

CHAPTER THREE

DEFENCE FUNDING IN CONTEXT

Current Level of Defence Funding

Budget 1997-98

3.1 The 1997-98 Defence budget was \$10,404.8 million, consisting of total Defence functions appropriations of \$10,961.2 million, offset by receipts of \$556.4 million.¹ The Budget also allocated \$1,022.5 million in non-Defence function outlays, largely comprising Defence superannuation-related expenditure. At that time, Defence outlays represented 1.9 per cent of GDP and 8.2 per cent of Commonwealth outlays.² On current estimates, and expectations that the Australian economy would grow by around three per cent per annum in real terms, Defence indicated that those current proportions would trend down over the next few years if the Defence budget were to remain stable at zero real growth. That is, the Defence share of both GDP and Commonwealth outlays would diminish over time as a result.³ Based on GDP growth of three per cent, the Committee calculates that a static Defence budget will fall below 1.7 per cent of GDP in five years, and below 1.5 per cent within nine years. Given higher growth in GDP, these decreases as proportions of GDP would be reached more quickly.

3.2 At its election, the current Coalition Government undertook to at least maintain Defence funding at its then-current level, and in line with the Forward Estimates in the 1995-96 Budget,⁴ in effect quarantining portfolio expenditure from decrease, in real terms, for the Government's first term in office. This commitment required reduction of the Defence budget in real terms by 0.5 per cent in the 1996-97 Budget, with the level of funding then to be sustained at zero real growth for the remainder of the Government's first term.

Apportionment of the Defence Budget

3.3 The Defence budget is funded on a global basis, which allows considerable discretion to the Minister for Defence for apportionment between areas of priority. In its broadest terms, the Defence budget is apportioned according to investment (usually in terms of materiel, such as capital equipment and facilities), personnel, and operating costs. A recent historical summary of that apportionment is shown in Table 3.1.

1 *Portfolio Budget Statements 1997-98, Defence Portfolio*, op cit, Table 3, pp. 22-23.

2 Dept. of Finance, Submission, p. S314.

3 Tonkin, Dept. of Defence, Transcript, pp. 241-242.

4 Howard, John, *Australia's Defence*, News Release by the Leader of the Opposition, 13 February 1996.

Table 3.1 Broad Apportionment of the Defence Budget ⁵

	1994-95 (Actual)	1995-96 (Actual)	1996-97 (Actual)	1997-98 (Estimated)
Personnel Costs (%)	38.0	38.7	41.0	40
Investment (%)	28.4	26.9	28.0	28
Operating Costs (%)	33.6	34.3	31.0	32

3.4 The Defence total capital equipment budget is about \$4 billion. Of this, around \$860 million is spent on replacement equipment, and around \$830 million on stores, leaving around \$2.5 billion for new capital equipment.⁶ More accurately, \$2,340 million was planned for expenditure on major capital equipment in 1997-98.⁷ The current apportionment on capital investment has averaged around 27 to 30 per cent over the last 10 years, and Defence has stated that it would aim to preserve this ratio.⁸ This is a substantial increase over the 20 per cent figure of the early 1980s,⁹ and reflects a significant shift of emphasis in Defence spending from personnel costs towards long-term investment. Defence presently spends about \$4 billion of its budget on labour (personnel costs).¹⁰ Again, this reflects a substantial shift from 20 years ago when personnel costs accounted for around 60 per cent of the Defence budget.¹¹

History and Trends in Defence Funding

Comparison with Other Departmental Outlays

3.5 The 1997-98 Budget Defence outlays represents 1.9 per cent of GDP and 8.2 per cent of Commonwealth Budget Outlays. These proportions have declined in the last decade from 2.6 per cent and 9 per cent respectively in 1986-87. In comparison, the proportion of Commonwealth outlays for Health, Social Security and Education has grown from 12 per cent to 16.3 per cent, 27.2 per cent to 40.1 per cent and 6.8 to 8.7 per cent respectively over the same

5 Sources: 1996-97 *Defence Budget: Fact Sheet*, Media Release by Minister for Defence, Commonwealth of Australia, 20 Aug 1996. Also, Dept. of Defence, Submission, p. S 8.

6 Tonkin, Dept. of Defence, Transcript, p. 254.

7 Dept. of Defence, Submission, p. S315.

8 White, Dept. of Defence, Transcript, p. 25.

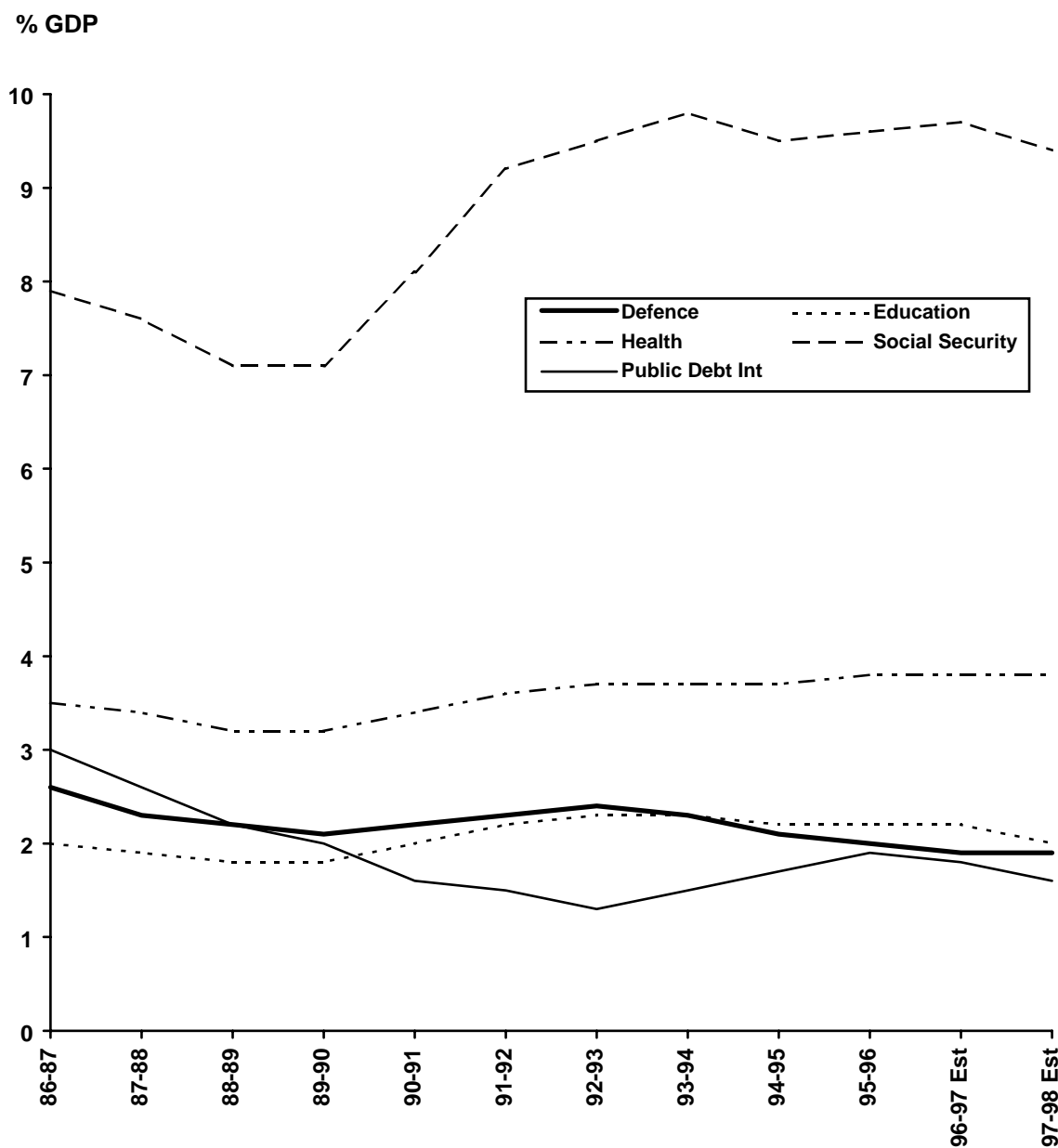
9 *Future Directions for the Management of Australia's Defence*, Addendum to the Report of the Defence Efficiency Review, Secretariat Papers (hereafter referred to as DER Secretariat Papers), p. 17.

10 Tonkin, Dept. of Defence, Transcript, p. 256.

11 *Defending Australia*, op. cit., p. 149, para. 14.17.

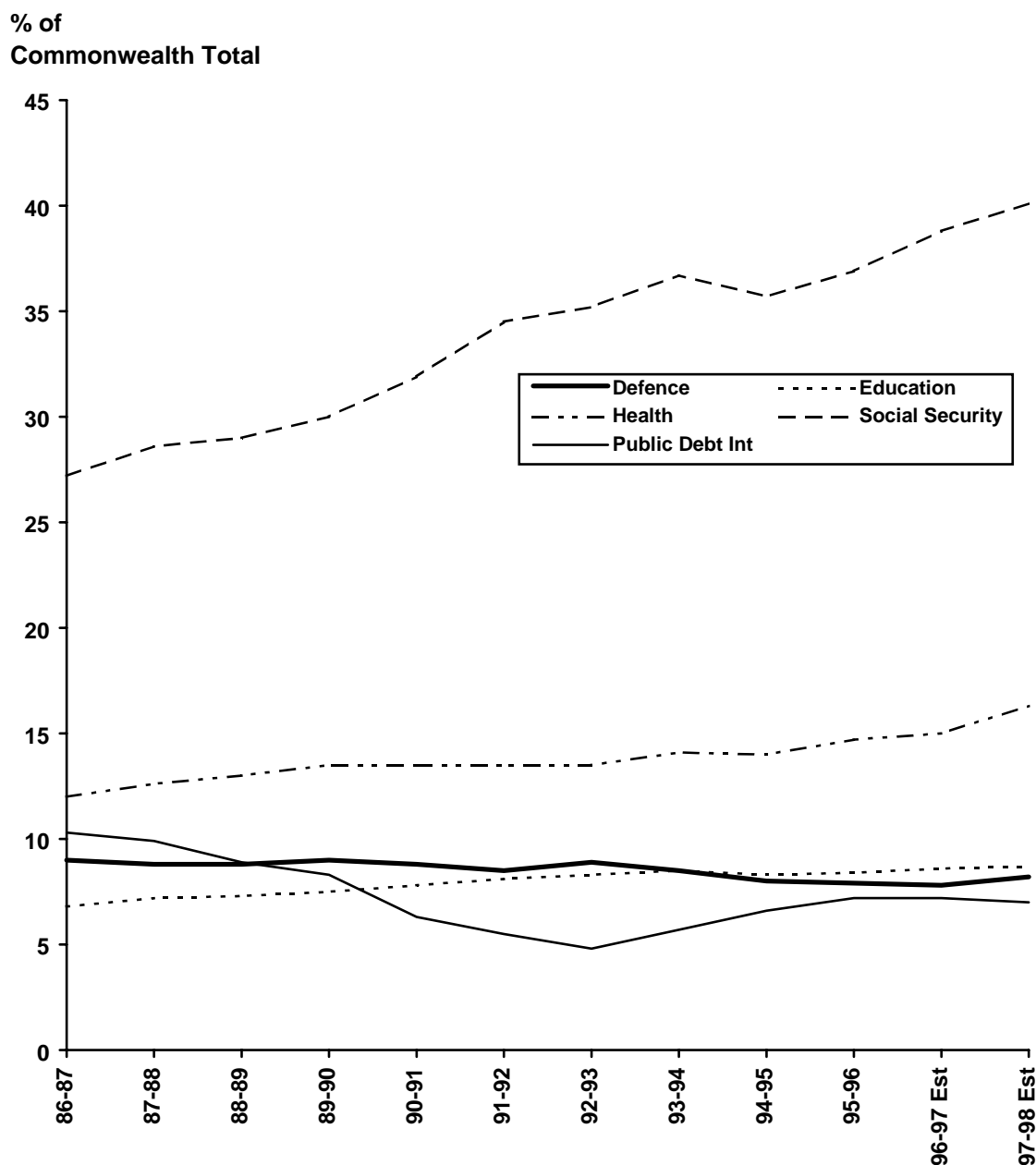
period, and the percentage of GDP for each of these portfolios has also grown over this period. Table 3.2 and Table 3.3 provide a comparison of the relative proportions of GDP and Commonwealth Outlays for these departments.¹²

Table 3.2 Departmental Outlays as a Percentage of Gross Domestic Product



12 Dept. of Defence, Submission, pp. S284-S285.

Table 3.3 Departmental Outlays as a Percentage of Commonwealth Budget Outlays



History of Change in Defence Outlays

3.6 The process by which the Defence budget is determined - usually with variations in terms of real growth applied to the previously agreed funding level, expressed as a percentage - has been examined. The recent history of percentage changes in Defence Function Outlays is shown in Table 3.4. Compared to 1988-89, Defence annual funding has reduced by 2.23 per cent in real terms.¹³

13 DER Secretariat Papers, op. cit., p. 17.

Table 3.4 Percentage Variations in Actual Defence Functions Outlays¹⁴

Year	Actual Outlay %
1987-88	-1.1
1988-89	0.5
1989-90	0.0
1990-91	0.0
1991-92	0.0
1992-93	0.0
1993-94	-0.75
1994-95	-0.5
1995-96	-0.5
1996-97	-0.5
1997-98	n/a

History of White Paper Guidance

3.7 Both the 1987 and 1994 Defence White Papers made assessments of acquisition priorities based on levels of defence funding that were not subsequently achieved. The 1987 paper assessed that:

[to meet] the levels of defence capability and the priorities reflected in this Paper, there is a need, over the life of the program, for an allocation of resources generally within the order of 2.6 per cent to 3.0 per cent of GDP.¹⁵

3.8 The 1994 White Paper estimated that, if spending was kept to the levels then planned, 'some modest growth' would be needed 'later that decade and in the following decade', with plans to sustain defence spending at approximately two per cent of GDP.¹⁶ Since that time, the Defence budget has decreased in real terms, falling by 0.5 per cent in 1994-95, an additional 0.5 per cent in 1995-96, and again by 0.5 per cent in 1996-97.¹⁷ Defence funding remained constant at zero per cent real growth in 1997-98, and is planned to remain at that level for 1998-1999. By comparison with the requirements stated in the 1987 White Paper, Defence outlays are forecast to be 1.8 per cent of GDP at the end of the 1999-2000 financial year.¹⁸

3.9 In simple terms, the level of funding necessary to achieve the stated requirements of the previous two White Papers has to date not been achieved.

Funding in a Regional Context

14 Source: Department of Defence, Submission, p. S320. Variations are calculated as a percentage of adjusted figures for each previous FY.

15 *The Defence of Australia 1987*, Australian Government Publishing Service, Canberra, 1987, p. 112, para. 9.15.

16 *Defending Australia*, op. cit., p. 146, para. 14.5.

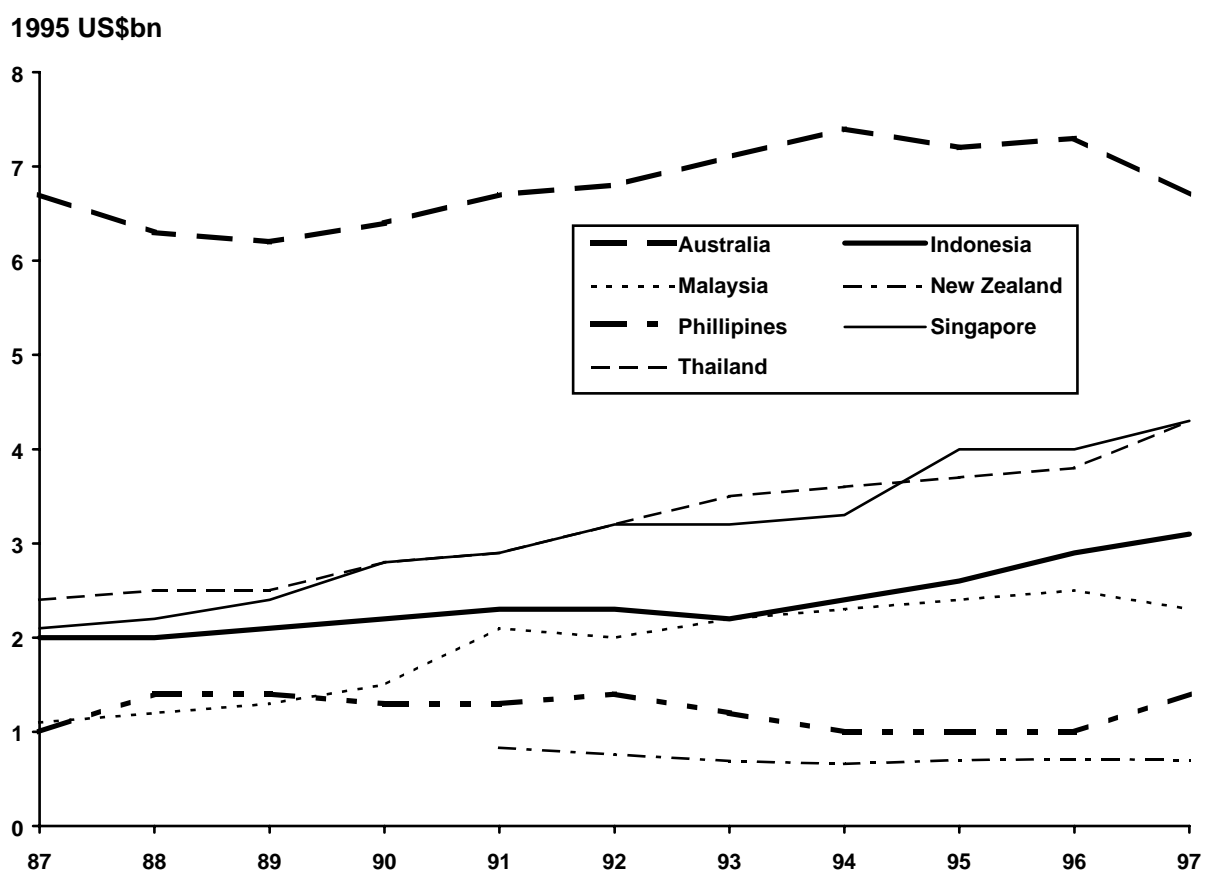
17 Dept. of Defence, Submission, p. S285.

18 *ibid.*

3.10 Australia's defence planning is not directed against any perception of a specific threat, but is based on the capabilities available within Australia's area of regional interest. However, the military capabilities of most Southeast Asian nations have undergone generational improvements, enabled by strong economic growth over the last decade. While global defence expenditure has fallen by more than 40 per cent in real terms since 1987, the defence budgets of the five original members of ASEAN (Indonesia, Malaysia, Philippines, Singapore and Thailand) have increased by more than 75 per cent in real terms over this period.¹⁹ The Asia Pacific has seen significant updating of military inventories, including the acquisition of recent-generation fighter and strike aircraft, missile-carrying naval surface combatants, surveillance assets, long-range missiles and submarines.

3.11 An indication of the historical trend in regional defence expenditures is shown on the graph at Table 3.5. The figures listed in this table are calculated in (1995) US dollars, to ensure equity in comparison, and are based on a 1997 analysis conducted by the Defence Intelligence Organisation.²⁰

Table 3.5 Comparison of Defence Spending - Australia, New Zealand and ASEAN 5 Countries (1995 US\$ billion)

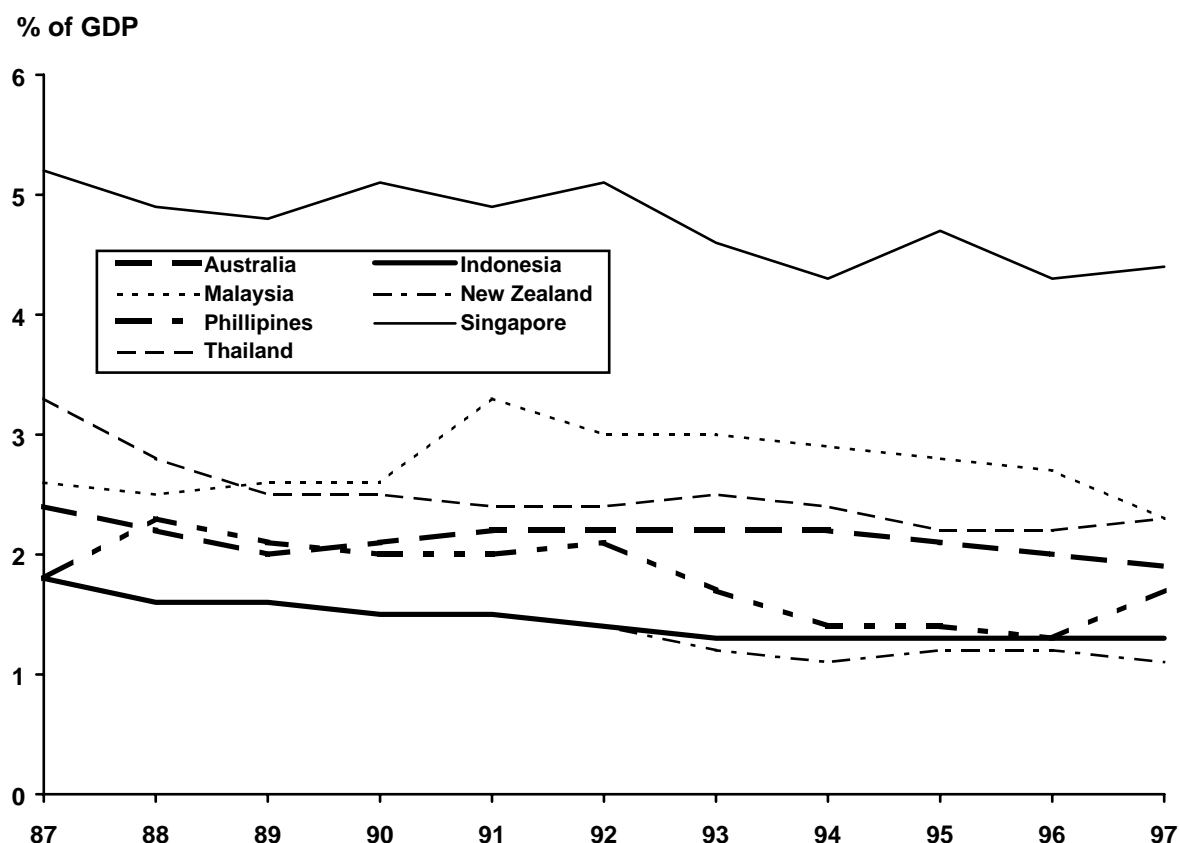


3.12 Table 3.6 provides a comparison of the proportion of GDP allocated to defence by selected other nations. Not shown on this graph are the trend lines for the United States and the United Kingdom. Over the time scale represented in Table 3.6, the proportions of

19 *Defence Economic Trends in the Asia-Pacific 1997*, op. cit., p. 1.
 20 *ibid.*, Tables 1-19.

GDP allocated to national defence by these two nations have reduced from 6.3 to an estimated 3.3 per cent, and from 4.5 to an estimated 1.9 per cent respectively.²¹ Although these two western nations maintain military interests within the Asia Pacific area, their geostrategic circumstances differ greatly from those of the nations shown in this graph. These figures are provided for indicative purposes only.

Table 3.6 Comparison of Defence Spending - Australia, New Zealand and ASEAN 5 Countries (Percentage of GDP)



The recent occurrence of the Asian financial crisis is an important consideration in assessing regional trends in defence funding. The rapid devaluation of a number of regional currencies has greatly reduced the economic growth and spending power of a number of regional economies since mid-1997. The security implications of this event will be considered later, but an early casualty of economic damage control measures in those nations hardest hit has been the defence budget. This has had obvious implications for the defence modernisation programs of a number of nations within the region, particularly Indonesia, Thailand and South Korea. A number of acquisition projects have been cancelled, with the result that trends in defence capability growth have been slowed, at least temporarily. One example is the reduction in the Thai defence budget by over 20 per cent,²² precipitating such measures as the planned disposal of its fleet of eight F/A-18 aircraft.²³ Indonesian defence spending has

21 *ibid.*, Tables 20 and 21.

22 *Jane's Defence Weekly*, Vol 28, No. 23, 10 December 1997, p. 16.

23 Budro, J. and Brooke, M. 'Thai F/A-18s Offered to Australia', in *Australian Defence Magazine*, February 1998, Vol. 6, No. 2, p. 10.

been slashed to nearly half of its planned 1998 levels of US\$3.3 billion,²⁴ and the planned acquisition of Russian Sukhoi Su-30 fighters and Mil Mi-8 helicopters has been postponed indefinitely.²⁵ There is ample evidence that the current economic problems will slow down the introduction of new military capabilities into the region, and the rate at which existing forces may modernise and integrate new tactics.

3.13 One advantage accruing to Australia from this is that our relative technological pre-eminence in several areas of military capability will be sustained temporarily until regional nations can resolve their economic difficulties and resume defence modernisation programs. Given a period of restructuring, the previously high growth rates experienced by many Asian nations over the last decade can be expected to continue, as can the recently experienced rates of defence expenditure. In terms of relative Defence funding, the recent crisis has produced only a pause in the inexorable trend of regional economies toward approaching, if not exceeding, Australia's level of defence expenditure.

3.14 As shown in Tables 3.5 and 3.6, New Zealand's defence expenditure has remained consistently low, both in terms of its proportion of national GDP and in absolute terms. This is discussed further in Chapter 5.

24 Opall, Barbara, *Economy Forces Jakarta to Focus on Home Defense*, Defense News, Vol. 13, No. 8, 23 Feb - 1 March 1998, p. 3.

25 *Jane's Defence Weekly*, Vol 29, No 3, 21 January 1998, p. 6.