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MP-IDSA Commentary

Creating Conditions for Utilisation of Higher Defence Outlay

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Summary

Defence expenditure must be aligned with operational requirements and the MoD's capacity to utilise the funds rather than be pegged to a certain percentage of the GDP.

According to Stockholm International Peace Research Institute (SIPRI), the total world military expenditure in 2024 was US$2718 billion. This was 9.4 per cent higher than in 2023, representing the steepest year-on-year increase since at least 1988. Military spending has been rising yearly for a decade, registering a growth of 37 per cent between 2015 and 2024.[1]

Bucking the trend, India not only slipped one notch to become the fifth largest spender on defence in 2024, but the annual increase of 1.6 per cent in its defence budget in 2023–24 (as per SIPRI) was also very modest compared to the first four largest spenders: the United States of America (5.7 per cent), China (7 per cent), Russia (38 per cent), and Germany (28 per cent).[2]

This is unlikely to have escaped the attention of those who favour India's military expenditure being pegged at a minimum of 3 per cent of its Gross Domestic Product (GDP). It will not be surprising if the parliamentary Standing Committee on Defence (SCoD)—a strong proponent of this idea in the past—reiterates this recommendation with reinforced vigour in one of its forthcoming reports. However, it has not been favoured by successive governments.

Replying to a question in Lok Sabha on 8 December 2023, the then Minister of State Ajay Bhatt had said,

> Defence expenditure as a definite percentage of total Government expenditure/GDP cannot be ensured because resource allocations are made among various competing priorities on a need basis.[3]

The Ministry of Finance (MoF) took a similar stand more than a decade ago when SCoD questioned it.

The case for a hike in the defence budget is generally built around the argument that the current level of funding is inadequate for the rapid modernisation of the armed forces. The paucity of funds inhibits the acquisition of the equipment required by the armed forces, as the acquisition plans get staggered because of financial constraints. Considering the long list of capital-intensive equipment, weapon systems, and other major platforms required by the armed forces, this argument is not without merit. However, the inadequacy of funds is not the only factor impacting the acquisition pace.

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[1] Xiao Liang, Nan Tian, Diego Lopes da Silva, Lorenzo Scarazzato, Zubaida Karim and Jade Guiberteau Ricard, "**Trends in World Military Expenditure, 2024**", Factsheet, Stockholm International Peace Research Institute (SIPRI), April 2025.

[2] Ibid., p. 2.

[3] "**Lok Sabha Unstarred Question No. 1110 answered on 08 December 2023**", Lok Sabha.

Writing for *The Times of India*, Somnath Mukherjee, CIO of an asset and wealth management firm, revived a dormant dimension of this discourse by arguing that India could counteract the slowing economic growth by increasing defence spending to 2.5 per cent of the GDP, provided the spending is domestic and the actual war does not hit us. He also acknowledged that military spending as a facilitator of economic growth is a contested axiom for moral reasons.

Even if moral compunction is kept at bay and there is a one hundred per cent certainty that higher military expenditures will spur economic growth, it will take a lot of work to raise the defence outlay to 3, or even 2.5 per cent, of the GDP and, more importantly, for the Ministry of Defence (MoD) to utilise the allotted funds. In other words, it cannot be a quick fix for any real or perceived economic slowdown.

Let us examine this proposition concerning the current financial year’s (FY 2025–26) defence outlay of Rs 6,81,210 crore, which accounts for 1.91 per cent of the GDP. An additional sum of Rs 211,238 crore or Rs 389,728 crore would have been needed to raise the outlay to 2.5 or 3 per cent of the GDP, respectively. Extrapolating it to the coming years, approximately Rs 2–4 lakh crore will be required yearly to keep the defence outlay at 2.5/3 per cent of the GDP, beginning with the next financial year.

It would be a significant challenge for the finance ministry to squeeze out that kind of additional money year after year without raising additional revenues, primarily via taxation, borrowing, or other means like disinvestment. The Finance Ministry could also curtail the allocation to different sectors, including health, education, infrastructure, agriculture and poverty alleviation. These sectors are in desperate need of higher outlays. Moreover, there are severe political and fiscal limitations on exercising these options.

Assuming the finance ministry can raise the defence outlay to 2.5/3 per cent of the GDP, it cannot be earmarked for capital expenditure (CAPEX). The economic argument would prefer this because CAPEX suits an enterprise's long-term growth by boosting its revenues and profitability. In contrast, revenue expenditure affects its cash flow and profit margins. This logic does not work very well in the case of defence.

Higher capital expenditures are bound to push up one-time and recurring revenue expenditures on infrastructure, workforce, training, maintenance, etc., associated with the capital acquisitions. This implies that the revenue budget will also have to be raised as a result of the increase in capital outlay, jeopardising the government’s efforts to contain the overall revenue expenditure to maintain fiscal stability.

It is true that CAPEX, which promotes domestic industrial manufacturing and associated activities, can generate employment and help the defence industry move up the value chain. Yet, to sustain this outcome, the MoD must keep increasing CAPEX every year to purchase locally manufactured products from the Indian industry.

The government may earn some revenue on that part of the CAPEX, which will help the public sector enterprises increase their exports, but these returns cannot be substantial. This is evident because while the exports have grown exponentially in recent years, India does not figure among the first 25 major exporters.[4]

At any rate, the MoD may find it hard to handle a substantial hike in the defence outlay, particularly the CAPEX, unless a long-term acquisition plan is in place and there is considerable improvement in the MoD's capacity to utilise the allocated funds. In the FY 2024–25 alone, a sum of Rs 12,500 crore lapsed as the entire capital outlay could not be fully used by the end of the financial year.[5] This has happened every year despite the formulation of Annual Acquisition Plans and numerous efforts to streamline the procurement procedures.

To conclude, unless these issues are addressed, any substantial hike, much less a hike that pegs the defence outlay at 3 per cent of the GDP, would be fruitless as the unspent capital outlay would keep lapsing at the end of the year, or the entire focus would be on somehow exhausting the budget without much concern for the outcomes.

Under these circumstances, it is advisable to link the quantum of defence outlay with the operational requirements, and the MoD's capacity to utilise the funds and pre-defined outcomes is advisable. While the former is a function of astute defence planning, the capacity to utilise the funds can be optimised only by creating a composite procurement organisation and simplifying the procurement procedures.

[4] Mathew George, Katarina Djokic, Zain Hussain, Pieter D. Wezeman and Siemon T. Wezeman, **"Trends In International Arms Transfer, 2024"**, Factsheet, Stockholm International Peace Research Institute (SIPRI), March 2025.

[5] Ministry of Finance, Union Budget 2025–26, Demand No. 21, Capital Outlay on Defence Services 2025–26.

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