

III. Transparency in military expenditure

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Many governments choose to not completely disclose spending on military-related matters.¹ Despite calls for improvements in levels of good governance and transparency in the military sector, a large part of actual military expenditure remains unknown. Levels of transparency vary greatly between countries.² Some, such as Japan, New Zealand and Norway, provide substantial amounts of information on spending to the public. Others, such as Eritrea, Qatar, Uzbekistan and Viet Nam, provide no information at all to the public. The behaviour of most states lies somewhere between these extremes, providing information on military spending that lacks overall detail or context. In many cases information such as sources of funding (e.g. extra and off-budget financing), actual expenditure categories (e.g. disaggregated spending information) or purpose of spending (e.g. linked to defence policies) is missing.

One of the main difficulties in furthering transparency in military expenditure is the use of off-budget mechanisms. Using off-budget spending means that some resources are allocated to the military without being subject to the usual deliberation and debate that applies to the general budget. Several countries in Africa and South America, for instance, rely on funds from natural resource extraction and export to finance their militaries. Often, these funds are not reported. Improvements in transparency in military expenditure are key to building confidence among countries and for avoiding mismanagement of resources, reducing corruption and creating an environment for accountability and good governance.

This section looks at the current reporting situation, summarizing the problems of governmental transparency at the international and national levels. It first discusses the decline in participation in the United Nations Report on Military Expenditures. This is followed by an analysis of the transparency problems at the national level caused by off-budget military expenditure. Using two examples—Peru and Venezuela—it highlights the potential consequences of a lack of transparency in military spending.

Reporting to the United Nations

In 1981 the UN General Assembly agreed to establish an annual report in which all UN member states could voluntarily provide data on their mili-

¹ See e.g. Transparency International, 'Government defence anti-corruption index', [n.d.].

² Gorbanova, M. and Wawro, L., *The Transparency of National Defence Budgets: An Initial Review* (Transparency International UK: London, Oct. 2011).

tary expenditure. The report, now known as the UN Report on Military Expenditures, aims at promoting confidence building among states in the political–military sphere. Participation in the report declined to a low level in the period 2012–16.

In 2016 only 49 of the 193 UN member states submitted information on their military spending in 2015.³ By 31 July 2017 at least 42 states had submitted a report on their expenditure in 2016.⁴ No submission had been received from any state in Africa or the Middle East or from four of the five largest military spenders in the world: the United States, China, Saudi Arabia and India.

The functioning of the UN Report on Military Expenditures was the subject of discussions by a UN group of governmental experts (GGE) in 2016–17, which followed up on a previous GGE in 2011. The GGE agreed on the utility of the report and made some minor proposals to amend the reporting system.⁵ It suggested a number of possible causes of the low rate of participation, including reporting fatigue among government officials involved in such instruments for building international confidence; a lack of confidence in the information submitted to the report; a lack of perceived benefit to reporting, in particular when the government information is already made available elsewhere in the public domain; and lingering concerns about the sensitivity of the data. However, it concluded that the causes of the low level of participation in the reporting mechanism should be established with greater confidence through an empirical study, and for that purpose the GGE produced a simple questionnaire to be completed by UN member states.⁶

The outcome of the GGE and the low participation in the instrument in 2017, including the fact that 9 of the 14 countries represented in the GGE are not listed among those that reported in 2017, do not bode well for the future of the UN Report on Military Expenditures.

Off-budget mechanisms in military expenditure

The core components of military budgets are often included in public government budgets as specific lines for ‘defence’, ‘defence and security’ or defence ministry spending. In addition, budget lines for other ministries

³ Kelly, N., Lopes, D. and Tian, N., ‘Transparency in military expenditure data’, *SIPRI Yearbook 2017*, p. 357.

⁴ United Nations, General Assembly, ‘Objective information on military matters, including transparency of military expenditures’, Report of the Secretary-General, A/72/328, 14 Aug. 2017. This report lists 41 submissions. At least 1 additional report was submitted in 2017: that from Russia, which is included in the online UN database. The report from Russia was submitted earlier than some submissions included in the published UN report, which raises questions about the comprehensiveness of the UN report.

⁵ United Nations, General Assembly, ‘Group of governmental experts to review the operation and further development of the United Nations Report on Military Expenditures’, A/72/293, 4 Aug. 2017.

⁶ United Nations, A/72/293 (note 5), pp. 11–12.

or functions may include spending for military purposes. These expenditure lines are often identifiable. For example, spending on fissile material for nuclear weapons is itemized in the US budget under the Department of Energy, and in Ukraine and South Korea military pensions are listed under a specific pension fund. Military spending may also include items that are less clearly identified in the budget, such as research and development spending and arms imports in China.

Even more problematic is the use by many countries of off-budget funding: spending that is outside the state budget and often non-transparent. It often includes funds earned from the export of natural resources. Off-budget funds can be used to pay for arms purchases, to receive payments from the private sector in return for security services, or to operate business activities by the military without going through the parliament or the finance ministry. When not administered according to rigorous and transparent procedures, off-budget funds offer lucrative opportunities for self-enrichment to public officials and businesses involved in the decision-making processes.

It is difficult to assess how common this type of hidden spending is or its size. However, it is suspected to be quite widely spread and it can be substantial enough to drastically change the understanding of the size and trend of a country's military spending, as shown by the examples of Peru and Venezuela.

Peru

Peru's off-budget expenditure mechanism was created by a 2004 law that established the Fund for the Armed Forces and National Police (Fondo para las Fuerzas Armadas y Policía Nacional) and funded it with revenue from natural gas fields.⁷ Since 2004 it has been used to fund the acquisition, modernization, technological innovation, repair and maintenance of military equipment. In line with the usual practice for off-budget spending, the fund is managed and regulated outside of the control of the Congress, by a committee consisting of the prime minister and the ministers of foreign affairs, defence, economy and finance, and the interior.⁸ It is completely outside the official national budget, and spending decisions are often unrelated to the broader economic realities of the country. Instead, they are based on the availability of natural resources, the rate of extraction, the demand for or sale of the natural resource, and the price of the commodity.

⁷ Ley que crea el Fondo para las Fuerzas Armadas y Policía Nacional [Law creating the Fund for the Armed Forces and National Police], Peruvian Law no. 28455, signed into law 23 Dec. 2004, *El Peruano*, 31 Dec. 2014.

⁸ Decreto Supremo no. 011-2005-DE Aprueban el Reglamento de la Ley No. 28455—Ley que crea el Fondo para las Fuerzas Armadas y Policía Nacional [Supreme decree no. 011-2005-DE approving the regulation of Law no. 28455—Law creating the Fund for the Armed Forces and National Police], 29 Apr. 2005, *El Peruano*, 2 May 2005.

Table 4.6. Off-budget military expenditure in Peru, 2005–17

Figures are in US\$ m. at current prices and exchange rates. Figures may not add up to stated totals due to the conventions of rounding.

	Selected years					Total, 2005–17
	2005	2008	2011	2014	2017	
<i>Lot 56</i>	–	54.4	700	423	196	3 436
Gas	–	–	312	110	54.6	1 228
Liquefied natural gas	–	54.4	388	313	141	2 208
<i>Lot 88</i>	191	354	574	645	387	5 380
Gas	14.9	59.2	114	185	218	1 473
Gas PLT (Pampa Melchorita Plant)	–	–	–	3.6	6.8	19.0
Liquefied natural gas	177	295	461	456	162	3 888
30% of Lot 56		16.3	210	127	58.8	1 031
20% of Lot 88 (2005); 40% of Lot 88 (2006 onwards)	38.3	142	230	258	155	2 152
Total for the Fund for the Armed Forces and National Police	38.3	158	440	385	213	3 183
75% for the Peruvian armed forces	28.7	118	330	288	160	2 387
Initial payment	18.8	–	–	–	–	18.8
Total off-budget funding	47.5	118	330	288	160	2 406
Original SIPRI estimate of military expenditure	1 149	1 385	2 025	2 929	1 926	
Total military expenditure (revised SIPRI estimate)	1 197	1 504	2 355	3 218	2 086	

– = nil.

Sources: SIPRI Military Expenditure Database, May 2018; and Perupetro, ‘Reporte de regalías histórico’ [Historical reports of royalties collected], various years.

There are three sources of funding for the fund: (a) an initial one-off payment of \$25 million from the national treasury in 2005 (\$18.8 million of which went to the armed forces); (b) 20 per cent of the royalties from Lot 88 of the Camisea gas-extraction project in 2005 and 40 per cent from 2006 onwards; and (c) 30 per cent of the royalties from Lot 56 of the Camisea project.⁹ Lot 88 is made up of revenues from gas and liquefied natural gas (LNG), and (since 2014) revenues from the LNG plant in Pampa Melchorita. Lot 56 is made up of revenues from gas and LNG.

The revenues from the fund are divided equally between the Peruvian Army, Navy, Air Force and National Police.¹⁰ Thus, 75 per cent of this off-budget fund is allocated to military expenditure. Allocations have ranged from a low of \$28.7 million in 2005 (excluding the one-off payment of \$25 million) to a high of \$346 million in 2013.¹¹ Between 2005 and 2017 a

⁹ Ley que crea el Fondo para las Fuerzas Armadas y Policía Nacional (note 7), Article 2.

¹⁰ Ley que crea el Fondo para las Fuerzas Armadas y Policía Nacional (note 7), Article 3.

¹¹ Unless otherwise stated, all spending figures are quoted in current US dollars.

total of \$2.4 billion was diverted from natural resource revenues to the military (see table 4.6).¹² On average, since 2005, the off-budget funding for the Peruvian armed forces accounted for 7.7 per cent of Peru's total military expenditure, ranging from a low of 3.3 per cent following the 2014 oil price crash to a high of 14 per cent in 2011.

The SIPRI Military Expenditure Database has been revised to take this additional spending into account. However, the exact uses for this money—whether for procurement or modernization plans—remain unknown. Other questions remain regarding accountability, parliamentary oversight and possible corruption. Such questions emphasize the need for greater transparency in military expenditure.

Venezuela

Venezuela also has an off-budget funding mechanism for its military: the National Development Fund (Fondo de Desarrollo Nacional, FONDEN), created in 2005.¹³ FONDEN's main objectives are to manage investments in development-related areas, such as education, health and infrastructure, and to finance public debt. It was intended to foster economic growth and sustainable development in Venezuela. The fund's resources are mainly provided by the Central Bank of Venezuela (Banco Central de Venezuela) and the state-owned oil company, *Petróleos de Venezuela SA* (PDVSA; see figure 4.5).¹⁴ No information is available on the sources of funding for FONDEN after 2012.

Over the years, FONDEN has been used to finance a wide array of projects, and its scope and budget have been greatly expanded. From its inception until 2015, a total of \$176 billion was used to finance 791 projects.¹⁵ FONDEN's funds are equivalent to a small country's spending: according to one study, FONDEN's allocations in 2010 were seven times bigger than Nicaragua's

¹² Perupetro, 'Reporte de regalías histórico' [Historical reports of royalties collected], various years.

¹³ Decree no. 3854, *Gaceta Oficial de la República Bolivariana de Venezuela*, no. 38.261, 30 Aug. 2005.

¹⁴ In 2011 Venezuela's National Assembly implemented a new law establishing a special mechanism to collect funding, under certain conditions, based on revenues from exports of liquid hydrocarbons: *Contribución Especial por Precios Extraordinarios y Precios Exorbitantes en el Mercado Internacional de Hidrocarburos* [Special contribution for the extraordinary and exorbitant prices in the international hydrocarbons market] (CEPEPEMIH). Decreto no. 8163 con Rango y Valor y Fuerza de Ley que Crea una Contribución Especial por Precios Extraordinarios y Precios Exorbitantes en el Mercado Internacional de Hidrocarburos [Decree no. 8163 bringing into force the law creating a special contribution for the extraordinary and exorbitant prices in the international hydrocarbons market], *Gaceta Oficial de la República Bolivariana de Venezuela (Extraordinaria)*, no. 6.022, 18 Apr. 2011.

¹⁵ Venezuelan Ministry of Popular Power for Planning and Finance (MPPPF), *Memoria y Cuenta 2015* [Report and accounts 2015] (MPPPF: Caracas, 2016). No information is available on projects funded by FONDEN in 2016 and 2017.

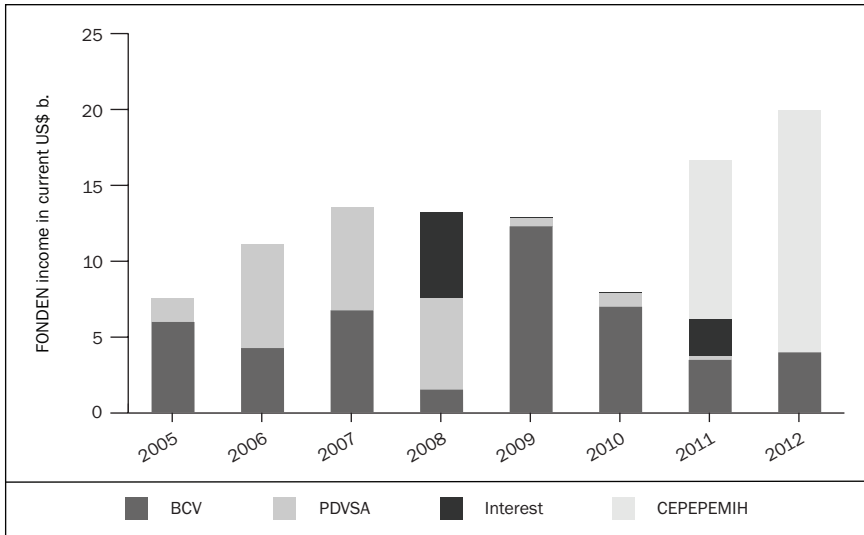


Figure 4.5. FONDEN's accumulated income, 2005–12

BCV = Banco Central de Venezuela [Central Bank of Venezuela]; CEPEPEMIH = Contribución Especial por Precios Extraordinarios y Precios Exorbitantes en el Mercado Internacional de Hidrocarburos [Special contribution for the extraordinary and exorbitant prices in the international hydrocarbons market]; FONDEN = Fondo de Desarrollo Nacional [National Development Fund]; PDVSA = Petróleos de Venezuela SA.

Source: Venezuelan Ministry of Popular Power for Planning and Finance (MPPPF), *Memoria y Cuenta 2012* [Report and accounts 2012] (MPPPF: Caracas, 2013).

state budget.¹⁶ However, Venezuela's National Assembly has no oversight of FONDEN's investments, despite the fund's large size.

It is known that the military has received large contributions from FONDEN as off-budget allocations.¹⁷ But FONDEN's lack of transparency means that the size of these contributions remains a matter of dispute, with estimates varying widely among analysts. Some argue that the military budget has increased sharply while social investment has remained relatively unaltered.¹⁸ Others assert that the military budget, which includes off-budget financing, corresponds to only a small fraction of the Venezuelan state budget.¹⁹

¹⁶ Transparencia Venezuela, 'Informe nuestro presupuesto' [Report of our budget], no. 11 (15 Dec. 2010), p. 8.

¹⁷ Bromley, M. and Solmirano, C., *Transparency in Military Spending and Arms Acquisitions in Latin America and the Caribbean*, SIPRI Policy Paper no. 31 (SIPRI: Stockholm, Jan. 2012), p. 15.

¹⁸ Corrales, J. and Penfold, M., *Dragon in the Tropics: Hugo Chávez and the Political Economy of Revolution in Venezuela* (Brookings Institution Press: Washington, DC, Feb. 2011).

¹⁹ Gott, R., *Hugo Chávez and the Bolivarian Revolution*, new edn (Verso: New York, 2011); and Jones, B., *Hugo! The Hugo Chávez Story from Mud Hut to Perpetual Revolution* (Steerforth: Hanover, 2007).

In 2010 the accounts committee of the National Assembly demanded that the Ministry of Planning and Finance provide further clarifications on the use of FONDEN's resources. A few months later, the planning minister, Jorge Giordani, presented a document with details of all funds allocated from FONDEN in 2010.²⁰ This was the first credible information from an official source to back up earlier claims and assessments on Venezuela's off-budget spending. It provided insight into the types of arms purchase that were funded by off-budget oil revenues, listing all existing and new arms procurements that had been partially or fully paid for by the end of 2010.

Based on the ministry's report, SIPRI started the process of revising its Venezuelan military expenditure figures to include FONDEN's off-budget allocations.²¹ Specifically, SIPRI analysed the annual report and accounts of the Ministry of Planning and Finance and the Ministry of Economy and Finance, which provide detailed figures for nearly all the projects funded by FONDEN.²²

The information found in these reports and accounts provided further detail on Venezuela's military expenditure. For example, between 2005 and 2013 FONDEN assigned around \$6.2 billion to the military to finance 39 projects. On average, off-budget allocations from FONDEN increased Venezuela's annual military spending by 26 per cent in 2005–15. These contributions have varied as oil prices have fluctuated (see figure 4.6). For example, in 2009 and 2014 the price of oil fell significantly and FONDEN's contributions were greatly reduced in those years.

The 2010 report to the National Assembly suggests that FONDEN's off-budget funds are mainly used to purchase weapon systems. For example, FONDEN assigned about \$2.2 billion for the purchase of 24 Su-30 combat aircraft from Russia between 2006 and 2008. However, Russian sources suggest that the cost of the aircraft was in the region of \$1.5 billion, highlighting possible misuse of funds or corruption.²³ In addition, FONDEN resources are used to cover some operational and personnel costs as well as acquisitions of small arms.

The available figures also reveal the relative priority given to funding the military in comparison with other sectors. Between 2005 and 2013, among

²⁰ Venezuelan Ministry of Popular Power for Planning and Finance, 'Proyectos y Recursos 2010 del Fondo y Fondo Chino' [2010 projects and resources of FONDEN and the China Fund], Apr. 2011.

²¹ Tian, N. and Lopes da Silva, D., 'Improving South American military expenditure data', SIPRI Commentary, 4 Sep. 2017.

²² Venezuelan Ministry of Popular Power for Planning and Finance (MPPPF), *Memoria y Cuenta* [Report and accounts], 2011–15 (MPPPF: Caracas, 2012–16). These reports provide data for spending in 2011–15. At the time of writing, there are no reports for 2016 and 2017. Data for 2005–2009 was taken from Colgan, J., 'Venezuela and military expenditure data', *Journal of Peace Research*, vol. 48, no. 4 (July 2011), pp. 547–56. Figures for 2010 were taken from Venezuelan Ministry of Popular Power for Planning and Finance (note 20).

²³ Makienko, K., 'The Venezuela contracts', *Moscow Defense Brief*, vol. 1, no. 7 (2007).

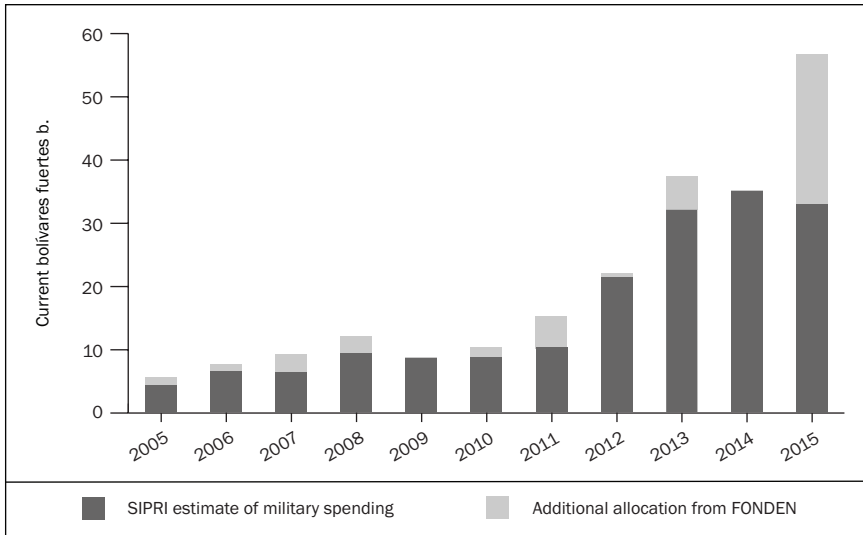


Figure 4.6. Off-budget allocations from FONDEN as a share of Venezuelan military spending, 2005–15

FONDEN = Fondo de Desarrollo Nacional [National Development Fund].

Note: Figures are in current bolívares fuertes b. rather than US dollars because of severe currency depreciation and uncertainty in the bolívar fuerte–dollar exchange rate since 2014.

Sources: Venezuelan Ministry of Popular Power for Planning and Finance (MPPPF), *Memo-ria y Cuenta* [Report and accounts], 2011–15 (MPPPF: Caracas, 2012–16); Colgan, J., ‘Venezuela and military expenditure data’, *Journal of Peace Research*, vol. 48, no. 4 (July 2011), pp. 547–56; and Venezuelan Ministry of Popular Power for Planning and Finance, ‘Proyectos y Recursos 2010 del Fonden y Fondo Chino’ [2010 projects and resources of FONDEN and the China Fund], Apr. 2011.

the 31 areas that received FONDEN resources, the \$6.9 billion (21.3 billion bolívares fuertes) given to the military ranked it as the sixth largest recipient. Healthcare, by comparison, ranked as the 12th largest recipient, having received \$1.4 billion (4.3 billion bolívares fuertes) to finance eight projects. FONDEN’s allocations for education were even lower, with \$1.2 billion (3.7 billion bolívares fuertes) to finance four projects.²⁴

Although accounting for FONDEN’s off-budget allocations is an important step towards more accurate and reliable data, Venezuela’s military spending remains underestimated. Alongside FONDEN, the Venezuelan armed forces also receive funds from the China–Venezuela Joint Fund (Fondo Conjunto Chino–Venezolano) and from the Large Volume and Long-Term Fund (Fondo Gran Volumen y Largo Plazo). Future efforts should focus on collecting data on these other sources.

²⁴ Figures for allocations for healthcare and education in bolívares fuertes are based on an average exchange rate to make them consistent with SIPRI’s calculation of the military allocation in that currency.

The revision of SIPRI's figures for Venezuela's military spending is particularly timely. The country now faces an acute economic crisis. Its gross domestic product (GDP) in 2017 was 34 per cent below the level in 2013, while GDP per capita fell by 37 per cent.²⁵ This bleak economic outlook is coupled with increasing political instability. Disclosing FONDEN's allocations to the military sector may help to elucidate whether the Venezuelan Government is managing its scarce resources according to its people's best interest.

The consequences of off-budget mechanisms in military expenditure

The non-transparent management of off-budget funds has harmful effects on democracy. The lack of accountability for and oversight of these finances can create an institutional environment prone to corruption. Questions over the management of such funds have been repeatedly raised.²⁶ The secrecy of arms purchases funded through Venezuela's FONDEN and, to a lesser extent, Peru's Camisea gas-extraction project, weakens democratic control since it prevents a more thorough assessment of the strategic necessity for such procurements.

The higher military spending of Peru and Venezuela, revealed by this analysis, only reinforces the importance of SIPRI's current effort to review the military spending figures of all South American countries to include off-budget allocations. It is suspected that off-budget funding is common (and not isolated to South America) and, as the above two cases show, can have a major impact on the level of military spending. Capturing off-budget mechanisms strengthens transparency within the military sector, which builds national accountability, improves trust and confidence among states and helps to discourage military corruption.

²⁵ International Monetary Fund, World Economic Outlook Database, Oct. 2017.

²⁶ Transparencia Venezuela, 'Nuestro presupuesto: seguimiento al Presupuesto Nacional en el 2012' [Our budget: tracing the National Budget in 2012], no. 25 (June 2012).