Mark Thomson | Canberra

Budget: Not all woe or go

Last year, all seemed lost. The hopes and promises of the 2009 Defence White Paper had been shattered by the headlong rush to deliver a fiscal surplus. Cuts and deferrals posing as savings and efficiencies had slashed funding for Defence by more than $20 billion in the three short years since 2009. *Force 2030* had gone from being a tangible goal to a half forgotten fantasy.

TWELVE months later, things look very different.

With the prospects of delivering a surplus blown out of the water by a massive revenue write-down, the possibility arose for the government to repair some of the damage done. After all, there never was an economic argument to justify the cuts. So with a surplus unattainable for the time being, there was little reason to constrain spending.

Most observers thought that other more politically expedient recipients—such as health, education and family payments—would benefit from the Treasurer's anticipated pre-election largess. That was not to be the case.

Defence spending will grow in real terms by 2.3 per cent next year to $25.4 billion, representing 1.6 per cent of GDP. That's a consequence of a roughly $3 billion boost (compared with previous estimates) spread across the next three years. All up defence spending will grow by an average of 3.6 per cent over the next four years.

There's also real growth planned for the subsequent six years. Consistent with the new funding arrangement announced in the 2013 Defence White Paper, 'funding guidance' of $220 billion was disclosed in the budget for the remainder of the decade—that's enough to sustain around 2.5 per cent real growth in defence funding between 2016 and 2022. That's a higher rate of long-term growth than promised back in 2009.

Of course, the newly promised money does not put us back where we would have been if the 2009 White Paper funding commitment had been kept. Much of the seemingly impressive new growth reflects that we are working from a low base.

It's important to remember that the budget for last year was fully 10 per cent below that for 2010. It will take two years until 2014-15 before we've climbed our way out of the hole that was dug in pursuit of a surplus.

Funding is only now recovering from three years of setbacks. At the same time, however, most of the goals of the 2009 White Paper have been retained in the new plan. And although some projects such as the Offshore Combatant Vessel have been set-aside for the moment, others have been brought forward or added.

On the maritime front, the replacement of navy's two support ships will be sought 'at the earliest opportunity' and consideration is being given to bringing forward the Future Frigate program to replace the Anzac class. On the submarine front, the narrowing of options to the two most costly and risky alternatives can only add to budget pressures in the future.

In the air domain, the government has decided to acquire 12 Growler-configured Super Hornet aircraft, which will be kept in service until at least 2030. Even if this acquisition is eventually offset by the purchase of fewer F-35 JSF, it adds to budget demands in the near term and commits us to multiple air-combat fleets and therefore multiple overheads.

This disparity between goals and funding means that, at best, plans will take longer to deliver than first thought. More realistically, it's almost certain that more money will eventually be required. Long-established historical trends in the unit cost of acquiring and operating military capability grow at around 3-4 per cent per year above inflation. With only 2.5 per cent growth on the horizon, either more money will be required or the government's plans for the ADF will have to be scaled back.

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Further, all this assumes that the money promised today will be available tomorrow. Recent events show that there are no guarantees in this regard. If the economy takes a turn for the worse, it's likely that defence will again be asked to make a contribution towards balancing the Treasurer's books. Given the uncertainty over the global economy and the risk of a growing structural deficit due to a further deterioration in our terms of trade, there may well be tighter times ahead and those times may come sooner than expected.

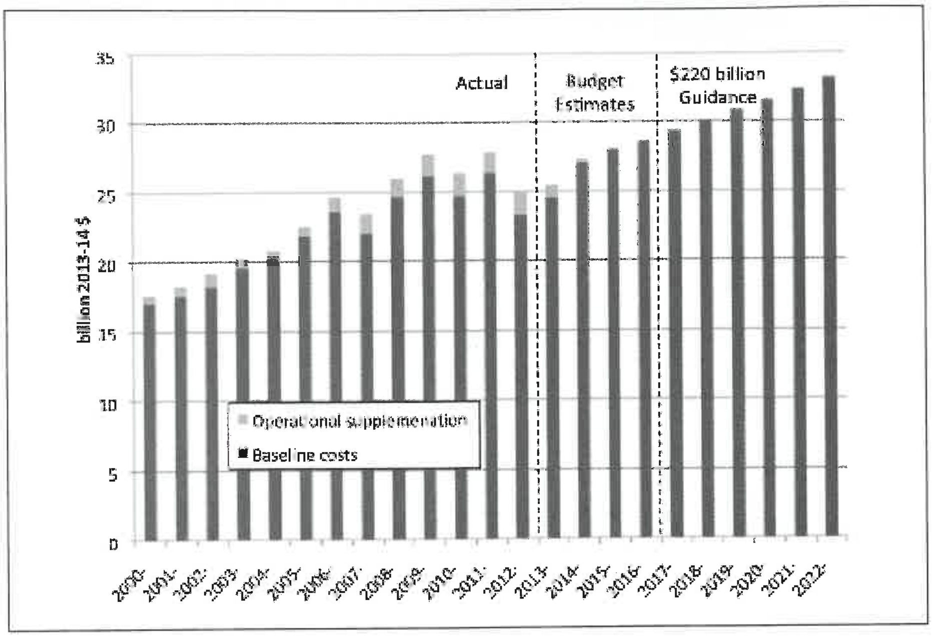
Under the government's current plan, a surplus will finally be attained in 2015-16. But at $800 million, it's wafer thin on the scale of government finances. No sane Treasurer will (again) promise to deliver a surplus one year out without a substantial buffer to take account of volatility in revenue.

On the basis of this year's $18 billion budget blow out, a cushion on that scale is needed to confidently avoid having to make excuses for failing to get over the line. Once again, Defence cannot count on being quarantined when the time comes.

Of course, there are always risks to defence funding due to economic turbulence. The past few years are a salient reminder that the good times never last forever and defence planning cannot proceed on a rigid clockwork schedule.

As has been the case through much of Australia's history, our defence force will move forward in fits and starts as dictated by strategic and economic events. So while its understandable that industry wants a degree of certainty on which to plan and invest, the reality is that flexibility and patience will be needed going forward.

Notwithstanding the uncertainty around defence funding that lies ahead, there's an important point to take away from this year's budget. At a time when politics is fraught and money is tight, the government has renewed its commitment to building a stronger ADF. There's little doubt that defence has been prioritised above other more politically expedient alternatives in this year's budget. It's not what was promised four years ago, but it's better than what most people thought was possible. That's about as good as it gets in the present environment.



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