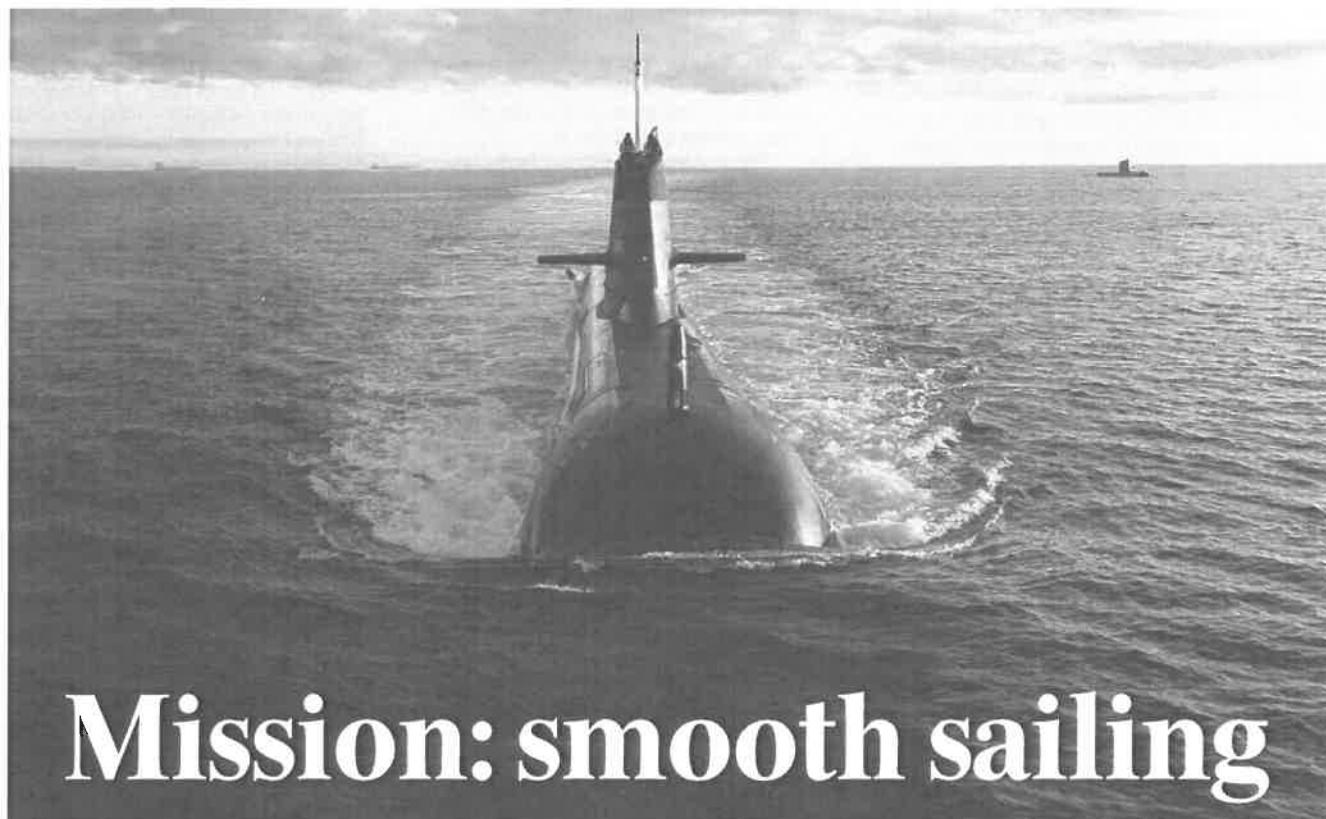




DEFENCE SPECIAL REPORT

THE WEEKEND AUSTRALIAN NOVEMBER 1, 2 2014
www.theaustralian.com.au



**A high-powered review panel is to investigate
Defence and provide answers to its problems**

MARK THOMSON



CONSISTENT with its 2013 election
promise, the Abbott government has

commissioned a first principals review of Defence. Planned to run in tandem with the development of the 2015 Defence White Paper, the review has a broad remit to ensure the Defence enterprise is "fit for purpose" out to 2030.

By any measure, the review will be wideranging. Its terms of reference make specific mention of Defence's organisational structure, business processes, high-level governance, efficiency and effectiveness. Unsurprisingly, the multi-billion dollar equipment procurement program rates special mention. Nothing has been ruled out of bounds.



The government has assembled a small, high-powered panel to complete the task. Chaired by ex-Rio Tinto managing director David Peever, the panel contains the ex-Chief of Army Peter Leahy, ex-BAE Systems executive Jim McDowell, Howard-government defence minister Robert Hill, and Rudd-government finance minister Lindsay Tanner. Peever and his panel are not working alone. In addition to an in-house secretariat from Defence, the Boston Consulting Group has been contracted to assist with the review.

With unbounded terms of reference and strong personalities on the panel, it's impossible to anticipate what will be

recommended. Nonetheless, on the basis of what Defence Minister David Johnston has said in public, there are three key areas where the government is looking for advice.

First, is what to do with Defence's equipment acquisition and sustainment agency the Defence Materiel Organisation (DMO). With a budget of \$12 billion a year, DMO acquires new equipment for the military and is responsible for the repair and maintenance of existing equipment.

Rarely a year goes by without front-page headlines reporting a major defence project running off the rails. From the long-running saga of the Collins class submarines through to the Seasprite helicopter debacle, successive governments have been frustrated and embarrassed in equal measure. The latest case has seen the \$8bn air warfare destroyer project, which has blown out by \$500 million, and has suffered a close to two-year delay.

Repeated attempts have been made to improve the performance of Defence's acquisition machinery. Following a review by businessman Malcolm Kinnaird in 2005, the DMO was re-established as a quasi-independent prescribed agency. That move was not without controversy, and a key question for the Peever review will be what comes next.

There are three broad options: reabsorb DMO into Defence, leave it as it is, or make it even more independent. Given recent developments in Britain, the option of bringing in a private sector firm to either assist or manage DMO is

likely to be under consideration.

Whatever is ultimately recommend-

ed, the outcome is unlikely to be smooth sailing. While DMO invariably gets the blame when things go wrong, it is at the mercy of defence equipment suppliers whose performance rarely matches their promises.

Second, the review will have to address Defence's structure and business model and, in particular, the role of the three military service chiefs.

The problem is as follows. In the late 1990s Defence was reorganised around a shared services model, whereby supporting activities were taken away from the army, navy and air force and centralised. Consequently, the three service chiefs now directly control around only half of Defence's budget.

Consolidated activities include equipment sustainment, corporate services, garrison support, personnel

services and estate management. A series of shared service provider groups were created within Defence as a result. Consolidating functions allow costs to be reduced through economies of scale and central cost control. For example, the range of meals provided in military messes has been reduced.

But while savings have undoubtedly been achieved, the shared services model has come at the cost of making the service chiefs passive consumers. The risk is that because the service chiefs lack control over parts of their businesses, they cannot properly be held to account for delivering effective military capability. At the same time, a sizeable bureaucracy has been built on the back of the shared services model, including an associate secretary and three deputy secretaries.

While it would be possible to return control of all or some of the consolidated functions back to the service chiefs, this seems unlikely. Rather, the challenge for the Peever review is to find a way to retain the savings from shared services, while enhancing the role and accountability of the service chiefs.

Finally, the government will be looking for ways to boost Defence's efficiency. Coming only five years after

the Rudd government's Strategic Reform Program sought to save around \$2bn a year from Defence, you'd think that further savings would be hard to find. But that's not the case. The previous government's reform program was abandoned in 2012 after repeated cuts to the budget made it untenable — there are certainly further opportunities for efficiency in the sprawling Defence behemoth.

Over the past 15 years, Defence has accumulated a heavy overlay of executive and middle management. Senior executive and star-ranked military officers have increased by 71 per cent and 72 per cent respectively, and the number of civilian middle managers has grown by 96 per cent. There are hundreds of millions of dollars to be saved by reversing this trend, but to do so will demand a focus of leaner management, greater delegation and streamlining of bureaucratic processes.

A lot hinges on the review and its subsequent reforms. The government has promised to increase defence spending to 2 per cent of GDP within a decade. To do so while returning the federal budget to surplus will not be easy. Unless taxpayers have confidence that Defence is well run and efficient, they will balk at paying higher taxes or enduring reduced public services elsewhere. The Peever review is the first step in building that confidence.

Mark Thomson is a senior analyst at ASPI. These are his personal views.