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Inefficiencies must be addressed

A MONTH ago, things were looking grim for the Department of Defence. Despite seven years of generous funding from the Howard government, it had managed to paint itself into a financial corner.

Not only was there too little money to operate new equipment due for delivery over the next several years, but the next batch of acquisitions was looking less affordable by the day. Even with the commitment from the new Government to continue growing the defence budget at 3 per cent a year, the gap between means and ends was going to be unfilled.

Faced with the choice of finding more money or cutting capability, the decision was made: to remove some of the fat out of the defence budget. It's not clear whose idea it was, the defence department's or the new minister's Joel Fitzgibbon — but a savings target of \$10 billion over 10 years was set. Even for a colossus like defence, a billion dollars a year is serious money.

Then something extraordinary happened.

Somewhere in the basement of Treasury the pre-budget estimates were completed of an arcane economic parameter — the implicit non-farm GDP deflator. It's like a CPI for gross domestic product, and just happens to be the index used to maintain buying power of the defence budget. Due to the rising demand for Australian commodities from Asia, the deflator is projected to reach 6.25 per cent next.

Defence had won the lottery.

Although the index had only spiked in the short term, its flow-on effect made it the gift that keeps on giving. In one fell swoop, defence received an extra \$11.6 billion across the decade including \$936 million next year.

Given that there was no reason to think that defence's costs had gone up as precipitously as the deflator, it was unlikely that they were ever going to get to keep the windfall next year. Any doubt disappeared when defence revealed it had an unspent \$680 million burning a hole in the pocket.

The solution the Government latched onto was pretty simple. Defence will get the extra \$936 million next year, but, in exchange, they have to absorb the billion-dollar cost of overseas deployments and deliver \$77 million worth of unfunded new initiatives. Even after all this is done, the budget for next financial year will be a healthy \$22.7 billion — fully \$1.5 billion above the result for this year. However, as a share of GDP, defence spending will fall from 2 per cent to 1.8 per cent due to the pace of economic growth.

The budget would have been even larger had it not been necessary to further delay the acquisition of new equipment. All up, just under \$1.8 billion of previously planned equipment purchases have been deferred until next decade, including \$1 billion from next year; not because the Government was unwilling to part with the cash, but because projects are simply not delivering equipment as planned.

Of course, given the radical surgery performed on next year's defence budget, things could be tight. It all depends on what underlies the \$680 million that went unspent this year. If it was simply the result of systemic excess funding, things should be okay, but if the surplus cash is just a one-off fluctuation in an otherwise robust funding arrangement, defence will need to find efficiencies to pay the bills next year.

Even if the latter turns out to be the case, it would not be a bad outcome. Defence is already committed to finding a billion dollars a year in saving over the longer-term — this would give them the incentive to get about the task, as they must. While the extra \$11.6 billion windfall over the decade will go part of the way to meeting defence's future costs, more money will be required if current plans are to be fulfilled.

And there is no reason why a good share of the extra money needed shouldn't come from savings surrendered by defence. After eight years of pretty much getting whatever they asked for, defence is far from lean and efficient. Civilian numbers have increased by 20 per cent at the same time as the defence force has grown by only 7 per cent. Civilian senior executives have grown in number by 50 per cent while corresponding military officers, so called "star ranks", have increased by 52 per cent. Yet, despite all the extra bureaucrats and generals, we still have more submarines than crews and more combat aircraft than pilots.

So far, defence's progress in identifying efficiencies has been limited. Apart from around \$200 million that the Defence Material Organisation plans to save from a more efficient approach to maintaining equipment, most of the initiatives amount to nothing more than salami-slicing existing activities. This will not deliver adequate or sustainable efficiencies in the long-term.

Instead, the root causes of defence's ponderous performance must be addressed. The multiple layers of administration need to be cut and the accountabilities clarified. Most of all, defence's performance needs to be



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measured and targets for productivity set.

Ultimately, the long-term level of defence spending will be decided through the defence white paper that the Government started work on earlier in the year. Whether more or less of the nation's wealth should be diverted to national defence is one of the strategic judgments it will have to make.

Irrespective of what the answer is, the taxpayer should not be asked to foot the bill for defence inefficiency.

Mark Thomson is a Defence Analyst at the Australian Strategic Policy Institute. These are his personal views.