



CHAPTER 6

Initial suggestions around the analysis of the defense budget

Analyzing the defense budget implies making -basically- the same questions that we would make for the study of the national budget, but with a focus on the institutional nature of defense. Following the logic presented in the previous sections, about who does the spending, what it is spent for, what it is spent on and how spending is funded, we will outline some of the elements for the analysis of defense budgets in the region.¹

6.1 Who does the spending?

Almost all governments in Latin America have defense ministries/departments leading the armed forces.² The existence of these ministries, including the universe of armed forces, specialized bodies (meteorology, hydrography, research and development, etc.) and defense-related manufacturing companies, allows us to answer the question of who spends the budget.

However, we should note that not all countries apply -rigorously- the accepted principle of unity and universality in their defense areas. These principles propose that there should only be one

¹ See a brief terminological definition for the budgets of the region in Annex 4.

² See the Comparative Atlas of Security and Defense of the RESDAL to visualize the characteristics and operational aspects of the ministries of defense in Latin America. See <http://www.resdal.org.ar/atlas/main-atlas.html>

budget that contain all expenditures and revenues of the entity for which it is elaborated. Consequently, our particular "*who*" (the Ministries of Defense) may fail to include expenditures that are made through other ministries/agencies for the conduct of activities that pertain to defense. In our region, this deserves a special consideration, since the idea of maintaining as much information as possible outside the realm of public knowledge is deeply rooted in our history. In budgetary affairs, this is revealed by various practices, such as an intensive use of "reserved expenses", information presented at excessively general level, or defense expenses disguised in other ministries.³

**Example 1: Budget of the Ministry of Defense of Uruguay,
per executing unit (2004)**

Executing Unit.	Budget 2004	
	Uru. \$ (2000)	%
General State Secretariat Directorate	555.736.051	11,88
General Defense Information Directorate	24,475,757	0,52
Army General Staff	1,514,077,437	32,37
Navy General Staff	823,004,832	17,60
General Staff of the Air Force	577,030,946	12,34
National Directorate of Civil Aviation and Aeronaut. Infrac	19,670,998	0,42
General Civil Aviation Directorate	39,887,305	0,85
National Health Directorate of the Armed Forces	412,549,627	8,82
General Aeronautical Infrastructure Directorate	621,857,962	13,30
General Directorate of Services	11,290,288	0,24
National Meteorology Directorate	12,007,791	0,26
Retirement and Pension Funds Servi. of the Armed Forces	30,155,796	0,64
National Bureau of Communications	35,294,173	0,75
TOTAL	4,677,038,963	100,00

Source: 2004 Budget Act (Ley de Presupuesto). Uruguay

³ RESDAL is carrying out a research project on transparency of the defense budgets in the region. It has already published the cases of Argentina, Ecuador, Nicaragua and Peru. See <http://www.resdal.org.ar/papers/main-papers-resdal.html>

Going back to the specific question of who does the spending, there are different levels of budget breakdown to answer that question in the defense sector specifically. To state that the Ministry of Defense spends \$100 is different from specifying that \$15 of those \$100 are assigned to the Ministry of Defense proper, \$40 to the Army, \$25 to the Air Force, \$20 to the Navy, and so on. Likewise, we could go even deeper "institutionally" as to descriptive levels, and break down the Army budget, for instance, into army corps, brigades, and regiments. *In that regard, we can say that the institutional or administrative classification of defense spending will be more transparent if it matches the organizational structure of the Ministry of Defense and the Armed Forces.*

Example 1 is an institutional breakdown of the defense budget in Uruguay, as a first example. We can identify -in general-the organizational structure of the Ministry of Defense and its relative role in the allocation of resources, where one third of the budget is allocated to the Army General Staff. The consistency and quality of this classification will depend on the level of agreement between organic levels broken down in the budget and the levels contemplated in the organizational charts of the appropriate jurisdiction. It will be richer if the institutional breakdown includes various levels of the organizational structure.

Most defense budgets in the region hopefully specify the expenditures of each branch; however, we know that, operationally, the Air Forces are divided into air brigades or companies, Navies into naval bases and Armies into brigades and regiments. Why shouldn't we break down spending into these more open components? This factor deserves consideration, since it will allow to evaluate the degree of transparency with which each country submits the defense budget and will define clear guidelines as regards additional information to be requested to the various government levels.

6.2 What is it spent for?

At first sight, the mere formulation of this question in the case of the defense budget may seem trivial. There is a temptation to automatically resort to each country's own definition of defense to answer the question. Therefore, we will encounter answers such as *"to defend the country's*

sovereignty", *"to assure territorial integrity"*, *"to repel external threats"*.⁴ However, nobody ignores that, in order to comply with those final objectives, it is necessary to perform very diverse activities, such as training officers and NCOs, building and operating hospitals and health units, building roads and bridges and carrying out training exercises.

The so called functional classification precisely tries to disaggregate the defense budget into functions according to the nature of activities carried out by the armed forces. The catalogue of functions that the vast majority of Latin American countries have adopted for the functional classification of their national budgets (and particularly their defense budgets) is based on a standard promoted by the United Nations and the IMF, called "COFOG" (Classification of the Functions of Government). Such catalogue identifies 10 broad areas (General Public Services, Defense, Public Order and Security, Economic Affairs, Housing and Community Services, Health, Education, etc.), opened up in 63 specific groups which are in turn divided into classes.

According to the COFOG, the defense division is made up of 5 groups: military defense, civilian defense, foreign military assistance, research and development related with defense and unspecified defense. However, the defense division explicitly excludes base hospitals (which are assigned to the health division); military schools and academies⁵ (assigned to the education division), pension plans for the military personnel (assigned to the social protection division). In some cases, we can also find armed forces expenses in the economic affairs division; these expenses come from activities related to air traffic control or promotion transport services.

As way of example, let's see how Argentina has tailored the COFOG. In this case, the defense division of the COFOG is called "purpose: defense and security services". As detailed in the following table (Example 2) containing the executed budget of the Ministry of Defense in the three-year period between 2001 and 2003, defense and security services represented -on average- only 54.5% of the Ministry's total spending. It is important to emphasize that the 43.3% of the social services category (education and health, among others), is an expense effectively executed within the Ministry of Defense, but which has been classified as such because of the nature of its activities.

⁴ See the Comparative Atlas of Security and Defense of the RESDAL to compare the definitions of defense in the countries of Latin America.

⁵ The condition imposed by the COFOG to assign them to the education division is that the curricula of those schools should be analogous to the civilian institutions, even when access to them is restricted to military personnel and their families. However, this condition is frequently ignored, and the expenses of most schools and academies are assigned to the education division.

Example 2: Budget of the Argentine Ministry of Defense broken down by purpose

Purpose	2001		2002		2003	
	\$,000	%	\$,000	%	\$,000	%
Government Administration	12.205	0,36	15.818	0,43	18.147	0,41
Defense and Security Services	1.853.369	54,06	2.035.422	55,48	2.368.961	54,11
Social Services	1.478.704	43,13	1.518.241	41,39	1.888.779	43,14
Economic Services	83.587	2,44	99.041	2,70	100.043	2,28
Public Debt	471	0,01	34	0,00	2.383	0,05
TOTAL GENERAL	3.428.337	100	3.668.557	100	4.378.314	100

Source: Own elaboration based on consultation to the SIDIF

According to the Argentine catalogue, the Social Services function includes health, social assistance and promotion, social security, education and culture, science and technology, employment, housing and urban development, potable water and sewerage. Economic Services include functions such as power, fuels, and mining, communications, transportation, environment, agriculture, industry, trade, tourism, insurance and finance. It is evident that some of these roles are directly related to the business, organization and objectives of the defense sector, but the percentage that corresponds to it is actually difficult to be determined. If we take education as an example, it is clear that all items assigned to the military academies that educate and train the Armed Forces personnel is directly related to the sector objectives and, hence, they are closer to a defense expenditure than to social services. However, schools that provide basic education to the children of military personnel do not have a direct linkage to the purpose of the sector, but are rather a benefit granted to those who serve in it.

Another example of COFOG's adaptation to the defense budget is the Mexican case (Example 3). As clearly shown, the similarity of the Mexican budget breakdown and that of the previous example is remarkable. The Government Administration function of the Argentine catalogue may be related to the Mexican Government Management function. Likewise, the Argentine Social Services function can be understood as a construction of both the functions of Health and Education in the Mexican example.

Example 3: Mexico's Defense Department Budget, by purpose

Function	2003 Budget	%
Government Management	3.004.607.823	13,16
National sovereignty	15.518.302.367	67,97
Public order and law enforcement	1.389.265.728	6,08
Health	1.991.155.901	8,72
Education	928.164.681	4,07
TOTAL	22.831.496.500	100,00

Source: 2003 Budget Act (Ley de presupuesto). Mexico

As opposed to the Argentine case, in Mexico almost 70% of the Defense budget is assigned to territorial sovereignty, whereas a relatively more reduced percentage (13%) corresponds to social functions.

6.3 What is it spent on?

This is the question most often answered by public budgets. Initially, budgets used to project the input intended to be used, without specifying what purpose those items were acquired for. In most Latin American countries, the need to describe what is acquired has been satisfied for some time by elaborating some kind of catalogue of goods and services. The arrangement of spending according to this criterion is usually called classification per Object of expenditure or Group of expenditure.

As in any activity, defense requires human resources, consumable goods, services of various kinds, capital goods, etc. In this sense, special attention should be paid to the catalogue or accounts plan designed by each country, considering its structuring and, most importantly, what each account covers.⁶

⁶ The Comparative Atlas of Security and Defense of the RESDAL has researched and presented the budgetary classification manuals that contain catalogues of goods and services.

**Example 4: Budget of the Argentine Ministry of Defense,
per object of expenditure**

	2 0 0 1		2 0 0 2		2 0 0 3	
	\$,000	%	\$,000	%	\$,000	%
Personnel Expenses	1.823.335	53,18	1.998.596	54,48	2.330.189	53,22
Consumer Goods	186.192	5,43	218.004	5,94	255.922	5,85
Non-Personal Services	280.952	8,19	242.012	6,60	294.891	6,74
Fixed Assets	43.343	1,26	74.808	2,04	80.935	1,85
Transfers	1.094.043	31,91	1.135.103	30,94	1.413.994	32,30
Debt Services	471	0,01	34	0,00	2.383	0,05
TOTAL EXPENDITURES	3.428.337	100,00	3.668.557	100,00	4.378.314	100,00

Source: Own elaboration based on consultation to the SIDIF

The Argentine catalogue, for instance, is broken down into sections and items (main and partial). Below we present this classification of the Ministry of Defense, at the level of sections, for the 2001-2003 three-year period. This perfectly portrays the picture of the military instrument in relation to the funds used for salaries and operations (Example 4). In the case presented here, items for personnel and transfers (mainly retirements) represent an average close to 85% of the total spending.

Example 5: Budget of the Ministry of Defense of Peru, per group of expenditure

Group of Expenditure	Budget 2004	%
Debt Amortization	2.728.572	0,09
Goods and Services	957.032.180	30,12
Debt Interests and Rates	2.521.428	0,08
Investments	18.610.115	0,59
Financial Investments	0	0,00
Pension Funds Obligations	563.344.000	17,73
Other Current Expenditures	395.093.592	12,43
Other Capital Expenditures	34.307.143	1,08
Personnel and Social Obligations	1.204.229.804	37,89
Contingency Reserve	0	0,00
TOTAL	3.177.866.834	100,00

Source: Budget Act (Ley de Presupuesto) 2004, Peru

In the case of Peru (Example 5), for instance, money assigned to personnel and retirements accounts for 55%, whereas goods and services represent 31%.

A way of reflecting on the budgetary classification criterion used here is to analyze the relations between different inputs. This means identifying the share of an input A as opposed to an input B. Probably the simplest and most universally studied example is that which relates personnel expenditure to the rest of expenses on goods and services. That is, what this relationship reveals is the intensity of the use of "labor".

6.4 How is spending funded?

The last question we will address in order to contribute to the analysis of defense budgets in Latin America relates to the origin of funds for budgets. In general, at least 3 or 4 valid sources of funding are found in Latin American countries: General Revenues or the National Treasury, that relate to the bulk of available taxes collected by the government; Assigned Resources (Recursos Afectados), that is, funds collected by virtue of a specific rule that expressly specifies the destination of such funds; the government's Own Resources, resulting from the sale or supply of goods and services by specific public entities; and finally, Debt, which may be internal or external.

Example 6: Budget of the Ministry of Defense of Brazil, per source of funding

Source of Funding	Budget 2004	%
Treasury	26.062.496.328	92,85
Other Sources	2.006.485.786	7,15
TOTAL	28.068.982.114	100,00

Source: Budget Act (Ley de Presupuesto) 2004. Brazil

This represents the funding structure of the Ministry of Defense in Brazil, in the budget project for 2004. Just as in almost all Latin American countries, the funding from the National Treasury has a decisive weight, with almost 93% of all funding.

In the case of defense budgets in Latin America, such breakdown per source of funding will allow to evaluate the degree of financial autonomy of the armed forces with respect to the central financial agency (namely, the Ministries of Finance). To the extent that the General Tax Revenues become the main component of budget funding, there will be more limits to self-determination regarding defense spending size and makeup. As regards its own resources, we could say that they are usually collected from subsidiary activities of a commercial or industrial nature. The degree of military penetration in the economy deserves to be analyzed since, depending on the case, we may find armed forces interest in various sectors such as hotel management, commercial fishing, banking and industries.

These trends are based on historical industrialization processes and the subsequent democratic transition. The military leadership, who held power in the region in most of the 20th century, was trained under a logistic doctrine that emphasized the assurance of supply provision. Simultaneously, the low level of industrialization in our economies strengthened the idea that the government could take an investor role and replace the private sector. This context explains why specific funds assigned to defense expenditures in the region stayed for years, including the "Copper Act" in Chile, the petroleum royalties in Ecuador until 1999, or the produce of a wide variety of business undertakings (hotels, banks, transport companies) in several Caribbean countries.

6.5 Where should we look for information?⁷

The first thing that every researcher should do is identify the information required according to the analyses he/she intends to undertake. Since budget information is classified according to various criteria, reflecting different aspects and times of resource allocation, it is key to define -very clearly- what it is that we want to know in order to find it. An initial proposal for a research process to be followed when working on the defense budget is the following:

⁷ Annex 3 identifies the fiscal information generally available to the citizens.

- Constitutional Provisions (*National Constitutions*)
- The administrative competencies of ministries and agencies (*administrative organization or ministry laws*)
- The way the budget system works (*organic laws of the budgetary system*)
- The way the defense system works (*defense or national security laws*)
- Resource and spending annual budget (*budget laws*)

The first step is to review the constitutional provisions regarding government financing in general. These provisions (except for an express reference in the Constitution) cover the defense sector, and are the first layer in the framework used for analysis. Aspects such as yearly budget submission, parliamentary approval as the necessary authority to impose charges and approve expenditures, the establishment of a central authority to coordinate the use of resources, etc., are typical elements to be considered in the analysis. References must then be found in relation to the missions of the armed forces, their constitution and operation. Most likely, these references are of a general nature, but other rules and regulations should be in line with them. At a lower regulatory level, they are generally regulated by law.

Administrative organization laws will allow to determine the organizational structure of the government and the distribution of functions and responsibilities. In our specific area, it will give us an idea of the nature of the work distribution between the Ministry of Defense and the armed forces for the formulation, execution and control of the defense budget.

The laws of the budget system will determine actors, processes, products and schedules for the various phases of the budget cycle (budget formulation, approval, execution and oversight). Unless there is a special legislation for the defense sector (something common in the past, but increasingly not used) in this law and its regulation, we will find a description of the process mechanics for the allocation of resources to the armed forces.

National defense laws will provide a conceptual definition of defense, establishing the scope of this term, assigning missions and objectives to the military instrument and establishing hypotheses for its use. It is also possible that official publications, such as white papers, may supplement and deepen the subject. In any case, for our purposes, this law will determine the budget scope, stipulating

the institutional ramifications the armed forces will have.

Out-of-budget defense spending

One of the most conflicting and difficult issues to deal with when we analyze budgetary transparency in defense is that of **out-of-budget spending**.

A good way to approach this phenomenon is by observing the origin of the revenues that finance defense spending. This aspect is important, because the different sources of revenue have attributes that imply a variable degree of discretionality and, therefore, susceptibility to transparency. It is clearly obvious, for instance, that the expenditures that are financed with resources from the national treasury have more transparency as compared to the expenses whose financing comes from revenues collected by units or bodies at a decentralized level. The centralization of the collection and subsequent distribution of national taxes eliminates the uncertainty of the spending in two dimensions: volume and destination. How much the armed forces are going to spend through these resources (volume) and on what (destination) represent data externally provided by the central body (generally the Ministry of Economy or Finance).

On the contrary, the expenditures that are financed with resources that are collected in a decentralized way have a larger degree of maneuver. Although the central body provides just as rigid guidelines for the execution of this type of expenditures, the truth is that there is no effective way of knowing per se when or how much is collected. For that, it should accept the information sent by the collection entities. In this case, the armed forces. On the other hand, these collection bodies many times have incentives to under-inform and under-enter in the circuit the funds that are collected, because they face the uncertainty of losing them if the central body finally does not authorize the spending.

Every now and then in Latin America there are cases where some unit of the armed forces is trading some good or rendering some service, whose product is not reflected in the budget. In general, this occurs in contexts where the units are under a high operative restriction. However, it must be assumed that this kind of behavior is counterproductive, to the extent that they promote the generation of suspicious visions that contribute tensions to the relations in the region and inside the countries.

Annual budget laws will be the core element to be considered in the study of resource allocation. They will contain defense budgets, where defense is understood as a sector or purpose.

Regular budget execution reports will indicate the effective evolution of resources allocated to the defense sector, as well as deviations with respect to the original provisions provided for in the budget law. Since reports are only partial (i.e. usually monthly or quarterly), deviations are not generated with reference to the total budgeted volume, but to the normal rhythm of execution (for instance, without seasonality 50% of the budget should be executed by the middle of the year). The expenditure account will represent a document to close the fiscal year, detailing to the maximum level of disaggregation the final execution of the pertinent fiscal year.

Finally, it is worth mentioning that there are several sources and various proposals that have been developed internationally to account for and systematize defense spending. For more details, see annexes 5 and 6.