POLITICS OF DEFENCE ECONOMICS IN AUSTRALIA

Defence economics takes centre-stage with budget cuts to the ADF, says **Dr Mark Thomson**

For the past 11 years, leading defence economist **Dr Mark Thomson** has produced a detailed 200-plus page analysis of the Australian defence budget every year. *The Cost of Defence* is widely respected as the most authoritative evaluation and analysis of Australia's defence budget. Dr Thomson spoke to defence analyst **Sergei DeSilva-Ranasinghe** about the long-term implications of the wide-ranging budget cuts to the Australian Defence Force (ADF), its capabilities, and Australia's defence industry; the stance on defence by Australia's main political parties; Australia's dependence on the US alliance; the ADF's capacity to provide credible expeditionary forces for overseas missions; and defence sector reform.

Sergei DeSilva-Ranasinghe: Much has been said about the impact of wide-ranging defence budget cuts, most of which are critical. How do you interpret the situation and the long-term implications for the ADF?

Mark Thomson: The recent cuts to defence spending have been substantial. In 2012, we saw the largest year-on-year cut (10.5%) since the drawdown from the Korean War in 1953. Defence spending, as a share of GDP, is down to its lowest level (1.56%) since the Munich crisis in 1938.

What's more, the cuts in 2012 were only the latest round in a steady erosion in defence funding since the government's Defence White Paper of 2009. As a result of cuts and deferrals, the funds available to Defence in the short term have reduced by around $20 billion.

Not surprisingly, there is widespread dismay among those who believe Australia needs to have a strong defence capability in the twenty-first century. The level of dismay has heightened because of the bold plans (and generous funding promises) made in the 2009 white paper. It's one thing to take on a defence policy with modest aspirations, it's quite another to announce an ambitious policy and then abandon it.

On the long-term implications of the cuts, even if defence spending bounces back in the short term, we will have lost the better part of a decade of building the sort of defence force envisaged in 2009—such is the inertia in defence investment.

But the situation may be much worse. The growing recognition that the federal government is facing a substantial structural deficit, at least in the medium term, probably means defence spending will remain subdued for some time yet. If that is the case, the best guide to the fate of the ADF are the lean years of the 1980s and 1990s when defence spending was held constant in real terms in the face of rising costs for military personnel, infrastructure and equipment.

Back then, the mounting shortfall was accommodated by reducing the size of the army, deferring the replacement of ageing assets, skimping on readiness, and outsourcing support activities to the private sector. Apart from the purchase of a handful of big-ticket items such as the Collins Class submarines and ANZAC frigates, it was hard times all around.

Dr Mark Thomson is a Senior Analyst at the Canberra-based Australian Strategic Policy Institute.

Until such time as defence spending recovers, I expect it will be a case of back to the future for the ADF.

Sergei DeSilva-Ranasinghe: How do you forecast the short- and long-term impact of budget reductions?

Mark Thomson: There's no doubt it's a tough time for the defence industry in Australia. Most of the recent cuts to defence funding have been accommodated by reducing investment in new equipment. To make matters worse, we have made a series of multibillion-dollar off-the-shelf purchases from foreign suppliers—a trend that is set to continue with the F-35 Joint Strike Fighter purchase and the future replacement of our P-3 maritime patrol aircraft.

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The formidable cost of designing and developing high-tech military equipment makes it impossible for Australia to go it alone in many areas. It's inevitable that we'll increasingly rely on foreign suppliers for most of our equipment. That does not mean a lack of opportunities for local firms. Foreign defence purchases often open the door for Australian firms to supply parts into global supply chains, as is occurring today with the F-35. Ultimately, however, the scale of Australian involvement in international defence supply chains will be set by their commercial competitiveness. And as with the manufacturing sector more generally, this will be put to the test in the years ahead.

But it's not all doom and gloom. Naval shipbuilding in Australia is undergoing something of a renaissance. Three Air Warfare Destroyers are being built in Adelaide and two Landing Helicopter Dock vessels fitted out in Melbourne. While these projects are a windfall for the firms involved and the workers employed, nearly all the critical systems, sensors and weapons are being imported from overseas. It would be a mistake to equate building vessels full of foreign systems with defence industrial self-reliance.

What matters most from a strategic perspective is that we have the local capacity to repair, maintain and support ADF equipment. On that count, there is some cause for optimism. Even though investment has fallen, spending on the sustainment of ADF assets continues apace, thereby keeping the most essential parts of the defence industry above water.

Sergei DeSilva-Ranasinghe: Given the world is going through a period of strategic uncertainty, why do you question the long-term commitment of Labour and the Coalition to strengthen Australia's defence?

Mark Thomson: There are two factors at play. First and foremost, defence spending has been cut in the headlong rush to return the federal budget to surplus. Given the unambiguously low level of Australian government debt (roughly 10% of GDP), the imperative is being driven by politics rather than economics. For better or worse, there is a bipartisan agreement that a balanced budget is synonymous with sound economic management. Don't get me wrong; I'm eager for the books to be balanced as soon as possible, but that shouldn't mean throwing out the baby with the bathwater.

It's been 23 years since a Labor government delivered a surplus, so it's hardly surprising they're trying so hard to get out of the red before the general election. And it's equally unsurprising that the Coalition has kept up the pressure on them to do so. As it turns out, the effort has been for naught with deficits anticipated for at least the next couple of years. It's a case of all pain and no gain.

The second factor is that public concerns about national security have been replaced by economic worries. Put simply, the strategic angst of the 9/11-decade has been replaced by the uncertainty of the post-global financial crisis era. People are more worried about their superannuation returns than far off risks to Australia's sovereignty. Only time will tell whether this is wise or not; in the meantime, it's made it easier for politicians to put

a low priority on defence.

Sergei DeSilva-Ranasinghe: An unspoken issue at the heart of Australian strategic policy is our penchant to 'free ride' off the United States. Given US concerns on this issue, what are the long-term implications of free-riding on the US alliance?

Mark Thomson: The clearest indication of Australia free-riding on the defence efforts of the United States is the long-running disparity in the share of GDP we devote to our respective defence forces. Post World War II, Australia has typically spent less than half as a share of GDP than our great and powerful ally. At the moment, we are spending 1.56% of GDP while the United States is spending around 4% of GDP. Per capita defence spending in Australia is around $1,100 compared to $3,300 in the United States.

Free-riding is also apparent in the disproportionately small scale and limited risk of our military contributions from Korea to Vietnam and Afghanistan to Iraq. As much as we like to claim that we punch above our weight in military terms, the opposite has been the case at least since the end of World War II.

Of course we are not alone. US allies in Europe and Asia have consistently left it to the United States to do the heavy lifting on defence spending and military operations (the only exceptions being the Koreans and Vietnamese during their respective civil wars).

There's no mystery about why junior allies free ride on a much larger senior partner such as the United States; it would be surprising if that was not the case. The logic of free-riding is compelling. US allies free ride because mustering a greater effort would make little real difference to their security. Junior partners can increase their costs, but doing so does not lead to any greater benefit. Moreover, because the United States undertakes military endeavours for its own reasons, there is nothing it can do to prevent free-riding by junior partners. At most, the United States can provide incentives for greater effort on behalf of its allies—such as the free-trade agreement with Australia in the aftermath of Iraq—though the returns tend to be disappointing for the United States.

We don't have much to worry about any long-term impacts on the alliance. Compared with other US allies, the extent of Australia's free-riding is firmly at the lower end of the scale. And that's the trick; so long as we remain near the front, or at least ahead of the back of the free-riding pack, we are likely to enjoy continued US security support.

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Sergei DeSilva-Ranasinghe: What impacts are defence cuts likely to have on Australia's ability to support future coalition operations on the scale of our involvement in the wars in Iraq and Afghanistan?

Mark Thomson: For the moment, we have the capacity to undertake a deployment on the scale of Iraq or Afghanistan. Whether we retain that capacity in the future will depend on how long our defence spending remains low and how the resulting austerity is accommodated.

As I said before, the last time we experienced such a prolonged period of defence austerity was in the 1980s and the 1990s when the Army budget was slashed. Given that recent operations have been largely land based, repeating that strategy would leave us with a reduced capacity to undertake similar operations in the future. But there's recognition that the fragile states in our immediate region can give rise to large-scale stabilisation operations at short notice. So perhaps the army will be spared this time.

However, without continuing growth in the defence budget, hard decisions are needed to accommodate the shortfall. Something will have to give. If we retain an army on the current scale—an army that's taken more than a decade of concerted effort to build—we will have to make do with fewer or less sophisticated air and maritime capabilities.

Sergei DeSilva-Ranasinghe: Do you believe Australia has sufficient defence capability to intervene on its own in the Asia-Pacific region should any crisis on the scale of East Timor arise?

Mark Thomson: A lot has been done to rebuild

the ADF in recent years. For the moment at least, we can repeat our deployment to East Timor with much less risk than the last time. Of course, that presumes we enjoy a similar level of international assistance like in 1999. It remains to be seen whether we retain the capacity to undertake moderate sized land-based deployments.

Whether we can act alone depends on the operation's scale and intensity. There are clearly credible missions—such as a permissive stabilisation operation to Bougainville—we could undertake tomorrow on our own. And there are other possibilities, such as systemic breakdown of law and order in Papua New Guinea, where our capacity would be easily overwhelmed. We can do little to change this. There will always be contingencies beyond our capacity to respond effectively alone, no matter how large a peacetime army we maintain. To pretend otherwise is delusional. Fortunately, there are growing patterns of international security cooperation we could rely on, just like we did in East Timor in 1999.

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Sergei DeSilva-Ranasinghe: You once said: 'The sprawling defence empire must be reformed root and branch. Outside intervention and independent oversight will be needed to reshape the enterprise so that it can be trusted with taxpayers' money.' What replacement system or model do you propose as an alternative to initiate the changes you argue are necessary?

Mark Thomson: That's a hard question and would take a long time to answer properly. Let me instead outline the three steps I think are necessary to make Defence a more efficient entity.

Step one. Rip up the *Public Service Act* and put in place a system that allows people to be hired, fired and remunerated in a manner akin to the private sector. Put in place similar arrangements for senior military officers. Clearly, such a scheme would have to extend beyond Defence to the entire public service. So be it. This would achieve two things. First, it would attract experienced people from the private sector to work in areas such as acquisition and financial management. Second, it would provide the tools to manage individual performance through effective sanctions and rewards.

Step two. Give the chiefs of the Army, Navy and Air Force full control of the resources necessary to deliver their respective capabilities *and* hold them to account for doing so effectively and efficiently. The imperative for much clearer accountability in Defence was shown when the Navy was unable to provide amphibious vessels on the eve of cyclone Yasi in Queensland in 2011. Subsequent revelations showed that confused and overlapping accountabilities within Defence had allowed a critical national capability to fall through the gaps.

Step three. Establish a regime of civilian oversight to measure and drive efficiency in Defence aligned with government policy. Allowing the military to run its own show in Defence is like handing over the Department of Health to doctors, or the putting teachers in charge of education policy. While the military has invaluable expertise that must be taken into account when formulating and executing defence policy, it also has a vested interest in the outcomes, which must be carefully guarded against.

To be honest, I'm not holding my breath that any of my suggestions will be embraced by the government in the near to medium term. There are too many risks and difficulties in adopting such an agenda, whereas the path of least resistance is easier. I fear things will have to get worse before our politicians marshal the gumption to take on the generals.