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India's Defence Budget 2025-26: Financial Overview, Challenges, and Modernization Initiatives

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Abstract—**The Ministry of Defence formulates policies related to defence and security and oversees their implementation by the armed forces, including the Army, Navy, and Air Force. Additionally, it manages defence production units such as public sector undertakings, research and development organizations, and support services like the Armed Forces Medical Services. This analysis examines budgetary allocations and expenditure patterns within the Ministry. It also highlights key concerns, including the declining defence expenditure as a percentage of GDP, the significant portion of the budget allocated to pensions, continued dependence on imports for defence equipment, and delays in the indigenous development of military hardware.**

I. FINANCIAL OVERVIEW

The Ministry of Defence's budget covers allocations for the three-armed forces, as well as expenditures on research and development and border road infrastructure. In 2025-26, the Ministry has been allocated ₹6,81,210 crore. This budget includes expenses related to the salaries of military and civilian personnel, pensions, modernization of the armed forces, production units, maintenance, and research and development organizations. The Ministry of Defence receives the highest allocation among all ministries, accounting for 13% of the central government's total expenditure.

Decline in Defence Expenditure as a Share of the Budget and GDP

Despite receiving the largest share of the central budget, the proportion allocated to defence has been gradually decreasing. In 2014-15, defence spending accounted for 17% of the central government's budget, which has now reduced to 13% in the 2025-26 budget estimates. Between 2013-14 and 2025-26, while defence spending grew at an annual rate of 9%, overall central government expenditure increased at a slightly higher rate of 10% per year.

The Standing Committee on Defence (2023) highlighted that a significant portion of India's defence procurements is conducted in US dollars. It recommended that fluctuations in the rupee's exchange rate and inflation should be factored into budget allocations for defence. Between January 1, 2024, and January 27, 2025, the Indian rupee depreciated by approximately 4% against the US dollar.

The Standing Committee on Defence (2018) recommended that the Ministry of Defence be allocated a fixed budget of approximately 3% of GDP to maintain the armed forces' readiness. However, over the past decade, India's defence expenditure has consistently remained below this suggested level. In 2025-26, the country's defence spending is projected to be 1.9% of GDP.

Excluding defence pension costs from the Ministry's total expenditure reduces defence spending as a percentage of GDP by approximately 0.5 percentage points each year. The Ministry of Defence has stated that allocating 3% of GDP to defence would result in significantly higher funding, which the armed forces may not be able to fully utilize. If India were to allocate 3% of its GDP to defence in 2025-26, the budget would need to increase to ₹10.7 lakh crore. Without altering the total budgeted expenditure, this would account for 21% of the central government's proposed spending for that year.

According to the Stockholm International Peace Research Institute (SIPRI), India ranked as the fourth-largest military spender in 2023, with a total expenditure of $84 billion, which includes spending on paramilitary forces. Among the top five military spenders, India's defence expenditure as a share of GDP was higher than only China. However, due to the larger size of China's economy, its absolute military spending was over 3.5 times that of India.

Improvement in Capital Budget Allocation for Armed Forces

The armed forces receive funding based on their projected requirements submitted during the budget planning process. Historically, there has been a gap between the funds allocated and the projected needs under both revenue and capital expenditure. Between 2015-16 and 2024-25, the actual budget allocation for the armed forces was approximately 20% lower than their estimated requirements. In previous years, this shortfall was more pronounced in the capital budget than in the revenue budget. However, in 2023-24 and 2024-25, the capital budget allocation has been aligned with the armed forces' projected needs.

Year of Reforms 2025

The Ministry of Defence has designated 2025 as the ‘Year of Reforms’ to modernize the armed forces and enhance their technological capabilities. The initiative aims to transform the military into a more advanced and combat-ready force. Key areas of focus for 2025 include:

1. Strengthening jointness and integration to support the establishment of integrated theatre commands.
2. Expanding capabilities in emerging domains such as cyber warfare, space technology, artificial intelligence, and robotics.
3. Streamlining acquisition processes to improve efficiency.
4. Promoting technology transfer and fostering collaboration between the defence sector and civilian industries.

Composition of the Defence Budget (2025-26)

For the fiscal year 2025-26, the central government has allocated ₹6,81,210 crore to the Ministry of Defence, reflecting a 6% increase compared to the revised estimate for 2024-25.

- Salaries and Pensions: Spending on salaries is projected to rise by 3%, while pension expenditure is expected to grow by 2%. Together, these components account for 50% of the total defence budget. However, salary estimates may be understated due to the lack of a detailed breakdown for revenue expenditure on Rashtriya Rifles, National Cadet Corps, and the Agnipath cadre.
- Capital Outlay: This category, which covers the procurement of arms, ammunition, and other equipment, is set to increase by 13% in 2025-26 compared to the revised estimate for 2024-25. However, the capital outlay for 2024-25 at the revised estimate stage is projected to be 6% lower than the original budget estimate.

Defence Pension Accounts for Over 20% of the Budget

- Defence pensions cover retirement benefits for personnel from the three-armed services, including civilian employees. These expenditures include service pensions, gratuity, family pensions, disability pensions, commuted pensions, and leave encashment.
- Between 2013-14 and 2025-26, defence pension costs have grown at an annual rate of 11%, surpassing the 9% annual growth in total defence spending. As a result, a significant portion of the defence budget is allocated to pensions. In 2025-26, pensions are expected to account for 24% of the total defence budget.

II. ONE RANK ONE PENSION (OROP) AND AGNIPATH SCHEME

- In November 2015, the government introduced the One Rank One Pension (OROP) policy, effective from July 1, 2014. Under OROP, soldiers of the same rank who have served for an identical duration receive equal pensions, regardless of their retirement date. The pension under this scheme is revised every five years.
- To manage the increasing burden of salaries and pensions, the 15th Finance Commission recommended that the Ministry of Defence take measures to reduce these liabilities. In June 2022, the government launched the Agnipath scheme for armed forces recruitment. Under this scheme, candidates, known as Agniveers, serve for four years in a distinct rank within the military.
- The primary objective of Agnipath is to create a more youthful force, but it is also expected to lower long-term pension expenses. Only up to 25% of each Agniveer batch will be absorbed into the regular armed forces. The remaining personnel will exit after four years with a Seva Nidhi package of Rs 11.7 lakh, but without pension benefits.

Declining Share of Capital Outlay in Defence Budget

- The proportion of the defence budget allocated to capital outlay has declined over the years. Capital outlay includes spending on infrastructure, machinery, and equipment such as tanks, naval vessels, and aircraft, as well as research and development and border road construction.

- In 2013-14, 32% of the defence budget was dedicated to capital outlay. However, since 2014-15, this share has consistently remained below 30%. For 2025-26, the Ministry has allocated 28% of its total defence budget to capital outlay.

Funding Challenges and the Need for a Non-Lapsable Defence Fund

- The Ministry of Defence has emphasized the need for alternative funding sources to meet its growing financial requirements. It highlighted that budgetary allocations have declined over time, making it difficult to finance large defence acquisitions. During 2021-26, the Ministry projected a requirement of ₹17.46 lakh crore for capital outlay but was allocated only ₹9.01 lakh crore, resulting in a 48% shortfall. This persistent gap in funding has affected operational preparedness and created capability deficits across the three services.
- To address these issues, the creation of a non-lapsable fund for defence capital expenditures has been a long-standing recommendation. The interim budget for 2004-05 recognized the necessity of such a fund, proposing a Defence Modernisation Fund with a ₹25,000 crore corpus. In 2017, the Standing Committee on Defence reiterated that a non-lapsable defence capital fund was essential for strengthening operational readiness. The 15th Finance Commission also recommended establishing a Modernisation Fund for Defence and Internal Security, ensuring continuous financial support for long-term defence projects.

III. CHALLENGES IN ESTABLISHING A NON-LAPSABLE DEFENCE FUND

Despite repeated recommendations, the central government has maintained that Constitutional provisions do not allow for the creation of a non-lapsable fund. The government has also opposed placing such a fund in the Public Account without a dedicated source of revenue from taxes, cesses, or other levies.

However, the Ministry of Finance is reportedly working on a separate mechanism to operationalize a non-lapsable Defence Modernisation Fund. The 15th Finance Commission suggested four potential sources for financing this fund:

1. Transfers from the Consolidated Fund of India
2. Disinvestment proceeds of defence public sector enterprises
3. Proceeds from monetization of surplus defence land
4. Revenue from defence land transferred to state governments and public projects

Committed Liabilities and Transparency Concerns

Defence capital acquisitions are divided into two components:

1. Committed Liabilities – Payments due for contracts signed in previous years, given the long gestation period of defence acquisitions.
2. New Schemes – Projects under approval or planning for future implementation.

A major concern is the lack of transparency regarding committed liabilities, as public data on these payments has not been disclosed since 2019-20. This lack of information makes it difficult to assess the actual financial burden of defence acquisitions and impacts budget planning.

Concerns Over Shortfall in Committed Liabilities Allocation

The Standing Committee on Defence (2019) raised concerns over inadequate budget allocation for committed liabilities, warning that this could result in defaulting on contractual obligations. Such defaults could harm India's credibility in international markets, affecting future defence deals.

Recommendations and Current Status

- The Committee recommended the creation of a dedicated fund to cover both committed liabilities and new schemes to ensure timely payments.
- In 2022, the Committee reiterated that a separate fund would help the armed forces meet payment deadlines for major defence acquisitions.
- However, no such fund has been created so far, and funding shortages continue to be a concern for defence modernization efforts.

Analysis of Service Budgets (2025-26)

- Army Revenue Expenditure: Estimated to increase by 5% over the 2024-25 revised estimate.

- Air Force & Navy Revenue Expenditure: Projected to increase by 8% each.
- Defence Pension Impact: Pension expenditure is higher by ₹8,000 crore, attributed to a recovery from the deposit account. However, the specific impact on each service (Army, Navy, Air Force) is not detailed.

This indicates a steady rise in operational costs while highlighting uncertainty in pension-related allocations across the services.

Army Budget Analysis (2025-26)

- Largest Force: The Indian Army is the largest among the three services in terms of budget and personnel strength.
- Personnel Strength: As of January 2022, the Army had an authorized strength of approximately 13 lakh personnel, including officers and soldiers.
- Revenue Expenditure: Due to its large workforce, the Army has consistently allocated over 80% of its budget to revenue expenditure, covering salaries, pensions, maintenance, and operational costs.

This highlights the personnel-heavy structure of the Army, which results in lower capital outlay for modernization compared to the Air Force and Navy.

Modernization of the Indian Army: Challenges & Recommendations

Current State of Equipment

The Indian Army's modernization is lagging behind the ideal standard for a modern force:

- Ideal Requirement:
  - 30% new generation equipment
  - 40% current generation equipment
  - 30% older generation equipment
- Current Status:
  - 15% new generation
  - 40% current generation
  - 45% older generation (outdated systems)

Key Challenges & Recommendations

1. Capital Budget Constraints
   - The Standing Committee on Defence (2023) recommended increasing the Army's capital budget to fund modernization and ensure deterrence capacity against two hostile neighbors.
2. Planned Acquisition & Indigenization
   - The Ministry of Defence has planned 500+ acquisition schemes for the Army over the next 15 years. These focus on:

- Battlefield Awareness & Surveillance
- Command & Control Systems
- Sustenance & Support Systems
  - Indigenous Ammunition Production:
- As of December 2024, 90% of ammunition variants used by the Army have been indigenized under Make in India efforts.

The Way Forward

- Higher capital allocation to meet modernization goals
- Faster procurement of new-generation weaponry
- Greater focus on indigenous defense production for self-reliance

The Army's modernization drive is crucial for operational readiness, but budget constraints remain a major challenge.

Provision of Clothing & Equipment for High-Altitude Troops

Challenges Identified by CAG (2020):

- Delays in procurement of high-altitude clothing and equipment (up to 4 years).
- Acute shortage of snow goggles, essential for protecting troops in extreme cold.
- Multi-purpose boots were not issued from Nov 2015 – Sept 2016.
- Troops received old versions of critical gear (face masks, jackets, sleeping bags), affecting their performance in severe conditions.

Budget Allocation for 2025-26:

- The government has allocated ₹28,654 crore for stores expenditure, covering:
  - Weapons replacement
  - Rations & fuel
  - Clothing & other necessities
- This constitutes 14% of the Army's revenue budget.

Recommendations for Improvement:

1. Timely Procurement & Inventory Management
   - Implement a faster procurement cycle to avoid shortages.
   - Maintain a buffer stock of essential items like snow goggles and boots.
2. Upgrading Equipment
   - Replace obsolete clothing & gear with modern, high-performance alternatives.
   - Prioritize troop safety & operational efficiency in extreme conditions.
3. Strengthening Indigenous Production

- Encourage domestic manufacturing of specialized clothing & equipment.
- Reduce dependence on imports for critical items.

Ensuring timely access to high-quality gear is crucial for troop effectiveness in high-altitude areas like Siachen.

Indian Navy: Modernization & Challenges

Threats to Maritime Security

The Indian Navy is focused on countering two major types of threats:

1. Traditional threats – From China and Pakistan.
2. Non-traditional threats – Piracy, drug trafficking, and illegal activities in maritime zones.

Modernization Efforts

- Increase in expenditure on naval modernization since 2020-21.
- 65 ships & submarines currently under construction for induction.

Challenges & Delays in Procurement

1. Project-75 (Submarine Induction Program)
   - Planned six submarines to be inducted by December 2017.
   - Multiple delays extended the timeline to December 2024.
   - Final submarine commissioned in January 2025.
2. Shortage of Aircraft & Helicopters
   - Reconnaissance planes & transport helicopters are below the required numbers.
   - This affects surveillance, search & rescue, and strategic mobility.

Recommendations for Improvement

- Timely completion of planned procurements to strengthen India’s naval presence in the Indian Ocean Region (IOR).
- Accelerate indigenous shipbuilding to reduce delays and dependency on foreign vendors.
- Enhance surveillance capabilities with advanced reconnaissance aircraft & helicopters.

The Indian Navy’s modernization is crucial to maintaining maritime security and deterring adversarial threats in the IOR.

Indian Air Force: Modernization & Budget Constraints

Largest Share in Modernization Spending

- Among the three-armed forces, the Indian Air Force (IAF) receives the highest allocation for modernization.
- Investments focus on fighter jets, missile systems, transport aircraft, and UAVs.

Budget Constraints & Challenges

- Funds allocated for modernization remain insufficient to meet the Air Force’s full requirements.
- Aging fleet issue – A significant portion of IAF's aircraft are older generation and require urgent replacement.
- Delays in procurement of critical assets like fighter aircraft, drones, and advanced radar systems impact combat readiness.

Key Modernization Priorities

1. Induction of new fighter jets – Procurement of Rafale jets, Tejas (LCA), and AMCA (Advanced Medium Combat Aircraft).
2. Strengthening air defense – Deployment of S-400 missile systems and indigenous Akash missiles.
3. Upgrading transport and surveillance aircraft – Increasing airlift and reconnaissance capabilities.
4. Boosting drone warfare capabilities – Acquiring combat and surveillance UAVs for advanced aerial operations.

Recommendations for Improvement

- Increase capital budget for modernization to meet operational needs.
- Fast-track procurement processes to avoid delays in acquiring advanced aircraft and weaponry.
- Strengthen indigenous production to reduce reliance on foreign suppliers.
- Enhance pilot training & technological advancements to ensure combat readiness.

With rapid technological advancements in aerial warfare, adequate funding and timely execution of modernization plans are essential for maintaining IAF’s superiority in the region.

Challenges in Indigenous Fighter Aircraft Development & Air Force Readiness

Delays in the Light Combat Aircraft (LCA) Program

- Project sanctioned in 1983, with an expected completion timeline of 8–10 years.
- Due to technical issues and delays, the first version of the LCA (Tejas) was inducted only in 2016.

- Hindustan Aeronautics Limited (HAL) has struggled to meet delivery timelines, leading to supply delays.

Current Fighter Squadron Shortfall

- Authorized strength: 42 fighter squadrons.
- Actual strength: 31 active squadrons, creating a deficiency of 11 squadrons.
- The shortfall may worsen as ageing MiG-21 and other legacy aircraft are phased out.

Standing Committee on Defence (2023) Observations & Recommendations

1. Need for at least 180 fighter jets to maintain operational strength.
2. Delays in LCA supply should be addressed by:
   - Boosting domestic production.
   - Exploring direct purchase of 5th-generation fighter jets from foreign suppliers.
3. Insufficient capital funding for new fighter aircraft procurement should be rectified.

Mitigation Strategies

- Accelerating LCA production – HAL must streamline manufacturing to meet Air Force demands.
- Over-the-counter procurement – Consider importing 5th-gen fighter jets (e.g., F-35, Su-57) to fill gaps.
- Upgradation of existing fleets – Contract signed for MiG-29 engine procurement (₹5,000 crore) to sustain operations for the next 15 years.
- Avoiding past upgrade delays – Example: A 2008 aircraft upgrade contract was delayed by 8 years, only completed in 2022. Future modernization should stay on schedule.

To maintain air superiority and combat readiness, the Indian Air Force must accelerate indigenous aircraft production, secure additional funding, and explore interim procurement solutions.

Key Issues in India's Defence Procurement and Modernization

1. India as the Largest Arms Importer

- India accounted for 10% of global arms imports (2013–2023), making it the largest arms importer, followed by Saudi Arabia, Egypt, and Qatar.
- 271 capital acquisition contracts signed (2023–24 & 2024–25 up to Sept 2024), out of which only six were with foreign vendors (Russia & USA).
- Major foreign procurements include assault rifles and missiles.

2. Declining Dependence on Foreign Defence Imports

- Between 2014–15 and 2022–23, over 30% of modernization expenditure was spent on foreign procurement.
- In 2023–24, this was reduced to 28%, signaling greater reliance on domestic manufacturing.

3. Risks of Foreign Dependence

- Strategic Vulnerability: Over-reliance on foreign suppliers poses security risks during emergencies, as suppliers may refuse weapons, spare parts, or support.
- Supply Chain Disruptions: Geopolitical factors (e.g., Russia-Ukraine conflict) can impact timely delivery of critical military hardware.

4. Recommendations for Enhancing Domestic Defence Manufacturing

- Promote Indigenous Defence Production:
  - Increase funding for domestic defence firms (both public & private).
  - Encourage collaborations between DRDO, HAL, and private defence firms.
- Policy Support for Private Sector:
  - Extend tax incentives, R&D grants, and ease of doing business reforms to boost Make in India for defence.
  - Expand Defence Production Corridors in states like Uttar Pradesh and Tamil Nadu.
- Strengthen Export Capabilities:
  - Encourage India-made defence equipment exports to reduce dependency on foreign vendors.
  - Leverage initiatives like Atmanirbhar Bharat (Self-Reliant India) in Defence.

IV. CONCLUSION

While India remains the largest arms importer, it has reduced foreign dependency in defence modernization. Strategic investment in domestic defence manufacturing will not only enhance self-reliance but also improve national security resilience.

The Ministry of Defence plays a crucial role in shaping national security policies, overseeing armed forces operations, and managing defence production and research. While it receives the highest budget allocation among all ministries, its expenditure patterns reveal key challenges, including declining defence spending as a percentage of GDP, an increasing burden of pensions, and funding constraints for capital acquisitions.

Efforts to modernize the armed forces under the ‘Year of Reforms 2025’ and initiatives like the Agnipath scheme aim to improve efficiency and long-term sustainability. However, continued dependence on imports for critical defence equipment and delays in indigenous production highlight the need for stronger domestic manufacturing capabilities.

Addressing funding challenges through a non-lapsable defence modernization fund, improving transparency in committed liabilities, and ensuring adequate capital outlay are essential for maintaining operational readiness and strategic deterrence. As India moves forward, a balanced approach between fiscal discipline and military modernization will be key to enhancing national security and defence preparedness.

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