

# Budget 2012:

## A thin case for optimism

Every reader of this magazine would have paid close attention to the headlines following the May Budget. Defence spending slashed by \$5.5 billion ... largest year-on-year cut (10 per cent) since our withdrawal from Korea in 1953 ... smallest share of GDP (1.6 per cent) since the Munich Crisis of 1938. It's all true, there's no point pretending otherwise; Defence copped a wallop.

WHAT'S more, the 2009 Defence White Paper is dead. Apart from a promise to deliver the 'core capabilities' (whatever that might mean) of *Force 2030*, all bets are off. There's certainly no suggestion at all that the government remains committed to three per cent real growth in defence spending. Indeed, given that the promised money hasn't materialised in any of the past three budgets, one might ask whether they were ever so disposed.

So where does that leave us from the point of view of defence industry? For the moment, things look dire. This year's cuts come on top of deferrals and cuts to defence spending over the past three years. And then, as now, the target for the cuts has been the capital investment program. As the graph on this page shows, the accumulated impact has been to gauge a deep valley where a mountain was supposed to rise. From a local perspective, things are actually worse, given the number of large foreign off-the-shelf purchases of recent years.

Even if we take the optimistic view that defence spending will recover as the economy gathers momentum in the years ahead, we are looking at nothing short of



The M777 was one of the few budget winners.

DEFENCE

### The capital case: 2003 till 2016

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Other Capital	0.771	0.857	0.802	0.917	1.126	0.967	0.818	0.674	0.928	0.758	0.172	0.248	0.250	0.240
Capital Facilities	0.486	0.492	0.524	0.546	0.795	0.665	1.062	1.619	1.272	1.027	1.019	0.724	0.749	0.539
Major Capital Investment	3.738	3.794	4.425	4.938	4.891	4.700	4.349	5.543	5.083	4.398	3.414	3.312	4.131	5.658

a lost decade of progress towards building a stronger ADF. Past experience shows that it can take a long time for industry to build sufficient capacity to undertake a larger volume of work - especially when they have to wait for Defence's glacial processes to get work approved.

But optimism is probably not justified at this point. The government's announcement of the 2013 Defence White Paper made clear that fiscal priorities will figure prominently. As they put it; 'Financial circumstances clearly present a real challenge to the 2013 White Paper'. The projected surpluses for the next two years are razor thin, each representing only around one-tenth of one per cent of Australia's GDP.

Even a tiny shortfall against projected economic growth will send the budget back into deficit. If that happens next financial year, the government will have to make further cuts mid-way through the year. But with only six months to make up the difference, they will have to dig twice as deep. Things could get even worse for Defence if such a situation arises.

The only positive aspect of the recent cuts to defence spending is that operational areas have been quarantined - deployed forces will still get everything that they need. Back at home, things will be tight; not just in terms of investment in new equipment, but right across the department.

Already, in this year's budget, \$2.9 billion has redirected over four years within Defence to address priority cost pressures in the portfolio.

This included an additional \$709 million for the sustainment of the Collins class fleet and an extra \$550 million for remediation of Defence's aging information technology systems. As usual, the money was taken from the

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only cash cow available - the major capital investment program. Looking at the pared back funding figures within Defence for the next couple of years, it would be surprising if further cost pressures do not emerge.

It will be up to the 2013 Defence White Paper to fix the mess. As things stand, there is a yawning gap between means and ends that must be closed one way or another.

### Action plan

Put simply, the government has two choices; spend more money, or plan for less capability. The critical issue for defence industry - indeed for all those committed to a stronger and more capable defence force - is the likelihood of sustained long-term increases to defence spending like that of the 2000s. It's hard to be optimistic. Support for defence spending is under threat on two fronts:

First, economic circumstances today are very different to those of a decade ago when economic growth and revenues exceeded expectations for years on end. From 2000 onwards, the Howard government was spoilt for riches. It's easy to make a strong commitment to defence spending when you neither have to raise taxes nor sacrifice spending elsewhere to do so. That's not the situation we have today, nor is a return to such a situation in prospect. Higher defence spending will incur real opportunity costs, through either higher taxes or reduced spending elsewhere in the community.

Second, the high operational tempo of

the last dozen years is drawing to a close. And as it does, the fears and misgivings which translated into public support for stronger defence are declining. The pattern after every war that Australia has fought has been the same (just as it has been for most other countries); defence spending has declined and the defence force has been reduced in size.

The attraction of a peace dividend is hard to resist, irrespective of which side of politics is in power. If anything, the opposition faces an even greater fiscal dilemma given their opposition to carbon and mining taxes coupled with promised spending elsewhere.

Of course, things can change quickly. A crisis in one of the fragile states on our periphery, or a clash in the waters of North Asia, could change things in a blink of the eye. The government could again be seized of the importance of a well prepared and equipped military. Equally, a repeat of the global financial crisis would likely put the last nail in the coffin of the prospects for anything like the sort of ADF planned in 2009.

There is little doubt that the 2012 Budget represents a turning point in Australian defence planning. In all likelihood, the 2013 White Paper will move us towards a somewhat more modest vision for the ADF of the future, and it will probably plot a more gradual path towards that vision. While many will disagree with such a move, it will better than the farce of the past few years where we've been playing make believe. \*

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