STRATEGY
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Your Defence Dollar

The 2006–07 Defence Budget

ASPI
AUSTRALIAN STRATEGIC POLICY INSTITUTE

August 2006

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Before joining ASPI, Mark Thomson held a number of positions in Defence, working in the areas of capability development and resource management. In 1999, he was Political Military Adviser to Major General Peter Cosgrove during the INTERFET operation. Prior to his time with Defence, Mark held a series of academic research and teaching positions in theoretical physics.

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Cover image: An Australian soldier from the Australian Army Training Team Iraq, July 2005.

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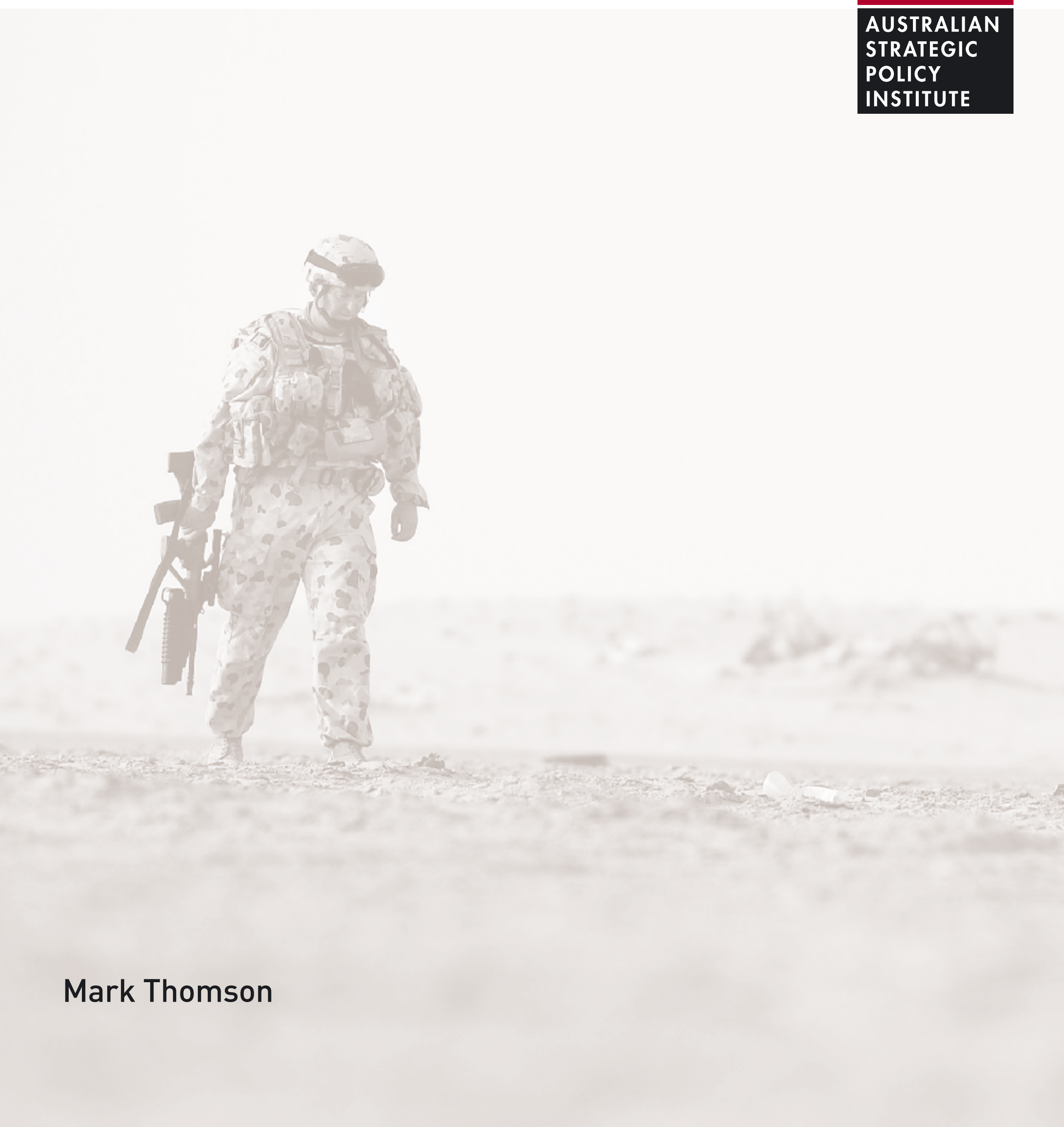

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Director's introduction

From a defence perspective, this year's federal Budget was the most important in half a decade. Not only did the government renew its commitment to 3% real growth in defence spending out to 2015, but there was substantial extra money for defence in the near term. With so much cash flowing into defence, it's more important than ever to keep a close eye on how it's being spent.

With this in mind, we've produced this report, *Your Defence Dollar*. It's a summary version of *The Cost of Defence* budget brief that came out two weeks after the Budget. This is the fourth year that we've produced such a summary. Our aim remains to inform discussion and scrutiny of the Defence budget and the policy choices it entails.

This year's report closely follows the structure we used last year. Unavoidably, this means that some background material has been repeated. However, the surprisingly fluid nature of Defence finances means that the story has changed in some important and interesting ways since last year.

As was the case in previous years, many people helped with the production of this report. They include Karla Bogaart from Optimum Business Consulting, who gave invaluable assistance on accounting matters, and Alanta Colley, who worked long and hard as an intern to make *The Cost of Defence* a reality. In addition, Defence was kind enough to look over a preliminary draft of *The Cost of Defence* and make valuable comments. This helped clarify some important points and resulted in greater accuracy in many areas. Of course, this does not in any way imply that Defence endorses *The Cost of Defence* or *Your Defence Dollar*, or supports the conclusions in either document.

My colleague Dr Mark Thomson, who is the manager of ASPI's Budget and Management Program, has written this report. As always, responsibility for the judgments in it lie with Dr Thomson and me alone.

Last, we should acknowledge that we at ASPI are not disinterested observers of the Defence budget, because our funding from government is provided through Defence. Details can be found in our annual report.

Peter Abigail
Director

Photo opposite: The 2nd/10th Field Regiment Royal Australian Artillery stands fast for the 1812 Overture played by the Combined Services Band, in a special event for the Commonwealth Games Cultural Festival, at the Sidney Myer Music Bowl in Melbourne, March 2006. © Defence Department

Executive summary

The big news in the 2006–07 Budget was that the government agreed to continue the 3% annual real growth in defence spending delivered by the 2000 White Paper to 2015–16. This amounts to an extra $10.7 billion over five years. Another $4.5 billion was provided over the next ten years for a variety of initiatives.

When this new spending is added to previously planned increases, the result is a significant near-term boost to defence spending. Indeed, the defence budget for 2006–07 is $19.6 billion—an increase of $1.9 billion on last year. Continued growth is planned across the next four years, with a budget of $21.1 billion set out for 2009–10. The 2006–07 defence budget equals 1.94% of Australia's gross domestic product. This will probably erode only a little over the next few years, given predicted economic growth.

Aside from the headline commitment of 3% real growth past 2010, the key initiatives in the 2006–07 defence budget were as follows.

- Four C-17 strategic lift aircraft are being bought at a cost of $2.2 billion, of which $1.9 billion is being provided by the government and $0.3 billion is being allocated from within Defence's existing investment budget. Each C-17 will have a carrying capacity four times larger than current Australian Defence Force (ADF) C-130 Hercules transports.
- $1.5 billion over ten years has been allocated for the second phase of the Hardened and Networked Army initiative. This will see the Army restructured into combined arms battle groups and the addition of 1,485 permanent personnel. The Army Reserve is also being revitalised through the creation of a high-readiness Reserve component that will be integrated with permanent units. And the Army's existing parachute battalion is going to be moved from Sydney to South Australia and developed into a mechanised battle group.

Photo opposite: Dusk finds Special Forces Task Group members on patrol near a Forward Operating Base in Afghanistan, September 2005. © Defence Department

- $625 million of previously deferred capital investment spending has been accelerated across the next four years, in recognition of the improved performance of Defence's acquisition and materiel support agency, the Defence Materiel Organisation (DMO). This will hasten the delivery of the equipment projects set out in the government's decade-long Defence Capability Plan (DCP).
- $623 million over four years for overseas deployments, including $393 million to continue operations in Iraq for another twelve months, and $233 million for our continuing role in Afghanistan for two years.
- $560 million over the next ten years will be spent on better remuneration for the active and high-readiness Reserve. Incentives include additional allowances, health benefits and annual completion bonuses. In addition, $194 million over four years will be spent to improve recruitment and retention in the permanent force and overcome shortfalls by hiring civilians to work in non-operational roles. The money for these initiatives will come from funds originally allocated for military personnel within the Defence budget.
- $342 million over ten years will be spent on a range of measures, including the redevelopment of the Mulwala munitions plant ($131 million), defence communications ($80 million), logistical funding for naval aviation ($26 million) and charting of our northern waters ($19 million). In addition, $213 million of investment funds earmarked for the new Joint Operations Command Headquarters has been handed back because the project will now be pursued as a private finance initiative.
- $252 million over ten years has been provided to reactivate and operate the two minehunting vessels withdrawn from service by the 2003 Defence Capability Review. The two vessels will now conduct coastal surveillance in the north.
- $661 million will be cut over ten years through an efficiency dividend ($405 million) and the handback of $256 million following the reorganisation of ADF command and control arrangements.

Is there enough money?

Unfortunately, notwithstanding all the new money flowing into Defence in this budget, there's still a mismatch between plans and funding. Put simply, not enough money has been set aside in the future to operate our current equipment, let alone that which is now being purchased.

On current plans, rising personnel costs and escalating investment levels look certain to squeeze the money available for operating costs from 2008–09 onwards. In part, this is due to a failure to continue around $200 million per year in logistical shortfall funding that was started in 2004–05. More generally, a significant number of new capabilities will arrive over the next several years, placing extra pressure on scarce resources.

People

Despite spending $500 million on initiatives to improve the recruitment and retention of military personnel over the past five years, the process of building up the size of the ADF has worse than stalled—it's gone backwards. In 2003–04, the average strength of the permanent ADF fell by 46 positions, in 2004–05 it fell by 221, and in 2005–06 it's projected to fall by another 624. This adds up to a cumulative loss of 891 personnel over three years, at a time when earnest attempts have been made to grow the force. In both 2004–05 and 2005–06, the final result was around a thousand below target.

The problem isn't spread evenly. The Air Force is in the best position, benefiting from the lowest separation rate in over a decade plus good recruitment. The Navy and Army are in a less favourable situation. All services are feeling the pressure in skilled trade areas, where demand is high across the broader economy. Unless personnel numbers start to rise soon, the situation will become more difficult once the new capabilities being delivered through the DCP start to enter service.

Performance

Over the past seven years, the ADF has done what was asked of it in demanding operational environments around the globe. But this has only ever involved a small part of the total force. We're entitled to ask just how ready for action the ADF as a whole is, especially given all the extra funds that have been provided in recent years.

The only real sources of information we have are the Defence annual reports, which provide surprisingly detailed data on how well equipped, trained and prepared the ADF is. Here the picture is reassuring. After fairly static and unspectacular results in 2000–01 and 2001–02, performance in 2002–03 and 2003–04 posted a solid improvement. In 2004–05, things levelled out somewhat—but at a respectable level.

Management

Once again, Defence's financial accounts were qualified by the auditors. The qualification reflects the difficulty in valuing some of the vast inventory held by Defence and, more seriously, accounting for the quantities of some types of stores. A plan is now in place to remedy the deficiency, but it will take several years. While much of the accounting problem is technical, the recent Australian National Audit Office report on the procurement and management of explosive ordnance showed that there are some very real problems in how Defence manages billions of dollars in assets.

The reforms to Defence and the DMO, following the 2003 Defence Procurement Review, continue. The acceleration of $625 million of previously deferred capital investment money in this budget is a vote of confidence from the government that the DMO can deliver.

Defence Capability Plan

One of the unintended impacts of the reforms flowing from the 2003 Defence Procurement Review is that the more stringent process of project approval is proving very time consuming. Approval of many of the projects in the 2004 version of the DCP was significantly delayed. Disappointingly, this trend has continued in the revised DCP released in June 2006, with an average delay of just under a year for pre-existing projects.

What does the future hold?

Challenges lie ahead for Defence. Declining personnel numbers need to be turned around, capital investment needs to be ramped up quickly, and financial reporting has to be put back on track. At the same time, the affordability of current plans needs to be assured. It makes no sense to spend billions of dollars on new equipment unless it's certain that there'll be enough money to operate it. The current piecemeal cycle of investment, followed by bids for additional personnel and operating costs, is no substitute for coherent long-term planning.

While the current approach might seem workable in today's buoyant economic climate, it's a very risky proposition. Once the business cycle turns and demographic factors hit the government's bottom line, it will be a lot harder to come back and simply ask for more.

Chapter 1

STRATEGIC CONTEXT FOR THE BUDGET

Thirty years ago, Defence policy was relatively straightforward, as the opening sentence of the Fraser Government's 1976 Defence White Paper shows:

> The first responsibility of government is to provide the nation with security from armed attack and from the constraints on independent national decisions imposed by the threat of such attack.

The priority at that time was squarely on the physical defence of Australia, which was understandable for a nation adjusting to Nixon's Guam doctrine and trying to forget the Vietnam War. A lot has changed since then. And when the Howard Government reworked the 1976 gambit in its latest defence policy statement, *Defence Update 2005*, it came up with a much broader statement:

> The first duty of the Australian Government is to provide for the security and defence of Australia and Australian interests.

While no single sentence can ever hope to capture a nation's defence policy, the differences between these two opening statements say a lot about how things have changed over the years and where policy sits today. Three things stand out.

First, armed attack no longer warrants an explicit mention. This isn't simply a matter of wording. The main body of *Defence Update 2005* talks only briefly about the territorial defence of Australia in its introduction and conclusion, and nowhere in between. In fact, the *Update* reassures us that it's unlikely Australia will 'face conventional threats' in the foreseeable future. What used to be the overriding focus

Photo opposite: Australian Defence Minister Brendan Nelson (L) listens to US Secretary of Defense Donald Rumsfeld speaks at a press conference at the Pentagon, 28 June 2006. EPA via AAP/Stefan Zaklin. © 2006 AAP of Australia's strategic policy has—in the view of the *Update*—been relegated to little more than a perfunctory aside. In its place is a pair of competing priorities: Australia's role in the immediate region and its interests further afield on the global stage.

Second, security and defence rate separate and equal mention in the opening to the *Update*. In the sense they are used, they imply the equal importance of defending against traditional military threats and securing against non-traditional threats like terrorism, transnational crime, drug smuggling and unauthorised border crossing. Of course, one of the key features in recent years has been the melding of these two areas. This has seen an increasing whole-of-government response to many security problems and the involvement of the Australian Defence Force (ADF) in humanitarian assistance, domestic security and offshore Australian Federal Police operations.

... in today's world it's not just Australia that needs to be defended (and secured) but also Australian *interests*.

Third, in today's world it's not just Australia that needs to be defended (and secured) but also Australian *interests*. Indeed, if the *Update* has a theme it's 'Australian interests'—a forgivingly malleable term that can and does mean many things. At the very least, it includes the safety of Australians abroad and, to some extent, our various overseas economic, political, trade and financial relationships. More generally, the *Update* argues that our security interests are global and says that 'Australia's vital interests are inextricably linked to the achievement of peace and security in the Middle East'.

Whatever Australia's interests might be, two clearly stand out in explaining our recent military endeavours: the alliance with the US and the security of our local region. The reasons are simple. We can't be secure unless we live in a secure region, and we need a powerful ally to underwrite our security more broadly. Moreover, while we have many 'interests', most of them are shared problems that we can't make a decisive difference to anyway. Not so with the alliance and the region—these are unique to us. That's what elevates them from mere interests to responsibilities. None of this is new; it was explicit thirty years ago in our defence policy. What's changed is that both the immediate region and the US are more demanding now than at any time since the 1960s.

In response, Australia is undertaking the most comprehensive and expensive military build-up since the mid-1960s. This has two threads: first, the force structure is being modernised and expanded; and second, the ADF's preparedness for rapid deployment is being steadily improved, along with its capacity for strategic mobility. What's more, the ADF is now being used more often and in more diverse theatres than at any time over the past five decades.

In the process, it's unavoidable that a balance has to be struck between our local and global interests. Finding this balance is likely to remain a key strategic challenge for Australia in the coming years.

... it's unavoidable that a balance has to be struck between our local and global interests.

Balancing the force of tomorrow

If *Defence Update 2005* made anything clear, it was that the old practice of developing military capabilities exclusively for the defence of Australia and the local region is over. The recently announced fleet of C-17 Globemaster transport aircraft is a case in point. While the aircraft will be useful within our neighbourhood, their RAAF designation as the 'responsive global airlift capability' clearly announces the intent. Developing a 'hardened and networked army' (HNA) that's adaptable for up to 'medium intensity warfighting in a coalition setting', arguably falls into the same category—although some would disagree.

But, so far at least, initiatives like the C-17 and HNA are *in addition* to a Defence Capability Plan that remains focused on a balanced force capable of independent action in our local region. In fact, both the C-17 and HNA were explicitly funded above and beyond the 2000 White Paper commitment. Nothing has been sacrificed and the ADF has been strengthened—including for operations locally.

There are, of course, very active debates over other proposed capabilities—like the Joint Strike Fighter, larger amphibious vessels and air warfare destroyers—but these are generally *not* about deciding between a defence force optimised for local or global operations.

There's a risk. The current fiscal and strategic environment enables and predisposes the government to invest in defence capabilities. We have no guarantee that these circumstances will persist for another five years, let alone ten. Moreover, there are clear signs that the operating costs of the investments now being made are well beyond the capacity of the projected budget. If current plans turn out to be unaffordable—as happened in 1991 and 2003, when cuts were made to the ADF—the danger is that the axe will fall on the basis of the timing of projects. Let's hope that it's not the Joint Strike Fighter or some other critical capability that's the next cab on the rank. Given the way in which defence financial and capability planning occurs, this fear is far from ungrounded.

Balancing the force of today

While most military capabilities tend to be 'dual use' when it comes to local and global operations, one restriction can't be evaded: no ship, plane or infantry unit can be in two places at the same time. Consequently, the balance between local responsibilities and global interests becomes most acute when we try to balance our commitment of forces on the ground.

The situation we find ourselves in at the moment is illustrative. We have around 1,600 personnel in and around Iraq, 200 (soon to peak at over 500) in Afghanistan, 400 in Solomon Islands and 2000 in East Timor. In absolute terms, the numbers aren't imposing—less than 8% of the permanent force is beyond our borders—but we shouldn't be complacent. The burden doesn't fall evenly across the force. We can't be far from having half of the Army's regular infantry companies offshore. And, back at home, spare a thought for the planners, intelligence analysts, logisticians and policy advisers who have to divide their attention among so many unrelated, disparate and often far-flung theatres.

Some of our current burden is unavoidable—when it comes to the region, we have little discretion. If we don't take care of business, nobody else will. What about Iraq and Afghanistan? Our original plan was to contribute to the initial phase of operations and disengage before the messy job of stabilisation came around. As things played out, this was not achieved. Both Iraq and Afghanistan turned out to be much more challenging post-invasion than anticipated in planning, and we've been trying to help put things right. And on at least one occasion we increased our commitment in order to help a friend (Japan) maintain a contribution in difficult circumstances. But while each incremental increase in the size of our forces in Iraq and Afghanistan made good sense at the time, when we step back we see that the scale and risk of our deployments are slowly but surely increasing.

That we find ourselves in this situation should perhaps not be surprising. We're operating in a new environment and feeling our way as best we can to become a so-called 'global player'. What's been missing is a principle to guide the nature and scale of our military contributions to coalition operations. *Defence Update 2005* discusses this issue but concludes little other than that a balance is needed.

We could do a lot worse than adopt a doctrine of 'one major global operation at a time'.

We could do a lot worse than adopt a doctrine of 'one major global operation at a time'. In the current situation, consolidating our contributions to Iraq and Afghanistan in one or the other location would double the resources we could devote to higher command, intelligence and policy, while at the same time delivering a greater capacity for force protection and independent national command on the ground. If we are to play a part in addressing shared global security issues, we need to work with our partners to employ our collective resources efficiently. This means not planting an Australian flag in every troublespot around the globe.

Being more focused about our global contributions would allow us to marshal our resources to maximum effect on the ground, and free up capacity by removing duplication of effort in our management of coalition deployments. This would make it easier to balance our responsibilities close to home with our interests further afield. Getting to such a situation from where we are now wouldn't be easy, but it would be worth it.

Photo opposite: Bosun mates of the HMAS BALLARAT prepare the ship to leave for the North Arabian Gulf, June 2006.
© Defence Department

Chapter 2

FUNDING, ORGANISATION AND COMMAND

Defence is a complex beast, not just because it's a vast entity with more than 90,000 employees spread from one end of the continent to the other, but because it's organised, funded and commanded through three largely separate arrangements. This chapter takes on the daunting task of describing these three frameworks and how they work in concert.

...the aim is to show not only how much an agency is *doing*, but how much it's actually *achieving*.

How Defence is funded: outcomes and outputs

The Defence budget is set out according to a framework of 'outcomes' and 'outputs'. This framework was introduced by the Commonwealth in 1999, and is applied to all Australian Government agencies. It works like this:

- **Outcomes** are the results or benefits that the government aims to deliver to the community through the work of its agencies. Outcomes are specified for each agency, and are meant to express the purpose or goal of the agency's activities.
- **Outputs** are the goods and services that the agency produces to achieve its outcomes.

Under the framework, the performance of agencies is measured to assess both how much output they're generating, and the extent to

Photo opposite: Australian Light Armoured Vehicles travelling over the Al Muthanna Province, Iraq, October 2005. © Defence Department which that output is actually delivering the intended outcomes. So the aim is to show not only how much an agency is *doing*, but how much it's actually *achieving*.

The outcomes and outputs framework isn't just an accounting device. It's intended to provide a structure for management decision-making and resource allocation throughout national agencies. So the way the framework is applied in an agency, such as Defence, is very important to the agency's management and performance.

The key to the effective application of the framework is the specification of the outcome or outcomes. Defence has six outcomes:

1. Command of operations in defence of Australia and its interests
2. Navy capability for the defence of Australia and its interests
3. Army capability for the defence of Australia and its interests
4. Air Force capability for the defence of Australia and its interests
5. Strategic policy for the defence of Australia and its interests
6. Intelligence for the defence of Australia and its interests.

There's actually a seventh outcome, mainly covering superannuation payments for current and former ADF personnel and housing subsidies provided under the *Defence Force (Home Loans Assistance) Act 1990*. This money is channelled through Defence as an administrative convenience, and we shan't consider it further.

One or more outputs contribute to the delivery of each outcome. The cornerstone of defence funding is the so-called 'output appropriation' that gives Defence enough money to cover the net cost of delivering the twenty-eight outputs that the government 'buys' from Defence. These are listed in Table 1, along with the budgeted net costs for 2006–07.

The funds appropriated annually for the net cost of the outputs exceeds the amount of cash spent to deliver them by around three billion dollars every year. This is because Defence is funded on the basis of an accrual budget that recognises non-cash expenses like depreciation. Put simply, Defence gets cash revenue for non-cash expenses. But don't worry; this cash surplus doesn't go to waste. Instead, it's used to partly fund Defence's Capital Investment Program, with the remainder made up through an additional 'equity injection' appropriation, counterbalanced as necessary by a 'capital withdrawal'. In recent years, Defence has also supplemented its investment program through the sale of assets, including (especially) property. If you want to grapple with the intricacies of how this complex arrangement works, our annual budget brief *The Cost of Defence* has an extended discussion.

… it's really a serious attempt to make visible the true cost of delivering military capability.

At first glance, all this accounting gymnastics can seem contrived and artificial, but it's really a serious attempt to make visible the true cost of delivering military capability. It would be wrong to ignore the depreciation on billions of dollars worth of equipment as it is used. The accrual approach tries to capture everything that's being consumed—both cash spent and assets used up.

Table 1: The Defence outputs		
Outcome	**Output**	**Cost $m**
1. Defence Operations	Command of Operations	433
	Defence Force Military Operations and Exercises	600
	Contribution to National Support Tasks	21
	Subtotal	1,014
2. Navy Capabilities	Capability for Major Surface Combatant Operations	1,572
	Capability for Naval Aviation Operations	598
	Capability for Patrol Boat Operations	311
	Capability for Submarine Operations	724
	Capability for Afloat Support	295
	Capability for Mine Warfare	399
	Capability for Amphibious Lift	422
	Capability for Hydrographic, Meteorological and Oceanographic Operations	294
	Subtotal	4,616
3. Army Capabilities	Capability for Special Operations	534
	Capability for Medium Combined Arms Operations	938
	Capability for Light Combined Arms Operations	978
	Capability for Army Aviation Operations	591
	Capability for Ground-based Air Defence	126
	Capability for Combat Support Operations	440
	Capability for Regional Surveillance	157
	Capability for Operational Logistic Support to Land Forces	588
	Capability for Motorised Combined Arms Operations	594
	Capability for Protective Operations	980
	Subtotal	5,905
4. Air Force Capabilities	Capability for Air Combat Operations	1,593
	Capability for Combat Support of Air Operations	954
	Capability for Surveillance and Response Operations	1,181
	Capability for Airlift Operations	1,108
	Subtotal	4,838
5. Strategic Policy	International Policy, Activities and Engagement	179
	Strategic Policy and Military Strategy	45
	Subtotal	224
6. Intelligence	Intelligence	467
Total		**17,063**

Source: 2006–07 Defence Budget Papers. Figures have been rounded.

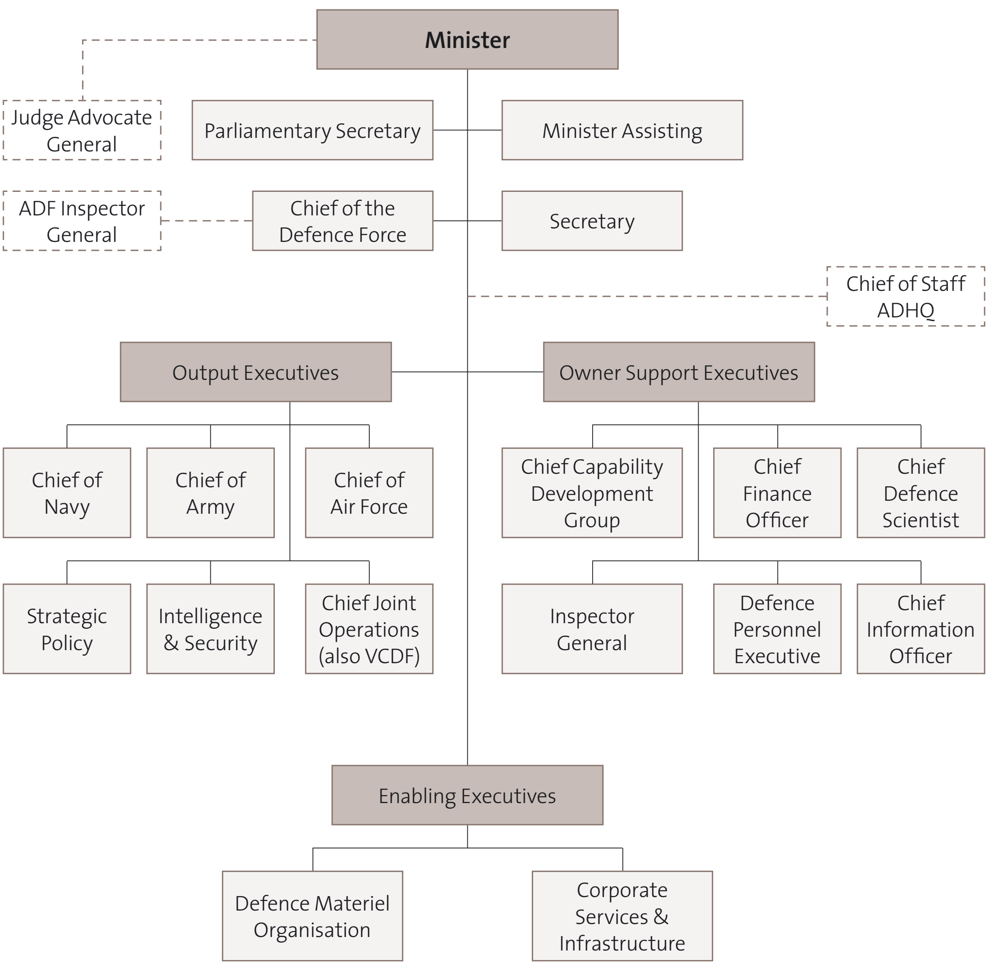
So, despite all the complications, the output framework makes sense. Unfortunately, over the past six years Defence has had a lot of trouble working out the net cost of the outputs. This has led to substantial volatility in the costs ascribed from year to year, making comparisons over time meaningless. Consequently, both Defence and the Department of Finance remain as focused as ever on the cost of inputs like personnel, facilities and logistics, with only scant regard to the cost of outputs.

How Defence is organised: groups

The traditional concept of Defence's organisational structure is that it consists of three services—Army, Navy and Air Force—and the Department of Defence. This impression is reinforced by the output structure, focused as it is on Army, Navy and Air Force capability outputs.

In fact, the Defence organisation isn't organised like this at all. It's divided into fifteen 'groups'; these are the entities between which the Defence budget is allocated. The arrangement of the groups is set out in Figure 1. (A new group structure is being phased in from 1 July 2006, details of which we explore in Chapter 7.) Perhaps the most striking feature is that, below the minister, no single person is in charge. The departmental secretary and the Chief of the Defence Force share control of Defence through a diarchy in which they each have separate and overlapping responsibilities.

Figure 1: The Defence organisation



Source: 2006–07 Defence budget papers

Note: As of 1 July 2006 a new organisational structure will be implemented, see Chapter 7.

The groups fall into three categories:

- **Output Executives groups** are (mostly) responsible for delivering Defence's outputs to the government (the customer).
- **Owner Support Executives groups** are responsible for protecting the government's interest as the owner of Defence, including by ensuring its long-term viability.
- **Enabling Executives groups** are responsible for providing business services, such as asset procurement and facilities management, to the other two types of groups.

The groups and their executives are responsible for spending Defence's money and doing its business. Consequently, financial accountability occurs within the group structure. Unfortunately, there's no simple correspondence between the groups where money is actually spent and the outputs that form the basis of Defence funding. This fundamental 'disconnect' is why Defence has trouble determining the net costs of its outputs. Ultimately, the net costs of outputs are entirely derived figures that don't correspond to the allocation of funds within Defence.

Table 2 gives the breakdown of the total attributed net cost of the Defence outputs across the fifteen groups for 2006–07. Note that the Defence Materiel Organisation (DMO) is now funded through the output groups under a system of purchaser–provider agreements.

Table 2: Allocation of the cost of outputs to groups

		2006–07 $ million	2006–07 % of total
Output Executives			
Joint Operations/Vice CDF		367	2.1%
Navy		3,145	18.4%
Army		3,443	20.2%
Air Force		3,277	19.2%
Intelligence		362	2.1%
Strategic Policy		127	0.7%
	Subtotal	10,721	62.7%
Owner Support Executives			
Defence Personnel Executive		600	3.5%
Defence Science and Technology		328	1.9%
Capability		48	0.3%
Chief Finance Officer		340	2.0%
Chief Information Officer		489	2.9%
Secretary/CDF Force		32	0.2%
Inspector-General		13	0.1%
	Subtotal	1,850	10.9%
Enabling Executives			
Defence Materiel Organisation[a]			
Corporate Services and Infrastructure		2,424	14.2%
Portfolio		2,068	12.1%
TOTAL		17,063	100.0%

a The Defence Material Organisation is funded through the Output Executives

Source: 2006–07 Defence Budget Papers. Figures have been rounded.

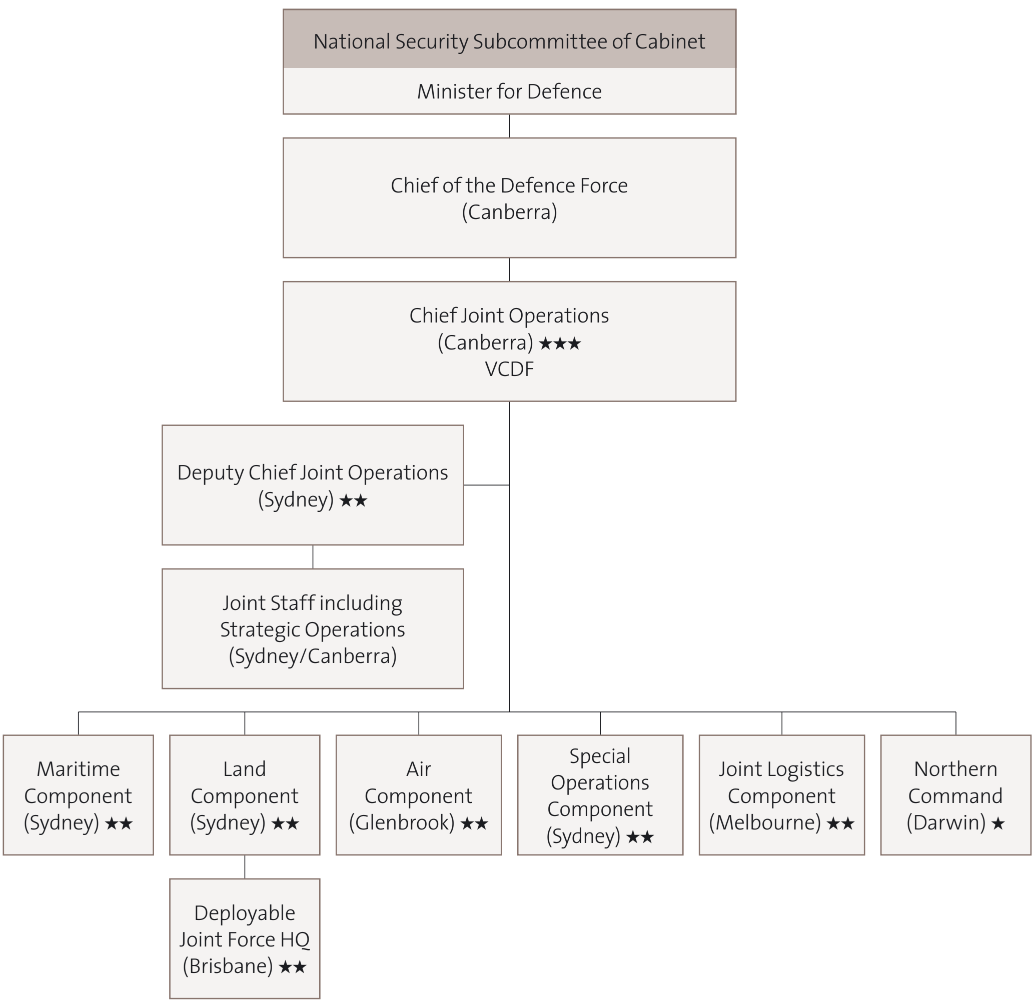
ADF command structure

It's important not to confuse the day-to-day management of the Department of Defence with the command of military operations. The former occurs through the diarchy and group/output arrangements, the latter through a formal command chain and dedicated headquarters structure. In this parallel arrangement, units are temporarily reassigned from the services to be commanded on operations and exercises as required.

In early 2003, the ADF command arrangements were revised through the creation of Joint Operations Command under the Chief of Joint Operations, who also happens to be the Vice Chief of the Defence Force. In this rearrangement, the old Headquarters Australia Theatre became part of the Joint Staff. Figure 2 outlines the arrangement.

Two points are worth noting. First, notwithstanding what might be implied by a naive reading of the Australian Constitution, the actual control of the ADF resides with the executive government through the National Security Committee of Cabinet. The Governor-General's role of commander-in-chief is entirely titular. Second, while many aspects of the management of Defence are shared between the Chief of the Defence Force and the Secretary of the Defence Department, the Secretary plays no role in the command of the ADF.

Figure 2: Defence command arrangements



How does this all hang together?

At the risk of oversimplification, Defence is funded and reports on the basis of twenty-eight outputs, organised and budgeted internally on the basis of fifteen groups, and is commanded on operations through an entirely separate arrangement of cascading headquarters.

… a lot of energy is devoted to keeping Defence's internal bureaucratic processes ticking over.

Viewed this way, it's surprising that things work as well as they do, but of course there's a price to be paid. All these overlapping arrangements require both orchestration from above and lateral coordination. As a result, a lot of energy is devoted to keeping Defence's internal bureaucratic processes ticking over.

Chapter 3

THE 2006–07 DEFENCE BUDGET

In the arcane world of Australian Government finances, several different figures are given for the size of the Defence budget, with each measuring different things. The figure that's most useful is the one for 'total departmental funding' in the Defence budget papers. It represents the funds available to Defence to deliver the six departmental outcomes and maintain the ongoing program of investment in new equipment and facilities. It's also the figure commonly used to measure movements in Defence's funding and is therefore the one to focus on. For 2006–07, it's $19.6 billion dollars. This is an increase of $1.9 billion, or 10.5%, on last year's figure. After inflation is taken into account, the real growth comes out at 7.8%. Note that the DMO has now been established as a prescribed agency, and will separately receive around $114 million that isn't counted in these figures.

As a share of national wealth, Defence spending is budgeted at 1.94% of gross domestic product for 2006–07, amounting to around 9% of overall Commonwealth payments. These statistics and those for recent years appear in Table 3, along with the projected figures out to 2009–10.

Table 3: Defence budget statistics

	2001–02	2002–03	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10
Funds (nominal $ million)	14,501	14,738	15,873	16,748	17,752	19,619	19,636	20,011	21,111
Growth (nominal)	14.65%	1.64%	7.70%	5.51%	6.00%	10.52%	0.09%	1.91%	5.50%
Growth (real)	12.12%	–1.51%	3.96%	1.55%	1.43%	7.82%	–0.95%	1.13%	3.37%
% of GDP	1.97%	1.88%	1.89%	1.87%	1.86%	1.94%	1.87%	1.82%	1.83%
% payments	8.85%	8.72%	8.85%	8.80%	8.55%	8.99%	8.65%	8.43%	8.45%

GDP = gross domestic product.

Note: Real growth is calculated relative to the implicit non-farm GDP deflator.

Photo opposite: Air Load Team members of the Australian Special Forces Task Group unload equipment off a United States Air Force C-130 Hercules at a Forward Operating Base in Afghanistan, September 2005. © Defence Department

The 2000 White Paper committed the government to a decade-long program of 3% real growth in the underlying level of defence funding. This isn't apparent in Table 3 for two reasons. First, substantial extra funding has been provided in the early years of the decade for logistics, personnel, overseas deployments and security initiatives since 9/11. This reduces the rate of growth from what it would otherwise have been. Second, some of the originally planned spending on new capital equipment has been deferred until after 2007–08. Although the total amount of money to be spent on new equipment remains unchanged, this means that some of the originally planned growth in funding has been deferred until near the end of the decade.

What's new in this year's Budget?

The national budget process is all about marginal changes to pre-existing funding levels. These take the form of budget 'measures' and funding adjustments. The key initiatives contained in this year's Defence budget are listed in Table 4. All figures refer to the total budget impact over the next four years.

In total, there is $15,888 million in new initiatives, for which Defence will receive $15,227 million across the next decade. Defence will need to find the remaining $661 million in expenditure from internal efficiencies. The level of funding made available is a generous 96%—which is less challenging than last year's 65%, when Defence was told to deliver $1,200 million in initiatives with only $780 million of funding.

Table 4: Initiatives in the 2006–07 Defence budget

		Total 2006–07 to 2015–16 ($ million)
3% budget growth past 2010		10,719
C-17 strategic lift aircraft		1,899
'Hardened and networked army'		1,548
Accelerated capital investment[a]		625
Overseas deployments		623
Personnel initiatives		560
Miscellaneous measures		342
Reactivate two minehunters		252
	Total	15,888
Savings measures		–661
	Total	**15,227**

a Accelerated funds over four years, net impact on 10-year total is –$55 million due to inflation.

Source: 2006–07 Defence budget papers

At last—3% real growth past the end of the decade

The big news in the budget was that the government agreed to continue the 3% annual real growth delivered by the 2000 White Paper from 2011–12 to 2015–16. This amounts to an extra $10.7 billion over five years. Importantly, while the 2000 White Paper delivered *average* 3% growth, the extended commitment is built around a more generous *compounding* real growth. The funding is spread across all areas of the budget—not just investment in new equipment.

… the government agreed to continue the 3% annual real growth delivered by the 2000 White Paper …

Heavy airlift capability—new C-17s

$2.2 billion will be spent over six years to acquire four new C-17 heavy airlift aircraft. The cost of this measure will be partly offset by $335 million from funding for unapproved projects in the Defence Capability Plan (DCP). This measure will enable the rapid deployment of armoured vehicles, helicopters and supplies to areas of operations, and increase the ADF's capacity to provide humanitarian assistance and emergency support. The chosen C-17 aircraft each have more than four times as much carrying capacity as one of the RAAF's current C-130 Hercules planes. Delivery of the aircraft is planned to be complete by mid-2008.

Hardened and networked army

$1.5 billion will be spent over ten years in the second phase of the Hardened and Networked Army (HNA) initiative to enhance the Army's protection and improve its firepower, speed, precision and information capability. Central to the HNA program is the restructure of the Army into combined arms battle groups and a retasking of parts of the Army Reserve into a High Readiness Reserve to provide direct support to regular operational units. The initiative also provides for the relocation of the Army's 3rd Battalion, the Royal Australian Regiment, from Sydney to Adelaide and its re-assignment from a parachute battalion to a mechanised battle group. Finally, funding for an additional 1,485 personnel is included in this initiative, along with $657 million to upgrade facilities at Defence bases.

Defence Capability Plan reprogramming

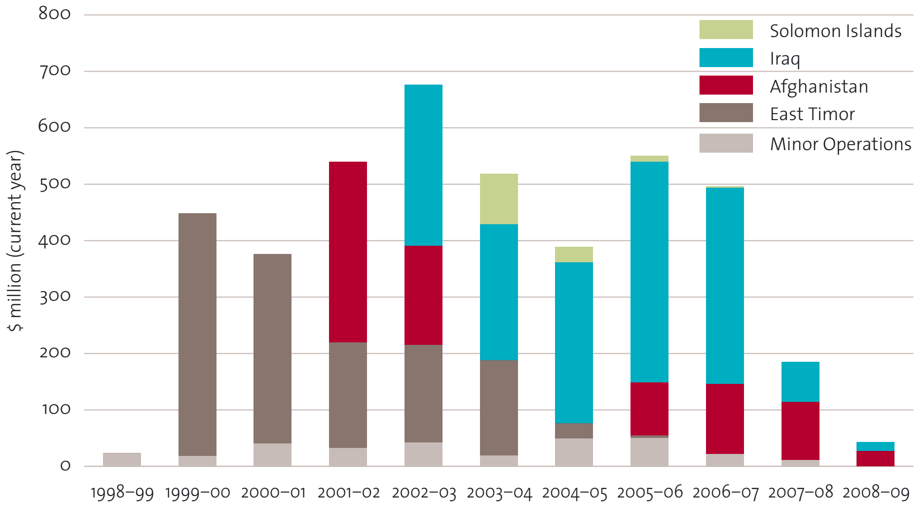
$625 million of previously deferred major capital equipment funding has been brought forward into the next four years to take advantage of improved performance by the DMO. This follows $300 million that was reinstated last year. On a ten-year basis, this initiative is effectively cost-neutral once out-turning is accounted for. This reprogramming should help get the DCP back on track.

This brings the total cost of our role in the invasion, stabilisation and rehabilitation of Iraq to $1.6 billion …

Deployments

$623 million was provided over four years for overseas deployments, including $393 million to continue current operations in Iraq for one year and $218 million for operations in Afghanistan for two years. This brings the total cost of our role in the invasion, stabilisation and rehabilitation of Iraq to $1.6 billion, with the corresponding figure for Afghanistan at $840 million. This budget also included an extra $12 million for coastal surveillance. Figure 3 shows recent and projected spending on operational deployments.

Figure 3: The cost of war



Source: Defence budget papers and annual reports

Personnel

$560 million will be provided over ten years to improve Reserve remuneration in order to attract and retain personnel. This includes funding for the establishment of the High Readiness Reserve in support of HNA. Key initiatives for all reservists include $600 per year health support allowance and $10 a day Reserve Allowance, with extra pay for ex-regular reservists. In addition, members of the new High Readiness Reserve will be eligible for a $5,000 a year completion bonus and an annual health support allowance of $2,500.

$194 million will be spent over the next four years on a variety of recruitment and retention initiatives to help attract and retain skilled military personnel, and also on a temporary increase in civilian staff in noncombat roles. The cost of this measure will be met fully from existing Defence resources—mainly from surplus funds due to the ongoing shortfall in military personnel numbers.

Miscellaneous measures

$342 million over ten years will be spent on a range of measures, including the redevelopment of the Mulwala munitions plant ($131 million), defence communications ($80 million), logistical funding for naval aviation ($26 million) and charting of our northern waters ($19 million). In addition, $213 million of investment funds earmarked for the new Joint Operations Command Headquarters has been handed back because the project will now be pursued as a private finance initiative.

Coastal surveillance (reactivate minehunters)

$252 million will be provided over ten years to increase surveillance and patrolling of high-threat maritime approaches to Australia to deter unauthorised boat arrivals by reactivating and deploying two Huon Class coastal minehunters. These vessels were previously taken out of service as a cost-saving measure following the 2003 Defence Capability Review.

... savings of $256 million over ten years will be realised through a restructuring of ADF higher command and control arrangements.

Savings measures

The government will realise savings of $405 million over ten years by broadening the coverage of the efficiency dividend to a range of civilian and non-operational areas in Defence that are currently not subject to the dividend. This measure increases the level of coverage from the current 8% to about 14% of Defence departmental expenditure. In addition, savings of $256 million over ten years will be realised through a restructuring of ADF higher command and control arrangements. The rationalisation and reallocation of personnel will help improve the efficiency and effectiveness of these arrangements.

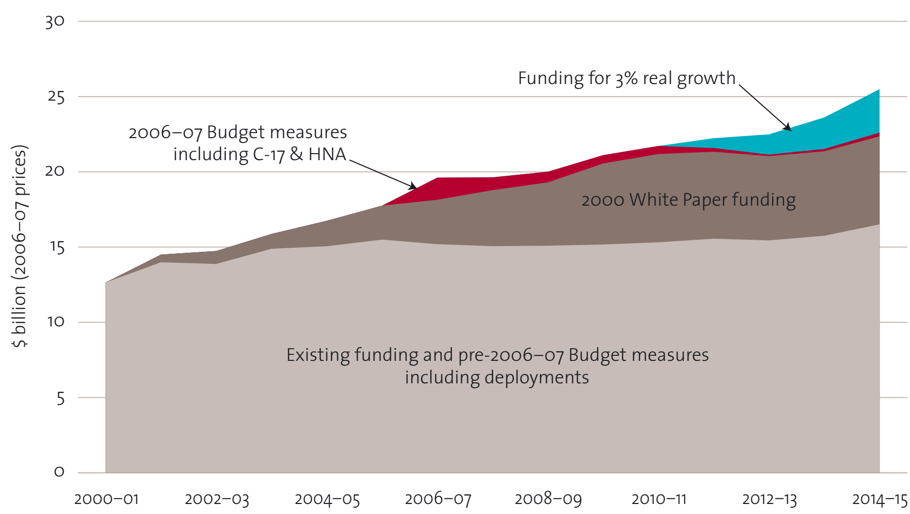
Price and exchange

Defence will receive an additional $546 million over ten years as a price adjustment, and will hand back $5.34 billion over ten years for foreign exchange movements. These adjustments maintain the buying power of the Defence dollar.

Adding it all up

New funding provided for defence in the 2006–07 Budget amounts to more than $15.2 billion over ten years, including $10.7 billion for 3% growth out to 2015 and $4.5 billion for other measures. This comes on top of the $28.5 billion provided through the 2000 White Paper and other post-2000 initiatives. Figure 4 plots total defence funding from 2000 through to 2015, showing the various sources of funding.

Figure 4: Defence spending, 2000–2015



Source: Defence budget papers, annual reports and ASPI estimates

The Budget isn't just about money: it's equally about what's going to be delivered for the money.

So what will we get for our money?

The Budget isn't just about money: it's equally about what's going to be delivered for the money. In the case of Defence, this comes down to performance targets for the twenty-eight outputs. The Budget papers set broad targets for the preparedness, core skills and quantity of the outputs.

Preparedness

Preparedness refers to the readiness of the ADF to undertake and sustain operations, be they national support tasks, peacekeeping or war. For example, the light infantry output might be required to 'be prepared to deploy a battalion at ninety days notice to assist in a regional peacekeeping operation and to maintain the deployment for twelve months' (this is a figurative example, not a real one).

Core skills

To take into account possible longer term tasks and the requirement to retain broad expertise in the three services, an enduring performance target for nearly all the outputs is to 'achieve a level of training that maintains core skills and professional standards across all warfare areas'.

Quantity

Most of the outputs include one or more 'quantity' measures that try to capture some aspect of *how much* capability will be delivered. Each of the three services uses a different type of measure. For the Navy, it's usually the availability of ships and their crew to undertake a mission; for the Army, it's the presence of adequate quantities of trained personnel and equipment; and for the Air Force (and Army and Navy aviation), it's the number of hours flown.

Recent performance

The past five Defence annual reports have consistently reported against performance targets at the output level, making year-to-year comparisons possible. Table 5 summarises the results from the 2004–05 annual report and tracks the changes from the year before. Defence uses a four-point performance scale for preparedness and core skills: *achieved*, *substantially achieved*, *partially achieved* and *not achieved*. To aid presentation, we've mapped the numerical 'quantity' results according to the key at the bottom of the table.

Between 2000–01 and 2001–02, performance levels remained largely static. In 2002–03, aggregate performance against targets improved substantially, and this positive trend continued in 2003–04. In 2004–05, performance remained largely static in aggregate with some changes in individual outputs. In detail, the Navy's already good performance showed a slight further improvement, while the Air Force remained static apart from a single decline.

The Army's performance remained largely where it was, apart from a decline across the board in operational logistics support. Meanwhile, Defence Operations and Strategic Policy continued to meet their targets and the reported performance of Intelligence improved.

Overall, it appears that the substantial extra funding provided to Defence in recent years for logistics and other initiatives is making a real difference to the delivery of capability, notwithstanding the high operational tempo that's been maintained over the same period.

Table 5: Recent performance

Output	Preparedness	Core skills	Quantity
1. Defence operations			
1.1 Command of Operations		↔	
1.2 Military Operations		↔	
1.3 National Support Tasks		↔	
2. Navy			
2.1 Major Surface Combatants	↔	↔	↔
2.2 Naval Aviation	↓	↑	↔
2.3 Patrol Boats	↔	↑	↑
2.4 Submarines	↔	↑	↔
2.5 Afloat Support	↑	↔	↑
2.6 Mine Warfare	↓	↔	↔
2.7 Amphibious Lift	↔	↔	↔
2.8 Hydrographic	↔	↔	↑
3. Army			
3.1 Special Forces	↔	↔	↔
3.2 Mechanised Ops.	↔	↔	↔
3.3 Light Infantry Ops.	↔	↔	↔
3.4 Army Aviation Ops.	↔	↔	↔
3.5 Ground-based Air Defence	↓	↔	↔
3.6 Combat Support Ops.	↔	↔	↔
3.7 Regional Surveillance	↔	↔	↔
3.8 Operational Logistics Spt.	↓	↓	↓
3.9 Motorised Ops.	↔	↔	↔
3.10 Protective Ops.	↔	↔	↔
4. Air Force			
4.1 Air Combat Ops.	↔	↔	↔
4.2 Combat Spt. of Air Ops.	↔	↓	↔
4.3 Strat. Surveillance & Resp.	↔	↔	↔
4.5 Airlift	↔	↔	↔
5. Strategic Policy			
5.1 Strategic Engagement		↔	
5.2 Military Strategy & Cmd.		↔	
6. Intelligence		Substantially Achieved ↑	

Improved since 2003–04: ↑	Static since 2003–04: ↔	Declined since 2003–04: ↓
Achieved	Substantially Achieved	Partially Achieved

Quantity: Above 95% = Achieved; 95% to 75% = Substantially; Below 75% = Partially

Source: 2003–04 and 2004–05 Defence annual reports

Chapter 4

CAPITAL INVESTMENT

An essential component of Defence's spending is the investment in new equipment, facilities and upgrades that allows the ADF to maintain credible military capabilities while other nations continue to modernise their forces. Table 6 shows Defence's planned Capital Investment Program.

Table 6: Capital Investment Program ($ million)

	2005–06 Projected	2006–07	2007–08	2008–09	2009–10
Major capital equipment	3,353	3,735	4,623	4,727	5,289
Capital facilities	347	491	463	415	368
Other capital	789	528	479	492	500
Capital Investment Program	**4,489**	**4,754**	**4,565**	**4,634**	**6,157**

Source: 2006–07 Defence budget papers

There are three components to the Capital Investment Program:

- *Major capital equipment projects* are worth more than $20 million each and mostly involve the purchase of military equipment. They range from small projects to acquire specialist communications equipment through to massive undertakings, like the $10 billion plus project to replace the F/A-18 tactical fighter fleet.
- *Capital facilities projects* include everything from new barracks to upgrades of existing facilities. The Defence estate includes about 25,000 individual buildings, so upgrading and development never end.
- *Other capital* includes minor capital equipment (projects costing less than $20 million), repairable items, non-capital facilities, plant and equipment, and software and intangibles.

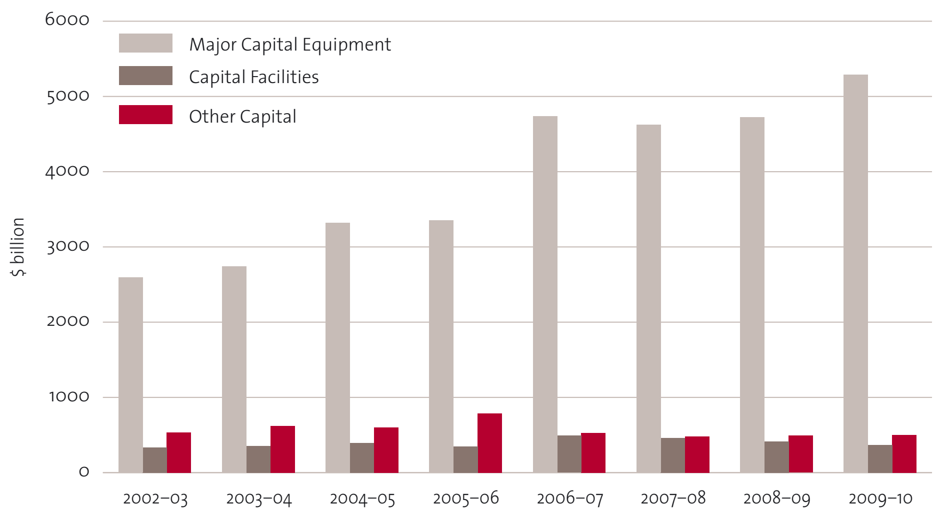
Photo opposite: An Australian Army Armoured Personnel Carrier patrols around the Gleno area, Timor-Leste, June 2006. © Defence Department

These three items together make up the total capital program. But not all of this money actually represents capital investment. Around 12.4% is used in the process of acquiring the assets. This includes project office costs, studies, research and development, travel, professional service providers and other overheads. This is in addition to the overhead represented by the infrastructure division in the Corporate Services and Infrastructure group and the DMO, who are responsible for the acquisition processes.

What are the trends in the Capital Investment Program?

The trend across the next four years is for a steady increase in the Capital Investment Program from $4.5 billion in 2005–06 to $6.2 billion in 2009–10 (a 38% increase in nominal dollars). Within these amounts, expenditure on capital facilities and other capital falls slowly, while the total spending on major capital equipment grows (Figure 5). Clearly, even after the reprogramming of capital investment funds, significant growth in spending on major capital equipment is still planned. This won't be an easy task for the DMO, even given recent improvements.

Figure 5: Planned trends in the capital budget



Source: 2006–07 Defence budget papers

Major capital facilities projects

There are currently thirty-two approved capital facilities projects. This includes sixteen major projects of more than $6 million (totalling $1.4 billion) and sixteen medium projects worth from $250,000 to $6 million (totalling $40.8 million). In the 2006–07 Budget, the government foreshadowed sixteen new major capital works projects and fourteen medium projects for parliamentary consideration.

The largest of the current projects are the RAAF Amberley Redevelopment ($286 million), the development of Special Forces working accommodation and base redevelopment at Holsworthy ($208 million), the redevelopment of RAAF Williamtown ($129 million) and the relocation of Defence Science and Technology Organisation facilities at Fishermans Bend ($106 million).

... there has been a notable improvement in the delivery of projects by the DMO.

Major capital equipment projects

In recent years, there has been a notable improvement in the delivery of projects by the DMO. Although more than $2 billion of planned investment was deferred in the first part of this decade due to an inability to initiate and deliver projects, $300 million was reinstated in the program last year, followed by $625 million this year. But it would be premature to conclude that we've seen the last of problems in the investment program. Not only will the planned increase in investment over the next several years be a real challenge, but delays continue to accrue in approved projects—the most recent example being the eighteen-month delay in the high-profile airborne early warning and control (AEW&C) aircraft project. Meanwhile, delays are also mounting among the projects awaiting government approval in the DCP.

Delivering the Defence Capability Plan

The 2001–2010 DCP outlined the government's major capital equipment investment plans for the coming decade, as decided at the time of the 2000 White Paper. It was originally planned that the DCP would undergo annual revisions to take account of new information and changing strategic priorities. But it wasn't until February 2004 that the first full revision of the plan (covering 2004–2014) was publicly released, followed by a second revision in June 2006 (covering 2006–2016).

Last year, we found that after a flying start in 2003–04 the approval of projects listed in the 2004 version of the plan had stalled. This situation continued through into 2005–06, with only thirty-three out of fifty-six projects scheduled for approval in the first three years of the 2004 plan actually gaining approval. Of the remaining eighty-one projects, five are no longer programmed following the move to the 2006 version of the plan and seventy-six have been carried forward taking account of project phases being consolidated in the move to the new plan (Table 7).

Table 7: The 2004 Defence Capability Plan

	Number	Cost ($ million)
Approved[a]	33	7,455
No longer programmed	5	255
Carried forward	76	43,883
Total	**114**	**51,593**

a Includes several non-DCP approvals

Source: 2004 and 2006 Defence Capability Plan

In addition to the projects carried forward from the 2004 plan, there are twenty-four new projects in the 2006 version (Table 8). The largest of these are the $3 billion naval combat helicopter project and the $875 million ground-based air defence project, both scheduled for approval in 2015. Next in value come three projects costing around $400 million each—the logistics information systems scheduled for approval in 2012, and the lead-in fighter and Anzac frigate upgrades scheduled for approval in 2013.

Table 8: The 2006 Defence Capability Plan		
	Number	**Cost ($ million)**
New projects	24	7,423
Carried forward	76	43,883
Total	**100**	**51,306**

Source: 2004 and 2006 Defence Capability Plan

Looked at in detail, the 2006 DCP represents a consolidation of the government's post-9/11 plans for the ADF. Most of the large changes result from finding smarter and more efficient ways of delivering the capabilities detailed in the 2004 version of the plan. Indeed, the projects that have been removed are small in financial terms and the new projects introduced are mainly, though not exclusively, in the outer years of the program, where new money has become available due to the extension of the plan to 2016.

The changes to cost and schedule of the seventy-six projects carried forward into the 2006 version of the plan are detailed in Table 9. Fully 34% of projects have had their in-service date delayed, while only 3% have had it brought forward. In terms of cost, 21% of projects are now in a higher cost band and 7% are now in a lower band.

Table 9: Changes to cost and schedule, 2004 DCP to 2006 DCP				
Project numbers				
	Schedule delay	Schedule static	Schedule accelerate	Total
Cost increase	2	14	0	**16**
Cost static	20	33	2	**55**
Cost decrease	4	1	0	**5**
Total	**26**	**48**	**2**	**76**
Total value ($ million)				
	Schedule delay	Schedule static	Schedule accelerate	Total
Cost increase	88	6,438	0	**6,525**
Cost static	8,458	27,213	113	**35,783**
Cost decrease	1,275	300	0	**1,575**
Total	**9,821**	**33,951**	**113**	**43,883**

Source: 2004 and 2006 Defence Capability Plan

The impact of the changes to cost and schedule is most pronounced in terms of schedule. In aggregate, the cost of the seventy-five projects only rose by 1.7% between 2004 and 2006. Some of this simply reflects inflation pushing projects from one cost band to another, while other changes represent new ways of delivering capabilities (like moving from upgrading to replacing equipment). Nonetheless, several projects appear to have incurred substantial real cost increases, including the F/A-18 structural refurbishment (from around $175 million to $675 million), the military satellite capability (from around $525 million to $1250 million) and the multimission unmanned aerial vehicle (from about $875 million to $1250 million). Overall, however, compared with the wholesale cost escalation of around 20% between the 2000 and 2004 versions of the plan, aggregate cost growth has been largely contained.

A somewhat less favourable picture arises for schedule delays. The average delay across the seventy-five projects carried forward is 11.4 months—not much different from the roughly 12 months delay that accrued between the 2000 and 2004 versions of the plan. The figure of 11.4 months is calculated on the basis of projected in-service dates; if we look at the delay in planned year-of-decision, the delay grows to 15.4 months. So, while costs have been effectively contained in aggregate, schedule slippage continues unabated.

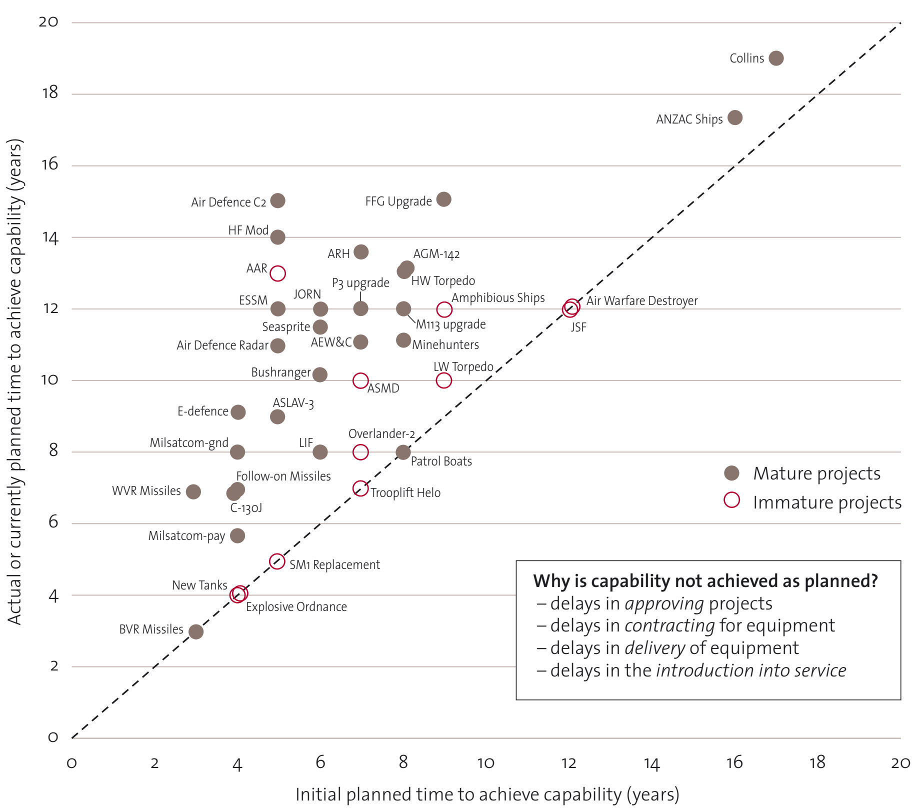
Why the delays?

As near as we can determine, there are three possible reasons for the mounting delays. First, the introduction of the new two-pass process of project approval has caused an extended hiatus while the new system is bedded down. The new process imposes much more stringent demands on information before a project is approved. While a delay of this sort is disappointing, it may eventually lead to better results in the long run. The new process might also help explain why the slippage in planned approval dates exceeds that for planned in-service dates. It could be that the new process, with its emphasis on more up-front analysis, allows projects to be taken from approval to delivery more quickly.

Second, changing priorities have seen the introduction of some new projects into the early years of the program, such as the $300 million naval training helicopter scheduled for approval in 2007–08. This, along with cost growth in existing projects, will inevitably cause delays as more projects are crammed into a fixed funding envelope.

Third, it might just be that Defence systematically underestimates the time it takes to deliver projects. Certainly, there are signs that Defence is almost always overoptimistic about the total time it takes to bring a project from conception to reality. Figure 6 plots the planned time to bring capability into service versus actual achievement for a wide selection of projects that we could find good data for.

Figure 6: The long wait



Source: ASPI analysis of multiple sources


AUSTRALIAN

Chapter 5

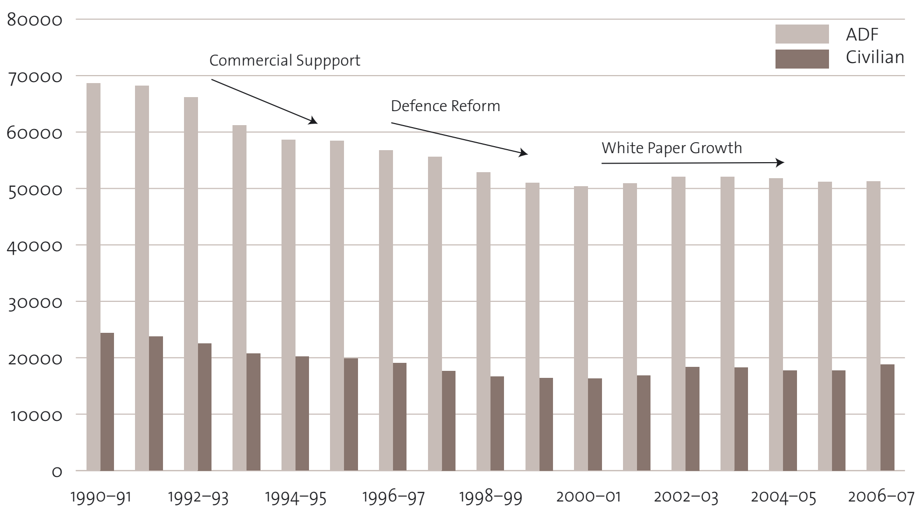
PERSONNEL

In this chapter, we look at the raw numbers and cost of the Defence workforce. This is an unashamedly limited view of the complexities of Defence personnel, but one that is appropriate for a budgetary report.

Personnel numbers

In the decade following the Force Structure Review in 1991, ADF numbers dropped from around 70,000 to 50,000 permanent personnel, as shown in Figure 7. Over the same period, civilian numbers dropped from around 25,000 to 17,000.

Figure 7: Defence workforce, 1990–91 to 2006–07



Source: Defence annual reports and 2006–07 budget papers

Photo opposite: Soldiers from 10 Platoon, Delta Company, 1st Battalion Royal Australian Regiment await to board Australian Air Force aircraft from Townsville for the Solomon Islands to assist the Australian Federal Police in support of Operation Anode, April 2006.
© Defence Department

The bulk of these reductions were due to outsourcing under the Commercial Support and Defence Reform programs. In fact, the initial goal of the Defence Reform Program was to reduce the strength of the ADF to 43,500, but this was soon revised up to 50,000, thereby arresting the decline. The 2000 White Paper subsequently set permanent ADF numbers on a growth path towards 54,000. However, as a result of the cuts made in the 2003 Defence Capability Review and subsequent increases through new initiatives like Hardening and Networking the Army, a long-term target of around 54,600 is now in place. Recent personnel numbers are in Table 10, along with the estimates for 2006–07.

Table 10: Workforce summary for Defence plus Defence Materiel Organisation (average funded strength)

	01–02 Actual	02–03 Actual	03–04 Actual	04–05 Actual	05–06 Projected	06–07 Budget
Navy	12,598	12,847	13,133	13,089	12,800	12,784
Army	25,012	25,587	25,446	25,356	25,259	25,220
Air Force	13,322	13,646	13,455	13,368	13,130	13,249
Total	**50,932**	**52,080**	**52,034**	**51,813**	**51,189**	**51,253**
Reserve	18,868	19,620	20,488	19,275	19,150	19,250
Civilian	16,819	18,385	18,303	17,754	17,781	18,768

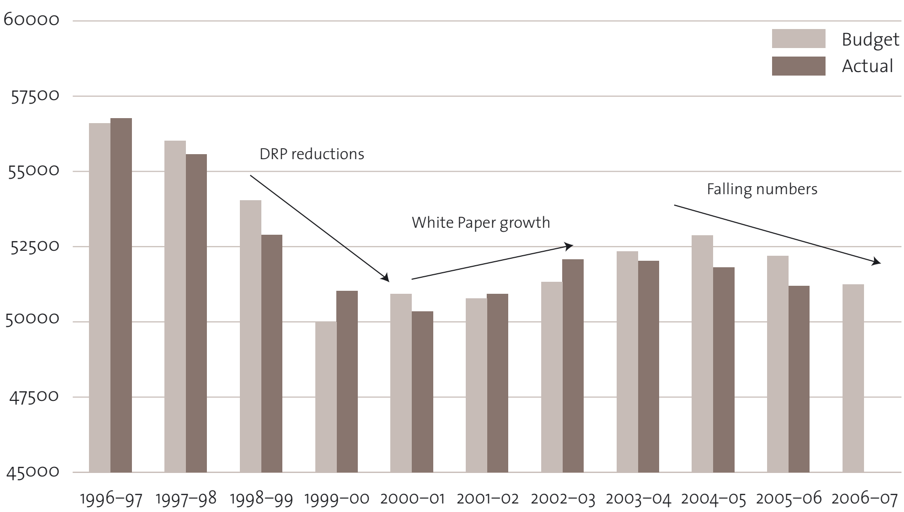
Source: Defence annual reports and 2006–07 budget papers

What are the recent trends?

Permanent ADF numbers

Despite costing $500 million in initiatives to improve the recruitment and retention of military personnel over five years, the process of building up the size of the ADF has worse than stalled—it's gone backwards. In 2003–04, the average strength of the permanent ADF fell by 46 positions, in 2004–05 it fell by 221, and in 2005–06 it's projected to fall by another 624 positions. This adds up to a cumulative loss of 891 personnel over three years, at a time when earnest attempts have been made to grow the force. In both 2004–05 and 2005–06, the final result was around a thousand below target (Figure 8).

Figure 8: Budgeted and actual ADF personnel, 1996–97 to 2006–07 (average funded strength)



Source: Defence annual reports and budget papers

The problem is not spread evenly. The Air Force is in the best position, benefiting from the lowest separation rate in over a decade plus good recruitment. The Navy and Army are in a less favourable situation. All services are feeling the pressure in skilled trade areas, where demand is high across the broader economy. Unless personnel numbers start to rise soon, the situation will become more difficult once the new capabilities being delivered through the DCP start to enter service.

The annual change in ADF strength is the difference between the numbers of people recruited into and separated from the force (typically around 5,000 in each case). Since the planned change in strength is usually a much smaller number, the outcome is finely balanced. With this in mind, we turn now to examine ADF recruitment and separations.

Table 11 shows the percentages of recruitment targets that have been met over the nine years to 2004–05. Following solid improvements earlier this decade, which saw the rate grow from 76% to 93% in 2001–02, performance dropped back to the mid-80% level in 2002–03 and 2003–04 before falling further in 2004–05. This is a long way short of the healthy 90%-plus figures from the mid to late 1990s.

Table 11: Recruitment targets met (per cent)

	96–97	97–98	98–99	99–00	00–01	01–02	02–03	03–04	04–05
Navy	92	98	76	57	74	85	84	86	73
Army	98	94	78.5	83	79	100	79	84	81
Air Force	93	101	90.5	83	88	87	94	90	91
ADF	**94**	**97**	**80**	**76**	**80**	**93**	**84**	**86**	**80**

Source: Defence annual reports

Table 12 shows the percentages of ADF personnel who separated from full-time military service over the same nine years. Some care must be taken with this data because figures for earlier years were affected by the deliberate reduction in the size of the ADF between 1997 and 2001 under the Defence Reform Program.

Table 12: ADF separation rates (per cent)

	96–97	97–98	98–99	99–00	00–01	01–02	02–03	03–04	04–05
Navy	11.5	11.1	12.6	13.3	13.2	11.5	11.6	10.1	12.2
Army	10.4	10.9	12.9	13.0	13.2	11.5	9.8	11.0	12.7
Air Force	9.0	10.0	11.9	11.6	15.6	10.4	8.1	7.4	8.4
ADF	**10.3**	**10.7**	**12.6**	**12.7**	**13.8**	**11.2**	**9.8**	**10**	**11.5**

Source: Defence annual reports

In summary, the plan to grow the ADF stalled in 2002–03 as adverse recruiting trends began to outweigh favourable retention figures and, as a consequence, personnel numbers have fallen over the past two years. All the services are concerned about personnel numbers, although the Air Force appears to be in a better position than the other two services. But things can change quickly: the Navy's improved recruiting and retention performance in 2003–04 was reversed in 2004–05.

Moreover, it's worth remembering that all the services have shortages in specific skill categories and rank levels. These will take time to rectify, even if recruitment and retention improve tomorrow. It takes years for personnel to be trained and gain sufficient experience to take up jobs at more senior levels, even (or especially) among the other ranks.

The Defence Minister is currently considering the recommendations of an external review of recruitment and retention.

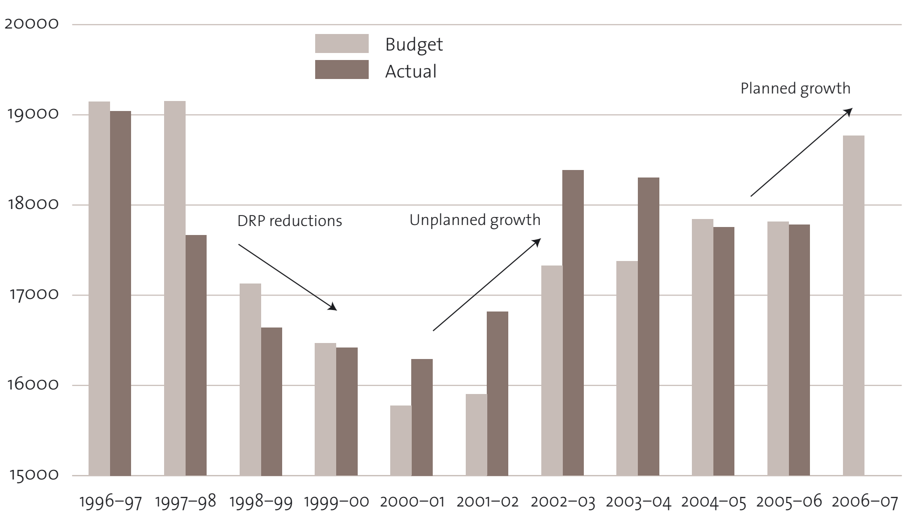
What's the solution?

In this budget, the government allocated $194 million over four years to fix ADF recruitment and retention ($138 million) and backfill non-operational military positions with civilian personnel in the meantime ($56 million). The recruitment and retention measures are being focused on twenty-five critical trades where personnel shortages are most serious. Measures include improved recruitment processes, retention and completion bonuses, improved rehabilitation to reduce medical discharges, sign-on bonuses, overseas recruitment and maintenance of the recruiting website. Further steps are likely in the near future. The Defence Minister is currently considering the recommendations of an external review of recruitment and retention.

Civilian numbers

Although civilian numbers fell quickly under the Defence Reform Program, they grew back very rapidly in the first two years of White Paper implementation—three times more quickly than military numbers grew. What's more, the growth was largely unplanned (Figure 9). Following a freeze on civilian recruitment in 2003, the growth was finally brought under control in 2004–05. However, civilian personnel numbers are set to rise by 950 in 2006–07 for several reasons, including civilianisation and backfilling of military positions.

Figure 9: Budgeted and actual civilian personnel, 1996–97 to 2006–07 (average funded strength)



Source: Defence annual reports and budget papers

Reserve numbers—declining again

Reserve numbers increased by 752 personnel between 2001–02 and 2002–03, and 868 between 2002–03 and 2003–04. This compared favourably with the decline of around 1,000 between 2000–01 and 2001–02. However, in 2003–04 numbers fell by 1,213 and by another 125 in 2005–06 due to lower Army recruiting. Consistent with this, the Army output for Protective Operations that employs most of the Reserve personnel mentioned personnel shortages as a problem in both the 2003–04 and 2004–05 annual reports.

This year's budget included $560 million over ten years for improved Reserve remuneration. This is related, in part, to the decision to create a 2,800-strong high-readiness reserve force as part of the Hardening and Networking the Army project. The Air Force will also have a high-readiness component.

At about 41%, this makes personnel the largest single slice of the Defence budget.

How much do personnel cost?

Personnel expenses in 2006–07 will be around $7.0 billion, rising to $7.9 billion in 2009–10. At about 41%, this makes personnel the largest single slice of the Defence budget.

In the past, growth in military personnel costs has created pressure on the Defence budget not because growth in remuneration has been out of step with civilian sectors, but because Defence didn't receive indexation to cover real growth in personnel costs. To remedy this, the White Paper provided funding for 2% real growth in per capita military and civilian personnel costs (although this extra funding did not commence until 2004–05). Following the 2004–05 Budget, the additional supplementation for military personnel cost growth was increased to 2.5% per year.

According to data in this year's budget papers and past annual reports, per capita military personnel expenses have been growing in real terms by around 0.6% a year over the past seven years, which is well within the supplementation being provided. In contrast, civilian per capita personnel costs have been growing by around 2.7% in real terms, which exceeds the supplementation provided. This latter figure can't be the result of faster rates of wage growth for civilian employees, because wage increases for civilians and military personnel have, on average, been identical for more than a decade. Most likely, it's because more civilians are gradually being employed at more senior levels, resulting in upward pressure on per capita expenses. We expect this to occur with the transfer of expensive short-term contractor jobs to civilian personnel, especially in the health service area where salaries will be relatively high because of the shortage in medical professionals in Australia.

Chapter 6

THE BOTTOM LINE

In this chapter, we examine the 2006–07 defence budget by looking at the three canonical chunks of defence expenditure: capital investment, personnel and operating costs. The critical question is whether adequate personnel and operating costs have been provided for the future, given the substantial investment in new equipment under way.

Capital investment—the Defence Capability Plan

For the first time, the Defence budget papers contained planned capital investment levels for the next ten years (Figure 10). There are three things worthy of mention.

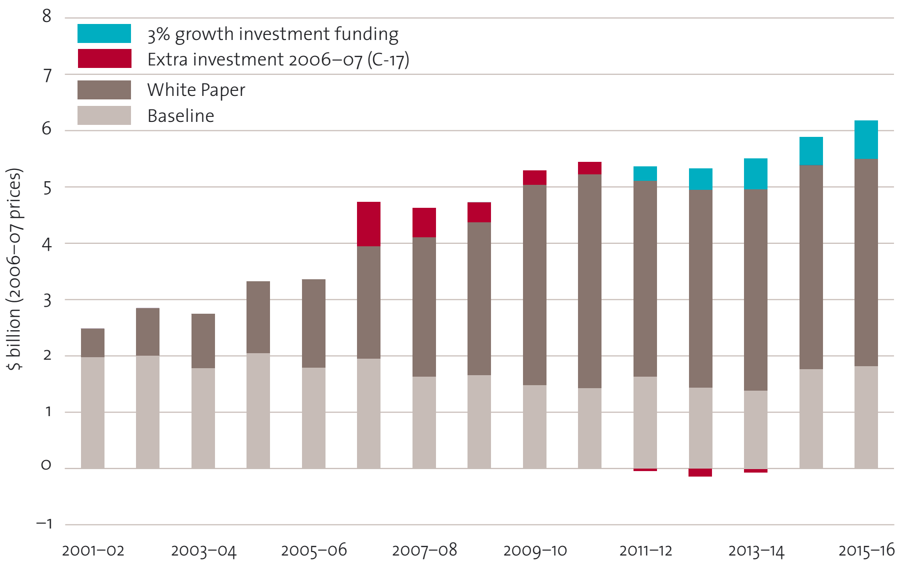
First, a substantial increase in investment spending is planned for next year. The resulting year-on-year increase amounts to a 41% jump. Fortunately, around half of the increase is accounted for by the off-the-shelf (actually out-of-the-factory) purchase of C-17 aircraft at a cost of almost $800 million in 2006–07. This will see the first aircraft in service with the RAAF by December this year. Nonetheless, and as Figure 10 shows, this is the first step up a very steep hill of investment spending.

Second, the relative emphases on capital investment in the latest 3% funding measure and in the 2000 White Paper are very apparent.

Third, the implied level of baseline (pre-White Paper) major capital equipment investment is less than $2 billion per year. This is surprisingly small, given that this is out-turned (inflation adjusted) data. It shows that some of what's claimed as 'new investment funds' is really just filling in a pothole in the baseline investment budget.

Photo opposite: A soldier from the 3rd Royal Australian Regiment Battalion Group stands guard outside a building at a village near Gleno, Timor-Leste, June 2006. © Defence Department

Figure 10: Capital investment—sources of funding



Source: Defence annual reports and budget papers

Personnel costs

Defence is currently around 3,000 full-time military personnel below its target for the next decade, which includes around 1,500 personnel for HNA. Given that personnel expenses rise 2% to 2.5% faster than inflation, the budget will be hit by two factors in the coming years: rising personnel costs and, hopefully, rising personnel numbers. Assuming that the growth in numbers occurs at a steady rate of around 350 people per year, it's possible to project the cost of personnel out to 2015–16 and in between. Doing this yields a bill of just under $9.8 billion in a decade's time.

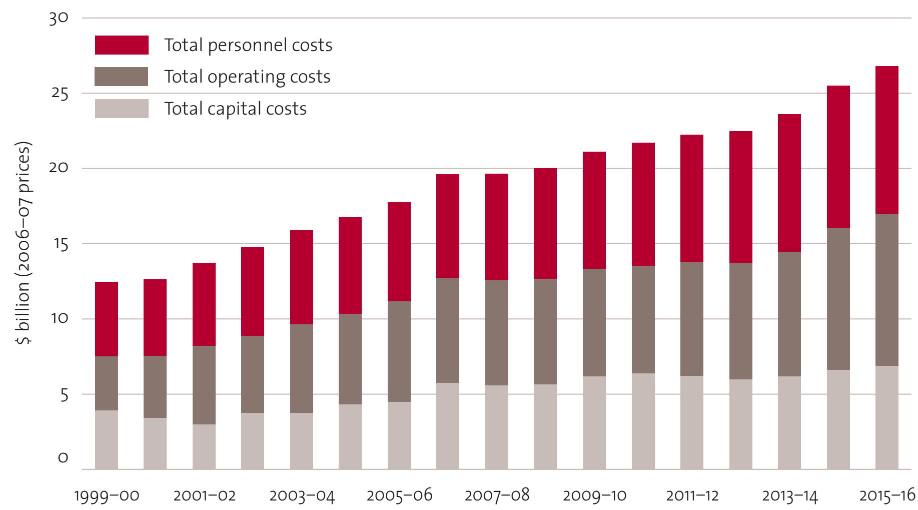
Adding it all up

With an estimate of personnel costs and a firm figure for planned capital investment, we can estimate the money left to cover operating costs. The results appear in Figure 11, where we've corrected for the hand-back of $780 million in 2001–02 to give a more accurate picture of the historical data.

> … it also appears that operating costs are going to be squeezed between now and the end of this decade.

The steady growth of personnel expenses is apparent in Figure 11, as is the planned growth in capital investment spending. Between these two expanding wedges sits the poor cousin—operating costs. Fortunately, it looks as though post 2010–11 the 3% growth funding allows operating costs to expand in unison with personnel and investment spending. However, it also appears that operating costs are going to be squeezed between now and the end of this decade.

Figure 11: Estimated personnel, operating and capital costs

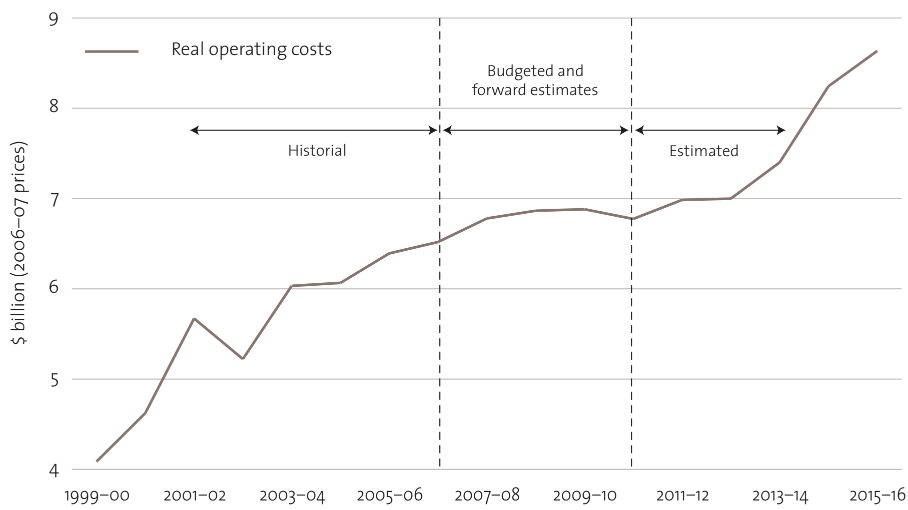


Of course, it's dangerous to draw simple conclusions from a graph like Figure 11. Not only are the figures expressed in nominal dollars, but the recent series of overseas deployments skews the picture. These two factors could mean that the apparent squeeze is nothing to worry about. To check, we've corrected for inflation and subtracted the cost of military operations going back to 1999–2000. In doing so, we've been careful to isolate capital spending and assumed that 90% of non-capital deployment supplementation goes to operating costs and 10% is attributed to personnel to reflect deployment allowances, etc.

The result is not encouraging. In Figure 12, we've plotted the actual, planned and estimated operating costs since 1999–2000 in 2006–07 dollars. From 2007–08 to 2012–13, the growth in operating costs falls flat, in direct contrast to the historical trend preceding it and planned spending from the middle of next decade. There are two reasons to believe that this is unrealistic:

- Over the next several years, just when the money available to cover operating costs falls flat, a large number of projects are due to deliver new capability into the ADF. These include four C-17 transport aircraft, six AEW&C aircraft, four A330 refuellers and twenty-two armed reconnaissance helicopters—not to mention a host of smaller projects that will be coming due over that period as a result of the elevated investment of the past several years.
- There are no major efficiency measures planned to cut the cost of maintaining ADF equipment. Indeed, the vast bulk of the outsourcing programs initiated by the Defence Reform Program have been completed. In fact, on the basis of the historical trend, we can expect an ongoing increase as the cost of maintaining equipment continues to outpace inflation.

Figure 12: Historical, budgeted and estimated operating costs



In part, the looming shortfall in operating costs can be traced back to the so-called 'logistics shortfall' measures of 2003–04 and 2004–05, when the government provided around $400 million per year extra for logistics. Because the measures from 2004–05 have not been renewed past 2007–08, it's not surprising that 2008–09 is the year where the money available for operating costs starts to flatten out.

At a minimum, the shortfall from 2008–09 to 2015–16 is in the vicinity of $1.6 billion on the basis of extending the 2004–05 logistics shortfall funding and accounting for some modest growth past the 2007–08 figure. This doesn't take account of the overall growth in operating costs or of the range of additional capability that will enter service over the period—like the C-17 fleet. The actual shortfall is almost certainly much larger.

… there appears to be a rush to purchase equipment in the near term without knowing what it will cost, let alone securing the money.

What does this say about Defence planning?

The 2000 White Paper was a 'bottom up' attempt to construct an affordable ten-year program of defence activity. It took account of the personnel and operating costs necessary to turn the equipment being bought into operational military capability. In retrospect, it was overoptimistic about both capital and operating costs, both of which have grown well beyond the estimates made in 2000, but the methodology was sound. Unfortunately, there's little sign that such a thorough approach has been applied this time. Instead, there appears to be a rush to purchase equipment in the near term without knowing what it will cost, let alone securing the money.

This makes no sense. It could easily lead to a situation like that in 2003, when the government cut two frigates and two minehunters and accelerated the retirement of the F-111 fleet to save money as defence costs spiralled. That showed just how expensive inadequate planning can be, and the current situation might actually be worse. If operating costs aren't being properly taken into account, what about personnel numbers? How many more people will the Navy need to operate its air warfare destroyers next decade? Are they factored into the plan?

Chapter 7

DEFENCE MANAGEMENT

It's beyond the scope of this document to canvass the intricacies of how the massive Defence enterprise is managed. With a workforce of over 90,000 spread across the continent and beyond, plus an almost $20 billion annual budget, it presents a range of unique problems. For this reason, this section focuses on just three key areas that are of systemic or topical importance, or both: organisation, efficiency and financial management.

Organisation

Ever since Sir Arthur Tange dragged the three services and the departments of Supply and Defence together (kicking and screaming) to create the current Defence organisation in 1973, successive ministers, departmental secretaries and defence chiefs have struggled to find a satisfactory organisational structure. Over the years, this has led to numerous reviews, reorganisations and a long string of revised organisational charts.

Another reshuffling of the bureaucratic deckchairs is now under way …

Most of the changes have been minor, like the creation of a Chief Information Officer in 2000. Others have been more significant, like the reestablishment of DMO as a prescribed agency in 2005. And some have been seismic, like the reorganisation in 1997 after the Defence Reform Program, which stripped the service chiefs of many of their powers. Another reshuffling of the bureaucratic deckchairs is now under way, and, while not earth shattering, it will have important consequences.

Photo opposite: Australian Soldiers crossing a suspension bridge near the town of Dhanni, November 2005. © Defence Department

Figure 13 sets out the current and planned upper-level organisational structure of Defence. The reorganisation does two main things: it creates a headquarters and consolidates control of a range of support activities.

Australian Defence Headquarters

A key recommendation of the 1997 Defence Efficiency Review (which underpinned the subsequent Defence Reform Program) was the formation of an Australian Defence Headquarters (ADHQ). Before this, the civilian and military sides of the department maintained more-or-less duplicate bureaucratic entities in several areas, including personnel, capability development and strategic policy. The new ADHQ was designed to bring these disparate parts closer together under the joint responsibility of the Vice Chief of the Defence Force and the now defunct position of Deputy Secretary, Strategy and Intelligence.

This arrangement remained in place from early 1997 until 2000, when it was discarded in favour of a set-up broadly in line with the upper part of Figure 13. The post-2000 structure had at its heart the concept of 'Output Executives', 'Owner Support Executives' and 'Enabling Executives', as explained in Chapter 2. It should be said that the decision to disband the then ADHQ caused few tears—it had never come even close to being a central headquarters for Defence. There are many reasons for this, including a failure to include critical functions like finance and personnel within its remit and, more importantly, the fact that no single person was in charge. It's bad enough that no single person below the minister is accountable for Defence's performance, but replicating that arrangement within the organisation extended the problem.

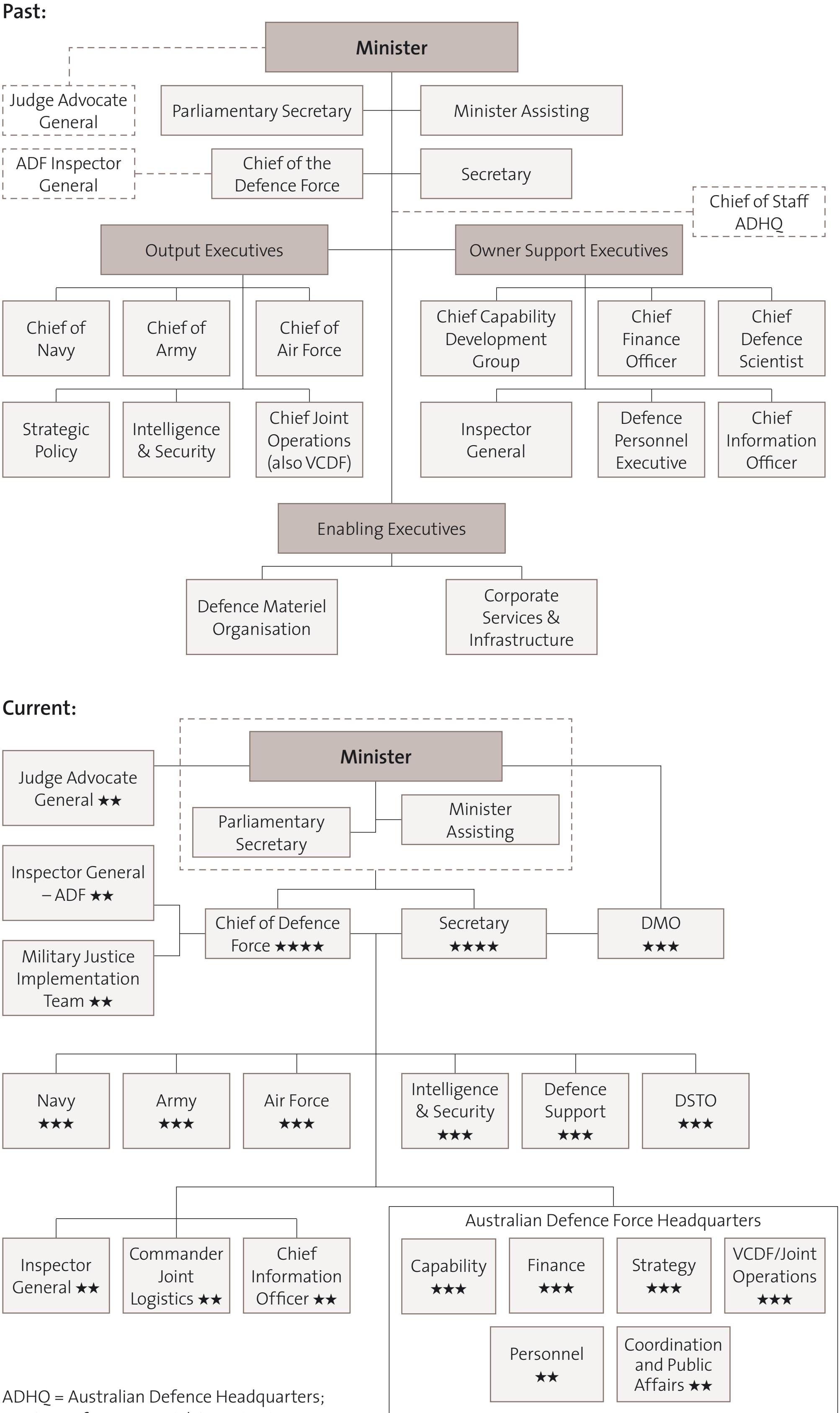
Six years on, and it's being tried again. This time, the plan has been thought through a little more carefully—the full gamut of what could make a credible claim to being a headquarters function has been pulled together, including capability development, strategy, personnel policy, finance, public affairs/coordination and operational command. This is a positive initiative. Although there have been some improvements in recent years, these various functions have historically lacked coordination, both administratively and from a policy perspective. The (re)creation of an ADHQ has the potential to further improve the higher level management of Defence. There are, however, two problems.

Someone must be put in charge of the new headquarters if it is to work.

First, it appears once again that no single person will be responsible and accountable for the ADHQ. Moreover, rather than impose a 'junior diarchy', as in the last incarnation of the ADHQ, the proposal is to have a management committee made up of the senior people from within the headquarters.

As if Defence needs yet another committee! Someone must be put in charge of the new headquarters if it is to work. Because the ADHQ includes operational command in its responsibilities and a civilian can't sit in the chain of command, the obvious choice is the Vice Chief of the Defence Force, but he already has a day job. Alternatively, the command function could be hived off and a civilian put in charge of the rest. If necessary, a new civilian or military position just beneath the Chief–Secretary diarchy could be created—a Deputy Chief or Under Secretary. Given the proliferation of senior sirs (especially on the civilian side) over the past decade, the cost could be recovered by recombining the roles of a couple of deputy secretaries.

Figure 13: Defence organisational structure



ADHQ = Australian Defence Headquarters;
DMO = Defence Materiel Organisation;
DSTO = Defence Science and Technology Organisation;
VCDF = Vice Chief of the Defence Force.

Unfortunately, it looks as though it's just too hard to decide whether a suit or a uniform should be first among equals below the diarchy.

Second, the new scheme for the ADHQ leaves the service chiefs on the outer, with no defined role in the day-to-day management of Defence beyond their presence in the monthly fourteen-member Defence Committee. Moreover, the reorganisation as a whole leaves unassailed the fundamental flaw in the current structure—the service chiefs still don't control the resources necessary to deliver the capabilities they're nominally accountable for.

Defence Support Group

The reorganisation bundles together a range of support functions under a single span of control. Whether this will make much of a difference remains unclear. There are very few synergies apparent in the new arrangement, so it's unlikely that efficiencies will arise simply from the new structure alone. But it does create a big fat target for savings.

Efficiency

This year's budget contained yet another instalment of efficiency and savings measures. Table 13 shows the cumulative impact of the initiatives since 2001–02. The initiatives take two forms. The first two items, the White Paper savings and administrative savings measures, are redirected back into Defence to offset costs in other areas. The last four items have effectively been sliced off Defence's bottom line.

Table 13: Efficiency measures and savings targets of Defence ($ million)

	01–02	02–03	03–04	04–05	05–06	06–07	07–08	08–09	09–10	after
White Paper savings initiatives	50	200	200	200	200	200	200	200	200	200
Administrative savings targets			50	100	150	175	200	200	200	200
Extra administrative savings						70	60	12		
Progressive efficiency dividend[a]					3	16	36	59	85	+ 30[a]
Absorbed budget measures 2005–06					65	78	46	28	?	?
Rationalisation of command/control						6	13	21	31	31
Total	**50**	**200**	**250**	**300**	**418**	**545**	**555**	**520**	**516**	**547+**

a After 2009–10, the efficiency dividend will continue to grow by roughly $30 million per year

Adding up the various initiatives, a somewhat forbidding figure of more than half a billion dollars per year emerges. So how are these various savings achieved?

In the case of the *White Paper savings initiatives*, the money was mainly recovered by 'rebaselining' the individual internal Defence budgets in one hit. Where the impact was felt, or how the savings were achieved, remains unclear. In contrast, the *Administrative savings initiatives* involve twenty-nine separate initiatives that are detailed in the budget papers. These initiatives show that Defence continues to improve its housekeeping both through reduced administrative spending and through better day-to-day business processes.

Credit is due for this self-generated efficiency.

It's unknown how Defence will cover the shortfall from the *Extra administrative savings*, *Progressive efficiency dividend* and *Absorbed budget measures*. Ultimately, it's for Defence to work out how to deliver these and the earlier administrative savings. With the more stringent internal budgeting framework that's developed over the past several years, Defence is much better placed to do so than in the past. The *Rationalisation of ADF command and control* is a genuine efficiency dividend: Defence reviewed its network of headquarters and found that it could get by with 241 fewer personnel. Credit is due for this self-generated efficiency.

With so much money flowing into Defence, the danger is that a 'magic pudding' is created as successive efficiency measures do little more than strip back the steady accretion of administrative overheads. Despite the churn, this is probably not a bad way to protect the taxpayer—provided the demand for savings doesn't let up.

Financial management

In recent years, media reports of an '$8 billion Defence black hole' have given the impression that the department had somehow misplaced, or perhaps lost outright, assets worth around half of its annual budget. The truth, while concerning, is hardly that dire.

At the centre of the matter was the qualification of Defence's financial statements for 2003–04 and 2004–05 by the Australian National Audit Office (ANAO). The form of the qualification was that the auditor was 'unable to, and [did] not express an opinion, as to whether the Statements':

- had been prepared in accordance with the orders made under the *Financial and Management and Accountability Act 1997* (FMA Act), and
- gave a true and fair view of Defence's financial position, performance and cash flows for the year.

These are more serious qualifications than the 'except for' qualifications that arose in 2001–02 and 2002–03, which essentially gave an assessment of 'true and fair' with a cautionary caveat due to identified uncertainties. In addition, and as was the case in 2002–03, the Department was found to have been in breach of section 48 of the FMA Act on a technical matter relating to the administration of 'Special Accounts'. The Secretary of the Department of Defence agreed with the ANAO assessment.

In comparison, of the 252 Australian Government entities audited by the ANAO in 2005, only four had their financial statements qualified and only eighteen breached the FMA Act. What's more, the time taken to finalise Defence's financial statements contributed to a delay in the finalisation of the consolidated financial statements for the Australian Government until 12 December 2005. The uncertainties in Defence's financial statements contributed to (but were not the sole source of) the 'limitation of scope' qualification of the government's overall consolidated financial statements for 2004–05.

As in previous years, the specific problem in 2004–05 was that Defence and the ANAO were unable to resolve significant uncertainties in the values assigned to assets and liabilities.

Does it really matter?

Yes and no. In one sense, whether Defence can precisely account for the *value* of all its assets and liabilities is of little importance. In four years of closely watching the Defence budget, this author has yet to see a single datum emerge from the accounting of assets and liabilities that might usefully inform the management of the defence dollar. After all, if Defence's property holdings were to rise in value by 50% or its military equipment fall in value by 50%, what action would need to be taken? If anything, what we have is a compliance nightmare (at least in so far as the mere question of valuation goes) that has diverted resources and energy away from much more important areas of financial management. The only possible exception is the better understanding of employee entitlements that's emerged, but that could have been achieved without all the accrual rigmarole. It's hard to see what will really have been gained, even once the battle to tame Defence's rogue balance sheet is won.

The problem is symptomatic of a failure to properly manage billions of dollars of assets.

But, in another sense, it matters a very great deal. The problem is symptomatic of a failure to properly manage billions of dollars of assets. The May 2006 ANAO report into the procurement of explosive ordnance for the ADF found that action's needed on procurement planning, financial management, inventory management, and safety suitability for service assessments for explosive ordnance. In short, pretty much the entire life cycle of some $2 billion worth of assets isn't being managed as well as it should. Extraordinarily, $1 billion of ordnance was classified as other than serviceable.

When will it be fixed?

Defence has been working to fix its management information systems and bed down its business processes since the late 1990s, following the Defence Efficiency Review. It's a story of repeated underestimation of the task, growing delays and increasing costs. Last year, Defence said that it will probably take at least two or three more years before an unqualified audit report can be achieved.

Acronyms and abbreviations

ADF	Australian Defence Force
ADHQ	Australian Defence Headquarters
AEW&C	airborne early warning and control
ANAO	Australian National Audit Office
CDF	Chief of the Defence Force
DCP	Defence Capability Plan
DMO	Defence Materiel Organisation
DSTO	Defence Science and Technology Organisation
FMA Act	*Financial and Management and Accountability Act 1997*
HNA	Hardened and Networked Army

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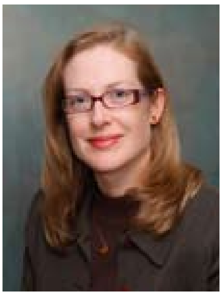

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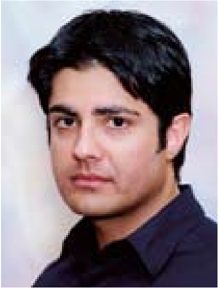

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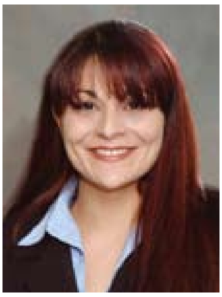

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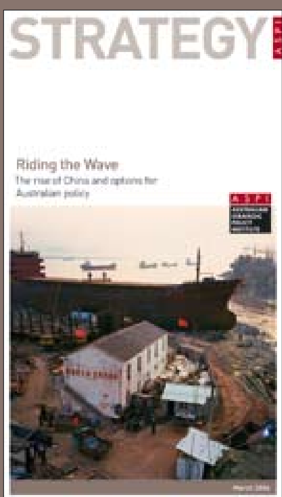

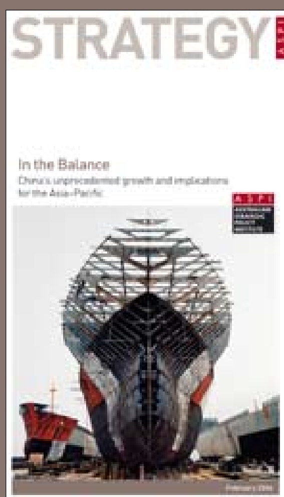

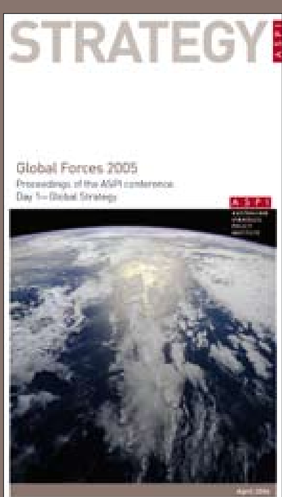

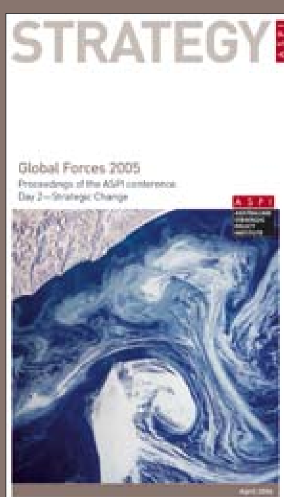

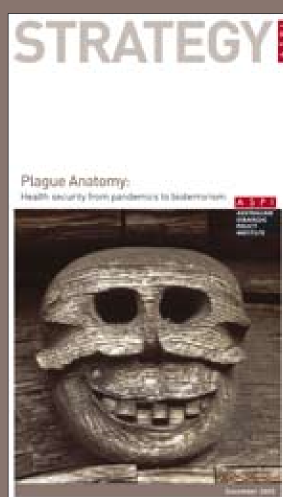

Your Defence Dollar

The 2006–07 Defence Budget

Defence's budget for 2006–07 is $19.6 billion, up $1.9 billion on last year. Continued growth is planned across the next four years, with a budget of $21.1 billion set out for 2009–10. The 2006–07 defence budget equals 1.94% of gross domestic product.

The big news in the budget was that the government agreed to continue the 3% annual real growth in defence spending, delivered by the 2000 White Paper, to 2015–16. This amounts to an extra $10.7 billion over five years. And an extra $4.5 billion over the next ten years will pay for such items as the purchase of four C-17 strategic lift aircraft, the second phase of the Hardened and Networked Army initiative and continued military operations in Iraq and Afghanistan.

Unfortunately, notwithstanding all the new money flowing into Defence in this budget, there's still a mismatch between plans and funding. Put simply, not enough money has been set aside in the future to operate our current equipment, let alone the new gear.

Aside from needing more money in the future to deliver current plans, Defence faces several big challenges in the near term.

First, despite spending $500 million on initiatives to improve recruitment and retention of military personnel over the past five years, the process of building up the size of the ADF has worse than stalled—it's gone backwards for three years in a row.

Second, the process of approving new acquisition projects has fallen behind schedule, and many projects will now be delivered later than originally planned.

Third, investment in new equipment is planned to increase dramatically over the next several years, putting pressure on both Defence and the defence industry.

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