



## CHAPTER 2

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### *Rationale and characteristics of the defense sector*

The defense budget exhibits certain particular features defined by history, political circumstances and each country's strategic project as well as by the type of activity itself. Thus, there are some specific aspects to be considered that affect not only budget oversight and transparency assurance procedures but also the strategies to be followed with regard to its treatment. This implies taking into account the political variables mentioned above and certain technical issues internal to the budget. This does not mean that this budget has to be given a different treatment from that accorded to the general budget of the Nation.

The public budget is the natural materialization of the Nation's political will. It may be said that every political proposal is only limited to words until it is reflected in the budget. The same happens with national defense. Otherwise, it would be impossible to make the necessary connection between defense actions and the activities of other public sectors. All national sectors have specificities. Each country has to analyze whether its reserves and the earmarked funds of defense budgets are related to the sector's particular characteristics, and to what extent they are the result of complex political relations or sectorial interests.

We will now examine some of the particular characteristics to be considered when addressing the defense budget.

## 2.1 *Defense is a public good*

The economic system prevailing in Latin America (capitalism), identifies the market as the best mechanism to resolve problems arising from the production, distribution and consumption of private goods. However, besides private needs, there are public needs that cannot be efficiently met by the market. The satisfaction of those needs through the so-called public good has been one of the arguments almost unanimously accepted by doctrine to justify the State's involvement in the economy of a country. In the case of defense, the need for its supply by the State derives from the very essence of this political organization: Which was one of the first *raison d'être* of the State if not the citizen's need for an entity to provide protection against external threats?

This starting point defines the first particular characteristic of this budget: national defense, contrary to other goods and services provided by the State, is a pure public good. Public health and education are also considered as public goods by economic theory, but the difference between those goods and defense is that defense is part of the concept of the State itself.

Moreover, defense is a non-rival and non-exclusive good. It is non-rival because the delivery of defense to a citizen does not result in the reduction in the amount of the good for another citizen. It is also non-exclusive, because it is not possible to exclude from the benefits of defense persons who do not pay for it. In other words, it is not possible to preclude anyone from enjoying the benefits of such consumption. In practice, this means that nobody should feel more defenseless in his/her country when a new fellow national is born. It is impossible to deprive certain individuals (such as tax evaders) from enjoying the feeling of protection granted by the mere existence of the Armed Forces. Therefore, defense is a typical public good. Its provision and financing must be provided exclusively by the national government.

The uniqueness of the product offered by defense lies precisely in the idea of public good. One of the major economic measurements used to define a budget is the relation between allocated resources and the results obtained with them. The resources assigned to defense can be readily identified, but the results are hard to define and even harder to measure. The subsidiary contribution of the private sector to health and education, for example, provide the State with several organization and operating parameters to design its public policies, even if it ultimately decides to grant a higher priority to criteria other than efficiency.

One cannot measure with any accuracy the defense obtained and compare it against the expenses incurred. Even in specific, well-defined cases, this kind of analysis would be extremely complicated. What is more, the analytic limits become stricter if one incorporates concepts such as the country's "security", which are almost impossible to measure according to financial models. Defense lacks any automatic efficiency indicators; only in a war can the efficiency of the expense be "proved", and even then, it would be impossible to affirm with any degree of certainty if victory or defeat were the exclusive product of a budgetary allocation. The picture is even more complicated, if we consider that one of the specific objectives pursued by the public defense policy is "deterrence" from possible war conflicts, but it would be practically impossible to measure whether the absence of conflict can be explained by the budget assigned to defense.

However, the resources assigned to defense can be measured in financial terms. They usually comprise the following elements:

- a) Personnel and associated costs (salary, retirement, training).
- b) Military equipment and maintenance.
- c) Normal overhead and other costs related to technology generation and acquisition.

On the other hand, the results cannot be measured in the same way. For this reason, defense cannot be considered as an end in itself, but rather as an instrument to achieve other purposes. An isolated analysis of defense is a dangerous methodological mistake, one that is liable to compromise the desired transparency and adequate national budgetary planning. What is the alternative to this? What does a non-isolated analysis of defense imply? What are the elements to be included in a proper analysis? The response will depend on the integration of information from different areas of knowledge and public activity.

## *2.2 Defense implies managing sensitive information*

The second major characteristic of the defense budget is that the information it handles sometimes prevents the use of transparency and accountability concepts in the same direct way as in any other public policy (i.e. making a public disclosure). There is sensitive information requiring certain levels of confidentiality, such as technological developments or intelligence activities

which the country does not wish to disclose.

This does not imply that defense management can be conducted without any control or with high levels of executive discretion. Although information cannot be publicly disclosed, accountability can, and must, be applied to the citizens' representatives. Legislation clearly establishing the mechanisms of secrecy, confidentiality and information with respect to the Legislative branch is key to ensure transparency in the use of resources and avoid both discretionary policies and acts of corruption. Solid institutional oversight mechanisms must, therefore, be established in order to prevent confidentiality from becoming a shield concealing something else besides national interests.

In the Latin American region, a veil of secrecy has surrounded this activity. This secrecy was related with a true need to keep the country's capabilities and intentions hidden from an eventual enemy, which was described as "national security reasons". Any opening with regard to the country's capabilities would grant substantial advantages to any potential aggressor, who would thus be in a position to calculate -with a higher degree of certainty- its chances of success or failure in the case of an attack. In this scenario, the uncertainty arising from the concealment of information is a material contribution toward the projection of the country's deterrent capacity. This was a relevant factor in the security context based on a power balance.

However, it is important to stress that both the changes in security relations between countries and new information technologies have eroded the importance of confidentiality. In any event, we have to admit that, in Latin America, a debate on the matters that should be kept secret or confidential within the national defense sphere has yet to take place.

### *2.3 Defense is not always a matter of public attention*

The existence of a military instrument at the disposal of the State implies two aspects which are central to the sector: this military instrument is designed in such a way that its mere existence creates a deterrent effect guaranteeing, to the extent possible, that it will never have to be used; on the other hand, the possibility that the military instrument will be used must always be latent.

The ownership of any type of good is based on the same rationale: even if held with the mere purpose of accumulating it, the possibility to use it must continue to exist in order for such ownership to make sense. Implies to look at it, to show it to others, to feel safe and protected, etc. And this means that the properties of the stored good (money, valuable objects, stamp collections) remain unaltered and if possible, improve over time. This is because a fundamental characteristic of goods is their ability to satisfy needs. This property is called *utility*, according to economic science.

The utility of a good also implies a certain scope: it meets a specific need and its nature consists of satisfying such need not only in an efficient but also feasible way. To own something means to know what can be done or achieved with it, i.e., what need it can help meet. Therefore, needs result from an objective reality men and society are immersed in. Thus, at the time of making a decision, not only aspirations but also possibilities must be considered. The best decision is made when, after contemplating both aspects of the same reality, both the means and the ambitions serve a credible and possible objective.

In the sphere of defense strategy and its corresponding military strategy, the scope of use of the military instrument differs according to the particular need to be satisfied. Global actors such as the United States have a military instrument with a global scope. With their military instruments, medium-sized actors such as the European States mainly seek to prevent any actions in their territory, but also contemplate other purposes (such as defending their political and economic interests in the Mediterranean area) through a greater asset: military alliances and security organizations.

Small countries face a different dilemma with regard to defense. With scarce resources and severe internal social and economic needs, their military instrument does not, and will never, extend beyond their borders. In such cases, the usefulness and scope of national defense will usually not arouse any public attention. The enjoyment of peaceful periods or the absence of perceived threats can be assumed as natural benefits more than as a consequence of defense activities. Defense is a desirable insurance but is not naturally perceived as a part of daily life: it is there to guarantee peace and it is only expected to appear in case of a conflict.

The legitimacy of the defense budget will therefore be fundamental to attain social acceptance. If there is a natural economic relationship between scarce resources and infinite needs, then an excessive allocation of resources to defense may take away social expenditures which are highly valued by the

people. In the mid 50's, American President Dwight D. Eisenhower liked to say that the cost of a modern bomber was similar to the cost of thirty schools in different cities, or two power plants, or two fully equipped modern hospitals. A modern destroyer cost equaled that of houses for over eight thousand people. The development of a balanced defense program and its conversion into a reasonable defense budget should be an ongoing effort, essential to develop public policies.

Society, and specifically Parliament as an expression of the people, has to clearly understand the absolute need for involvement, for adherence to the legal definitions of the budgetary process and for the endorsement of the defense planning effort to higher national interests. Parliament must prevail in the approval process of the national defense budget and must know the criteria used to prepare it. Transparency in defense budget development and approval creates conditions which guarantee the legitimacy of the approved budget and contributes to strengthen civil-military relations and to the people's feeling that defense is part of public policies implemented for their welfare.

#### *2.4 Defense is a continuous need*

The government cannot interrupt the provision of defense as a public good. To do that, it would require knowing with almost total certainty when a threat will materialize: an unreal condition in the strategic context of this century's international security situation.

Short-term solutions are not an option: medium- and long-term solutions represent differential characteristics to attain efficiency of resources assigned to defense. Decisions on partial or total deletions or significant changes to defense expenditures in an annual budget cannot be made without deeply affecting the defense capability. For example, acquired equipment requires ongoing maintenance and the cost of overhauling them after having stopped their use will certainly exceed the "maintenance" item that would otherwise have been included in the budget. The same applies to the personnel requiring training and education which, if lost, may take decades to recover.

In this respect, the subject of multi-annual defense budgets deserves to be highlighted. Although the multi-annual approach is usually a common feature of the State budget, since it refers to the State's ongoing activities, defense costs are different from those of health or education. Equipment maintenance, mechanical and electronic parts replacement and equipment training costs are, in the case of defense, much higher than acquisition costs. This characteristic explains future

cost growth.

For this reason, each capital investment in defense bears a cost projection which includes maintenance, training and other actions cutting across several budget periods. This projection grows at a significant pace. For example, the area of spare parts and ammunitions is critical. Whenever new military equipment is incorporated into the defense system, the first thing to check is whether their future use can be jeopardized by the lack of spares or by the economic impossibility to maintain them. In other words, the price of equipment is important, but the implicit use and maintenance costs must also be calculated, especially when acquisition costs seem to be very low and convenient, because the defense sector may be acquiring something that it will not use effectively, thus wasting public funds.

Therefore, not only is it necessary to have the society's valuation of defense within a given period, but it must also be maintained in time to assure consistency of the defense budget with the values that society considers important for its welfare.