

Defence's business environment - good news and bad – ADM 2004

Mark Thomson chaired several sessions at the ADM 2004 Congress - this is an edited version of his opening remarks regarding the new DCP.

It's been more than three years since the release of the 2000 White Paper and Defence Capability Plan (DCP). So it's a good time to ask how the delivery of new capability to the ADF is going, and also to reflect on the defence-industry relationship that underpins that capability.

The good news is that we now have a new DCP that looks forward to 2014. This provides industry with an up-to-date basis on which to plan. There was some impatience with the three years it took to complete what was supposed to be an annual process. But it's understandable that the Government took time to work out the implications of September 11, 2001, and the two wars that followed. In any case, let's hope we don't have to wait another three years for the next one.

While we're on the good news, several recent big-ticket projects are doing well including AEW&C and AIR 87, and some of the older problem projects are now doing better, like the FFG upgrade.

But not all the news is good. Although excellent progress has been made on some specific projects, and the Government has largely met its schedule for approving new projects over the last three years, the overall delivery of defence projects has fallen behind schedule. Over the last three years more than \$1.3 billion-worth of capital investment spending has been deferred, including \$500 million this year alone. The problem is that DMO and industry are simply unable to match the pace set in the 2000 White Paper, even though the Government remains willing to provide the cash.

To make matters worse, many projects in the new DCP have been delayed compared with the original plan. Some of this is due to changed priorities and new projects, but the extent of the delays has also been aggravated by some very big cost increases since 2000. In a fixed funding envelope, there's no escaping the fact that every cost increase translates into delayed capability for the ADF.

The Kinnaird Review of defence procurement reflected the Government's serious concerns about these issues. Now, having accepted the Review's recommendations, the Government appears committed to drive through fundamental reforms in how Defence plans and delivers new capability.

Finally on the DCP. It's not widely appreciated that the additional three years added to the rolling DCP program are flat-line financially. That is, there is no extension of the 3% real growth provided by the White Paper past the end of the decade. In the near term this should not be a concern because throwing more money at capital investment before the Kinnaird reforms take effect would be a mistake. But in the longer term it's a worry. The seemingly unstoppable growth in the cost of Defence equipment will not be slowed by going back to the habits of the 1990's where funding was held constant in real terms.

As things stand, the Government has reserved its decision on future funding until the next or subsequent budget. No doubt, they are waiting to see how things go in the new DMO.

On the Defence-Industry relationship there have been two big developments dating back to the so-called 'strategic approach to defence industry' outlined by the then Minister Peter Reith back in 2001.

The first is the move to place Australian defence industry into global supply chains. It's good to observe that real progress is being made, and not just with the JSF project but also in other projects. This will be the way of the future as international defence industries rationalise and arms markets become more global. But competing with foreign manufacturers will not be easy, and the vast bulk of Australian defence industry remains dependent on the Department of Defence to survive.

The second development is the industry sector plans that have been developed jointly between Defence and industry. Beyond the observation that progress appears slow, it's difficult to see what's happening. The first and best indication of what's going on will occur in late March when the Government's independent inquiry into the shipbuilding sector concludes. My guess is that we will see a less interventionist, and more competition friendly, approach than previously discussed.

Finally, there's a third and more recent development worthy of mention. Among the many recommendations to come from the Kinnaird review is the suggestion that industry should be more involved in the pre-approval process and that more money be spent up-front to support this. This is long overdue. The best way to improve project planning and reduce risk is by involving industry early. The AEW&C project is a good example of just how this can be achieved - three funded studies allowed Defence to make a properly informed decision while industry got a chance to do preliminary work to refine cost, capability and manage risk.

Overall then, we are not where we thought we would be three years ago but a lot has been accomplished nevertheless. And while challenges remain, there are initiatives in place to address them.

The next three years will take us past the mid-point of the ten year White Paper funding commitment. The prospect of continued funding increases next decade depend on several factors, including whether Defence, DMO and Industry can deliver capability on time, within budget and at specification. Unless the Government are confident this will occur, they will be hesitant to up the ante.

Mark Thomson is ASPI's defence budget analyst. These are his personnel views.