
Defense Sector Budget: Trends and impact of COVID-19

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Summary

The COVID-19 coronavirus pandemic has been producing a negative impact on the country's macroeconomic situation, causing budget reductions in the Defense Statement, as the Government's priorities have been focused on areas such as health, education, well-being, among others. In this sense, fulfilling its strategic roles with a reduced budget allocation constitutes a challenge for the Defense Sector and its executing units. In this regard, the relationship between the different elements of the problem must be analyzed and understood in order to understand the effects that the measures adopted may bring¹. This situation marks an unprecedented challenge for the units executing the specifications, as they have to carry out operational, administrative and logistical procedures, where the timely capacity of spending is the backbone for the fulfillment of their missions. This article analyzes the current economic situation facing the Defense Sheet and how it will be affected in the fulfillment of its objectives. Likewise, the budgetary behavior of the Defense Statement is observed to better understand the actions or reactions, as a prospective method that helps the administration to be able to face these challenges efficiently and achieve quality in budgetary spending.

Keywords: National Defense, Modified Institutional Budget, Gross Domestic Product, Generic Spending.

Introduction

The national and global economy is going through a catastrophic situation as a result of the effects of the COVID-19 pandemic. However, before their arrival in Peru, some of the main macroeconomic variables were already showing negative behavior; therefore, tax collection had not reached the expected levels. Faced with this situation, the Peruvian Government has seen the urgent need to redefine the General Budget of the Republic to address priorities with regard to health, food, and labor factors, which

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has caused a lower budget assigned to the Defense Statement, making it impossible for the Armed institutions effectively fulfill their constitutional mandate to guarantee independence, sovereignty and territorial integrity, not to mention activities in support of internal order, national development, the State's foreign policy and the National System for Risk Management of Disasters (SINAGERD).

In 2021, the budget allocation for the Defense Sector had its worst moment since 2010, mainly with regard to budget items for goods and services, which only represents 23% of the total allocated, while The remainder is mainly focused on the payment of assets and supplements; Despite this, the Armed Forces have been carrying out -with many limitations- military actions in support of other Sectors to face the effects of the pandemic. This situation is aggravated by the scarce uptake in the source of financing of direct collection resources, as well as by the drastic decrease in income from the Defense Fund, accruing from Camisea gas royalties due to the reduction in gas prices. natural gas and the flow of future resources from this source already committed until the year 2023 based on previous contracts.

This article analyzes the current economic situation facing the Defense Sheet, including the impact on the fulfillment of its objectives, as well as the budgetary behavior of the Defense Sheet to better understand the consequences of these decisions.

Situation of COVID-19 in Peru

In Peru, the first case of SARS-COV-2 (COVID-19) was announced on March 6, 2020; Two weeks later, Supreme Decree No. 094-2020-PCM was promulgated, which established the measures of social isolation aimed at a new social coexistence, extending the State of National Emergency². The effects of this pandemic in Peru not only showed the serious deficiencies of the Health System, but also forced questions such as what should be the role of industry and society to face these emergency situations?³ As a consequence, multiple sociocultural changes that used to take generations have accelerated, drastically changing customs throughout the world.

Classified as one of the largest pandemics of the last 100 years, COVID-19 has exceeded the health field, altering interpersonal relationships and -in general- the daily lives of both people and institutions, who have to work in a more articulate manner. For this purpose, the Armed Forces had to bring out the most sublime of its essence: discipline and its organization, not only to comply with the urgent requests of other Sectors aimed at counteracting the effects of COVID-19 but, also, to support themselves in a climate of uncertainty and chaos. Many troops fell ill and others died, including their direct relatives, having to face challenges such as raising the morale of the members of the Armed Institutions and continuing to comply with the demands of the Government and citizens.

Economic situation in the country and budget in the Defense Sector

It was in the 1990s, when Peru began a commercial opening that brought with it an increase in its trade flows and Foreign Direct Investment - FDI (which is the placement of long-term capital in a foreign country), which produced a sustained increase in its Gross Domestic Product - GDP (an indicator that encompasses the entire economy). Thus, through the implementation of prudent macroeconomic policies, structural reforms and increased internal security, Peru went from being a country with inflation rates that reached triple digits, high unemployment levels and low growth, to be one of the leading growth economies in Latin America and the Caribbean. These favorable internal conditions, together with a context of high prices of raw materials, such as copper, gold, zinc and other minerals, meant that between 2005 and 2015 the average GDP growth rate reached 5.9%, while average inflation was 2.9%, one of the lowest in the region⁴. However, the economic situation in the Defense Sector, between 1990 and 2000, had different behaviors in terms of budget allocation, having to face different areas such as natural disasters (the child phenomenon), illegal mining, fight against terrorism (remnants) and narco-terrorism (emergence), illicit drug trafficking, among others.

According to the World Bank (2020), Peru's GDP -in terms of annual percentage- has been decreasing steadily since 2010 with a difference of -6.18%. The effects of COVID-19, without a doubt, have accelerated this trend⁵. The government responded vigorously to the health crisis and the economic response was similar to that implemented by advanced countries. In this sense, the authorities imposed strict mandatory social distancing measures shortly after detecting the first confirmed case of COVID-19 in the country. In parallel, taking advantage of Peru's macroeconomic strength, a package of economic support was launched for households and companies whose relative size is close to that adopted in some advanced economies⁶. However, various economists agree that the Peruvian economy will lose between 2.5 and 4.2 growth points just due to the international shock. In this regard, it is estimated that in 2020 the Peruvian economy experienced a contraction of 12%. According to the National Institute of Statistics and Informatics (INEI), GDP contracted by 30.2% in the second quarter of 2020⁷.

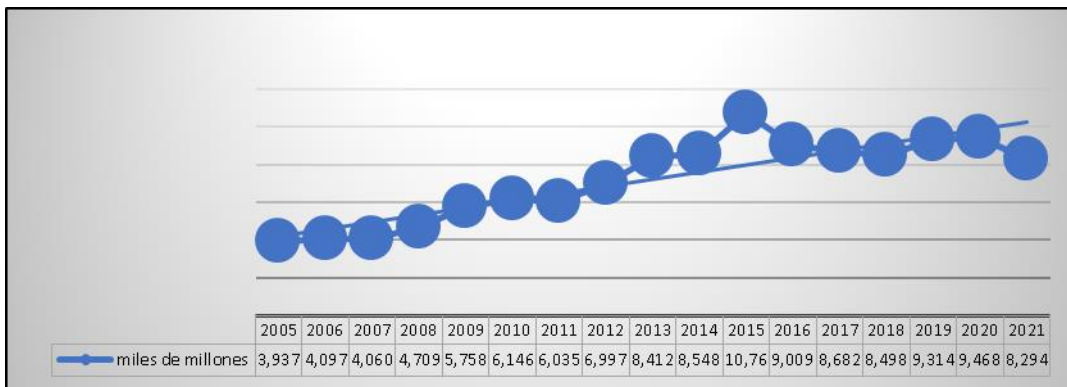
However, in the first quarter of 2021, the GDP increased by 3.8% when compared to the similar quarter of the previous year, after the contraction shown in the four quarters of 2020. This result is associated with the measures of economic reactivation implemented to counteract the effects of the COVID-19 pandemic. GDP growth was influenced by the increase in domestic demand (6.5%), while exports decreased (-5.5%) and imports increased (5.0%). In this regard, the higher domestic demand is explained by higher spending on goods and services for private final consumption (2.1%) and for government consumption (7.2%), as well as higher gross fixed investment (30, 4%). Other data are private final consumption, which increased 2.1%, and government final consumption expenditure, which increased 7.2%⁸.

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It should be noted that one of the most negative effects of this pandemic has been the increase in levels of poverty, extreme poverty and social inequality in the country. It should be borne in mind that the pandemic has not only shown the serious problems of the Health System, but also the existing problems in all other Sectors of the State, which have a significant impact on the well-being of Peruvian society⁹.

Based on the budget information obtained from the Ministry of Economy and Finance (MEF), through the SIAF application, in Graph 1 the budgetary evolution by all source of financing is observed from 2005 to 2021, in reference to the Modified Institutional Budget (PIM). Now, considering that the PIM is the updated budget of the public entity as a result of the budgetary modifications made during the fiscal year from the Institutional Opening Budget (PIA), the trend line is positive, going from 3.93 thousand million soles to 8.29 billion soles. However, such behavior should be analyzed on the basis of general expenses for a better appreciation.



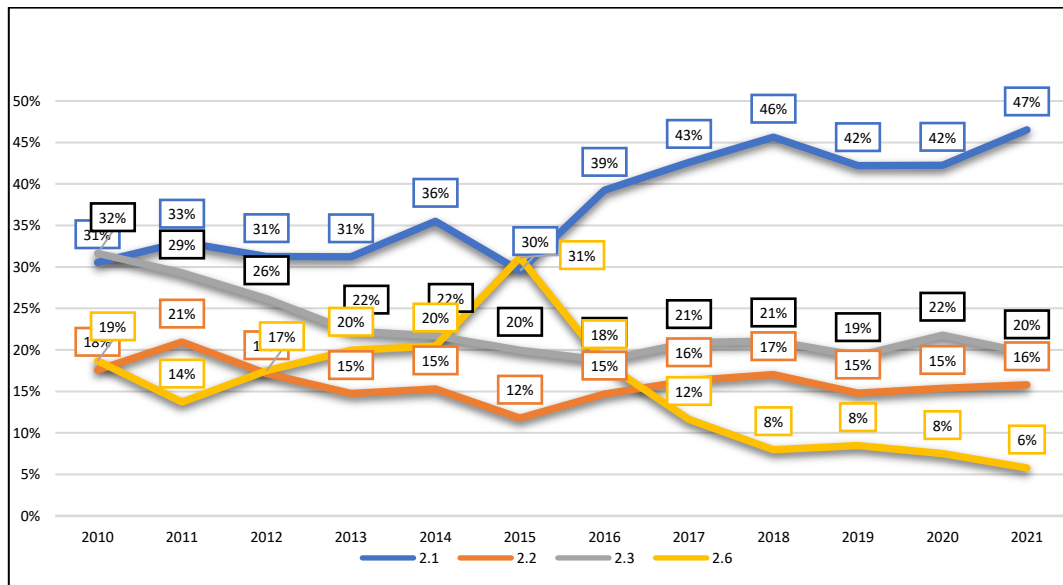
* Miles de millones (Thousands of millions)

Graph 1. Budgetary situation of the Defense Sheet 2005-2021 (PIM) / Source: Own elaboration with data from the MEF-SIAF

On the other hand, in Graph 2 it is observed how the budget of the Defense Statement from 2010 to 2021 is made up, by spending category.

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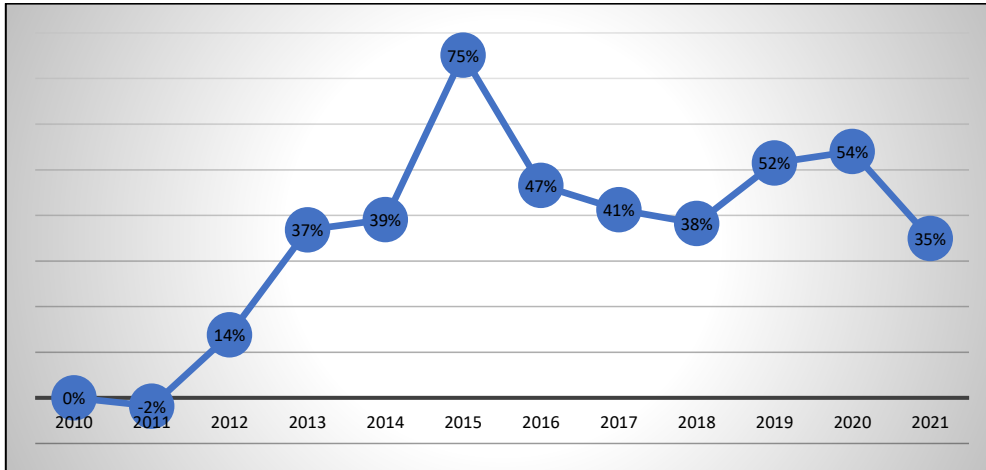
Graph 2. Budgetary situation of the Defense Statement 2010-2021 Generic expenditure (composition% PIM) / Source: Own elaboration with data from the MEF-SIAF

In this regard, said Graph shows that the level of percentage composition of General Expenditure 2.1 (Personnel and Social Obligations: Expenses generated by way of remuneration, contributions by social laws, training and other benefits and expenses incurred in favor of active personnel with an employment relationship, as well as the Board of Directors' allowances.¹⁰) It has a positive trend based on the PIM of each fiscal year, increasing from 31% to 47%. Likewise, the level of percentage composition of the Generic Expenditure 2.2 (Pensions and Other Social Benefits: Expenses for the payment of pensions to unemployed and retired people of the public sector, benefits in favor of pensioners and active personnel of the public administration, social assistance provided by public entities to the population at social risk.¹¹) has had an almost stable behavior in reference to the PIM granted, remaining between 18% in 2010 and 16% in 2021. Similarly, the percentage composition level of the General Expenditure 2.3 (Goods and Services: Expenses for the acquisition of goods for the institutional functioning and fulfillment of functions) has had a negative trend based on the PIM of each fiscal pipe, reducing from 31% in 2010 to 20% in 2021. Finally, the percentage composition level of the General Expenditure 2.6 (Acquisition of non-financial assets: Expenses for investments in the acquisition of capital goods that increase the assets of public sector institutions. Includes additions, improvements, repairs of the productive capacity of capital goods and investment studies) has had a negative trend behavior in reference to the PIM granted, decreasing from 19% in 2010 to 6% in 2021.

On the other hand, establishing 2010 as the base line to analyze the budgetary behavior of the Defense Sheet until 2021, it is observed that the trend is positive with an average budget increase of 36% for all generic expenses, as shown in Figure 3.

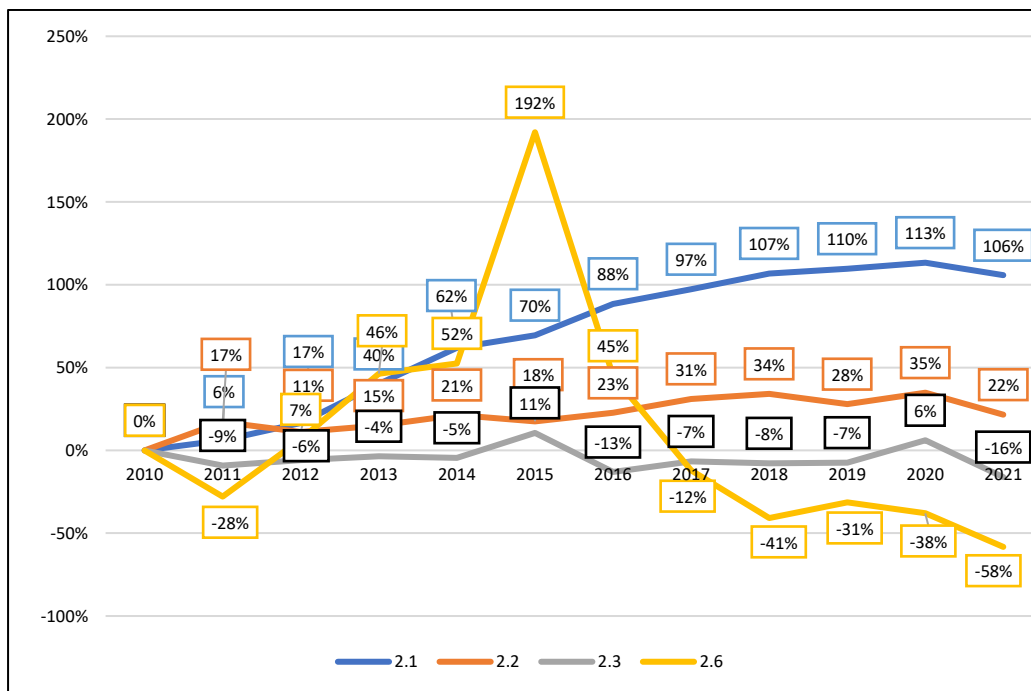
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Graph 3. Budgetary situation of the Defense Statement 2010-2021 - Baseline 2010 / Source: Own elaboration with data from the MEF-SIAF

Likewise, in Graph 4 it is possible to observe the budgetary behavior from 2010 to 2021 by spending category.

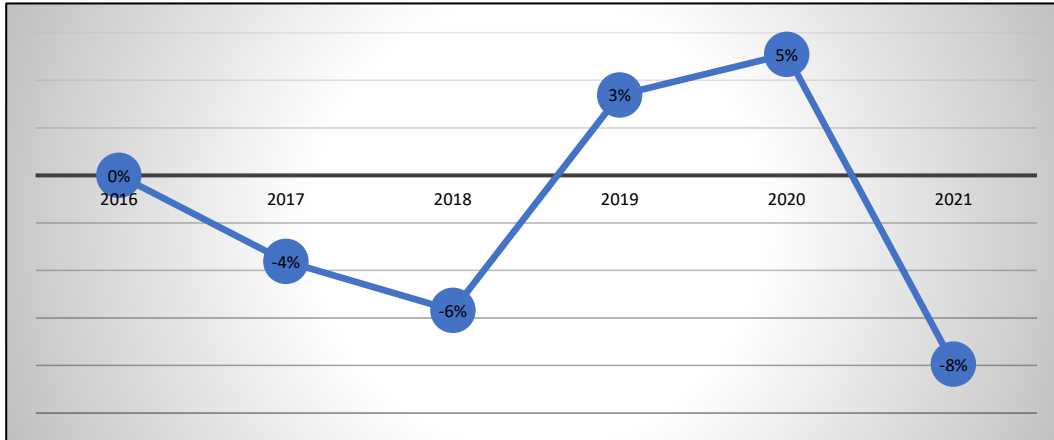


Graph 4. Budgetary situation of the Defense Statement 2010-2021 - Generic expenditure / Source: Own elaboration with data from the MEF-SIAF

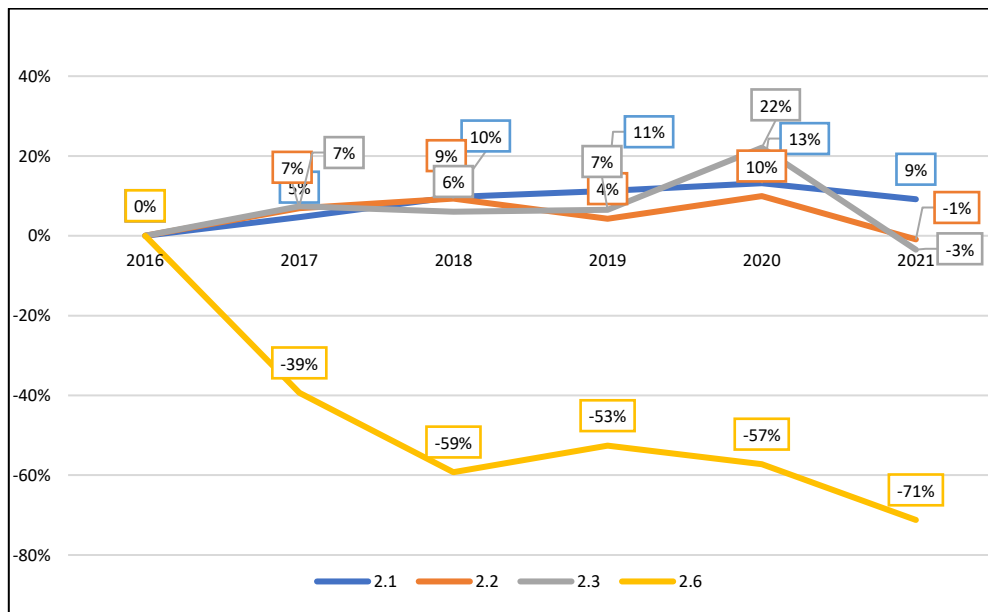
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Likewise, another perspective can be established in the budget analysis of the Defense Statement if the year 2016 is established as the baseline, as can be seen in Figures 5 and 6.



Graph 5. Budgetary situation of the Defense Statement 2016-2021 - Base line 2016
/ Source: Own elaboration with data from the MEF-SIAF



Graph 6. Budgetary situation of the Defense Statement 2016-2021 - Generic of Expenditure / Source: Own elaboration with data from the MEF-SIAF

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All these budgetary changes in the Defense Sheet produced various situations. First, the budget increase in the specifications since 2010 has an increasing average of 39%, while since 2016 it has a decreasing average of 2% in reference to that year until 2021. Second, the composition by generic of spending of the PIM average percentage, from the year 2010 to the year 2021, shows that the trend of the generic Personal and Social Obligations and Pensions and Other Social Benefits represent 53% of the budget; However, from 2016 to 2021, there is an increase that represents 59% of the budget. Third, the composition by generic of spending of the PIM average percentage, from the year 2010 to the year 2021, shows that the trend of the generic Goods and Services, and Acquisitions of Non-Financial Assets represent 38% of the budget; However, from the year 2016 to the year 2021, there is a change and it represents 30% of the budget. Fourth, the decreasing budget in the specifications since 2016, by 8% to 2021. Fifth, the behavior of the generic Personal and Social Obligations expense since 2010 increased to an average of 74%, Pensions and Others Social Benefits increased to 23%, Goods and Services decreased to 5%, as well as Acquisition of Non-Financial Assets increased to 12%.

With these data it is observed that both the generic expenses of goods and services and the acquisition of non-financial assets had radical budget drops since 2010 (with the exception of 2015), highlighting that the budget allocation in the generic mentioned for the year 2021 is the lowest of all, with only S / . 1,630'406,051.00. A similar situation can be seen for the generic cost of acquisition of non-financial assets, registering its worst budget allocation with S / . 479'054,895.00 for the year 2021.

It is indisputable to recognize that the capabilities of the Peruvian Armed Forces have played a key role every time the country has been affected by some calamity; However, the development and maintenance of these capacities requires an adequate budget allocation by the Government so that the Armed Institutions can effectively fulfill the various strategic roles assigned by the Peruvian State.

Conclusions

With COVID-19, not only the serious deficiencies of the Peruvian Health System were emphasized, but also the need to work in a more articulated manner among the institutions, ministries, governments and powers of the Peruvian State. For the Ministry of Defense and its various executing units, it continues to be a challenge to have to comply with the continuous demands of the Government and the population in order to try to counteract the effects of COVID-19, mainly due to the limited budget that is available to them, that has been assigning in recent years. Likewise, the budgetary situation of the Defense Sheet for all sources of financing from 2005 to 2021 had a positive trend, going from 3.93 billion soles to 8.29 billion soles, which is why it is concluded that there are a direct correlation with the economic situation of the country. However, the Defense Statement only has 35% of its annual budget to fulfill the strategic roles assigned by the Peruvian State, since almost 65% of this budget is assigned to the payment of salaries, pensions and other social obligations.

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It is here where the different executing units of the Defense Document face the challenge of financial, budgetary and logistical administration to prioritize and be efficient in spending, as well as to demonstrate the transparency of the processes before the control bodies and then resort to the different additional demands in order to demonstrate that the allocation granted is insufficient to face the roles assigned to it by the Peruvian State. It is necessary to emphasize that the Armed Forces - at all times - must effectively comply with the constitutional mandate to guarantee independence, sovereignty and territorial integrity, not to mention activities in support of internal order, national development, and foreign policy of the State and the SINAGERD, for this they need the adequate allocation of resources by the Peruvian Government.

Endnotes

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⁷ Ibid.

⁸ INEI.GOB.PE (2021)

⁹ Fernández, Jackeline y Roxana Huaman "Economic and Social Impact of COVID-19 in Peru." Journal of Defense Science and Research-CAEN ISSN 2709-1422, 2021: 40.

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