

Defence budget

Introduction

- 3.1 The Australian Defence Organisation is one of the largest government employers in Australia, and is responsible for employing more than 22,000 public servants and 56,000 military personnel.¹
- 3.2 It is also responsible for a wide range of functions, including conducting military operations within Australia and internationally, disaster relief, planning for and delivering Australia's military capabilities, and the day to day functioning of the Australian Defence Force (ADF).
- 3.3 As a result, Defence has one of the largest budgets of any Australian government agency, with a total spend of \$25.291 billion in 2011-2012.² The *Annual Report 2011-2012* elaborated on this figure:
- This is an overspend of \$170.9 million when compared to the revised estimate as at *Portfolio Budget Statements 2012-13* after factoring in no-win/no-loss movements of \$117.0 million. The budget overspend was funded by utilising carry forward appropriation from previous years.
- This is primarily a result of an overspend in operating costs (\$239.2 million) and an under-receipt in own-source revenue (\$89.8 million), offset by underspends in capital purchases (\$138.5 million) and employee costs (\$19.5 million).³
- 3.4 When reporting on its budget, Defence divides its activities into three outcomes. Outcome 1 accounted for the bulk of the Defence budget in
-

1 *Defence Annual Report 2011-2012*, p. 285.

2 *Defence Annual Report 2011-2012*, p. 9.

3 *Defence Annual Report 2011-2012*, p. 9.

2011-2012, costing \$22.047 billion. This outcome is focused on the maintaining Defence's 'capacity to support current commitments and future contingencies', including through the provision of military capabilities and all of the 'policy, command and support functions undertaken by the entire Defence organisation'.⁴

- 3.5 Outcome 2 accounted for a further \$958 million in 2011-2012. This outcome is focused on the conduct of military operations in support of Australia's regional and global interests, and is split into two broad areas: operations in the immediate region and operations in support of wider interests.⁵
- 3.6 Operations in the immediate region cost \$176 million in 2011-2012. This involved Australian defence personnel being deployed to Solomon Islands, Timor-Leste, Papua New Guinea and the island countries of the Southwest Pacific.⁶
- 3.7 Operations in support of wider interests cost \$782.66 million in 2011-2012. This mainly involved Australian defence personnel being deployed to Afghanistan, but also includes support for United Nations operations in the Middle East and Africa.⁷
- 3.8 Outcome 3 accounted for \$18.4 million in 2011-2012. According to the *Annual Report*, this outcome is focused on:
- ...the security of the Australian coastline from illegal immigration, smuggling, quarantine evasion and other intrusions to Australian sovereignty, counter-terrorism responses, search and rescue, and natural disaster relief.⁸
- 3.9 Specifically, this outcome involved the ADF:
- supporting Border Protection Command through the provision of maritime surveillance assets;
 - the provision of assistance to flood affected communities in New South Wales, Queensland and Victoria; and
 - support for the security arrangements surrounding the October 2011 Commonwealth Heads of Government Meeting and the November 2011 visit of US President Barack Obama.⁹

4 *Defence Annual Report 2011-2012*, p. 31, 35.

5 *Defence Annual Report 2011-2012*, pp. 109-115.

6 *Defence Annual Report 2011-2012*, pp. 116-119.

7 *Defence Annual Report 2011-2012*, pp. 120-123.

8 *Defence Annual Report 2011-2012*, p. 127.

9 *Defence Annual Report 2011-2012*, p. 127.

- 3.10 This chapter will focus on the following selected areas of the Defence budget:
- Budget cuts and their impact;
 - Reporting the Defence budget; and
 - The budgetary implications of operations both in Australia and overseas.

Budget cuts

- 3.11 While Defence's funding increased by 4.2 per cent in the 2011-2012 financial year, in the 2011-2012 budget the Government announced a significant cut to the Defence budget of \$4.3 billion over seven years.¹⁰ In the 2012-13 budget, this figure was adjusted to \$5.5 billion over four years.¹¹
- 3.12 While this Review examines Defence's annual report for the 2011-2012 financial year, it is still necessary to examine these long term budget cuts. The Committee focused particularly on the impact of cuts on capability planning and acquisition, and on the provision of services at bases and other facilities.

Capability planning and acquisition

- 3.13 In regard to capability planning and acquisition, Defence noted that while 'critical capabilities' would continue to be delivered as planned, it has still been necessary to defer some projects:

There were 57 projects in all which were deferred mostly by one or two years as part of the last budget.¹²

- 3.14 Defence discussed further the budgetary implications of the economic uncertainty, noting that it would not affect the delivery of the core capabilities outlined in the *Defence White Paper 2009*:

The government is committed to delivering the core capabilities enunciated in the 2009 white paper such as the air warfare destroyers, the helicopter landing docks, the Joint Strike Fighter program, the future submarines and the like. The government is on the public record as doing that. We do face challenges, quite obviously. The 2009 white paper was predicated on Defence

10 Australian Strategic Policy Institute, *Cost of Defence 2011-2012*, p. vi.

11 Australian Strategic Policy Institute, *Cost of Defence 2012-2013*, p. vi.

12 Vice Admiral James, Australian Defence Force, Transcript, 15 March 2013, p. 24.

spending increasing by three per cent real out to 2018-19 and, because of fiscal circumstances, that has not been able to be implemented. We have had, as you have stated, a reduction in the Defence budget as part of the government's broader fiscal strategy and we have had other matters move to the right. All of that poses challenges for us, but at present we will be able to deliver on the core capabilities identified in the 2009 white paper, even though the delivery of some may be deferred beyond the original timetable.¹³

3.15 Defence elaborated on the ways it is managing the delivery of key capabilities in light of reprioritisation:

The reprioritisation of Defence expenditure in the 2011-2012 budget was designed to have minimum impact on the delivery of core Defence capabilities. A number of lower-priority capability projects were deferred with a small number cancelled where they were superseded by alternative capabilities, and other capability and facility programs were subject to re-scoping. Australia will continue to maintain one of the strongest military capabilities in our region.

[...]

In conjunction with establishing a new funding model for Defence, the Defence budget has been reprofiled over the Forward Estimates for expenditure on priority Capital Investment and Sustainment Programs. This includes the acquisition of 12 new EA-18G Growler aircraft, as announced in the White Paper, for which the Government will also provide Defence an additional \$200 million in 2014-2015. The reprofiling of the budget will in the usual way involve adjustments to the priority of activities across Defence, including proposed capability acquisitions. Details will be provided in the next Public Defence Capability Plan, to be published before the end of the 2012-2013 financial year.¹⁴

3.16 In regard to capability acquisition, the Defence Materiel Organisation (DMO) told the Committee that, despite the impression given by public discussion that capabilities are often delivered over budget, Defence has a strong track record of completing such projects under budget. The DMO argued:

Defence projects which come in under budget are the norm. Since July 2010 59 major projects have been closed following successful

13 Mr Richardson, Department of Defence, *Transcript*, 15 March 2013, p. 25.

14 Department of Defence, *Submission No. 5*, p. 8.

introduction into service. On average these projects were completed within 95 per cent of the approved budget. Of this only four projects required a real cost increase to complete approved scope.¹⁵

- 3.17 The DMO also told the Committee that its practices and project management policies are ‘under constant review to incorporate lessons learned and streamline processes’. The DMO elaborated on how it was achieving this:

The DMO has invested heavily in people through the establishment of a project management professionalism framework to enable people in project management roles to acquire the knowledge, skills and competence for the effective management and delivery of projects. This framework provides a range of training pathways including practitioner courses, nationally accredited vocational based training and post graduate education options. DMO has developed Communities of Practice across the scheduling, cost estimation and project management streams, which enable knowledge sharing and the identification of best practice processes that can be applied across the organisation.¹⁶

- 3.18 When questioned about the cost growth indexation figures it currently uses when formulating budgets, Defence noted that the indices it uses were:

...formulated back in the Pappas review, when McKinseys did their review. It is a composite of indices. [...] The indices that the Pappas report referred to is quite an extensive list, but we with Pappas eventually settled on a more manageable list of indices. Some of the indices that he in the first instance recommended were a little obscure and it was difficult to obtain regular updated information for them. There is a practicality involved in that as well.¹⁷

- 3.19 Defence elaborated on the specific cost growth indices currently in use:

The cost growth figures used in the Defence budget utilise a basket of five indices to model the future costs of Defence. The basket of indices is as follows:

15 Department of Defence, *Submission No. 5*, p. 3.

16 Department of Defence, *Submission No. 5*, p. 5.

17 Mr Prior, Department of Defence, Transcript, 15 March 2013, p. 27-28.

- Military Equipment Capital and Sustainment – 4 per cent US Department of Defence Procurement Index; 39 per cent Wage Price Index and 21 per cent Producer Price Index;
- Personnel – 100 per cent Wage Price Index;
- Facilities – 100 per cent Gross Fixed Capital Non-Dwelling Construction Index; and
- Other Operating Expenses – 100 per cent Non Farm Gross Domestic Product implicit price deflator.¹⁸

Provision of services to ADF personnel

3.20 Another area of focus for the Committee where significant savings are being achieved within the Defence budget is in ‘non-equipment procurement’, which includes the provision of services to ADF personnel and Defence facilities, travel, building maintenance, professional services and removals.¹⁹ This is examined in greater detail in Chapter Six on the Strategic Reform Program.

Reporting the Defence budget

3.21 The *Defence Annual Report 2011-2012* contains two mentions of the effects of the current budgetary constraints. The main mention is contained in the section dealing with the DMO, which notes:

Current budget conditions are tight and the impacts cannot be avoided or ignored. The only way to survive is through expert management of our day to day business. For acquisition, this means extracting every bit of value from every dollar we spend. For sustainment, it means making every effort to align support concepts with customer demands, and ensuring that we do not allow capabilities to be hollowed out over time.²⁰

3.22 When asked whether there is any wider public reporting on the consequences of the constrained budget, Defence stated:

I suppose Senate estimates and this committee hearing today go to just that. At the last Senate estimates hearing, we spent a day before the Committee; and, if the Committee had wanted to, we could have spent two days before the Committee. Senators were free to ask the department any question they wanted on any matter and, indeed, there were a lot of questions digging down

18 Department of Defence, *Submission No. 5*, p. 11.

19 Mr Grzeskowiak, Department of Defence, *Transcript*, 15 March 2013, p. 30.

20 *Defence Annual Report 2011-2012*, p. 148.

further. [...] So, in terms of our responsibility to provide information to Parliament, this is what we are doing.²¹

3.23 Defence also noted that, in addition to the estimates process, Defence's annual report, and reviews of their annual report, there is 'an articulation of any cuts documented' in its portfolio budget statements.²²

3.24 Additionally, Defence argued that the *Annual Report* is not of sufficient size to incorporate all of the effects and implications of declining budgets:

In the sense of practicality this [annual] report for 2011-2012 is 540 pages thick; if we were to go through it project by project and take out lessons learnt we will be in something even less manageable. There is a need for practicality here as to where the information about the department is coming out.²³

3.25 Furthermore, Defence told the Committee that the Australian National Audit Office (ANAO) regularly produces reports that highlight the impact on capabilities that declining budgets can have. In particular, Defence directed the Committee's attention to a recent ANAO report on the project to acquire the MU90 lightweight torpedo, noting:

Yes, we acknowledge that there are calls for greater transparency and so forth but there are many routes to achieve that; it does not have to be in a single document. Indeed, this [annual] report is for 2011-2012, so if you are looking at implications of financial reductions made in the budget 2012-2013 one would not expect them to be reflected in this report - hence they are reflected in the PBS for the period.

Operations

3.26 A significant portion of the 2011-2012 Defence budget went towards a number of operations within Australia, in Australia's immediate region, and in Afghanistan. Furthermore, a large portion of the operations occurring overseas came in under budget.

Flood relief operations in Australia

3.27 The Defence *Annual Report 2011-2012* notes that 'the ADF provided support to the Queensland, New South Wales and Victorian Governments

21 Mr Richardson, Department of Defence, *Transcript*, 15 March 2013, p. 26.

22 Mr Richardson, Department of Defence, *Transcript*, 15 March 2013, p. 26.

23 Gen. Hurley, Australian Defence Force, *Transcript*, 15 March 2013, p. 27.

in the wake of serious flooding events'.²⁴ Defence told the Committee that the additional costs incurred by this support operation totalled \$1.157 million.²⁵

3.28 Defence further noted that these costs were incurred primarily by flights to Brisbane, and that when expenditure on any operation is below \$10 million a year, any costs are absorbed by Defence into the current structure of its budget and will not appear in its *Annual Report*.²⁶

3.29 Furthermore, while natural disasters do form part of Defence's preparedness and readiness planning, they do not form part of its budgetary planning. This is because these operations usually do not cost more than \$10 million. In cases where they do cost more than \$10 million, Defence informed the Committee of the means by which the budget is maintained:

For any of our operations, wherever they occur and however they occur, there is an appropriation arrangement where, if the costs are greater than \$10 million, we are funded on a no-win, no-loss basis – that is, we are supplemented for them. Where they are less than \$10 million we absorb the costs within the base of our funding, and that has been a long-standing arrangement.²⁷

3.30 Overall, Defence characterised the impact of natural disaster relief on its budget as 'marginal'. This is because a large portion of the cost of responding to natural disasters is tied up in defence personnel and does not constitute additional expenditure. Defence elaborated on this at a public hearing:

Those [personnel] costs are already there; there is no marginal cost of deploying people to those disasters as opposed to their regular activities, in the main. It is the same with asset deployments – vehicles and the like. We do have budget lines for the fuel and for the running costs of those assets, so it is a matter of reprioritising the assets and the activities to what other activities they might have done.²⁸

24 *Defence Annual Report 2011-2012*, p. 127.

25 Department of Defence, *Submission No. 2*, p. 3.

26 Gen. Hurley, Australian Defence Force, *Transcript*, 15 March 2013, p. 28.

27 Mr Prior, Department of Defence, *Transcript*, 15 March 2013, p. 28.

28 Mr Prior, Department of Defence, *Transcript*, 15 March 2013, pp. 28-29.

Operations in the immediate region

- 3.31 Operation ANODE, which supports Australia's mission of assistance in Solomon Islands, came in \$5 million under budget in 2011-2012. Defence explained this at a public hearing:

Actual expenditure for Operation ANODE was \$5 million less than budget due to lower than estimated costs for the use of reservists on continuous full time service, lower than anticipated logistics support requirements, lower than planned strategic lift costs, and lower than planned costs for sustainment and remediation of equipment.²⁹

- 3.32 Similarly, Operation ASTUTE in Timor-Leste came in well under the \$160.2 million it was expected to cost. The *Defence Annual Report 2011-2012* explained this:

Actual expenditure for Operation ASTUTE was \$18.5 million less than budget due to lower than estimated personnel costs for Permanent and Reservists on continuous full time service, saving under the logistic support contract, variations in planned facilities works, lower than anticipated strategic lift requirements and lower than planned costs for sustainment and remediation of equipment.³⁰

Operations in Afghanistan

- 3.33 In regard to Operation SLIPPER in Afghanistan, the *Defence Annual Report 2011-2012* notes:

The 2011-2012 Budget initially provided \$1.221 billion for the continuation of operations in Afghanistan in 2011-2012. The Government provided a further \$2.2 million at Additional Estimates to enhance detainee management in Afghanistan taking the 2011-2012 Revised Estimate to \$1.224 billion.³¹

- 3.34 However, actual expenditure came in significantly lower than was budgeted, with SLIPPER costing \$157.3 million less than expected. Defence explained that this was due mainly to:

...delays in facilities projects, delays in the implementation of the logistics and base support services contracts, lower than anticipated strategic lift requirements due to savings associated

29 Department of Defence, *Submission No. 2*, p. 4.

30 *Defence Annual Report 2011-2012*, p. 113.

31 *Defence Annual Report 2011-2012*, p. 113.

with contracted helicopter support, and lower than anticipated costs against sustainment and remediation of equipment.³²

- 3.35 Furthermore, the *Defence Annual Report 2011-2012* notes that enhanced force protection in Afghanistan was \$233.2 million less than the 2011-2012 revised estimate of \$392.4 million. Force protection is dealt with in greater detail in Chapter Four.

Committee comment

- 3.36 The Committee acknowledges that Defence reports on its budget in a variety of contexts, including through parliamentary processes like Senate Estimates and this Review, as well as through budget documents and ANAO audits. Furthermore, the Committee accepts Defence's contention that the *Annual Report* is already of substantial size. Nonetheless, it is clear to the Committee that the *Defence Annual Report* does not currently deal with the Defence budget in enough detail. Ultimately, it should be possible to ascertain which projects are of most concern as a result of budgetary considerations from reading the annual report. However, this is not currently the case.
- 3.37 Additionally, it has become clear through the Senate Estimates process that over the last several years, Defence's budget for sustainment has been reduced by budget cuts. This reduction in the sustainment budget could have an impact on Australia's ability to conduct a major operation. As a result, greater transparency in the reporting of the budget for sustainment in the *Annual Report* is required.
- 3.38 In light of this, the Committee believes it would be desirable for a more holistic account of the important information relating to the Defence budget and its implications for capability acquisition and sustainment of capabilities and facilities to be included in future *Annual Reports*.
- 3.39 The Committee deals with the issue of reporting in greater detail in Chapter Seven.

32 Department of Defence, *Submission No. 5*, p. 15.