

CHAPTER TWO

THE MECHANICS OF FUNDING FOR DEFENCE

General Arrangements

2.1 The process used in budgeting for the Department of Defence is different to that used for other government departments. The Department of Defence is funded on a global basis at the Function Outlays level, as distinct from other areas of government where budgeting is performed at a program level within the portfolio.¹ The distinction between the two methods is that accounting for Defence involves the aggregation of all outlays directed towards defence objectives or purposes. Under a portfolio-based approach, accounting would be on the basis of all outlays falling within the Minister for Defence's portfolio.² The most significant difference in this distinction is in the treatment of superannuation outlays, which are not included in a Function Outlays approach. If the 1997-98 Budget estimate for Defence, of \$10.405 billion, were accounted on a Portfolio Outlays basis, the comparable estimate would have been \$11.480 billion.³

2.2 Under the global funding arrangement for Defence, the Minister for Defence is advised of a funding limit at each budget and has significant discretion on the allocation of resources within the global Defence budget. This includes the prerogative to assign a balance between expenditure on major investment and recurrent items,⁴ such as personnel and operating costs. The global funding limit is determined through the application of cabinet-determined real growth to the baseline of funding outlays established each previous year. By contrast, other portfolios have their component programs scrutinised, and the portfolio outlay is determined through aggregation of the apportioned program outlays. For the 1997-98 financial year, government guidance was that the Defence budget should be maintained at zero real growth; an improvement over the decrease of 0.5 per cent in real terms applied to reach the 1996-97 outlay.

2.3 A global funding arrangement is necessary to fund Defence because of the nature of the decisions which have to be made within that budget. More than any other department, the output of Defence is dependent on the balance reached between funding of various areas, and decisions on that balance require experienced military judgements. In addition, decisions on military capabilities invariably have national security implications, and information on these decisions must be protected by the Defence organisation. For these reasons, the internal distribution of resources within Defence is determined by the Minister for Defence on the advice of military professionals within his Department. Government review of budget items line by line by an external approval agency is not appropriate to Defence spending and would generate an unnecessary bureaucratic barrier to decision making in the nation security interest.

1 Mann, Dept. of Finance, Transcript, p. 108.

2 From *Budget Paper No 1, 1996-97*, Australian Government Publishing Service, p. 7-20.

3 Dept. of Finance, Submission, p. S309.

4 *ibid.*

2.4 A number of other arrangements have also been agreed for Defence, as a consequence of the global nature of its budget, and in recognition of specific problems. For example, Defence is not subject to general running costs arrangements, with the Minister for Defence being given discretion to determine a running costs allocation from within the Defence global budget each year. Defence does not endure year-on-year restrictions to running costs variations, like other departments. Similarly, Defence is not required to pay an Efficiency Dividend imposed by Government.⁵ While efficiencies *may* be imposed on Defence, and the Department is required to report to the Minister on achievement of those efficiencies (as in the case of the current Defence Reform Program), cuts are not made to the Defence budget to effect imposed efficiencies.⁶ In effect, savings made against running costs, from staffing reductions, and from commercialisation initiatives are retained by the Department, and not returned to Consolidated Revenue, as in other departments.⁷ A clear advantage of this arrangement is that it provides significant incentive for the Department to initiate and implement major reforms.

2.5 Special arrangements also exist to permit Defence to carry over funds, from one financial year to the next, subject to the agreement of the Minister for Finance.⁸ This overcomes a previous tendency in Defence, particularly on high-value capital equipment projects, to spend (on occasions precipitously) funds remaining at the end of the financial year, to avoid automatic reduction in the Defence funding base. Recently revised arrangements for carry-over now permit an increased limit of \$150 million, although additional carry-overs can be sought on a case-by-case basis.⁹

Effects of User Charging Reforms

2.6 A number of other changes have been applied across the public service over the last decade, resulting in changes to the levels of outlays recorded under the Defence function, without any real change to the underlying level of Defence activity. These changes include the introduction of:

- three per cent superannuation;
- Comcare premiums;
- Fringe Benefits Tax;
- devolution of property funding;
- Customs duty for departments; and
- devolution of Attorney General's legal services.

2.7 While these changes have added approximately \$500 million to the level of outlays recorded under the Defence function in the 1996-97 estimates for Defence Function Outlays, this addition to resources is offset by an increase in costs faced by Defence, and has resulted in no real net increase in spending power for the Defence budget.¹⁰

5 *ibid.*

6 Mann, Hurst, Dept. of Finance, Transcript, p. 118

7 Brown, Gary and Woolner, Derek, *Should the Defence Budget be Cut? Arguments For and Against*, Parliamentary Research Service, Current Issues Brief No. 6, 1996-97, p. 5.

8 Dept. of Finance, Submission, p. S310.

9 Dept. of Defence, Submission, p. S323.

10 Dept. of Finance, Submission, p. S312.

2.8 A change in the treatment of military and civilian superannuation schemes which was applied in the 1992-93 Budget has also produced an apparent significant change in Defence outlays. From that Budget onwards, outlays related to superannuation were no longer recorded under Defence outlays, while payments for accrual-based superannuation commenced at that time (and *were* recorded under Defence function outlays).¹¹ This change, while not influencing spending power, largely invalidates comparisons between personnel-related Defence outlays from before the 1992-93 Budget, and subsequent outlays.

The 'Defence Deflator'

2.9 The Defence budget is subject to adjustment by means of a mechanism known unofficially as the 'Defence Deflator'. This is a series of adjustments which reflect compensation for price and exchange, and is in general terms a price indexation whereby costs associated with the budget may be translated from one year to another.

2.10 As outlined earlier, Defence outlays are adjusted from year to year, based on the outlays of the previous year, according to Government policy directing the required rate of real growth (or decrease) to the global budget. Defence is one of very few departments which gets a real growth calculation.¹² This real growth calculation is applied according to the following established budget arrangements for Defence.

2.11 For accounting purposes, the Defence budget is divided into two main elements. The larger of the two elements comprises all outlays over which the department has direct control, and so may exercise discretion. This element is referred to as the 'above-the-line' portion of Defence outlays, and in the 1997-98 Budget, amounted to \$10.25 billion, or around 98.5 per cent of total Defence function outlays.¹³ This portion of Defence outlays is adjusted from the previous year's outlays to compensate for the effects of foreign exchange rates movements (for that portion of expenditure spent overseas) and for wage cost and other standard government price adjustments. Once all sub-elements have been adjusted to keep them equivalent in real terms with the previous year's outlays, they are recombined to provide the total above-the-line outlay. It is this combined element to which the Government's specified real growth guidance is applied. Within the 1997-98 Budget for the first time, there were a small number of sub-elements to which this real growth was not applied, but these amounted to a total of only around .01 per cent of above-the-line outlays.¹⁴

2.12 The second element of Defence outlays is that referred to as the 'below-the-line' portion, which consists of a number of discrete funding amounts provided to finance specific activities which would not normally form part of Defence's function. These are not adjusted for real growth, but are varied depending on the program requirements. The largest sub-element of this portion of the Defence budget is usually compensation and legal expenses, which for the 1997-98 Budget totaled \$125.5 million, or around 82 per cent of below-the-line outlays. In circumstances where the ADF undertakes peacekeeping or other operations for which no financial allowance was made in the overall Defence budget, an appropriate adjustment for this operation may be added to the funding base as a one-off inclusion. Such items are often described as being funded on a 'no win, no loss' basis.

11 *ibid.*

12 Tonkin, Dept. of Defence, Transcript, pp. 15-16.

13 *Portfolio Budget Statements 1997-98, Defence Portfolio*, Budget Related Paper No 1.3A, 7 May 1997, Table 1, pp. 19-20.

14 *ibid.*

2.13 Other variations can also occur to the total of a particular year's defence outlays as unavoidable under (or over-) expenditure from one year is held over to be recredited (or debited) to a subsequent year or years. The combined effect of all the above adjustments may be seen through a simple comparison of a particular year's Defence outlays with that of the previous year. It is this change that is frequently referred to as the 'Defence Deflator', although such a mechanism does not exist as a single adjustment.

Scrutiny

2.14 Given the size of the Defence budget, there is a need to provide the public with some reassurance that public funding is spent in accordance with established procedures, and Government intentions. The financial management of the Department of Defence undergoes scrutiny at a number of levels. These may be broadly categorised as:

- internal (within the Department), and
- external (by the Department of Finance, the Parliament and the ANAO).

Internal Scrutiny

2.15 There will always remain the perception that no government department is capable of impartial review and self-criticism of its methods and efficiency. This is especially the case where the department is as large, or is allocated as substantial a proportion of national wealth as Defence. However, the Department does have a formalised hierarchy of accountability for resources, where sub-program managers report to program managers, who report to the portfolio-level manager. The portfolio budget manager in turn reports to the Parliament. The internal process is also held accountable through the activities of the Defence Inspector-General, whose responsibilities include auditing Defence financial processes, and investigation of the regularity, efficiency, effectiveness and economy of management policies and practices.¹⁵ In FY1996-97, the Inspector General's division directed significant effort to the examination of financial management within Defence, including asset recording and financial management training.¹⁶

2.16 A recent, specific initiative relating to scrutiny is the joint Performance Information Review (PIR), which is intended to address shortcomings in performance information and reporting. This is a government-wide initiative, and in the case of Defence, was conducted jointly by Defence and the Department of Finance. The report of the PIR identified a number of problems within current management processes. Two significant findings were that:

There is little systematic or comprehensive reporting of performance by Programs to the Portfolio and limited visibility at the Portfolio level of program and Sub-program performance.¹⁷

and:

15 From *Defence Annual Report 1996-1997*, Dept. of Defence, 1997, p. 31.

16 *ibid.*

17 *Performance Information Review*, Joint Report of the Dept. of Defence and Dept. of Finance, July 1997, para. 316.

At present, Defence is not able to identify fully the costs of activities and outputs or the resources required to achieve them. ... There are similar difficulties in the review of bids for additional funding, in terms of the level of funding required to achieve specific outcomes, their relative priority, and the opportunity cost of funding some activities rather than others.¹⁸

2.17 While these deficiencies did not inspire complete confidence in Defence's current internal scrutiny processes, the Committee noted that the identification of process deficiencies is the first step towards their rectification. The PIR has been externally mandated by government, and its full implementation is hoped to produce a greater accountability, enabling government's reporting requirements to be met.

External Scrutiny

2.18 Apart from Defence's internal processes, review of Defence activities is also conducted by the Department of Finance, the Australian National Audit Office, and the Parliament.

2.19 The Department of Finance provides external scrutiny of Defence funding issues to ensure that accounting processes are adhered to. In financial negotiations between the two departments, Finance takes a clear position as defender of the public purse, and rarely argues over the strategic rationales proposed by Defence. Its role tends to focus more on achieving the results specified by the Department of Defence by the most economical means.¹⁹

2.20 The amount of scrutiny able to be applied by the Department of Finance has been reduced in recent years as the result of restructuring within that department. Whereas there was previously a departmental branch devoted to review of Defence financial matters, there is now a small specialist section of around seven people. This small group devotes a lot of its time to preparation of Estimates, and is also involved in review of certain proposals involving large expenditures within Defence.²⁰ Thus Finance has a reduced capacity to focus on points of fine detail,²¹ and its level of scrutiny has become smaller and less strategic in its focus.²² Consequently, Defence (along with other departments) has been given more flexibility in management of its own financial affairs.²³ Defence views this as contributing towards a better relation between the two departments, and understandably expresses satisfaction with the current relationship.²⁴

2.21 The Department of Finance concedes that its advice to government on Defence expenditure does not involve an active validation of requirements. Rather, Finance concentrates on advising Government in terms of affordability, and how funding for Defence affects the overall fiscal position of the Government. The department has no particular expertise in the area of the strategic environment facing Australia, and sees its role as

18 *ibid*, para. 335.

19 White, Dept. of Defence, Transcript, p. 5.

20 Mann, Dept. of Finance, Transcript, p. 116.

21 Tonkin, Dept. of Defence, Transcript, p. 4.

22 White, *ibid*.

23 Tonkin, *loc. cit*.

24 *ibid*.

ensuring that the right issues are brought to the attention of Ministers, and that requests for resources are well supported and well documented.²⁵

2.22 The Australian National Audit Office (ANAO) provides another avenue of external scrutiny of Defence issues. It does not restrict its audits to funding matters, and ranges across all performance areas of portfolio activity. Where particular aspects of Defence performance problems or inefficiency are identified, these form part of each ANAO report, and Defence is asked to respond to each recommendation made, and to report subsequently on actions taken. A number of such issues are addressed later in this report.

2.23 A further mechanism for review of Defence activities is at the level of the Federal Parliament. This particular inquiry is an example of that scrutiny. During the 1996-97 Financial Year, the following Committees conducted inquiries on aspects of Defence operations:

- Senate Foreign Affairs, Defence and Trade Legislation Committee;
- Joint Standing Committee on Foreign Affairs, Defence and Trade;
- Joint Standing Committee on Treaties;
- Senate Foreign Affairs, Defence and Trade References Committee; and
- Joint Statutory Committee on Public Works.²⁶

2.24 However, issues are inquired into by the Parliament only as particular topics emerge which require specific investigation in the public interest. Only the first of the above Committees examines Defence financial matters on a regular basis, and that examination is generally restricted to the issues published in the Defence Annual Report, the Defence Portfolio Budget Statements and Defence Portfolio Additional Estimates Statements. The current composition of the Senate, and hence the Senate Foreign Affairs, Defence and Trade Legislation Committee tends to concentrate its reviews on political issues, rather than detailed scrutiny of strategic justifications. The essential element of the process, however, is that Defence's financial statements are tabled in the Parliament, and thus made available for public review.

2.25 The final channel of scrutiny of Defence funding matters is through the Cabinet Expenditure Review Committee (ERC), which establishes Government priority for all areas of Commonwealth funding. The ERC examines individual projects and programs within most portfolios, to determine where additional funding is required and where activities need to be curtailed. However, the Minister for Defence is not required to justify individual spending initiatives before the ERC,²⁷ because of the global nature of the Defence budget. As previously examined, this difference means that Cabinet sets planning targets in terms of the year-on-year real growth in the base level of Defence Function outlays, rather than examining programs individually, as it does in other Portfolios.²⁸

2.26 Other ad-hoc means of scrutiny also exist, such as interdepartmental committees, established to investigate particular aspects of Defence activities. One such was a committee

25 Mann, Dept. of Finance, Transcript, p. 110.

26 *Defence Annual Report 1996-1997*, op. cit., pp. 32 - 37.

27 Brown and Woolner, op. cit., p. 6.

28 Dept. of Finance, Submission, p. S309

established to review the effectiveness and accountability of the Defence commercialisation program.²⁹

2.27 In examining mechanisms for scrutiny, the Committee determined that the global nature of the Defence budget, and the consequent flexibility available to the Minister for distribution of finances within the portfolio, work to limit the detailed examination the Defence budget to the macro level. There exists a perception from this arrangement that the overall level of scrutiny of the Department's financial affairs is accordingly lower than that for other departments. The frequently-expressed concern arising from this situation is that this permits an inordinate amount of autonomy for a department with so large an annual budget.

2.28 Publication of detailed strategic justifications for all aspects of Defence spending is not compatible with the requirements of national security, and in part the funding arrangements for Defence differ from those of other departments for that reason. Internal auditing within Defence is able to ensure accountability, although the level of information will be improved with the implementation of the PIR. Reviews by the Department of Finance ensure that agreed processes are observed, and the public purse is protected. Final review at parliamentary level is able to inform the public, while reaching a compromise with the need for security. Given the generally satisfactory outcome in Defence accountability in the past, the Committee is content that a reasonable and workable balance of scrutiny is currently in place.

Mechanisms for Quantifying Funding

2.29 In considering a level of funding required for national defence, an important consideration is how that level of funding can be defined. The mechanism used to date has already been discussed: that is, the adequacy of the current base level of funding is assessed, and variations are implemented by means of Government-specified growth or decrease. This is not the only means of defining the required level of funding, and this section will examine the arguments for alternatives.

29 Tonkin, Dept. of Defence, Transcript, p. 20.

Percentage of GDP

*The most common measure of Defence spending is the proportion of GDP spent. This is a handy shorthand comparison, but it has no strategic significance in indicating whether a government is spending enough to achieve its strategic objectives.*³⁰

2.30 Concerns over the level of Defence funding are commonly expressed in terms of percentages of GDP. The 1994 Defence White Paper spoke of the need to maintain Defence funding at approximately 2 per cent of GDP, and the arguments for increases in funding outlined in some submissions to the inquiry also discussed those increases in terms of percentages of GDP.³¹ At one point in its evidence, Defence echoed this position, nominating a proportion of 2 per cent of GDP as sufficient to alleviate many of the deficiencies currently being faced.³² While a sustained allocation of 2 per cent of GDP may certainly improve Defence's overall financial position, the Committee saw no initial justification for the arbitrary definition of Defence outlays as a fixed proportion of GDP.

2.31 Allocation of the Defence budget on the basis of a percentage of GDP does not provide an objective basis for the amount of funding that should be provided, as much depends on the movement in GDP itself.³³ The Department of Finance submitted that there was no logic why spending on Defence should be sensitive to factors affecting GDP (such as drought),³⁴ and there is clearly no direct correlation between increases in GDP and changes in Australia's security environment.

2.32 However, Defence maintained the usefulness of GDP as a broad indicator, and offered the position:

GDP share does not provide a magic index of adequacy of defence spending, but it does provide an interesting indication of the amount of effort that a government or a country believes is worth putting into that risk management process.³⁵

and asked:

Are our strategic circumstances today ones which make it appropriate for the country as a whole to be putting less of its national effort and less of its national wealth into managing the risk of armed threat than it did in the mid-1980s?³⁶

2.33 There existed broad agreement between all witnesses who dealt with the issue of mechanisms, including the Departments of Defence and Finance. The Committee accepted that there existed no logic for the establishment of Defence funding as a defined proportion of

30 *Australia's Strategic Policy*, op. cit., p. 50. This principle is also supported by the Friends of the Earth, Submission, p. S249.

31 RSL, Submission, p. S163, and Australia Defence Association, Submission, p. S175

32 White, Dept. of Defence, Transcript, p. 219.

33 Dept. of Defence, Submission, p. S285.

34 Dept. of Finance, Submission, p. S310.

35 White, Dept. of Defence, Transcript, p. 218.

36 *ibid.*, p. 223.

GDP. However, calculation of GDP share may still provide a useful means of comparison of government spending priorities within a given financial year. It may also be used to indicate general trends in a given area of government spending over a prolonged period, although external factors and implementation of efficiency initiatives will reduce the precision of GDP share as an analysis tool.

Percentage of Commonwealth Outlays

2.34 A second mechanism used for definition of Defence funding targets is to specify them in terms of a percentage of government outlays. Two submissions to the inquiry argued that a level of funding of not less than 10 per cent of government outlays is required to develop and maintain technologically advanced forces.³⁷

2.35 The Department of Finance opposed measurement against government outlays as a means of setting a level for Defence funding, as it presupposes that government spending priorities remain constant.³⁸ This fixed relationship with government outlays would also subject the Defence budget to considerable uncertainty and annual fluctuations, depending on the Government's intentions with each Federal Budget. Reductions in government spending, to balance the Budget, or achieve a surplus, would entail a sudden drop in Defence spending, while an increase in government spending would provide an unexpected, and unplanned-for increase in the Defence budget, without strategic justification. This would be undesirable, and the need for consistency in Defence budget planning is covered subsequently in this report.

2.36 As an unusual corollary, the linking of Defence outlays to Commonwealth Budget Outlays would require that any increase in Commonwealth spending, say, for Health, Welfare or Education, would necessitate an incremental increase in Defence outlays, to keep these at a fixed proportion. There is clearly no logic to such an arrangement.

Assessment

2.37 The Committee noted a number of arguments which militate against defining the level of Defence funding as a fixed proportion of either GDP or total government outlays:

- Neither measure is related to either the security environment, or the level of defence tasks required. For example, changes in commodity prices or other economic factors may cause large fluctuations in Australia's GDP, while the security situation may remain unchanged. Conversely, should Australia's security environment deteriorate rapidly, it is unlikely that GDP or government outlays will suddenly increase, to cope with a requirement to finance increased security measures.
- The high cost of major items of Defence capital equipment is subject to significant fluctuations due to exchange rate variations and the need to incorporate sudden advances in technology. Again, these fluctuations occur independently of variations in GDP.

37 RSL, Submission, p. S164 and Navy League of Australia, Submission, p. S186

38 Dept. of Finance, Submission, p. S310

- Changes to work practices forced on the Department of Defence from either within or outside the department may result in efficiencies which, as is planned for the savings resulting from the Defence Reform Program, are retained by Defence for reallocation to areas of need. This increases the effectiveness of Defence spending without change to GDP or level of government spending.
- Because most significant technological advances tend to find some application within the military, the nature of warfare is continually evolving. For example, the development of the aircraft carrier ended the era of the great naval gun battles, and the use of aircraft-launched anti-shiping missiles in the Falkland Islands War reinforced the need for airborne early warning and control (AEW&C) aircraft. This tendency for new weapons types to emerge frequently results in the need for a nation to modify its military systems, or to acquire new forms of defences to remain effective in combat. Again, these sudden advances in technology rarely occur in synchronisation with increases in GDP. The topic of sudden technological advances is dealt with later in this report, under the heading 'technological edge'.
- Many recent efficiency initiatives within Defence have been instigated as the result of the financial stringencies of a constrained budget. Were the Defence budget to be set at a fixed rate of GDP, the incentives toward achievement of further efficiencies would wane in periods where GDP growth was high.

2.38 One submission to the inquiry summarised the case that:

The measuring adequacy [of defence funding] by reference to a percentage of GDP is misleading when GDP is growing (or contracting) in real terms each year. Similarly, measuring on the basis of the proportion of Federal outlays spent on Defence is susceptible not only to the demands made upon the economy by the government but also on the seemingly innumerable variations in accounting practice. Similarly, the adequacy of a given dollar amount can only be measured against an assessment of what is needed and no such assessment exists in this country.³⁹

2.39 What is omitted from this assessment is the consideration that no nation may ever be funded to ensure against all forms of risk. Absolute security is unlikely ever to be achievable.⁴⁰ Funding decisions must hence be taken by Government through determination of a balance between the level of strategic risk it is willing to accept, and the level of resources that may be made available to reduce those risks. Should the resources required to achieve defence tasks not be available, the level of risk will increase.⁴¹

2.40 This principle can be used to explain why defence spending may tend to fluctuate in synchronisation with GDP, although not necessarily in a fixed relationship. If the strategic situation remains largely unchanged, and governments are able to afford greater expenditure (because of larger government outlays resulting from an increased GDP), a logical

39 Australian Defence Association, Submission, p. S174

40 From Friends of the Earth, Submission, p. S238.

41 Dept. of Defence, Submission, p. S285.

government priority for a share of that increased spending will often be to decrease the level of risk. Of course, there may also be higher priorities for increased government funding.

2.41 The weight of arguments against defining Defence funding as a proportion of GDP or of Commonwealth Budget Outlays dictate that neither method should be used. Definition in terms of GDP or Commonwealth Budget Outlays produces a variable outcome subject to the external influences on those measures. Defence believes that:

The most useful measure for quantifying the level of Defence funding is the real change to the [funding] base over time.⁴²

The Committee has adopted this method for its key recommendations.

2.42 The Committee also noted that discussion of Defence funding levels in terms of either GDP or Commonwealth Budget Outlays has important limitations, as both methods have inadequacies as indicators and can frequently prove misleading. Notwithstanding these deficiencies, the use of both measures is likely to continue, owing to the lack of practical alternatives. The Committee makes frequent reference subsequently in this report to comparisons on the basis of proportions of GDP, as this provides the most useful means of broadly comparing historical and international trends.

The Need for Consistency

Whatever level of Defence funding is adopted, it is important that there is reasonable, longer-term continuity in general Defence funding. Recognising the long lead-times for the planning, acquisition and introduction into service of capabilities, Defence funding needs to reflect longer term security needs and related defence investment and support needs. Funding should not be subject to large-scale unpredictable Budget changes.⁴³

2.43 Independent of the arguments over the quanta of defence funding, or the mechanisms by which it may be defined, there is a demonstrable need for a degree of certainty or at least consistency in that level. Of all potential outcomes of this inquiry, Defence identified inconsistent funding levels - 'significant swings and variations over the years in the level of funding' - as the least desirable.⁴⁴ This is due to the need to program its investment budget well in advance to include new capabilities.

2.44 High technology, and hence high cost, major weapon systems are introduced into military service over long time frames. This is due to their complexity, the need to assess and evaluate competing systems, the need for subsequent development, to establish support infrastructure, and to spread the large amounts of investment over multiple years (and financial years). Defence requires the ability to plan its acquisitions over the long term more than any other government department or federally-funded organisation.

42 *ibid.*, p. S319.

43 *ibid.*, p. S6.

44 Tonkin, Dept. of Defence, Transcript, p. 235.

2.45 There are a number of historical examples where government guidance to Defence was significantly at variance with the delivered outcome. Some the more extreme examples are:

- 1981-82 - Although the previous year's Government guidance had been for Defence to expect a rise of 6.4 per cent of its budget, the actual outlay delivered was a *decrease* of 1.7 per cent in real terms, and
- 1987-88 - While Government advance guidance was an increase of 3.8 per cent, actual outlay was a fall of 1.1 per cent.

2.46 Before 1992-93 there was a tendency for real growth in the Defence budget to be planned across the Forward Estimate period, but this was generally not delivered. Since 1992-93, planning guidance has been for small decreases in most years, but this has been stable and realistic.⁴⁵ The Committee acknowledges that the annual planning guidance provided by government and covering the Forward Estimates period has been reliable, and has benefited Defence forward planning.

2.47 Defence's argument for reliable advice of funding levels is convincing. Dependable forward advice of expenditure allocations allows planning to be better matched to resources available,⁴⁶ and allows more certainty in programming of major capital equipment expenditure. Ironically, Defence was also opposed even to significant funding increases, where these were the product of a short-notice fluctuation, noting that 'it takes time to spend money in a really cost effective and efficient manner'.⁴⁷

2.48 The Committee also noted the potential for funding fluctuations to result in unexpected detriment to ADF capability. Large proportions of the Defence budget can be committed in advance, due to contractual obligations for capital equipment. There is even less discretion available in personnel costs, because of the long notice required to vary personnel numbers. This would indicate that a high proportion of sudden fluctuations in overall funding would be likely to be borne by Defence's operating costs allocation. Such cuts result in sudden drops to preparedness levels, which the Committee viewed as highly undesirable. By providing a firm forward planning basis for Defence financial planning, investment and personnel strategies may be adjusted to minimise the impact of overall funding fluctuations on activity levels, and hence preparedness.

2.49 Measures are available to address the problems resulting from lack of consistency in Defence financial guidance advice. One is government application of a five-year Budget commitment, as proposed in the 1994 White Paper for introduction in the 1996-97 financial year.⁴⁸ This proposal was not taken forward with the change of government, and has not been considered subsequently,⁴⁹ although Defence is keenly supportive of such an approach.

Recommendation 1

45 Dept. of Defence, Submission, pp. S320-S321.

46 *ibid*, p. S320.

47 White, Dept. of Defence, Transcript, p. 235.

48 *Defending Australia* Defence White Paper 1994, Australian Government Publishing Service, Canberra, 1994, p. 150, para. 14.23.

49 Tonkin, Dept. of Defence, Transcript, p. 10.

The Committee recommends that the Government undertake to provide Defence with a five-year budget commitment, to provide Defence with a more secure basis for long term planning of resource allocations.

