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Defense Expenditure: Central America and The Dominican Republic

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Defense Expenditure

Central America and The Dominican Republic

**Iñigo Guevara Moyano
Latin American Defense Analyst**

September 2010

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The views expressed in this research paper are those of the author and do not necessarily reflect the official policy or position of the US Government, Department of Defense, US Southern Command or Florida International University.

EXECUTIVE SUMMARY

It is often speculated that the high allocation of funds to retirement pension systems has influenced the capacity of Central American and Dominican Republic military to modernize. Yet, the comparative study of the allocation of pension and social funds in these particular countries suggest that there is not direct linkage between the poor funding of military modernization plans and the allocation of funds to military pension systems. The research conducted on this subject shows the following results:

1. The Dominican Republic is the only country that has embarked on a considerable procurement of modern equipment and still reports the largest proportion of social expenditures.
2. El Salvador's defense budget allocates minimal funding to Social Welfare Institute, which as alternative sources of funding. In 2009, El Salvador increased 15 percent funding to the military to respond to increased role in domestic security issues.
3. The Guatemalan defense expenditure on social programs is fairly low, but it has grown during the past six years due to processes of demobilization. However, the Military Social Welfare Institute is administered by a decentralized institution funded directly by the Ministry of Finance. If it were to be considered as a part of the defense budget, its social expenses would account for almost 16% of it.
4. The Honduran Defense Budget has faced a considerable enlargement during the past four years, with social spending expenses taken precedence over modernization efforts.

5. The Nicaraguan system of military pensions is administered by a decentralized entity (IPSM) through a system of salary deductions. Information on the funding of this entity is inconclusive. The Nicaraguan Defense spending on social services has reported a drastic 90% drop since the year 2007.

INTRODUCTION

In recent years, Central American countries and the Dominican Republic have engaged in military modernization programs with varying degrees of effectiveness in its implementation. In most cases, lack of funding is the main issue. Yet, the lack of transparency and accountability in the procurement process creates difficulties in making real assessments. Nonetheless, in general, it is recognized that Latin American military do not exercise long - term planning for modernization.

One factor worth analyzing that may also be influencing modernizations plans is the cost of pensions. This may be due to the high proportion that pensions drawn from defense budgets, as well as the fact that the costs can represent an expense that can only decrease due to shifts in government policy, which often carries high political costs.

This paper will thus look at the Armed Forces' allocation of funding for retirement pensions and other administrative expenses in Central America and the Dominican Republic, and the impact of such expenses on a country-by-country basis. Specifically, it analyses pension costs as a percentage of the overall defense budget and compares it to other military expenses, such as operations or procurement. Such a comparison will enable observers to identify current trends, both in regards to budget allocation and long- term funding of force modernization. A country-by-country study allows one to evaluate the different outcomes on similar percentages allocated for pensions and identify long-term effects or challenges posed for specific countries.

DOMINICAN REPUBLIC

The Dominican Republic has one of the region's largest proportions of social expenses fixed into its defense budget. Of these expenses, pensions occupy the vast majority (over 97% of the total contributions). The Ministry of the Armed Forces (SFFAA) provides significant contributions to a number of social groups in addition to the military. For example, it contributes to a children and teens' hospice and to the "Brotherhood of Pensioners and Retired Members of the Armed Forces," a civic and social action association with significant political (and electoral) weight.

Table DR 1-- Dominican Republic Defense Budget

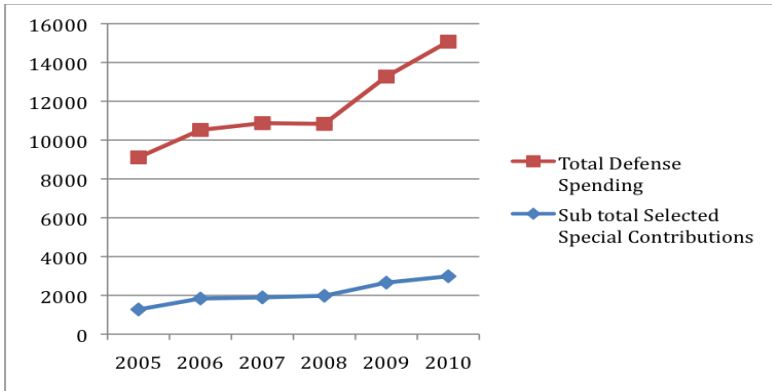
SRD	2005	2006	2007	2008	2009	2010 ¹
Ministry of Defense	739,760,231	927,933,232	978,837,305	854,160,132	992,263,028	
Army	2,412,463,064	2,713,762,056	2,889,007,164	2,707,037,400	3,010,218,452	
Navy	1,340,149,720	1,499,568,091	1,363,229,184	1,239,435,117	1,471,925,810	
Air Force	2,067,235,223	1,673,660,368	1,814,786,978	1,831,305,334	2,129,066,098	
Military Education				185,901,172	230,076,260	
Other Special Contributions		34,000,000	36,000,000	56,000,000	127,588,625	
Sub Total Defense Spending	6,559,608,238	6,848,923,747	7,081,860,631	6,873,839,155	7,961,138,273	9,105,244,498
Pensions	1,245,362,177	1,787,798,404	1,844,322,506	1,926,668,165	2,601,443,741	2,927,348,198
Assistance	7,131,840	8,300,292	8,554,320	12,000,000	12,000,000	14,452,880
Brotherhood of pensioners	1,000,000	1,200,000	1,200,000	1,200,000	1,300,000	1,200,000
Children and teen program	4,289,600	4,590,000	5,590,000	5,590,008	5,590,512	5,580,900
Border Zone assistance	18,000,000	36,000,000	36,000,000	36,000,000	36,000,000	36,000,000
Sub total Selected Special Contributions	1,275,783,617	1,837,888,696	1,895,666,826	1,981,458,173	2,656,334,253	2,984,581,978
Total Defense Spending	7,835,391,855	8,686,812,443	8,977,527,457	8,855,297,328	10,617,472,526	12,089,826,476
% of social expenditure	16.28%	21.16%	21.12%	22.38%	25.02%	24.69%
% Increase in Sub Total Defense Spending		4.41%	3.40%	-2.94%	15.82%	14.37%
% Increase in social expenditure		44.06%	3.14%	4.53%	34.06%	12.36%
% Increase in Total Defense Spending		10.87%	3.35%	-1.36%	19.90%	13.87%
Inflation, average consumer prices (Percent change) (IMF)	4.19%	7.57%	6.14%	10.64%	1.47%	6.53%

Source: Elaborated by author based on information contained in the *Presupuesto de Ingresos y Ley de Gastos Públicos*, Secretaría de Estado de Hacienda for each year plus inflation average provided by IMF as a point of reference.

The overall proportion of social expenditures in the Dominican Republic's military budget averaged 22% during the past six years and has an incremental tendency, which is directly related to the overall increase in defense expenditure.

¹ 2010 figures are approximate based on the projected budget and due to the illegibility of the actual 2010 budget available online at: <http://www.digepres.gob.do/Publicaciones/Presupuestado/tabid/76/Default.aspx>

Table DR 2 - Dominican Republic: Defense Spending and Special Contributions



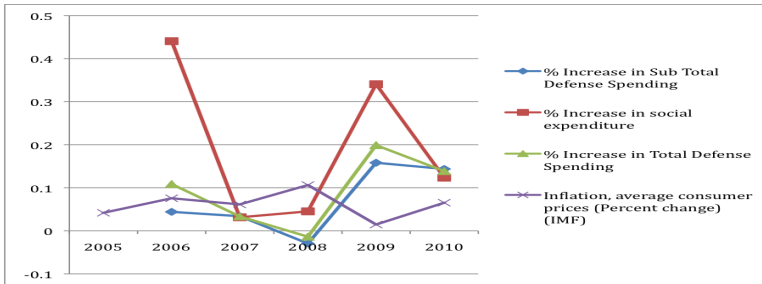
Source: Elaborated by author based on information contained in the *Presupuesto de Ingresos y Ley de Gastos Públicos*, Secretaría de Estado de Hacienda. For each year plus inflation average provided by IMF as a point of reference

Regarding other increases, the graph below (Table DR3) provides a better understanding of the actual increase in social expenditure. In 2006, Special Contributions allotment in the Dominican Republic’s military budget received a significant increase, which did not concord with inflation or other similar variables. In 2007 Special Contributions allocations were consistent with non-social budget increases and also with the aggregated total Dominican defense expenditures. By and during fiscal 2008, Social Contributions again were the only part of the Dominican defense budget to have a considerable increase.

Dominican defense budget expenditures pertaining to Social Contributions in 2008 followed a similar pattern of increases with all other expenditure indicators (the non-social spending budget as well as the “Total Defense Spending” variable), which although dependent on the previous two, is included in table DR3 in order to better assess the trend. Both independent variables (the social

spending and the non-social expenditure) and its dependent control variable show consistency for 2010.

Table DR 3 --Dominican Republic: Patterns of Military Expenditure



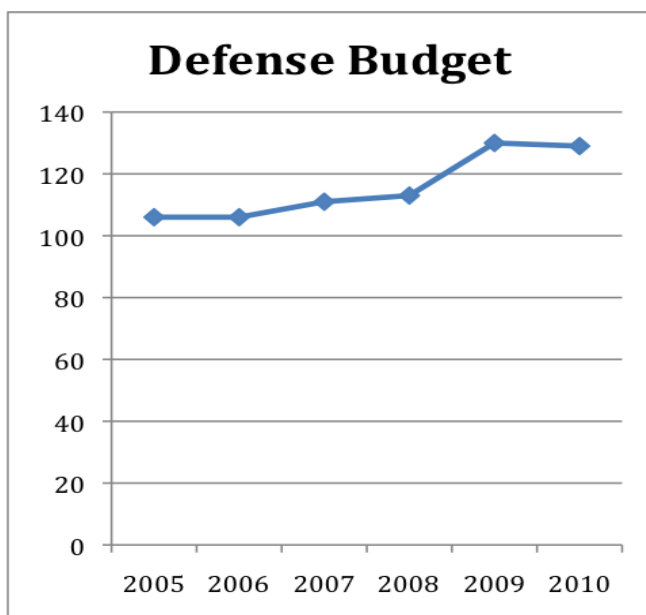
Source: Elaborated by author based on information contained in the *Presupuesto de Ingresos y Ley de Gastos Públicos*, Secretaria de Estado de Hacienda for each year plus inflation average provided by IMF as a point of for each year plus inflation average provided by IMF as a point of reference.

EL SALVADOR

The Salvadorian Armed Forces are experiencing a transformation that seeks to re-engage the military with an internal security role and to expand its activities in the national development area.² In this sense, the Armed Forces received a 15% increase (Table ES 1) during 2009. This was the year that the Armed Forces were ordered to embark upon anti-crime operations, to include taking control of the prison system.

² El Salvador: National Reconstruction Program. In partnership with Inter-American Development Bank, El Salvador has embarked on a national reconstruction that takes into consideration the following sectors: [1] National system of preparation and response to disasters, [2] Health, [3] Housing, [4] Reconstruction and expansion of the local infrastructure, [5] Promotion of micro and small enterprises in the rural areas, & [6] Environmental measures.
http://www.iadb.org/regions/re2/consultative_group/plans/elsalvador.htm

Table ES1 -- El Salvador Defense Budget



Source: Elaborated by author based on information from the Salvadorian Ministry of Defense budgets from 2005 to 2010.

The amount of funding El Salvador allocates to the Armed Forces' Social Welfare Institute (*IPSFA- Instituto de Previsión Social de la Fuerzas Armadas*), however, is minimal: \$2 million USD in 2008 and 2009, and \$3.5 million USD was allocated in 2010. IPSFA depends on several other sources of funding, including direct funding from the national Treasury. Its costs are reported to be approximately \$24 million USD annually.³

3 Avalos, Jessica, La Fuerza Armada debe tomar un rol más efectivo contra la delincuencia, La Prensa Gráfica, March 25, 2009 <http://www.laprensagrafica.com/el-salvador/politica/24724--la-fuerza-armada-debe-tomar-un-rol-mas-efectivo-contr-la-delincuencia.html>

Table ES2 - El Salvador Defense Budget

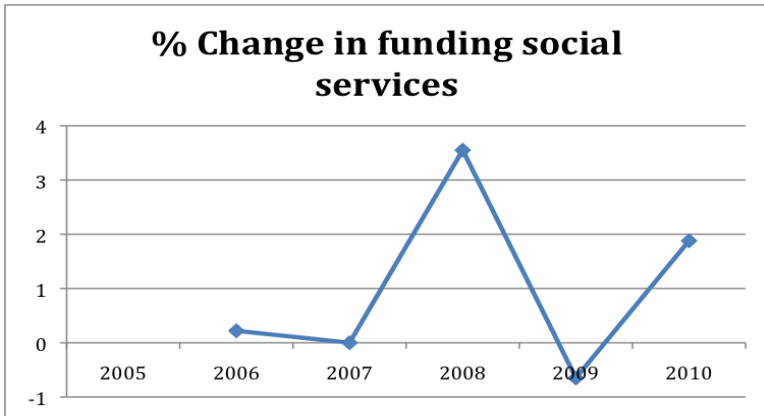
SRD	2005	2006	2007	2008	2009	2010
Ministry of Defense	739,760,231	927,933,232	978,837,305	854,160,132	992,263,028	
Army	2,412,463,064	2,713,762,056	2,889,007,164	2,707,037,400	3,010,218,452	
Ministry of Defense	3,938,430	3,524,110	4,257,220	4,718,875	5,173,625	6,477,615
Army	89,140,270	89,941,625	94,341,300	93,590,620	113,982,660	115,453,485
Navy	2,414,125	2,093,010	2,302,000	2,200,000	1,590,000	1,390,595
Air Force	2,640,405	2,574,485	2,600,000	2,600,000	2,115,120	2,052,415
Investment in Infrastructure	500,000	1,730,000	1,500,000	1,500,000	1,850,000	1,288,960
Investment in Equipment	2,000,000	2,000,000	1,900,000	2,500,000	1,650,000	2,711,040
Strategic Communications	5,400,000	4,500,000	4,500,000	4,500,000	4,500,000	
Procurement Aircraft				1,800,000		
Sub Total Defense Spending	106,033,230	106,363,230	111,400,520	113,409,495	130,861,405	129,374,110
Pensions				2,000,000	2,000,000	3,500,000
Total Defense Spending	106,033,230	106,363,230	111,400,520	115,409,495	132,861,405	132,874,110
% of social security	0.00%	0.00%	0.00%	1.73%	1.51%	2.63%
% Increase in Sub Total Defense Spending		0.31%	4.74%	1.80%	15.39%	-1.14%
% Increase in pensions		NA	NA	NA	0.00%	75.00%
% Increase in Total Defense Spending		0.31%	4.74%	3.60%	15.12%	0.01%
Inflation, average consumer prices (Percent change) (IMF)	4.69%	4.04%	4.58%	7.26%	0.54%	0.52%

Source: Elaborated by author based on information from the Salvadorian Ministry of Defense budgets from 2005 to 2010; additional data on inflation obtained from the IMF.

GUATEMALA

In Guatemala, during the past six years, there have been two significant changes in the Ministry of Defense's social expenditure sector. These are directly related to demobilization expenses and have caused a disruption in the trend analysis of social spending (Table G1).

Table G1 - Changes in the Guatemalan Armed Forces' Funding for Social Services



Source: Elaborated by author based on information published by the Guatemalan Ministry of Public Finance.

From 2009, Guatemalan defense accounting began to reallocate the resources assigned to the military for internal security operations in support of the National Police. The cost of health services is also evident, as shown on the following table.

Table G2 -- Guatemala Defense Budget

Guatemala	2005	2006	2007	2008	2009	2010
Administrative Support for the MoD	353,931,545	278,904,153	278,904,153	259,941,823	281,928,452	355,177,020
Independence and sovereignty	524,103,686	633,926,670	633,926,670	517,401,957	444,149,483	473,882,996
Citizen Security Support					174,000,000	89,882,822
Construction and Cartography	22,248,117	34,044,168	34,044,168	44,764,496	44,004,363	
Foreign Military Operations				73,545,147	65,440,564	54,338,344
Water Spaces regulation				9,253,591	10,229,853	
Military Education System	64,648,902	120,025,455	120,025,455	160,173,029	213,000,569	197,136,055
Sub Total Defense Spending	964,932,250	1,066,900,446	1,066,900,446	1,065,080,043	1,232,753,284	1,170,417,237
Health and Social services	35,712,500	43,847,224	43,847,224	51,819,488	67,126,958	53,423,685
De-mobilization and retirement fund	148,860	144,000	144,000	148,403,599	1,386,391	144,325,711
Sub Total Social services Spending	35,861,360	43,991,224	43,991,224	200,223,087	68,513,349	197,749,396
Total Defense Spending	1,000,793,610	1,110,891,670	1,110,891,670	1,265,303,130	1,301,266,633	1,368,166,633
% of social security	3.58%	3.96%	3.96%	15.82%	5.27%	14.45%
% Increase in Sub Total Defense Spending		10.57%	0.00%	-0.17%	15.74%	-5.06%
% Increase in social services		22.67%	0.00%	355.14%	-65.78%	188.63%
% Increase in Total Defense Spending		11.00%	0.00%	13.90%	2.84%	5.14%
Inflation, average consumer prices (Percent change) (IMF)	9.11%	6.56%	6.82%	11.36%	1.86%	3.26%

Source: Elaborated by author based on budgets published by the Guatemalan Ministry of Public Finance and Guatemala Inflation, average consumer prices from the IMF.

Military pensions in Guatemala are administered by the Military Social Security Institute (*IPM- Instituto de Previsión Militar*), which is a de-centralized institution and therefore is not linked to the Ministry of Defense, but funded directly by the Ministry of Finance. The IPM has been in operation since 1984.

IPM related figures (see below) are available only since 2007. Figures (see below) are available only since 2007.

Table G3 --Guatemala Allocation of Funds to the Military Prevision Institute

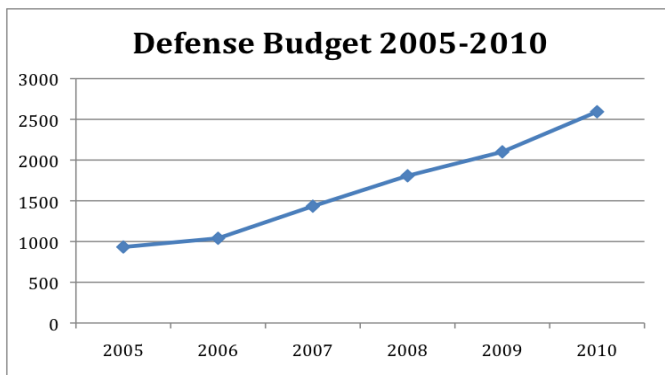
	2007	2008	2009	2010
IPM	263,707,404	273,210,684	213,912,294	245,261,282

Source: Elaborated by author based on budgets published by the Guatemalan Ministry of Public Finance.

HONDURAS

The Honduran defense budget has seen a consistent increase since 2006, and the internal turmoil experienced by Honduras during 2009 does not seem to have provoked any drastic increases. This has translated into an increase of over 105% in real terms.⁴

Table H1-- Honduras Defense Budget 2005-2010

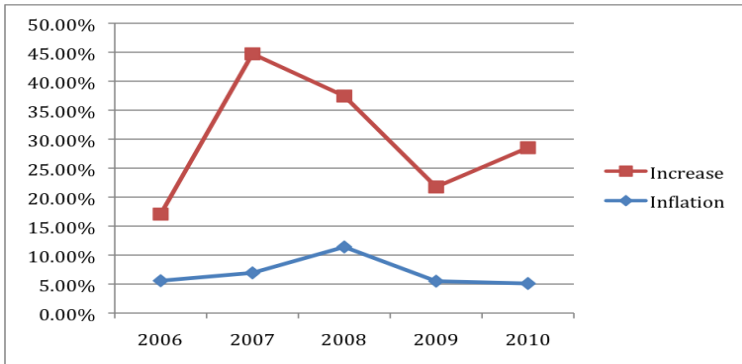


Source: Elaborated by author based on information published by the *Secretaría de la Defensa Nacional*.

⁴ Taking as a base the 2005-2010 nominal increases minus the accumulated inflation.

The social spending proportion of the increase seems to outperform inflation trends considerably:

Table H2 - Changes in the Honduran Military Budget and Inflation 2006-2010



Source: Elaborated by author based on data from the *Secretaría de la Defensa Nacional* and Honduras' inflation and average consumer prices from the IMF.

The increase has been considerable, with the social spending taking precedence, and with no visible increase to procurement or modernization efforts.

Table H3 --Honduras' Shift in Allocation of Funding to Social Programs and its Comparison with Shifts to the Overall Defense Budget



Source: Elaborated by author based on information published by the *Secretaría de la Defensa Nacional*

The social spending programs include pensions, contributions to the military prevision institute, the National Institute for Retired Personnel belonging to the Executive power, and both medical services/attention (which is not disaggregated but assumed to be military medical services for active duty personnel) and the Central Military Hospital. The proportion that these social services take up from the overall military budget is increasing, having risen from just over 8% in 2005 to 11.5% of the overall budget by 2010. In nominal terms this can translate into an increase of more than 300% assigned to these services since 2005.

Table H4 --Honduran Defense Budget, 2005-2010

	2005	2006	2007	2008	2009	2010
Ministry of Defense	102,651,804	114,704,987	261,320,908	327,493,293	461,348,996	232,573,572
Joint Command	117,185,262	130,079,086	152,310,551	169,709,213	224,522,498	667,963,763
Army	469,777,520	527,240,315	696,072,406	923,346,124	952,252,694	1,150,532,166
Navy	91,938,099	102,332,121	126,388,301	153,678,102	201,813,340	232,772,713
Air Force	151,898,515	166,384,491	197,953,634	233,209,167	261,321,712	309,685,686
Sub Total Defense Spending	858,021,442	948,532,108	1,290,696,687	1,601,264,523	1,855,500,367	2,295,192,217
Contributions to the National Institute for Retired Personnel of the Executive		551,763	761,545	868,900	1,092,588	1,315,730
Military Provision Institute		62,316,600	107,335,110	165,443,100	198,050,730	241,825,396
Social Security Contributions		0	437,200	437,200	496,632	4,367,142
Medical Services		1,500,000	1,500,000	1,500,000	2,400,000	2,400,000
Military Hospital	22,285,045	27,840,529	33,315,258	37,922,176	43,438,923	48,147,415
Contributions for retirement	53,144,713	0	0	0	0	0
Pensions	0	0	0	0	280,000	280,000
Total Social Spending	75,429,758	92,208,892	143,349,113	206,171,376	245,758,873	298,335,683
Total Defense Spending	933,451,200	1,040,741,000	1,434,045,800	1,807,435,899	2,101,259,240	2,593,527,900
% of social security	8.08%	8.86%	10.00%	11.41%	11.70%	11.50%
% Increase in Sub Total Defense Spending		10.55%	36.07%	24.06%	15.88%	23.70%
% Increase in social programs		22.24%	55.46%	43.82%	19.20%	21.39%
% Increase in Total Defense Spending		11.49%	37.79%	26.04%	16.26%	23.43%
Inflation, average consumer prices (Percent change) (IMF)	8.82%	5.58%	6.94%	11.40%	5.50%	5.10%

Source: Elaborated by author based on data from the *Secretaría de la Defensa Nacional* and Honduras Inflation, average consumer prices from the IMF

NICARAGUA

Nicaraguan military pensions are administered by a decentralized agency known as the Social Welfare Military Institute (IPSM), created in 1994. Initial creation of the pension fund was possible due to the sale of military equipment to Peru and Ecuador. Since then, each service member is charged a small percentage (which varies according to rank), that may not surpass 10% of a service member's total monthly salary.

Active duty social services are funded through the Ministry of Defense and are insignificant, they range from 4% to .6% over the past three- years. Nicaragua's military social expenditures have experienced a 90% drop from 2007.

Table N1 -- Nicaraguan Defense Budget, 2006 - 2010

	2006	2007	2008	2009	2010
Central Activities	17,809,342	16,837,443	17,323,460	14,492,375	14,221,046
National defense	562,972,900	666,695,797	770,203,158	802,602,765	812,067,208
Capital Investments	28,781,784	33,142,288	21,370,296	20,103,000	20,000,000
Sub Total Defense Spending	609,564,026	716,675,528	808,896,914	837,198,140	846,288,254
Social Benefits	3,795,982	342,443	342,443	423,060	513,840
Total Defense Spending	613,360,008	717,017,971	809,239,357	837,621,200	846,802,094
% of social security	0.62%	0.05%	0.04%	0.05%	0.06%
% Increase in Sub Total Defense Spending		17.57%	12.87%	3.50%	1.09%
% Change in social security		-90.98%	0.00%	23.54%	21.46%
% Increase in Total Defense Spending		16.90%	12.86%	3.51%	1.10%
Inflation, average consumer prices (Percent change) (IMF)	9.14	11.127	19.826	3.7	5.1

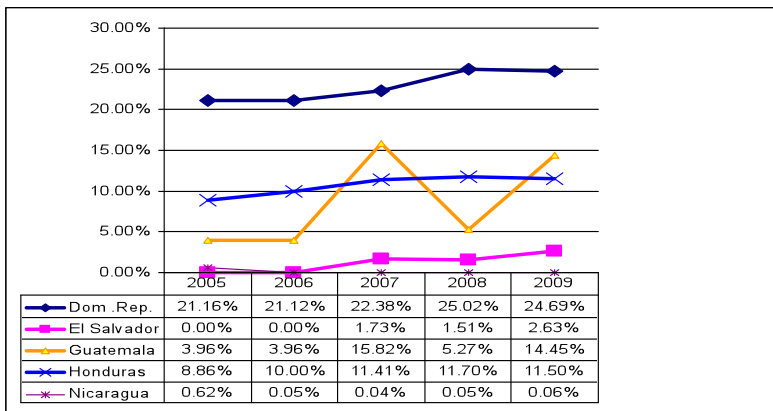
Source: Elaborated by author based on the Nicaraguan Defense Ministry Budgets for 2006 to 2010 plus data on inflation provided by the IMF.

Nicaraguan defense spending in the area of National Defense (highlighted above) has been consistent with inflation during the past four years.

CONCLUSION

The proportion dedicated to the funding of pensions allocated to defense budgets in the Central American region and the Dominican Republic are considerably heterogeneous, as exemplified by table CA1.

CA1 --Yearly Proportion of Defense Budget Assigned to Social Pensions and Other Related Social Programs.



Source: Elaborated by author based on proportions obtained from documents consulted in government sources cited in each country section.

When comparing these allocations, the Dominican Republic stands out as having the highest proportions of social services allotment in its military budget. In 2010, it represents one fourth of the defense budget and is by far the highest in the area. The Dominican Republic is followed by Honduras in regards to the proportion of the budget assigned to pensions, which amounts to an average of

slightly over 10% of the Honduran military budget over the past six years. Like the Dominican case, its increase in proportion seems to have stabilized and is consistent.

The Dominican Republic is, however, the only country that has embarked on a considerable procurement of modern military equipment.⁵ This disassociates the high allocation of funding to pensions from the ability to fund procurement programs.

The Guatemalan case varies. This variation has to do with the fact that it bore huge costs linked to the demobilization of large parts of its manpower allocation and which were assigned as “social costs”. Otherwise, Guatemalan defense expenditure on social programs remains considerably low, at around 4 to 6%. However, this does not mean that the government does not spend a considerable amount of funds on military pensions, as the independent IPM spends an amount that, if considered a part of the defense budget (as a purely comparative study) would consist of over 16% of its military budget for 2010 (see Table CA2).

Table CA2 -- Guatemalan Defense Budget + IPM Budget and Proportion of Combined Figures.

	2007	2008	2009	2010
Budget	1,110,891,670	1,110,891,670	1,265,303,130	1,301,266,633
IPM	263,707,404	273,210,684	213,912,294	245,261,282
Budget + IPM	1,374,599,074	1,384,102,354	1,479,215,424	1,546,527,915
Proportion of IPM	19%	20%	14%	16%

Source: Elaborated by author based on data provided by the Guatemalan Ministry of Public Finance.

⁵ The Dominican Air Force has procured eight EMB-314 Super Tucano aircraft valued at USD \$93 million, a command and control center plus associated surveillance radars worth an estimated USD \$38.5 million.

Regarding funding for procurement, it should be noted that the Guatemalan case is special, in that the state announced requirements worth about \$100 million USD since early 2008,⁶ and has not been able to complete the procurements.

Likewise, the Salvadorian defense budget only considers a fraction of the total cost of the national pension system administered by the IPSFA, which at the 2009 figures would represent (again, in the spirit of a comparative study) a comparable 15.4% slice.⁷ Yet the Salvadorian defense ministry has found it difficult to obtain congressional approval to fund a \$150 million USD modernization program intended to procure new vehicles and helicopters for the Armed Forces. Although we do not have official data on Nicaraguan funding for the IPSM, based on the regional trends we can expect that this would amount (again, as a purely comparative exercise) to around 10-15% of the aggregated⁸ defense expenditure.

Considering these five cases, we can conclude that there is no direct link in this region between the administration of military pensions and the ability to fund modernization or procurement programs. It is important to note that countries that have set up separate, autonomous organizations to administrate pensions have not had more success in funding any major modernization or procurement programs.

⁶ Guevara, Inigo, "Guatemala looks to Brazil for trainer aircraft and fast patrol vessels", Jane's Defence Weekly, 14 April 2008.

⁷ Considering the FY2009 budget for USD \$132 million plus USD \$24 million for IPSFA minus the USD \$2 million specifically earmarked for pensions out of the Defense budget, which gives us a total defense expenditure of USD 154 million.

⁸ Defense combined with IPSM budgets.

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