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# Defence Funding and Planning: Promises and Secrets

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In terms of defence funding and capability planning, the new Defence White Paper is a peculiar mix of clarity and concealment. While it paints a relatively detailed picture of what the government says the defence force will look like in 2030, it says very little about what will happen between now and then. Similarly, although a funding commitment stretching twenty-one years into the future is offered; actual budget figures have only been disclosed for the next four years. Neither commercial nor national security considerations explain this pattern of near-term secrecy and long-term openness. Instead, it appears that the government wants to take credit for being strong on defence, while deliberately not setting any targets against which progress can be measured and also retaining the option of further reducing defence spending in the medium-term, dependent on economic circumstances.

The 2009 Defence White Paper paints a vision of an expanded Australian defence force. Building a force of the scale, complexity and sophistication envisaged will require sound plans and lots of money. This article examines the funding and planning associated with the new Defence White Paper. It begins by looking at funding, including the \$20 billion of savings that the Department of Defence has to find over the next decade, and concludes by exploring what is known about the plans to deliver the expanded vision.

## Defence Funding

The 2000 Defence White Paper delivered 3% real growth in defence funding out to financial year 2010-11. As a result of government decisions in 2006 and 2008, the 3% growth trajectory was extended to 2017-18. In addition, around \$20 billion of new funding was granted to Defence between 2005 and 2007 for previously unplanned capabilities. This included \$6 billion to acquire and operate 24 F/A-18 Super Hornet fighters, \$3.2 billion for four C-17 Globemaster aircraft and \$10 billion to expand, network and harden the Army, including the raising of two new infantry battalions. On top of this, Defence has received \$10.6 billion of supplementation for overseas operations over the past ten years, including \$4 billion for East Timor, \$3.6 billion for Afghanistan and \$2.4 billion for Iraq.

As a result of these successive injections of new funding, the defence budget has grown from \$15.6 billion in 2000-01 to a planned \$26.8 billion in 2009-10 (both measured in 2009-10 dollars),<sup>1</sup> amounting to a 72% real

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<sup>1</sup> Real growth is calculated using the Consumer Price Index, ABS series 6401.0.

increase over nine years. This stands in stark contrast to the 1980s and 1990s when defence funding largely remained fixed in real terms.

The recent period of growing defence funding broadly coincides with the heightened strategic anxiety that began in 1999 with East Timor and accelerated through the events of 9/11 and subsequent deployments to Afghanistan, Iraq and Solomon Islands, and return deployments to East Timor and Afghanistan. All up, no less than six major offshore deployments in less than ten years.

But circumstances had changed by the time the 2009 Defence White paper was ready for release. Not only had the electorate long-ago absorbed the events of the past decade—people were neither alert nor alarmed—but the Global Financial Crisis had thrust the economy into the limelight ahead of all issues including defence. By early 2009, few observers thought that defence funding would emerge unscathed from the mounting fiscal pressures faced by the government.

It was a surprise, therefore, when the White Paper failed to hedge its bets. “For the first time”, it said, “an Australian Government has committed to funding a Defence White Paper for the life of the White Paper”.<sup>2</sup> While this statement is manifestly false (the 2000 Defence White Paper was accompanied by a decade-long funding commitment), a financial plan was presented with the following key features:

- 3 per cent real growth in the Defence budget to 2017-18;
- 2.2 per cent real growth in the Defence budget from 2018-19 to 2030;
- 2.5 per cent fixed indexation in the Defence Budget from 2009-10 to 2030.<sup>3</sup>

In addition, Defence has to find \$20 billion of internal savings over the next decade for re-direction to priority initiatives under the auspices of what is being called the Strategic Reform Program.

Four questions arise. Is the financial plan adequate to deliver the goals set out in the White Paper? Are the planned savings achievable? Will the promised funding be delivered? And, finally, how will the money be spent?

### **IS THERE ENOUGH MONEY?**

Because the White Paper sets few tangible goals prior to 2030, the adequacy of the financial plan is impossible to judge. Several useful observations can be made nonetheless.

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<sup>2</sup> Department of Defence, *Defending Australia in the Asia Pacific Century: Force 2030* (Canberra: Commonwealth of Australia, 2009), para 18.1.

<sup>3</sup> Ibid., para 18.4.

To start with, it is noteworthy that the funding plan is expressed explicitly as a financial constraint. While any defence funding scheme is inherently a compromise between the benefits sought and opportunity costs incurred, in practice either the demand for defence or the supply of funds drives the outcome. For example, the funding provided by the 2000 Defence White Paper was demand-driven in the sense that the 3% real growth was the bottom-up result of individual initiatives rather than a formulaic approach to funding. The new White Paper's adoption of a supply-driven funding plan coupled with an aggressive efficiency program heralds a return to the mindset of the 1990s—albeit with increasing rather than constant real funding.

It is also worth noting what's not new about the funding plan. Specifically, the promise of 3% real funding growth to 2017-18 delivers no additional funding—it is simply a restatement of existing policy. On the other hand, the 2.2% real growth for the period 2018-19 to 2030 is a new commitment, albeit a reduced one.

But analysis of the underlying trend in the cost of delivering military capability shows that real funding growth of around 2.7% per year is needed to maintain a modern defence force.<sup>4</sup> Consistent with this, the trend in Australian defence funding over the past sixty years has been 2.7% real growth.<sup>5</sup> It follows that 2.2% real growth post 2018-19 will force a contraction of either the scale and range (or both) of capabilities in the defence force. This would be a concern if promises of funding in the decade after next were worth taking seriously.

Of more relevance is the adoption of a fixed 2.5% per annum indexation regime. Indexation is intended to protect the buying power of the Defence budget against inflation. For the past eight years, defence funding was indexed relative to the implicit non-farm gross domestic product deflator. This was unfortunate because not only did the deflator fluctuate wildly (from 5.75% in 2008-09 to negative 1% in 2009-10, for example) but the fluctuations were largely unrelated to the changing cost of delivering military capability. The move to fixed 2.5% indexation will remove the fluctuations and align the indexation of the Defence budget with the mid-point of the Reserve Bank inflation target range.

As reassuring as this might sound, the move to fixed 2.5% indexation disadvantages Defence relative to the historical average consumer price index of 3% recorded over the past ten (and twenty) years. What is more, the adoption of a fixed index subverts the goal of maintaining the buying

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<sup>4</sup> Mark Thomson and Andrew Davies, *Strategic Choices: Defending Australia in the 21<sup>st</sup> Century*, Strategic Insights, no. 45 (Canberra: Australian Strategic Policy Institute, 2009).

<sup>5</sup> Mark Thomson, *The Cost of Defence: ASPI Defence Budget Brief 2009-2010* (Canberra: Australian Strategic Policy Institute, 2009), Chapter 5. See this publication for an extended discussion of the Defence budget figures in this article.

power of the Defence budget against changing circumstances. It would have made more sense to index the budget to the consumer price index, that way defence funding would be protected against an extended period of higher than average inflation (and the taxpayer would be protected against the converse).

Be that as it may, because the present deflator is abnormally low, the move to fixed 2.5% indexation delivers a large one-off injection of funding over the next decade and beyond. Indeed, for all but the final year of the next decade, it is only the new indexation regime that provides additional money.

### **CAN THE SAVINGS BE DELIVERED?**

Central to the government's financial plan are \$20.6 billion of gross savings over the next decade, from which \$18.2 billion of net savings will be available for reallocation after transition costs. While details of the savings program are limited, aggregate figures are available.

An average of around \$580 million per year across the next decade will be saved from the roughly \$5 billion presently spent on non-military support, including garrison support, travel, catering, financial and personnel management, and general administration. Taking inflation into account, this amounts to a saving of around 10% of present spending in this area.

Another \$510 million per year across the next decade will be saved from the roughly \$5.5 billion presently spent on military materiel support, including inventory spending and maintenance of weapons systems. This amounts to a saving of around 8% once inflation is taken into account. A further \$190 million per year will be saved through workforce reform, representing only around 2% of present personnel spending. And an additional \$190 million per year will be found from within the \$1.9 billion annual information technology budget. Finally \$5.9 billion will be saved over the next decade from pre-existing savings initiatives, although fully \$4 billion of this represents unallocated funds that Defence were holding as a central reserve. How this amounts to a saving is unclear.

Unlike previous attempts to improve the efficiency of Defence, the Strategic Reform Program is not planned to have a large impact on the workforce. In fact, once the planned initiatives in the White Paper are taken into account, the net result will be an increase in military and civilian personnel by 2,000 and 1,200 respectively by the end of the decade. It follows that savings will mainly come from reducing the demand for and price of goods and services purchased from the private sector.

The proposed saving represent 7% of present spending once inflation is taken into account. While this might sound a lot, it needs to be seen in context. Over the past eight years, Defence's permanent work force has grown by 11% while the purchase of goods and services has grown in real

terms by 83%. Moreover, with the Defence budget set to grow by an average of 3% per annum over the next nine years, and 2.2% in the tenth, any savings are relative to a rapidly growing bucket of money. In fact, in most cases the savings will represent 'costs avoided' rather than 'costs recovered'. Taking all this into account, the anticipated savings are not as ambitious as they might look at first glance. So while the Strategic Reform Program cannot be taken for granted, it is neither as ambitious as the 1997 Defence Reform Program nor will it be anywhere near as disruptive.

### **WILL THE PROMISED FUNDING BE DELIVERED?**

No. Ten days following the release of the Defence White Paper, the government reneged. Specifically, in the 2009 Budget, funding from the new indexation regime was delayed for four years and \$2 billion of pre-existing funding was 'reprogrammed' into the future. As best can be estimated, around \$8.8 billion was deferred from the first six years to the last three years of the forthcoming decade and the decade beyond that. It is impossible to be more precise because the budget papers assiduously fail to disclose or explain what happened.

The best explanation is that defence spending has been deferred to reduce the accumulation of debt and hasten a return to surplus. It is unlikely to be an accident that the deferrals push spending to beyond 2015-16—the year the government predicts that the budget will move from deficit to surplus.

Though this is far from surprising given the present economic situation, the degree of obfuscation and secrecy is difficult to understand. And it is not just the deferral of funds that is being withheld from public and parliamentary scrutiny. Despite claims from the government that the White Paper is "fully costed" and "affordable" to the year 2030, explicit funding figures are being kept secret beyond the four years automatically disclosed in the formal budget. All we have is a promise that budget growth will average 3% out to 2017-18 and 2.2% thereafter to 2030.

Assuming that the promise of 3% average growth still holds, the government has created a problem for itself. After a one-off boost to the defence budget in 2009-10, the deferral of funds will see the Defence budget decline slightly in real terms over the three years that follow. If 3% average growth is to be delivered, the rate of growth will have to be rapid in the years thereafter. But this will be exactly when the government is trying to move from deficit to surplus. And it would be a rare government that would keep the country in deficit for an extra year to fulfil a promise on defence spending made more than half a decade earlier.

Thus, given the experience of the 2009 budget and the unfavourable medium-term fiscal situation, there is a substantial risk of further deferrals in the years ahead. The government's steadfast refusal to even disclose planned defence funding for the period in question reinforces this conclusion.

### **HOW WILL THE MONEY BE SPENT?**

The government claims to have \$45 billion of new initiatives planned for the next decade, even though there is only around \$29 billion of new money available; \$18 billion of net savings from the Strategic Reform Program and \$11 billion of additional funding from the new indexation regime. The remaining \$16 billion comes from Defence's existing funding, including roughly \$8 billion unallocated from previous price-indexation adjustments (not to be confused with the one-off boost from the move to the new indexation regime or the \$4 billion of unallocated funding unconvincingly claimed as a pre-existing saving) and around \$8 billion freed up by delaying existing plans.

Of the \$29 billion of genuinely new money, around half will be spent remediating shortfalls in existing funding, including cost increases in planned major capital equipment purchases and unfunded personnel and operating costs associated with new and replacement capabilities. The remaining \$15 billion will be spent on new initiatives contained in the Defence White Paper.

Given that more than \$300 billion is promised to be spent on defence over the next decade, the new initiatives (exclusive of remediation) in the White Paper represent less than 5% of total spending. Or to put it another way, 95% of what the present government plans to spend on defence over the next ten years will go to delivering the previous government's plans. While Australia might not have a declared bi-partisan defence policy, it has the next best thing.

One area where money will not be spent is major capital investment—at least not on the scale previously intended. The budget papers disclose that \$750 million of previously planned investment in major capital equipment has been deferred from 2009-10, and there are signs that as much as \$3.5 billion of investment has been deferred from the next four years. This continues a persistent trend from the past eight years where planned investment has been deferred year after year. At last count, around \$4.4 billion of investment had been pushed into the future, not counting what might have happened over the next four years. Given the secrecy surrounding defence funding, it is impossible to say how much money has been deferred from later years or how far into the future any of the delayed spending has been pushed.

### **Defence Planning**

The Defence budget is only a means to an end; the development and maintenance of military capability. Defence planning is about allocating the resources—human and financial—to deliver the sought military capabilities at a desired time. This includes funding the preparedness of existing capabilities and the development of new capabilities.

Defence White Papers are major exercises in capability planning. In the most recent case, it was an exercise with a planning horizon of twenty-one years. The government claims that the White Paper process was the most comprehensive ever undertaken by an Australian government. There is no reason to doubt this. The White Paper was developed over a period of sixteen months and involved most areas of the defence organisation. Moreover, given the persistent failure over the past nine years to pull together an affordable and achievable plan for the defence force, the government and Defence had every incentive to try and get it right this time.

A further sign that the Defence White Paper is backed up by detailed planning is the new policy for a five-year defence planning cycle. According to the new policy, a new Defence White Paper will be produced every five years with a Force Structure Review and an independent Budget Audit undertaken in the preceding year. For the other three years of the cycle, a formal Defence Planning Guidance document will be taken to government for approval. Whether the proposed regime survives the inevitable disruptions wrought by the irregular Australian electoral cycle remains to be seen, but the declared commitment to comprehensive planning is important.

Thus we have a paradox. On the one hand, we are told that a detailed plan exists for the defence force for the next decade and beyond. On the other, great secrecy surrounds future defence funding, and, although the White Paper presents a vision of what the defence force will look like in 2030, very little has been disclosed about what will occur in the intervening twenty-one years. We do not know when new capabilities will enter service. We do not know when problems with existing capability will be fixed. Nor do we even know the extent of deferrals to previously planned major capital investment.

The secrecy surrounding future plans appears to be unrelated to any commercial considerations. It is difficult to see how the government would gain any advantage by keeping their schedule of acquisitions and upgrades secret. If anything, the contrary is the case. Without visibility of future requirements, industry will be unable to make the investments necessary to meet future demand. And although the Defence Capability Plan released in June 2009 did provide additional information beyond that in the White Paper, it was limited by a four-year time horizon and a deliberate blurring of costs and schedule milestones.

Nor do national security considerations explain the government's reticence to publicly detail their plans. A number of potentially sensitive issues have been openly disclosed in the White Paper. For example, we know how many submarines the government wants, we know that the new submarines and the under-construction Air Warfare Destroyers will be fitted with land-attack cruise missiles, and we know that a cyber-security centre is going to be established. Add to this the White Paper's forthright if confused discussion of how the rise of China affects Australia's security, and it is hard

to see how greater detail of funding and timing would damage our national security.

We are therefore left to speculate on the secrecy surrounding the government's plans for defence. There are at least two plausible explanations, each of which is likely to have been a factor. The first explanation is that the lack of disclosure is a deliberate attempt to evade external scrutiny. The 2000 Defence White Paper set a large number of targets for the upgrade of existing capabilities and the acquisition of new capabilities. Much to the embarrassment of the government and especially Defence, a great number of these targets have not been met. In fact, it is safe to say that the majority of the scheduled projects from the 2000 White Paper have been delayed.

Clearly, the easiest way to avoid being held to account for delivering a plan is to keep the plan secret. Hence the absence of concrete schedule targets for initiatives in the new White Paper. Similarly, the repeated and growing deferral of capital investment over the past eight years has been a clear sign of the failure to deliver the planned program of acquisitions. Hence the new practice of not disclosing the scale or timing of deferrals. But while secrecy is a remedy for the discomfort of scrutiny, it comes at a cost. In the absence of external scrutiny, the motivation for Defence to deliver will be much reduced, as will the imperative for the government to drive Defence's performance. The very real risk is that a happy accommodation will be reached where taxpayer's money is consumed and problems concealed.

The second explanation is that the government is keeping its plans secret to increase its flexibility to further delay spending in the years ahead. This would be fully consistent with the anticipated fiscal pressures discussed earlier as well as the general economic uncertainty.

## **Conclusion**

Although the new Defence White Paper promises a larger defence force, the government has opted to neither set measurable goals for the development of the force, nor disclose details of future funding. Not only does this mean that public and parliamentary scrutiny of Defence's performance will be significantly reduced, but it suggests that the government's commitment to the development of a stronger defence force is contingent on favourable economic conditions. In any case, because there will inevitably be mounting pressure in the years ahead for still greater fiscal stringency, the risk of further cuts to defence funding cannot be discounted.

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