. In fact, a little increase over the previous year's allocations or expenditure is considered appropriate and no explanations are sought. However, reductions or large increases draw a lot of explanations. Though Minor Heads and Detailed Heads are listed, the real purpose for allocations, primarily in the Stores in Revenue and the entire Capital budget is not reflected. From financial year 2003-04, an expanded version of the DSE, viz., DSE Volume II, is being published. This volume contains Command-wise allocations under certain heads and

user-wise allocations under the Stores head. However, it has not been able to reflect any programmes or objectives.

## **Past Measures**

### *Pre-2000*

Dean Appleby's report on Government Financial Systems in 1953 recommended the introduction of performance budgeting. The Estimates Committee of the Parliament further highlighted the need for it in 1958. In 1968, the Administrative Reforms Commission (ARC) in its report on Finance, Accounts and Audit pointed out the deficiencies in our expenditure management system very clearly. The committee recommended the introduction of performance budgeting systems to provide a link between financial outlays and fiscal targets. It also recommended changes in the form and content of the budget to serve as a tool of management and as a device for evaluating performance.<sup>19</sup> Based on the recommendations of the ARC, all demands for grants presented to parliament have a supporting document in the form of a Performance Budget. However, the Ministry of Defence was exempt from preparing this document. While the Ministry of Defence does give an Annual Report which details achievements in various sectors of its activities, it does not have a document reflecting physical progress of even major items linked to the outlays in the budget.<sup>20</sup>

Following the recommendations of the ARC to introduce performance budgeting, a team of officers was set up to consider matters of accounts and budgeting and to recommend a meaningful classification structure so that Government operations could be viewed in terms of functions, programmes and activities rather than just by objects of expenditure. The team recommended, in 1972, a scheme of classification of accounts based on five tiers.<sup>21</sup> This system of classification is in vogue at present.

To bring about closer association between the administrative Ministries and their financial advisors and to enable the latter to play a more effective and constructive role, the system, of integrated financial advisors was introduced in 1975. Under the system the financial advisors became part and parcel of the administrative ministry and thus were more closely associated with formulation and implementation of proposals. In defence, the system was first introduced in DRDO, DGQA and DGOF in 1976. The

introduction of integrated financial advice system in the Ministry of Defence took place in 1983. Since 1994 Integrated Financial Advisors have also been placed in the Services, initially at Service Headquarters levels and subsequently at lower levels.

By way of reforms, a new system of budgeting, viz., Zero Based Budgeting (covered later in the paper) was introduced in 1989-90. However, not enough preparation was done and this appeared to be a half-hearted effort. This made no impact and was subsequently given up. In 1992, the Ministry of Defence set up a task force for "Review and Rationalisation of Accounting Classification of Defence Services for Expenditure and Budgetary Control". The task force recommended the following:

- Introduction of decentralised resource management in logistic areas with concept of budget centres.
- Control of commitment of expenditure for future years through the mechanism of indicative budget for three to four years for each budget centre.
- Institution of proper information system through restructuring the classification code heads for better control.
- Allocation of budget to be made detailed head-wise, both for earlier commitments and fresh commitments.
- Clear segregation of funds for meeting the requirement of past commitments.<sup>22</sup>

Other than having changed the classification system, no other reforms were implemented and even now the defence budgeting is primarily incremental and input-oriented. However, some developments took place at the services level. The Navy introduced the New Management Strategy (NMS) in 1994 and the Army followed suit in 1997 by implementing the New Financial Management Strategy (NFMS). These systems primarily relate to delegation of financial powers in the revenue budget. Software-based systems relating primarily to logistics aspects of spares and stores procured out of the revenue budget have also been introduced by the Services.

#### *Post-2000*

Enhancement of Delegation of Financial Powers (2001): In 2001, the existing financial powers of various authorities in the services were

enhanced by four to ten times. This gave the Services greater responsibility along with more satisfaction.

Defence Procurement Organisation (2001): Consequent upon the recommendations of the Group of Ministers (GOM) in 2001, a Defence Procurement Organisation comprising the Defence Acquisition Council, Defence Procurement Board (DPB), Defence Research and Development Board and the Acquisition Wing has been constituted. The DPB was constituted in April 2001 with the objective of making defence procurements faster and swifter. While the Board oversees all acquisition activities, it has no financial power to sanction any projects. Even under the fast track procedure, the role of the DPB is recommendatory in nature. It may be stated that DPB does not deal with cases that are taken up under the normal procedure. The DPB only makes recommendations and it is the concerned acquisition wing that takes further action and after obtaining the final approval of the CFA, the contracts are signed. The DPB also does not disapprove any case. If need be, cases are sent back to service headquarters for further information. Up to October 2004, out of the 75 cases recommended by DPB, contracts were signed only for 51 cases, including 48 under the fast track procedure. As per the report of the Standing Committee on Defence (2004-05) on Demands for Grants of the Ministry of Defence, DPB seems to have added one more tier in clearance of defence proposals causing further delays in procurement of defence equipment. The Committee also observed that the very nature of structural and procedural aspects in acquisition and modernisation of defence forces, and the stages involved therein require a thorough study to identify the bottlenecks and remedial measures are needed to streamline the system. The Committee has recommended that a Study Group may be constituted to examine the entire gamut of defence procurement procedures and structures and suggest appropriate modifications.<sup>23</sup>

Introduction of Certain Budgetary Reforms (2003-04): The GOM also recommended constitution of a study group to make recommendations on budgetary reforms in defence. As per the terms of reference of the study group, three recommendations were made:

- The Defence Services Estimates (DSE) be prepared in two volumes. The existing DSE be sufficiently expanded to include more meaningful information for laying on the table of Parliament. The second volume should contain all details as in DSE along with

details of allocations by Principal Staff Officers to various Commands and some identified budget centres.

- For classification of expenditure into Revenue and Capital, the cost criteria be revised to Rs 10 lakhs from the existing Rs two lakhs, the life of the item remaining seven years.
- Introduction of Programme-based Budgeting. However, the Committee recommended that Programme-based Budgeting be introduced in a phased manner.

While the first two recommendations above have been implemented from financial year 2003-04, no concrete steps seem to have been taken towards Programme-based Budgeting.

Fiscal Responsibility and Budget Management Act, 2003 (FRBM): In response to the challenge of continued high fiscal and revenue deficits, the Indian Parliament passed the FRBM Act in 2003. FRBM proposes elimination of revenue deficit by 2007-08.<sup>24</sup> FRBM requires a minimum annual reduction of 0.5 per cent of GDP in the revenue deficit, and 0.3 per cent in the fiscal deficit. It also requires that the fiscal deficit in 2008-09 be below 3 per cent of the GDP. While the Act basically pertains to improvement in the tax collection system in the country and expenditure management, it proposes to stabilise defence expenditure at 2.3 per cent of GDP.<sup>25</sup> Therefore, expenditure management in the defence services is likely to be under greater pressure in coming years. It may also be noted that the allocations in defence budgets have been used by successive governments to reduce deficits in annual budgets.

Defence Modernisation Fund: The Finance Minister in his interim budget speech in February 2004 had proposed establishment of a non-lapsable, Defence Modernisation Fund of Rs 25,000 crore. However, this proposal has not been implemented so far. While discussing the Demands for Grants 2004-05, the Defence Secretary in his evidence to the Standing Committee of Defence in August 2004, stated that the point had been studied in consultation with the Comptroller and Auditor General and the Ministry of Finance and it was found that the experience of “these non-lapsable funds”, was not good. He also stated that while the concept in theory might appear to be very attractive but practically it has not worked because ultimately the money available in any fund would be the fund that the Ministry of Finance is able to allocate. The Finance Minister has a

certain constraint of resources and, therefore, whatever money is allocated in any such fund, after some time, when the money is used, replenishment of this amount would again depend on the availability of funds with the Ministry of Finance. Ultimately, it was found that this would not work.<sup>26</sup> This aspect is substantiated by the fact that the government reduces allocations in the defence budget at the Revised Estimates stage by large amounts, which was as high as Rs 9,000 crore (13.85 per cent of initial allocation) in financial year 2002-03. This supports the fact that the Defence Modernisation Fund can be recouped and sustained only if the Government has the necessary resources at the given time.

### **Alternate Budgeting Systems**

The need to provide value for money runs to the heart of the political process, and is one of the obligations, which lie in the Government and the Services. We should constantly be seeking out new ways of providing more for less, or at the very least more for the same. Military commanders throughout the ages have won battles and wars by being clear about the objective and setting out to achieve it. Unfortunately, the same clarity of purpose cannot be found in our planning and financial mechanisms. There is a requirement to have in place a planning system which can set objectives for the outputs to be achieved by people at all levels throughout the Services, from the Defence Plan downwards. These outputs are essentially intermediate outputs. The ultimate output is the fielding of a battle-winning force.

#### *Planning Programming and Budgeting System (PPBS)*

Criticism of input budgets for defence led to the development of an alternative approach, namely, programme or output budgeting. With its emphasis on objectives, outputs, and total programme costs over a period of years, it is in complete contrast to input budgets. Programme budgeting or a Planning, Programming, Budgeting System (PPBS) provides information for assessing the efficiency with which Defence uses resources. It requires answers to four questions:

- What are the objectives of the Defence Ministry or the Department of Defence and is it possible to formulate a set of programmes, which can be related to these objectives? Examples of programmes

include conventional forces, strategic forces, special forces, and reserve forces.

- What are the current and expected life-cycle resource costs of each programme?
- What are the results or outputs of each programme?
- Are there alternative methods of achieving each programme and what are the costs and outputs of each alternative? For example, air defence can be provided by manned combat aircrafts or ground-based missiles.<sup>27</sup>

Programme Budgeting had its origins in the RAND Corporation and was pioneered by the US Department of Defense as part of a management revolution in 1961. It provided a framework for applying cost-benefit or cost-effectiveness analysis in which individual and alternative force structures such as a bomber squadron or a warship were properly cost analysed with costs then related to benefits, outputs, or effectiveness of each force structure. In this way, programme budgeting draws attention to important trade-offs in defence choices.<sup>28</sup> The problem, which PPBS in defence was intended to solve, was not the lack of systems analyses in defence planning, but the inadequate link between planning and budgeting. A purpose of the introduction of PPBS in defence was to increase the impact of relevant analyses on high-level decisions by connecting them to budgeting via the programme concept. A reason for presenting analytic approaches, such as cost-utility analysis, as part of programme budgeting concept was apparently to advocate the use of systematic analysis in fields where such analyses up to then had seldom been tried.<sup>29</sup>

The shift to programme budgeting reflected the revolution in military technology since the end of the Second World War. The great technical complexity of modern-day weapons, their lengthy periods of development, their tremendous combat power and enormous costs have placed an extraordinary premium on sound choices of major weapons systems. There was also a need to take a defence and national perspective in selecting new, costly equipment. Traditionally, each service had pursued its own priorities and missions, often to the detriment of joint missions, seeking a larger share of the defence budget for its new weapon systems and protecting the overall size of its own forces some times at the cost of combat readiness.<sup>30</sup>

### *New Management Strategy*

Programme budgeting is not without its limitations. It should be seen as an information system for planning and evaluation; but it does not remove the need for individuals to make decisions. Some of these limitations have led to new defence budgeting initiatives. The UK, for example had moved from programme budgeting to management-based defence budgets, the New Management Strategy. This is designed to improve internal efficiency through creating clearly defined budget holders with specific defence tasks (e.g. submarines, air defence) and delegated budget responsibility within each task. However, problems arise where the budget holders have little choice over most of their inputs and expenditure, and where their employment contracts provide no incentive to improve efficiency.<sup>31</sup>

### *Zero-Based Budgeting (ZBB)*

A method of budgeting in which all expenditures must be justified in each new period, as opposed to only explaining the amounts requested in excess of the previous period's funding. For example, if an organisation used ZBB, each department would have to justify its funding every year. That is, funding would have a base at zero. A department would have to show why its funding efficiently helps the organisation toward its goals. ZBB is especially encouraged for government budgets because expenditures can easily run out of control if it is automatically assumed what was spent last year must be spent this year. The ZBB planning process eliminates one of the major disadvantages of most traditional management and budgeting systems. Typically, in the traditional budgeting system planners focus on the incremental cost increases from year to year. ZBB overcomes this traditional budgeting weakness by subjecting all proposed programmes and expenditures to the type of scrutiny that is normally conducted for new programmes. The comprehensive resource cost analysis process is a strong internal planning characteristic of ZBB. Like any other system, ZBB has its cons – firstly, it may increase the time and expense of preparing a budget; secondly, it may be too radical a solution for the task at hand. You don't need a sledgehammer to pound in a nail; and thirdly, it can make matters worse if not done in the right way. A substantial commitment must be made by all involved to ensure that this doesn't happen. Since August 2002, China is reported to have introduced ZBB in its defence budgeting.

### *Organisation-Wise Budgeting*

Presently, the budget is presented head-wise for all the Services as a whole. In the organisation-wise budgeting system, the budgeting is done for a smaller organisation within the Service and the entire amount under various heads is allotted to the organisation. For example, budgetary provisions may be made for each Command. Heads of the organisation then become responsible and accountable for planning and control. This system enables a comparison of management of budget by different organisations thus establishing yardsticks for efficient management by all. Similarly, within an organisation, sub-organisations, say down to a corps/division and equivalent levels, may also be accordingly budgeted and provided for. This will lead to greater decentralisation, delegation of authority, responsibility and accountability. The system presupposes establishment of budget or financial planning cells at lower levels. Central procurements may be undertaken by central agencies and expenditure debited to the concerned organisation. The system of central budgeting for acquisition of new equipment, as at present, may be continued. Budgets of Military Farms, Directorate General of Quality Assurance, Rashtriya Rifles and the National Cadet Corps within the Army's budget are existing examples.

### *Biennial Budgeting*

Annual budgeting devalues the planning and evaluation phases of the resource allocation process. Annual budgeting leads to short term focus by all concerned. Only the allocations for the next year are taken seriously. No thought is given to the allocations for the subsequent years of the plan, even if there is one. More proposals are floated by the Services than the budget can fund them. Consequently, some programmes have to be cut back or put on hold. On the other hand, biennial budgeting provides better evaluation of policy execution, more effective long-range planning, less turbulence in weapon programmes through more stable funding levels, and increased savings in procurement contracts through better deals with contractors. The first must be viewed as the fundamental management prerequisites to better resource allocation within the Defence Ministry; the last two can be seen as the specific savings that occur if the prerequisites are put in place. None of these benefits are trivial, even if we cannot specify with precision the exact rupee gains from each. In the US, biennial

budgeting for defence was mooted in 1986. Pentagon submitted a two-year budget for financial year 1988-89, and has done so each year subsequently. The US Congress, however, has never shifted to a two-year cycle, largely because of opposition from the powerful Appropriations Committee. Due to this Congressional reluctance, the Department of Defense has essentially retained an annual process where it attempts to perform planning, programming and budgeting.

## **The Way Ahead**

### *Ingredients of a Sound Defence*

If a nation is to have a sound defence policy, it must do three things: First, it must devise a military strategy that properly supports its foreign policy goals. Second, it must create a defence organisation that is conducive to producing the types of fighting forces for which its strategy calls. Third, it must construct a resource allocation mechanism that enables its defence establishment to translate efficiently the raw materials of military power into the requisite fighting forces. The strategy must set the goals that the nation's military forces should attain; the defence organisation must foster the types of political expectations and incentives that, in turn, would encourage military personnel to meet these goals; and the allocation mechanism must provide the means to convert efficiently the resources of personnel, material, and monies into programmes that support the strategy. A sensible strategy, a proper set of organisational and political incentives, and an efficient resource allocation mechanism – these, then are the three ingredients of a sound defence policy.<sup>32</sup>

### *Defence Organisation*

It is necessary at this stage that a mention is made of the defence organisation that is suitable for sound policies, decisions and execution.

The OKW Solution: The Oberkommando der Wehrmacht (OKW) was responsible to Hitler during the second World War II for all German Armed Forces. The OKW solution would involve establishing a large Tri-Service Planning Headquarters separate from the Ministry of Defence and interposed between the Ministry and the Armed Forces. This idea was hotly discussed, or rather argued against, in the UK during the years preceding the 1964 reorganisation by those who said that any further

weakening of the Service departments would lead to a situation in which the central defence staff would grow greatly in size and come to resemble the OKW in Germany between 1939 and 1945. According to these critics, OKW had immense powers to plan operations, but no responsibility for carrying them out. In consequence, so the argument goes, the German armed forces were set impossible tasks and lost the war.<sup>33</sup>

With the creation of HQ Integrated Defence Staff, rather than having an integrated Ministry of Defence we have probably interposed another headquarters, like the OKW, between the Services headquarters and the Ministry of Defence. As per the Annual Report 2003-04 issued by the Ministry of Defence, "The principal task of the ministry is to obtain policy directions of the government on all defence and security related matters and communicate them for implementation to the Services Headquarters, Inter Service Organisations, Production Establishments and Research and Development Organisations."<sup>34</sup> This statement clearly indicates that the hierarchical level of the Ministry is higher than that of the Service Headquarters and the integration as envisaged in the creation of HQ IDS has not materialised except on the letterheads of HQ IDS. A coherent, effective defence organisation would have the following characteristics:

- Strong administrative departments for each Armed Service.
- A powerful central policy and planning staff (with Service officers and civilian administrators and scientists) to plan defence policy, the budget, and weapons projects.
- A long-term or multilayer budget system to provide as stable an environment as possible for future plans.
- A full career civilian bureaucracy of administrators and scientists to operate this system in equal partnership with their service colleagues.<sup>35</sup>

### *Defence Planning*

In a good planning system, goals serve as a potential basis for the planning process. In the light of the results the goals have then to be reformulated in a feedback process until a proper balance has been established between goals, resources allotted and estimated effectiveness of the armed forces. The politicians must have knowledge of the basic principles of defence planning. The best way of organising the politicians'

participation in planning seems to be to integrate them with the planning system. Of course the politicians have to be supported by various kinds of experts. This cooperation must be based on mutual confidence and respect for the specific kind of knowledge they represent.<sup>36</sup>

It is vital that at least five-year Defence Plans are prepared and, after they have been critically discussed and accepted, firm fiscal guarantees, not assurances, are provided to the Ministry of Defence to enable the latter to provide valid guidelines and annual cash outgo ceilings within a five year cycle to each of the three defence forces.<sup>37</sup> A major task of the Ministry of Defence should be to ensure that the maximum benefit is derived from the resources devoted to defence. If each Service is allowed to its share of the budget according to its own judgement, there will probably be waste and duplication as each of them sets aside funds for tasks that are better done by another Service, or that are of doubtful value anyway. It is also possible that the resulting defence strategy may contain serious gaps because one Service has failed to devote sufficient funds to provide the necessary support for another, leading to what is sometimes called a distorted or disjointed defence budget. To the extent that this happens, inter-service rivalry may be the cause.

Defence planners, seeing the need for very expensive weapons programmes for all three Services stretching over a number of years, will inevitably have to tailor and time these programmes so that the cost peaks in each do not all occur in the same year and swamp the likely defence budget. For this task they need as much certainty as possible about future defence budgets. Long-term financial planning has another significant advantage – it facilitates inter-service agreement on the timing and size of weapons programmes, if one service is confident that it can introduce the programme within the next two to three years with the agreement of the other two services. This ability to negotiate over time is a key part of Defence by Discussion.<sup>38</sup>

There is a need to ensure that the Defence Plans (both the Long-Term Perspective Plan and the Five-Year Plan) are formulated in the Ministry of Defence rather than in Service headquarters.<sup>39</sup> The increased costs and complexities of military power require that adequate staff structures be created to provide for strategic Defence Planning. A combined military and civilian professional senior staff under the defence minister could meet this need. Such a strategic planning division should be tasked to work

essentially on defence doctrine, strategy, and overall policy, including long-term assessments and planning, while the departments of defence as they exist today, continue to manage the current tasks and needs. Air Cmde. Jasjit Singh recommends that a strategic planning division be set up in the Ministry of Defence to undertake the task of long-term defence planning in a coherent manner linked to resources availability and which commits the requisite resources after examining alternative choices of policy and their costs.<sup>40</sup>

### *Budgeting Goals*

The budget should serve a set of purposes, which should enhance the goals implicit in the allocation and management of resources, and provide the basis for efficient decision-making by indicating the costs of particular decisions. Some of the objectives that defence budgeting should seek are outlined below:

- It should provide a meaningful estimate of the total financial cost for accomplishing definite objectives, and not merely what the objective would cost in a particular financial year. The budget statement should project the total cost of a scheme through a period that can be forecast with some degree of accuracy and relevance. The budget presentation should also clearly identify the future cost implications inherent in the commitments entered into at present.
- The budget structure should facilitate a comparison of alternate ways of accomplishing a given objective.
- The budget should generate sufficient economic data to make it possible to carry out meaningful analysis and understanding of the level of investment of national resources and governmental spending on defence.
- It should provide effective control over expenditure.<sup>41</sup>

### *Restructuring the Budget*

Though the budget of the Defence Research & Development Organisation (DRDO) was segregated from that of the Army from financial year 2003-04, the budget of the DGQA and the NCC also needs to be segregated. Similarly, the newly created Minor Head of Joint Staff, which caters for the expenditure of Integrated Defence Staff and the Tri-service Commands, should also be separate from the Navy's budget.

### *Defence Services Estimates*

The Defence Services Estimates reveals nothing of funds spent by various spending authorities in relation to the milestones achieved. There are, however, areas where outside the budget document monitoring mechanisms exist, for example – most of the DRDO projects, certain major projects like Project Sea Bird of the Navy, in the case of ordnance factories where value of production, value of issues, money spent etc are correlated. Segments that can be easily targeted are schemes pertaining to acquisition of major equipment, productivity of various workshops, base repair depots and naval dockyards. Construction Works is another area where physical progress needs to be measured in terms of various projects against budgetary allocations and overall costs. Ultimately, to link defence objectives in various facets with budgetary allotments would require the objectives to be spelt into programmes. The programmes would be required to be broken into components. A programme could be service-specific or cutting across the three services. HQ IDS is the most suitable organisation to define and outline these programmes.<sup>42</sup>

### *ZBB in Defence Research and Development Organisation*

ZBB is especially recommended for research organisation budgets because expenditures can easily run out of control, if it is automatically assumed what was spent during the previous year must be spent in the current year. There may be a requirement of reviewing the research and development projects on a regular or annual basis. Projects not making headway and having high-cost overruns may be shelved for better utilisation of the budget.

### *Getting Over the March Rush*

A common feature of the spending cycle is the tendency to spend all balances of allotted funds in the last quarter of the financial year, particularly in the month of March. This often leads to unplanned and wasteful expenditure. While the budget is allotted for a whole year, the expenditure should be evenly paced out during the financial year. There are arguments that certain programmes can commence only on allotment of the budget and the various steps up to the finalisation stage take a major part of the financial year. This argument only re-emphasises the need to have plans approved in advance so that the planning phase can be over before the

commencement of the ensuing financial year. The Ministry of Finance issued a very important directive for financial year 2004-05. It stated that for the last quarter of the financial year only 33 per cent of the year's allotted budget would be available. It meant that if 67 per cent of the budget is not spent by the month of December, funds would have to be surrendered. This created a positive sense of urgency in the Ministry of Defence and the Service headquarters to evenly pace out expenditure round the year and ultimately no surrender of the defence budget took place. Consequently, 69.72 per cent of the defence budget was spent by December 31, 2004 against less than 65 per cent in the previous years. This may well be the main reason for no surrender of the defence budget at the RE stage in the previous financial year.

#### *Budget for Cost-Effective Decision-Making*

At present, we follow a system that indicates only the input expenditure under broad heads and sub heads. There is no way of assessing the capability that this expenditure buys. With the present system, it is not possible to know the cost of acquisition and the recurring cost of maintaining a component of the force. SIPRI launched a study in 2001 on the process of budgeting for the military sector in Africa. The objective was to understand the process by which military spending decisions are made as a prelude to monitoring and strengthening this process. It is an exploratory study, based on eight country case studies, and uses an analytical framework consisting of a combination of elements of sound governance principles and universally acknowledged basic security considerations. The study lists out the following main elements of a proper budgeting process:

- The fiscal envelope for the security sector is defined by government and communicated to those responsible for overseeing strategic planning for the defence sector.
- The security environment is analysed.
- The constitutional and legal framework within which the decision is to be made and implemented is identified.
- The challenges for the armed forces are defined. What type of challenge is envisaged for defence? These are usually articulated in a defence White Paper or a similar policy paper.
- The types of military capability required to manage the challenges are identified and the options weighed.

- The size, shape and structure of the armed forces are defined.
- Resources are allocated and the defence budget prepared.
- Planned activities are implemented and functional areas aligned and rationalised in order to produce an effective defence organisation.
- Outputs (results) are monitored.
- Expenditures are properly accounted for. Outputs are evaluated and audited, and results are fed into future plans and reported to the relevant legislative and executive bodies.<sup>43</sup>

While it is recognised that the framework described above may not be applicable in its entirety to all existing military budget processes, the need for standard measure of good practice in military policy, planning and budget process make such an ideal type of framework attractive.

## **Conclusion**

The absence of a well-defined defence policy has grave implications for budgeting and planning generally. Without a definite policy it will be difficult to develop a strategic doctrine, and this in turn will affect the determination of appropriate force levels, the organisation of the armed forces, financing and weapon procurement. The absence of a defence policy to guide the budgeting and planning processes is a result of:

- Lack of expertise in the Ministry of Defence to draw up such policies.
- Absence of an enabling environment, i.e:
  - Lack of political will on part of the Executive.
  - Absence of national policy framework that defence can feed into.
  - Lack of coordination between defence and other sectors with which defence should interact.

The existing budget structure of the defence services is merely allocation of funds without relating them to the Defence Plan. While elaborate Five Year Plans are drawn out by the Services, budget allocation and expenditure is an exercise in isolation. A goal-based budgeting system will allow the Services to fulfill the requirements of the Plans and indicate the progress that has been made over the years. Politicians tend to make only very broad and general statements or declarations on national defence goals

that avoid future commitments. Also, given the nature of the electoral system, politicians have a narrow time-horizon for political thinking. Their main interest is therefore, normally directed towards annual budget problems.<sup>44</sup>

Amiya Kumar Ghosh recommends that the aim of reforms in the budgetary system should be to bring about changes in the decision-making system by restructuring the issues in an appropriate manner. If the money involved is large and the stakes are high, budgetary decision-making should be well structured and should help in putting issues in focus rather than obscuring them.<sup>45</sup>

The purpose of planning and budgeting should be to rationally allocate defence resources, to identify major issues for decision, and to provide a construct for making them in the absence of a precipitating event such as Kargil. Allowing it to do so requires structure, discipline and leadership. A carefully crafted and well managed system cannot guarantee that India will always have the right forces, with the right capabilities, in the right proportion and at the right time. No process can. It can, however, increase the odds of such a positive outcome quite significantly.

## Appendix

### Defence Budget Financial Year 2005-06 (in Rs Crore)

<u>Minor Head</u>	<u>Army</u>	<u>Navy</u>	<u>Air Force</u>	<u>Total</u>
<b><u>Revenue</u></b>				
1. Pay & Allowances	14,780	1,482	2,334	18,596
2. Transportation	1,239	150	173	1,562
3. Stores	9,904	2,600	5,826	18,330
4. Works	2,794	410	718	3,922
5. Other Expenditure	998	140	142	1,280
<b><u>Capital</u></b>				
6. Land	74	50	1	125

7. Aircrafts & Aero-engines	939	1,259	9,565	11,763
8. Heavy & Medium Vehicles	505	7	4	516
9. Other Equipment	5,526	1,168	2,792	9,486
10. Construction Works	2,233	157	430	2,820
<b>Total</b>	<b>38,992</b>	<b>7,423</b>	<b>21,985</b>	<b>68,400</b>

- Notes:
1. The Table does not show the complete defence budget. Organisations other than the three services have not been shown.
  2. Minor heads common to all the three services have only been shown.

### References/End Notes

- <sup>1</sup> Financial Regulations, Part I.
- <sup>2</sup> Amiya Kumar Ghosh, *India's Defence Budget and Expenditure Management in a Wider Context*, Lancer, New Delhi, 1996, p. 34.
- <sup>3</sup> In the absence of the five-year Defence Plans being approved by the Government, likely availability of funds in future is not known.
- <sup>4</sup> Amiya Kumar Ghosh, no 2, p 74.
- <sup>5</sup> 'Three Wheeler Phenomenon' is prevalent on Delhi roads, where the driver of the autorickshaw somehow finds place for the front wheel; the balance of the autorickshaw has to be given way by others.
- <sup>6</sup> Amiya Kumar Ghosh, "Scope for Meeting National Security by Effective Management and Availabilities", paper presented in National Security Seminar in November 1996.
- <sup>7</sup> Jasjit Singh, *India's Defence Spending*, Knowledge World, New Delhi, 2001, p xvi.
- <sup>8</sup> Ibid, p.35.
- <sup>9</sup> Ibid, p. 36.
- <sup>10</sup> K Subrahmanyam, "Wanted for India: A Long-term Defence Planning", *Vayu*, 1 (200), p 66.
- <sup>11</sup> Ibid, p 69.
- <sup>12</sup> K Subrahmanyam, "Strategic Failure - Defence Budgeting Lacks Vision, Leadership" *Times of India*, February 26, 2005.
- <sup>13</sup> Report of the Standing Committee on Defence (2004-05) (Fourteenth Lok Sabha), on Demands for Grants of the Ministry of Defence for the year 2004-05.
- <sup>14</sup> Elisabeth Skons *et al*, "Military Expenditure", *SIPRI Yearbook* (2003) p.332.
- <sup>15</sup> *Jane's Intelligence Review*, March 14, 2005.
- <sup>16</sup> Jaswant Singh, *Defending India*, Macmillan India Ltd., New Delhi, 1999, p 215.

- <sup>17</sup> Michael D Hobkirk, *The Politics of Defence Budgeting*, The Macmillan Press Ltd., London, 1984, p.14.
- <sup>18</sup> Condensed from Report on Financial Information System and Management by P.R. Sivasubramanian, former Secretary Defence (Finance), October 11, 2002.
- <sup>19</sup> Report of the Administrative Reforms Commission on Finance, Accounts and Audit, 1968 and quoted in Amiya Kumar Ghosh, *India's Defence Budget and Expenditure Management*, (Lancer, New Delhi, 1996, p. 3.
- <sup>20</sup> no 18.
- <sup>21</sup> Amiya Kumar Ghosh, no 2, p 3.
- <sup>22</sup> Amiya Kumar Ghosh, no 2, pp 1-2.
- <sup>23</sup> no. 13.
- <sup>24</sup> The Finance Minister, in his speech in Parliament on July 8, 2004, has proposed to shift this date to 2008-09. Accordingly, the report of the Task Force takes the target for elimination of revenue deficit as 2008-09.
- <sup>25</sup> <http://www.ey.com>. (Accessed March 10, 2005).
- <sup>26</sup> no 13.
- <sup>27</sup> Todd Sandler and Keith Hartley, *The Economics of Defence*, Cambridge University Press, 1995, pp 179-180.
- <sup>28</sup> Ibid, p 181.
- <sup>29</sup> Brita Schwarz, "Trends in Planning" (A collection of essays from the Planning Department of the Swedish National Defence Research Institute, 1977) p. 31.
- <sup>30</sup> Todd Sandler and Keith Hartley, no 27, p. 181.
- <sup>31</sup> Ibid.
- <sup>32</sup> Robert J Art, "From Budget Wars to Real Wars: The Pentagon and Biennial Budgeting", *Making Defence Reforms Work*, Brassey's (US), Inc, New York, 1990, p. 25.
- <sup>33</sup> Michael D. Hobkirk, no. 17, p. 120.
- <sup>34</sup> Ministry of Defence, *Annual Report 2003-04*.
- <sup>35</sup> Michael D Hobkirk, no. 17, p.131.
- <sup>36</sup> *The Defence Planning System: The Goal Setting Procedure*, Paper prepared by Swedish Ministry of Defence, 1969, p. 1.
- <sup>37</sup> N.N. Vohra, "Foreword", in Amiya Kumar Ghosh, *India's Defence Budget and Expenditure Management in a Wider Context*, Lancer, New Delhi, 1996, p. x.
- <sup>38</sup> Michael D. Hobkirk , no. 17, p. 127.
- <sup>39</sup> Jasjit Singh, no. 7, p. 213.
- <sup>40</sup> Ibid, p xvi.
- <sup>41</sup> Jasjit Singh, no 7, p 87.

<sup>42</sup> no. 18.

<sup>43</sup> Wuyi Omitoogun, "The Process of Budgeting for the Military Sector in Africa", *SIPRI Yearbook*, 2003, p 370.

<sup>44</sup> Michael D. Hobkirk, no. 17.

<sup>45</sup> Amiya Kumar Ghosh, no 2, p. 67.

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