CHAPTER-II

FACTORS AFFECTING THE DEFENCE EXPENDITURE

General

Defence by its very existence ensures security of the nation. Yet, it has to be tailored from within the available national resources. Over-ambitious Defence planning and spending, may lead to the collapse of the national economy and thereby negate the very "Raison d'etre" for its existence. Admittedly, Defence expenditure provides intangible benefits which become tangible only on occasions of hostilities and internal insurrections. Another paradox connected with Defence expenditure is that higher the defence capability (which implies higher defence outlay), the less likely any aggression by adversaries and consequently more infruc-tuous the expenditure appears to be. Force structure of the Defence Services and hence the extent of outlay on Defence, are by and large dictated by the following factors: -

(a) Threat posed by the likely adversaries and level of collaboration likely to be achieved by them.
(b) Capabilities of the adversaries as distinct from their stated intentions. This is an important aspect, as many critics of the Defence budget tend to be carried away by the atmospherics rather than the realities.
(c) The internal situation in the country and the extent to which the Armed Forces will be required to assist the Civil Administration in internal security duties.

(d) The ability of our diplomatic initiatives to mitigate the assessed threats.

(e) The state of the National economy and competing claims on the already inadequate National funds by various agencies, both for development and non developmental expenditure.

The above stated factors can be broadly summarised as follows:-

(a) Political Environmental Factor.

(b) Technological Environmental Factor.

(c) Economical Environmental Factor.

Before we consider these in detail, an overview of certain fundamentals which govern the Defence economy are being discussed in the succeeding paras.

**Economic Theories on Defence Expenditure**

Over a period of time, many theories on the subject have been propounded. Adam Smith was the first economist to consider the implications of defence expenditure for a society for its well being. He advocated that it was the
utmost duty of the Government to protect the society from violence and invasion from other independent societies, which is possible only with the help of a viable military force. Since the military force was to protect the entire society, the burden of expenditure for maintaining the force should be shared by the complete society. Kautiliya in his book "Arthashastra", has linked Defence to development.

This theory was further reinforced by David Ricardo, Malthus, Jean Baptistesay and Marx Ricardo, who gave out methods for restraining the government from embarking on costly wars at public expense. They regarded the raising of funds by the Government through public debts as an unnecessary evil, which increased the risk of war for flimsy reasons or wicked ambitions or financial gains. They have advocated financing the wars through loans or taxes: While the loans shifted the burden to the future, the taxes imposed burden on the present. Too heavy a tax burden because of the war, may not be acceptable to the people. Hence, the government may weigh the pros and cons before deciding on this course. Malthus propagated war as a means of controlling population as also believed that Wars lead to prosperity and economic boom which follows.

Jean Baptistesay was of the opinion that loss of human life is loss of wealth, which is composed of the total
expenditure used in the previous years for its maintenance and education. The theories propounded by Smith and Ricardo calculated the cost of training a recruit, the equipment and expenses on the military force as Defence expenditure: a new dimension ie cost of human life was also added. Smith called a soldier an 'unproductive worker', whereas Say called him a destruction worker as he does not enrich the society with any product and without any personal advantage to himself is called upon to destroy the fruits of others hard labour. Karl Marx showed concern with the economics of class struggle and did not write specifically about the economics of war. Engels who went deep into the subject of war, was particularly struck by the influence of technology on military tactics.

The economic destruction caused by the two World Wars, has provided scope for a great deal of economic comments and comparison on Defence and military power. Upto the First World War, military matters were considered as the exclusive province of the military, but the War brought out the relevant connection between the military and the industry: A sound industrial base is the backbone of the military power. F.W. Hirst enunciated 'Principles of War Finance' in 1911, as under:-

(a) In the economic sense all expenditure on the
Army, Navy and weapons of destruction is wasteful.
(b) Until universal and perpetual peace is established, some expenditure on the Defence Services is absolutely necessary.

F.W. Hirst also advocated, that effort should be made to secure a proportional limitation of armaments and there should be severe financial supervision, to make sure that tax-payer gets full value for his money. All over-heads and provocative expenditure should be avoided.

Keynes in his book "General Theory" (Written in 1936), has attributed the increased industrial production as a result of the First World War to the increased demand. After the Second World War the emphasis has once again turned to limiting the Defence expenditure. This caused unemployment as very large number of people who were employed in the Defence industry, been laid off. Unlike after the First World War when various countries were economically not prepared to undertake this burden of unemployment which took nearly a decade to be absorbed, by the end of Second World War the economies had well developed and the economic growth of these countries after the War was much faster.

Many scholars have used the term "Economic War Potential": It usually means the maximum fully utilised capabil-
ity of an economy to supply the men and materials required to fight a War'. This depends on political and moral factors which fluctuate with circumstances. The time available to convert the resources to war potential directly affects the war output. There are only two exceptions: Firstly, the vagueness or uncertainties of the war and Secondly, the technological developments which tend to greatly reduce the significance of war potential. The "Economic War Potential" is less decisive against subversive elements operating in Mizoram, Punjab, Jammu & Kashmir, Assam, etc where sabotage, assault by infiltration, civil war and similar techniques are employed. Diplomacy is likely to pay higher dividend than military action in such situations.

The foreign policy of nation is based on the military and economic strength of a nation. Military strength in-turn depends on economic strength. However mere economic strength is not adequate, as it must be converted into military strength to meet the perceived threat to national security.

**Threat Perception**

Threat perception is identifying and arriving at a reasonably accurate assessment of the nature and source of challenges and threats to a country. An under-assessment of threat perception may release greater resources for develop-
ment, but the consequent lower level of Defence preparedness, in itself may create conditions for disturbance by a potential adversary. The experience of 1962 Chinese aggression cannot be forgotten by the Indian planners when the Defence expenditure was a meagre 1.5 to 1.9 percent of GNP and the Defence preparedness was totally neglected.

**Geographical Parameters**

The sheer size of India, forces her economy to devote enough resources for guarding her national frontiers: The land frontier with China, Burma, Bangladesh, Nepal and Pakistan is nearly 15,200 kilometers and the territorial sea limit extends over 7500 kilometres. The island territories in the Bay of Bengal are more then 1100 kilometres from the Indian mainland. Besides the territorial sea limit extends to 12 kilometres and Exclusive Economic Zone (EEZ) 200 kilometres into the sea. The Indian land mass has an area of about 3.2 million square kilometres which includes substantial under water assets. India is the seventh largest country in the World.

**Political Environmental Factors**

The requirement to meet the threat from her neighbours, particularly China and Pakistan, is generally taken as the
basis for discussing the quantum of Indian Defence forces and the expenditure thereof, by the military experts. It is felt that during the next few years, China would be preoccupied with internal economic problems and those generated by collapse of the USSR. China is modernising her economy, with special emphasis on agriculture, industry, science and defence. After the visits of high level delegations from both the countries during the recent past, Chinese attitude towards India indicates a conciliatory and accommodative approach demonstrative of a desire to maintain peace and tranquillity.

As regards Pakistan, even though our relations with her are on normalisation track and we cannot afford to relax our Defences and impose cuts in the Defence expenditure. The global events seem to have been of little consequence to Pakistan. She continues to prop up the Kashmir issue in international forums. Pakistan has always had a compelling urge to be seen as the leader of the Islamic World. She has spared no effort in the past towards the achievement of this goal. She is likely to continue interfering in India's internal affairs and aim at involving India in Low Intensity Operations (LICO). The 'Babri Masjid' episode has provided her additional scope for exploiting her anti-India campaign. There is no doubt therefore, that she would build on this state of affairs to her advantage and India must
therefore, take suitable steps to guard against this.

India's other neighbouring countries like Bangladesh, Srilanka and Mayanmar are likely to continue their love-hate relationship with India. The socio-economic and ethnic issues would dominate, but would remain subdued. These countries may continue to provide covert support to forces unamenable to India, thereby requiring constant vigil on the borders. India needs to initiate urgent steps to ensure that existing level of bilateral relations show a marked improvement. With India's unresolved border problems with China, it is necessary that our politico-military thrust towards Bangla Desh aims at dispelling Bangla Desh's fears from India.

There is no doubt that India's relations with her neighbouring countries are improving, which is a very healthy sign and perhaps calls for restricting her Defence expenditure and diverting resources for development purposes, yet she cannot relax her guard, as the intentions take very little time to change, whereas building up of Defence capability requires a long lead time.

The Armed Forces have an important role to play for the maintenance of internal political stability of a nation. This aspect is significant, as far as nations of the third world
are concerned. Ever since independence India has had a number of very serious insurgency problems in various parts of the country: The Naxalite Movement, the agitation relating to 'Foreigners Issue in North Eastern States', the 'Punjab Terrorists Problem', the 'Gorkha Land Issue', the 'Bodo Land Problem' and more recently the Kashmir Issue are some of the glaring examples of insurgency in India. Defence Services have been involved in a big way for quelling these problems. This has essentially resulted in higher Defence expenditure.

It is very encouraging to note, that political thinkers, the world over, think that India is capable of emerging as a 'Regional Power Centre'. It is therefore for India to claim and achieve this position for which she will have to be strong enough to assert herself and prove her supremacy in the area of her influence. This indeed calls for substantial increase in her Defence expenditure. The efforts of International Monetary Fund (IMF) to insist on reduction in India's Defence expenditure, which is already very low as compared to her adversaries, as also Global Defence Expenditure, while negotiating economic assistance to her may be seen as an effort to deprive her from becoming the 'Regional Power Centre' which she is capable of becoming.
Technological Environmental Factor

In 1947 when India attained Independence, the industrial base and the technological level were of a rather low standard. The British believed in taking raw materials from India and selling back finished goods at good profit. The capabilities to produce weapons and other Defence stores were non-existent. The Ordnance Factories were only producing clothings and allied items for the Services. Most of the hardware, heavy machines and special materials had to imported.

The problems faced by India's Defence industries, for their development are:-

(a) Shortage of financial resources.
(b) Special materials required for the production of weapons were not indigenously available and hence had to be imported.
(c) As skilled workers were not available for the manufacture of armaments, substantial amount had to be spent on their training.
(d) Under-developed technology and techniques.

As a result of the above mentioned problems, the construction cost of various products in India, have been very high: Construction cost of HD-748 aircraft in India was $
Material costs in the developing countries such as India are comparatively high, due to the following reasons:

(a) The Government is forced to heavily subsidise to encourage indigenous production.

(b) Parts or components imported from the developed countries are generally costly as compared to finished products due to their high transportation costs.

(c) Because of resource starvation caused due to extensive utilisation in the field of Research and Development (R&D) and the 'produced equipment testing facilities'.

The Indian ship building industry has fared better in terms of pure economics. Profits have been steadily increasing, although a foreign exchange outflow has lately occurred owing to the purchase of weaponry, electronics and other equipment. However in terms of the Defence development plans of the Indian Government, this industry has not been accorded a high priority. The Defence oriented industry has now developed and it is expected that the estimated production cost for new and indigenously designed weaponry will decrease considerably. A properly developed Defence industry has a multiplication effect on employment, economic growth
and overall development of the country. If Defence industry is allowed to develop in the private sector, the multiplier effect is likely to be much higher than in the public sector.

**Effect on Defence Expenditure**

While the increase in India's Defence expenditure over the last four to five years has been very marginal, in fact, not even enough to compensate for the rate of inflation, the cost of weapons and equipment are increasing at very high rate as can be seen from the following examples:-

(a) T-72 Tank which cost Rs 1.5 crores in 1985 is priced for Rs 3.5 crores (approximately) today. MBT Arjun is under development in India. Its production is expected in 9th plan, when each tank may cost as much as Rs 7.5 crores.

(b) Mirage 2000 aircraft which was available for Rs 24 crores in 1985 was Rs 47 crores in 1989 and is quoted for Rs 60 crores at present.

(c) Cost of 'Naval Tanker' increased from Rs 65 crores in 1985 to Rs 159 crores in 1990. Similarly, a Destroyer which costs Rs 466 crores today was available for Rs 293 crores in 1989.
Even replacement of existing equipment, stores and weapons procured through Defence Public Sector Undertakings (PSUs) and Director General of Ordinance Factories (DGOF), of which the Defence Services are captive customer, has been costing very dearly.

To keep pace with her adversaries and to keep the Armed Forces well equipped with 'state of the art' equipment, to achieve the goal of operational preparedness, it is imperative that India's Defence allocations are substantially hiked.

**Economical Environmental Factor**

Benoit had deduced, that Defence expenditure had both 'adverse' and 'favourable' effects upon the economic growth:

The adverse effects are :-

(a) The growth of a country is limited, because the Defence establishments use resources which might be otherwise employed for development purposes.

(b) The resources spent on Defence Services exhibit no observable productivity increases, hence the resources got transferred to a relatively productive sector.

(c) An increase in Defence expenditure lowers the GNP.
The combined effect of the above mentioned factors has been calculated at 0.25% per year. The trends between pattern of imports and Defence budgets between 1956 and 1976 in India, have generally followed the same pattern.

The aggression on India by Pakistan in 1947-48 and massive arms aid by USA to Pakistan, forced India to develop tangible military strength. The conflict in 1962 with China further forced India to build-up her Defence preparedness at a faster pace. Even though import of arms increased substantially, the need to expand the indigenous sector was realised. Indian Defence expenditure trebled in the next four years: During 1962-65, India imported weapons worth $140 million from USA and UK. Erstwhile USSR set up three Mig Assembly plants in India.

The Indo-Pak Wars of 1965 and 1971 necessitated, that Indian Defence forces be maintained and equipped at the appropriate weapon technology level. As Vice Admiral WE Perry said, "India's geographical position should enable her Naval and Air force to dominate the Indian ocean. A powerful and developed India might change the equation of power in the region in the process upsetting the existing dominant voices. The emergence of such an India will be most definitely challenged and attempts made to put impediments in her path of economic development".
Besides providing National Security, the armed forces can play the following crucial roles:

(a) Graduating the economic assets.

(b) Helping in the actual process of development eg, construction of border roads, educational facilities, expanding mass communication facilities, etc.

(c) Achievement of developments in various fields, through spin-off effects of Defence R&D and technology into areas such as nuclear science, space, avionics, oceanography, etc. Besides, by civil applications and finally by promoting national integration: Because today, one of the organisations holding India together is her Armed forces.

Indian economy has been under mounting pressures throughout the 1980s. It however assumed crisis proportions by the beginning of the fiscal year 1990-91. The Gulf Crisis worsened the already precarious fiscal situation. In addition to imposing an additional burden on our foreign reserves, the Government had to spend Rs 300 crores on repatriating Indians stranded in Kuwait. The fiscal deficit which measures the resource gap, rose to more than 8 percent of GDP as compared with 6 percent at the beginning of 1980 and 4 percent in mid 1970s.
The Budget 1991-92 (presented on 24 Jul 91) took a bold step in the direction of correcting the fiscal imbalances. It envisaged reduction in fiscal deficit from 8.4 percent of GDP in 1990-91 to 6.5 percent of GDP in 1991-92. In real terms, this involved a fiscal correction of nearly Rs 12000 crores. This was supported by essential reforms in economic policy initiatives.

Perhaps the major reason for this grim state of affairs has been the low productivity of our Central Government enterprises. As compared to some of the industrially advanced nations like Japan, Taiwan and Korea perhaps India has much more natural resources. The difference between India and those countries is only due to inefficiency in the management of the same.

There were 246 'Central Government Public Undertakings, (CPU's) as on 31 Mar 91 out of which 236 were in operation. Net profit of these Undertakings declined from Rs 3789 crores in 1989-90 to Rs 2368 crores in 1990-91. The rate of return as measured by the ratio of net profits to capital employed, declined from 4.5 percent in 1989-90 to 2.3 percent in 1990-91. Like in previous years, 90 percent of the total profit came from 'Petroleum Sector' undertakings. The situation in State Commercial Undertaking's is perhaps the worst. Of all the states and Union Territories run enter-
prises, only the Forests and Mines Departments have been generating net surplus. The overall losses from other sectors were estimated as a staggering Rs 1827 crores during 1991-92. Delhi Electric Supply Undertaking (DESU) accumulated losses to the tune of Rs 392 crores and Delhi Transport Undertaking (DTC) Rs 306 crores in 1990-91. Though the social costs and subsidising of fares and taxes are advanced as reasons for justifying the losses, but the fact remains that non-business-like and unprofessional approach in managing the government undertakings are responsible for these losses. For example, the DTC employs 9.5 workers for every bus operated by them, as against 4 to 5 workers per bus in countries like Korea and Taiwan. Whereas all State owned steel plants in India employing two lakh workers produce eight million tones of steel per year, in South Korea a single state owned plant employing 14000 workers produces 10 million tonnes of steel per year.

Even if a capital of over Rs 100000 crores invested only in the Central run Public Enterprises generates a profit equivalent to Bank interest ie 13 percent per annum, our entire budgetary deficit will be wiped out.

Seeing the general economic situation and the sacrifices the people have to make to reduce the resources gap, perhaps there is a case for reduction or at least restrict-
ing the Defence expenditure.

Considering the political and technological developments, there is a requirement to invest substantially in Defence, particularly if we wish to claim the Regional power status, which we are capable of. Considering the dismal economic situation, our Government perhaps may not be able to afford any increase in the Defence expenditure.

Indian Ocean has a new geo-strategic importance in International arena. In case India has to protect its island territories as also its wealth in the Exclusive Economic Zone (EEZ), it must build a strong Navy.

It is important that besides other factors, threats to her National Interests are taken into account while planning Indian Defence Expenditure. No doubt, the state of economy will play a major role in dividing such expenditure yet it is of paramount importance that the integrity and sovereignty of the country is not jeopardised by restricting resources for National Security. It is becoming clearer that in the future wars will be fought with most sophisticated weapons. All the three wings of Defence and Para Military Forces have to be equipped with the latest equipment. Investment in these and the upgrading technology is not a one time proposition, but a continuous demand. The cost of
technology is growing at an astronomical rate and will have major impact in Defence expenditure. A judicious assessment of various factors such as political, technological and economical which affect the Defence expenditure mainly, are therefore an important aspect to be examined while allocating resources.