



COMMONWEALTH OF AUSTRALIA

JOINT STANDING COMMITTEE

ON

FOREIGN AFFAIRS, DEFENCE AND TRADE

(Defence Subcommittee)

Reference: Inquiry into level of funding for Defence

CANBERRA

Monday, 4 August 1997

OFFICIAL HANSARD REPORT

CANBERRA

JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE

(Defence Subcommittee)

Members:

Senator MacGibbon (Chairman)
Mr Ted Grace (Deputy Chairman)

Senator Ferguson	Mr Bob Baldwin
Senator Sandy Macdonald	Mr Bevis
Senator Margetts	Mr Bradford
	Mr Brereton
	Mr Brough
	Mr Dondas
	Mr Georgiou
	Mr Hicks
	Mr Lieberman
	Mr McLeay
	Mr Price
	Mr Sinclair
	Mr Taylor

Matters referred:

To inquire into and report on:

The level of funding required to ensure that the Australian Defence Force is equipped, trained and maintained to a level necessary to provide for the defence of Australia as principally defined by a strategic guidance, with particular reference to:

- . equipment and facilities on order; equipment and facilities to implement essential new capabilities; equipment and facilities required to replace obsolete material and for which no alternative technology is appropriate;
- . training to achieve appropriate and sustainable levels of preparedness of personnel;
- . operational activities and capabilities necessary to support Australia's foreign policy, regional engagement, regional stability and UN support;
- . stockholding requirements for weapons, consumables and maintenance spares;
- . research and development to ensure continued development of Defence capabilities, to adapt foreign technologies to Australian conditions, and to provide the

knowledge essential for Defence to remain an informed intelligent customer;

- . essential management and administrative overheads required for the efficient management of the Defence organisation.

WITNESSES

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JOINT COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE
(Defence Subcommittee)

Level of funding for Defence

CANBERRA

Monday, 4 August 1997

Present

Senator MacGibbon (Chairman)

Senator Sandy Macdonald

Mr Bevis

Mr Hicks

Mr Sinclair

The subcommittee met at 9.17 a.m.

Senator MacGibbon took the chair.

BARRIE, Vice Admiral Christopher Alexander, Vice Chief of the Defence Force, Department of Defence (Australian Defence Headquarters), Russell Offices, Canberra, Australian Capital Territory

TONKIN, Mr Robert Henry, Deputy Secretary Corporate, Department of Defence, Russell Offices, Canberra, Australian Capital Territory

WHITE, Mr Hugh John, Deputy Secretary Strategy and Intelligence, Department of Defence, Russell Offices, Canberra, Australian Capital Territory

CHAIRMAN—I declare open this public hearing of the Defence Subcommittee of the Joint Standing Committee of Foreign Affairs, Defence and Trade. This hearing is the first of an inquiry being presently conducted by the Defence Subcommittee into the level of funding required to ensure that the Australian Defence Force is equipped, trained and maintained to a level necessary to provide for the defence of Australia. It is an important issue, given current financial constraints and recent public debate over the government's decision to quarantine the Defence budget over the term of this parliament.

I draw the attention of the witnesses to the terms of reference for the inquiry, which restrict consideration of the level of defence as principally defined in current strategic guidance. The intention of this restriction is to prevent expansion of the debate into the wider implications of Australia's security within the region. That is another but separate issue. The inquiry will be constrained to consider purely Defence requirements, which will allow the subcommittee to remain within its portfolio in making recommendations.

In the course of the inquiry the subcommittee is conducting a number of public hearings, speaking with government, business and various representative groups associated with defence, finance, foreign affairs, peace research and defence related industry. The committee expects to table its report around the end of this year.

On behalf of subcommittee, I welcome Vice Admiral Chris Barrie, the Vice CDF, Mr Hugh White and Mr Robert Tonkin of the Australian Defence Headquarters. I must advise you that the proceedings here today are legal proceedings of the parliament and warrant the same respect as proceedings in the respective houses of parliament demand. Although the subcommittee does not require you to give evidence on oath, you should be aware that this does not alter the importance of the consideration. On all occasions you should proceed on the belief that, when you inform the parliament, that is equivalent to speaking under oath. A deliberate misleading of the subcommittee may be regarded as a contempt of the parliament.

The subcommittee prefers that all evidence is given in public, but should you at any stage wish to give any evidence in private, you may ask to do so and the committee will give consideration to your request for an in camera hearing. We have received your

submission and it has been authorised for publication. Could I ask the witnesses if they have any additions or corrections to the submission received on behalf of the Department of Defence?

Mr Tonkin—No, we do not.

CHAIRMAN—I now invite one or several of you to make a short opening statement before we proceed with questions.

Mr Tonkin—We do not have an additional statement to make. We are happy just to take questions.

CHAIRMAN—Could I start by asking some general questions about the relationship between the Department of Defence and the departments that dole out money such as Treasury and Finance? In general terms, is there much opportunity for discussion about the objectives that you seek for Defence and defence expenditure and principally Finance?

Mr Tonkin—The dialogue we have with the Department of Finance tends to be centred largely around the considerations which go before cabinet each year in terms of the overall quantum of Defence funding. The issues which would get discussed between the two departments in that context tend to be issues about the nature of cost pressures and opportunities or otherwise for achieving further economies within the Defence budget. You can imagine that the Defence position is that we have done an awful lot in that regard; the Finance position usually is that perhaps more could be done and there is a dialogue on that issue.

There are questions of whether Defence should be insulated from overall cost reductions which apply often across government. There is debate about Defence quantum. Defence is globally funded; in other words, the government considers how much resources in total should be provided to Defence and the debate centres on whether or not Defence funding should be increased, decreased or remain the same in real terms after adjustment for inflation and exchange. So the debate tends to be at that macro level in the broad sense. We also have discussions about individual financial initiatives, the operations of carry overs and so on. I might leave it to Mr White to discuss the more detailed involvement of the Department of Finance on equipment issues.

CHAIRMAN—Before you do that, could I ask you to characterise the generality of the debate. Is it a productive, constructive and amicable relationship or is it an adversarial relationship?

Mr Tonkin—I would categorise it that historically the relationship has improved over time.

CHAIRMAN—From a bad start?

Mr Tonkin—From a relationship which has tended on occasions to be adversarial. I think that in recent years it has been characterised by a good and increasing degree of genuine cooperation. The Department of Finance has focused on more substantive matters than perhaps in the past. They have less capacity because of their restructuring to focus on points of fine detail. Financial reforms have enabled departments, not only Defence, to have more flexibility. So I think the dialogue generally has been good. That is not to say that we do not have sharp words exchanged down telephones from time to time, but it is generally a productive relationship.

CHAIRMAN—Before Mr White comes on, it is essentially, though, a short-term discussion. It is of the moment; it deals with the issues of the moment rather than saying, ‘Look, we are in business for a few hundred years defending this country.’

Mr Tonkin—It essentially does, but it deals with the longer term when discussions go to matters of financial management arrangements and practices where the Department of Finance is charged with looking at the long-term evolution of how the government manages its overall financial affairs. I think Defence and Finance have a good track record in recent years in cooperating in areas like accruals and so on. We are a very active player, and Finance are very open to us participating in the overall evolution of those things. Genuinely on both sides we are trying to cooperate more fully, so in that regard it is longer term. In terms of the quantum of Defence funding, it tends to be a more short-term focus in terms of the straight financial dialogue.

Mr White—If I could add a couple of points to what Rob said in terms of my own dealings with Finance in two capacities—firstly, in discussions on what you might call the government’s broad strategic policy and, secondly, on the contribution Finance makes to the capability development process through their participation in a couple of our key committees, one of which I look after. I think it would be fair to say that Finance does not attempt to compete with Defence in either the formulation of strategic policy or the assessment of international strategic circumstances and that sort of thing on the one hand, or in the judgment as to which kinds of capabilities we ought to be investing in on the other, but they do retain a pretty substantial body of knowledge about the defence business. There are people in Finance who have been working on defence issues for a good long time, and they are knowledgeable about the issues and well versed in them. So, whilst they do not, if you like, come to the table as competitors with us in that area, and do not seek to replicate our skills, they certainly come well informed and well attuned to what is going on.

As Rob has said, the key focus of Finance is not in the long-term strategic issues, and that is appropriate to their charter, but I have not found them unsympathetic to the sorts of long-term strategic things which have to shape Defence policy. Of course, they would always be looking for the cheapest solution, but I have not found in my discussions

with Finance on broad strategic guidance documents that they resist on what you might call fiscal grounds the sorts of longer term considerations of our strategic circumstances that we put forward.

On shorter term things, and more specifically on individual procurement projects, I have generally found that the Finance people have a good understanding of the sorts of imperatives—strategic, technological and whatever—that lead us to have to make particular kinds of investments. By and large, let me put it this way: over the last couple of years I cannot recall an occasion on which Finance have argued against a proposal on strategic grounds. They have not said, ‘No, you don’t need that kind of capability; it is not appropriate to our strategic circumstances.’ They are more likely to argue, ‘Is this the cheapest way of achieving the result?’ So again it is not that they attempt to replicate or compete with us in the strategic judgments that we make, but they are I think properly playing their role as guardians of the public purse and, if you like, providing a second opinion on a range of things. In that regard, by and large, we find their involvement in our processes—for example, the old FSPPC, now replaced by the DCC—a good part of the process and a useful contribution.

CHAIRMAN—Is there any institutional memory within Finance in relation to Defence? Having dealt with Defence through most of my time in the parliament, there is more or less a stability in the personnel. In Defence they roll over very slowly. They advance but, despite that, they still make some enormous mistakes with equipment. Have you got the same personnel stability within Finance, or are you dealing with a new team every year?

Mr Tonkin—Historically, there has generally been a fair degree of stability. There is more moving around in the Department of Finance. I think perhaps it needs to be noted that they have essentially very small teams engaged in looking at particular portfolios. The recent restructuring, as I can follow it, has meant there is really a section devoted to Defence where there used to be a branch. In other words, Finance has focused down as the level of their scrutiny has become smaller and less strategic in its focus and less down into the fine detail. But the same names are still there. Although, as people progress to higher levels in Finance and go into other areas, there has been a reasonable degree of continuity, but not to the same extent as we have had. I would point out that in our financial area not the same people are always there; people move in and out of our financial areas into other parts of the department.

CHAIRMAN—Could I ask some questions about the changes that have taken place in recent years? We have seen the introduction of the fringe benefits tax and the removal of the compensatory mechanisms for wage and salary rises, and all these things now have to be absorbed within the annual budget without any supplementation at all. That was imposed, I presume, by Finance. Did Defence object to that when it happened?

Mr Tonkin—I think I would put that it was imposed by decision of the

government rather than perhaps the Department of Finance position, but I presume they proposed it. Defence did not oppose it. We certainly raised questions, as did many others, about productivity based pay, about perhaps the sustainability of that over the longer run. Ultimately you can shave your overheads, make changes to your processes and become more flexible and get better value for money but, at the end of the day, if you progress it continuously over a long period, the only way you generate increased productivity is to have fewer people who form the large part of your overhead. Ultimately, you get to a point where that becomes more difficult.

In terms of fringe benefits tax and accrual based superannuation, which are the two largest effects upon Defence funding, Defence did not object to fringe benefits tax because we were funded for it. In other words what happened was that a calculation was made at a scale of fringe benefits tax which would be paid by Defence—and we are the largest payer of fringe benefits tax in the country, public or private—and the Defence budget was supplemented for the estimated cost of that. It then became within Defence's scope to modify its use of resources to minimise its tax, which we have done. We are reasonably content at the moment with the fringe benefits tax arrangements.

Accrual based superannuation was changed whereby we now have to have within the Defence budget the actuarial cost of the future pension cost of the current work force each year. In other words, whatever percentage of the employer contribution would go to funding future pensions is in the Defence budget. We again agreed with that arrangement. The numbers were calculated. Defence's budget was adjusted upwards for that factor. It comes back to the point I made before about a reasonably cooperative relationship. Clearly it was in our interests. Under accrual funded superannuation, if your work force is decreasing and you are realising a savings on salaries and overheads, the provision for superannuation is an overhead you are saving. So the arrangement worked in our favour.

CHAIRMAN—How many more years can we persist with this mythology of two per cent efficiency divisions and the rest of it that has been the policy of this government and the preceding government, which introduced it? I have always found it very hard to understand, particularly in a department like Defence where it is not a company. Measuring efficiency where you have so much inherent reserve capacity becomes a very dubious intellectual argument.

Mr Tonkin—I do not know that I would want to put a date on it. What I would observe is that since 1990-91 we have achieved ongoing efficiency gains of \$500 million in terms of the force structure review, commercial support programs and so on. We took another \$125 million off last year from overheads, another continuing saving. We are now at \$600 million. The Defence efficiency review, Defence reform program, has the prospects of between \$800 million and \$1 billion, a further efficiency gain which will not be mature for another three or four years. That reflects that there is a substantial scope to generate efficiencies inside a \$10 billion budget.

It is difficult to answer your question as to what would be the end state date of when we are going to run out. Our capacity to achieve future savings are determined, to a large extent, by externalities. How much more flexibility and freedom will we have as a result of the changes to the Public Service Act, the Workplace Relations Act and accrual accounting? Those things are for the future to tell us. I would not want to put a boundary on it, but I think I take your general point that the law of diminishing returns must apply at some point.

Vice Adm. Barrie—That is a good point in terms of how far can further efficiencies go. Certainly from the military side of the house, our perspective is that the results of the Defence reform program will leave us with a military force of somewhere between 50,000 and 60,000 personnel in uniform. That is, in our judgment, the bottom limit of what we can do. We do not see further scope for further efficiencies inside the fighting force of the ADF.

Mr BEVIS—Page 4 of the submission states:

The increased personnel and operating costs of capabilities already approved by Government can largely be met from current Defence allocations.

I was interested in the qualification 'largely be met'. What will not be met from current allocations? What sort of shortfall are you referring to in respect of those things already approved?

Mr Tonkin—I think it is largely language.

Mr BEVIS—So you want to retract 'largely' now?

Mr Tonkin—No. The point being made is that we would struggle to find a delta arising to \$360 million per annum out of our existing future programming without impacting upon funds available for capabilities. The point here is that the things you see listed are additional capabilities. There is not an offset for them. Often when we buy something it is replacing something already in inventory. There at least is some capacity to yield a saving from the previous piece of equipment.

In the case of something like AWACs we do not have it; therefore, we have to find the additional cost. It is a delta. The challenge for us is: what does that delta eat? Does it eat efficiency gains, of which there is a large queue of things queued up asking for it? Does it eat investment, which would seem to be counterproductive? Does it eat activity rates or preparedness, which would also be counterproductive? So we have to obviously start looking for it out of our productivity improvements, and there is a competition for that. So the word 'largely' becomes a judgment. If we spend it on this, we do not spend it on something else. Putting a figure on it, we might be able to fund two-thirds of that. Otherwise, we have to start making very hard decisions and something misses out.

Mr BEVIS—Implied in the sentence and fleshed out by your comments is the fact that there are going to be decisions required under current planning that will mean assets, structures or services that are seen to be required will have to be forgone in order to meet other approved projects.

Mr Tonkin—One of the things that the committee chaired by Mr White now does is look at a new capability proposal in terms of not only its capital cost but also its personnel and operating costs and its through-life cost. When you decide to acquire a capability you just do not acquire that; you acquire everything that comes with it. We are now bringing that much more clearly to account. That paragraph demonstrates the process that we are now undertaking.

Mr White—I have a couple of points to add to that. I think the gloss I would put on ‘largely’ in the sentence that you read out is, particularly in the new capabilities, that the scale of personnel operating costs is to some extent uncertain until the equipment is brought into service. We do a lot of work to make sure we get as good a fix as we can as the basis for our planning, but we have to prudently recognise that there is a degree of uncertainty. Rob mentioned AWAC. We have not operated that kind of capability before. What is going to be involved in operating is going to be a little uncertain until we have got it in place.

The other point that Rob mentions is a very important one. We work very hard to take as much account of the through-life cost of the entire capability in making our capability decisions and in doing our financial planning as we can. That is changing the way we do our business. We have in the past until recent years tended to focus primarily on the capital costs which have been reflected in the pink book. We are now broadening that out to make sure that we capture the person up costs.

The last point is that, in doing that sort of thing, we always aim to end up with the mix of capabilities which provides the best overall capability. While it is true that there are things that we would very much like to have and that we think would be an important contribution to the Defence of Australia, in the end we will propose that the government funds whatever capabilities provide the best overall mix of capabilities. I am not quite sure that it is something that is required that is not funded; it is just that you fund the highest priority capabilities. The ones that fall off the list that do not get priority for funding could nonetheless be very important ones. That is where the whole business of risk judgment and risk management for the government comes in.

Mr BEVIS—The same philosophy would have to be adhered to if there were a 10 per cent, 20 per cent, or 30 per cent cut as well, obviously.

Mr White—That is right.

Vice Adm. Barrie—I think one of the other characteristics of uncertainty here is

the increasing requirement for skill levels in the work force itself. As an example, the skill level in the navy submarine force going from Oberon class submarines to Collins class submarines, even though the size of the crew has dropped by 50 per cent, has risen quite dramatically. That is going to be reflected in expectations for remuneration and other things in personnel costs in the future.

Mr BEVIS—The second part of that paragraph actually talks about those other projects that have not yet been approved but are on the assessment list. I appreciate that is a shorthand version of a couple of the highlights. But just for completeness in the record I assume the omission of the Collins was for brevity in the submission not an indication that it is not considered in the same category as AWACs or other things.

Mr White—It has already been approved and programmed and is steaming along.

Mr BEVIS—I am talking about the extra two.

Mr White—It is just one of the many other things we have on our list.

Mr BEVIS—I thought that was the case but I just wanted to clear it up for the record. On page 2 under the heading 'Financial commitment to defence' the second paragraph refers to global budgets. It states

Defence funding is planned to remain constant at zero per cent real growth.

It then says:

Given anticipated growth in GDP, Defence outlays are forecast to be 1.8% of GDP at the end of this period.

What is the anticipated growth in GDP that you are assuming?

Mr Tonkin—I think it is three per cent per annum.

Mr BEVIS—My recollection—and I do not have the document with me; your memory may be better—is that the 1994 white paper also included a statement remarkably similar to that but based on a different GDP growth figure.

Mr Tonkin—You want to know what the percentage growth figure was then?

Mr BEVIS—Yes. My recollection is that it was something considerably more than three per cent. We could check that before we finish this morning. It would be easy enough. That might help me on a couple of other questions I would then want to ask. Elsewhere in the submission on page 6 the middle paragraph ends with the sentence:

Funding should not be subject to large-scale unpredictable Budget changes.

I suspect that is a view widely shared everywhere. In that context, can you tell me what the situation is at the moment with the 1994 white paper suggestion or commitment to a five-year budget process?

Mr Tonkin—That was contained in the 1994 white paper but it was not ever taken up by the previous government.

Mr BEVIS—You might recall the 1994 white paper gave a commitment to start it in the 1996-97 financial year.

Mr Tonkin—I am clearly aware that the previous government did not take that proposal forward. It was not ever put to government as a whole other than being stated as an objective to be progressed in the white paper. It never went up for government consideration. It has not been considered to my understanding by the current government. What it was intending to reflect was the point Mr Bevis is making: if you want to maximise the efficiency of defence long-term planning and the way in which Defence uses the funds that the parliament provides, we do need some degree of certainty or stability.

It is not so much a lock-in but what you do not want to have is a situation where there is speculative provision of substantial improvements or increases in the future which turn out not to be the case. If you have figures put into forward estimates, for example, which are substantially in advance of what the department currently receives, planning to some extent at least tends to get seduced by those numbers. If those numbers are not borne out by the annual budgetary provision, then that essentially is a disservice. It does not help us at all in trying to provide a structured process.

What we want is to have some pretty clear idea that we are not going to have the budget reduced unilaterally by significant percentage numbers or varied in that way. We would rather know what our envelope was and be able to plan within that. We need, parallel to that, maximum flexibility to move our money around inside when it comes to the global budget. We need some degree of certainty. I am not saying a fixed promise necessarily, but as good a certainty as we can get within the budgetary process—we accept that economic circumstances change and so on—and the maximum flexibility as we can get will enable us to maximise the amount of defence capability we can provide for the dollars we have.

That was essentially the point of the 1994 white paper argument, although it attempted to go further to say that in order to provide you with the absolute maximum certainty there would be desirability in having a five-year budget provision. As I said, it never got to government.

Mr BEVIS—When you say that it ‘never got to government’, the document was

approved by cabinet including that. My clear recollection was that there were a number of issues in some discussion at that time. I think it was understood by cabinet that that provision was there.

Mr Tonkin—In order for many things in white papers to actually be given effect you require a specific decision of government on those specific points, otherwise you would have a line by line debate.

Mr BEVIS—What you are saying is that there is not a cabinet minute that says, ‘We will do this.’

Mr Tonkin—No, there is not.

Mr BEVIS—But the concept itself no longer is being pursued?

Mr Tonkin—I am not aware of it being pursued.

Mr BEVIS—Can I ask about the flexibility of assets and structures and to what extent the assets and structures that we develop are able to meet different roles? This inquiry is limited to existing strategic guidance. I would think that before the year is out and possibly before this committee finishes its work there may be another set of strategic guidance. To what extent are assets able to be used for activities other than a stricter interpretation of defence of Australia?

Mr White—Successive governments have always placed a very high premium on ensuring that the capabilities required for the defence of Australia have the maximum capacity to undertake a range of other tasks. So, if you like, a degree of adaptability has always been a part of our posture and, for example, was very clearly set forward in DA 1994 as one of the objectives in our force structuring approach. That certainly continues to be the case and I expect would continue to be the case under the new strategic guidance being prepared for the government’s consideration at the moment.

In a sense, one of the judgments one has to make in making force structure decisions is striking the balance between forces which are perfectly and specifically adopted or oriented towards one particular task, like defeating attacks on Australia’s own mainland, and doing wider tasks. That can be a very important factor in making specific decisions on specific issues. Overall we find that the set of decisions we make around that has provided a force with a great deal of adaptability, and that will continue to be the case—a force that has a substantial fleet of highly capable surface ships, a few squadrons of very effective F18s and quite a lot of F111s. These are forces that give the government a lot of options for doing things beyond the direct defence of our own continent. That has always been an important part of our posture and I think will continue to be in the future.

Mr BEVIS—The other side of the budget coin is getting value for money where

you spend it. I am thinking particularly of the big ticket items. What is now occurring with value for money in expenditure on major items and in particular the Australian industry involvement guidelines? I would be interested in any comments you may have about the state of the working relationship between defence and key Australian industry suppliers and that broad question of Australian industry involvement.

Mr Tonkin—I do not think that the people at the table could answer that question adequately, but someone such as Dr Pearce or Mr Jones could perhaps come along to talk to that point specifically.

Vice Adm. Barrie—I could give you some thoughts on what I think it means for the future. To go back to what I said earlier, if the Australian Defence Force is targeted at somewhere between 50,000 and 60,000 people in uniform then I think that the scope for greater involvement of Australian business and industry in the defence function is certainly going to be there in the delivery of goods and services and in the means of production if we are going to be successful in mounting a proper defence for this country. In the future, I see a much greater involvement of industry and business in the defence function. I think that will do much to put defence as an issue further out in the community than ever before. That is an essential ingredient of the program for the future.

Mr BEVIS—Obviously, it is a matter that the chairman and the committee might want to consider at another time. I flag the fact that I think integral to the issue that the committee is looking at is not just the budget but how it is spent and the extent to which that contributes to long-term sustainability. Integral to that, in my view, is the partnership arrangement with Australian industry. At some point, I would like to revisit that.

Mr Tonkin—One point I could make—and this is a fairly crude measure—is that the estimate of the proportion of our capital equipment expenditure spent in Australia versus overseas for the 1997-98 budget is 65 per cent. There has been a trend over a decade of increasing that. If we went back to 1985-86, 32 per cent of capital equipment expenditure was spent in Australia. It bounces around a little year on year depending on particular acquisitions, but it is now at 65 per cent. There has essentially been a doubling of that expenditure which reflects expenditure on the submarine and ANZAC projects and so on which, at least in lead contractor terms, are funds expended in Australia. That does not perhaps go to the totality of Mr Bevis's question which is the relationship aspect.

CHAIRMAN—Surely there is another dimension to that too. In absolute terms, I think it is good that we spend 65 per cent rather than 32 per cent, and there is no argument about that. There is also the qualitative element. If we are spending 65 per cent on just welding bits of steel we are not acquiring anything that is an asset for the defence capability of this country because we have that skill in-house at the moment. If we do not penetrate the high-technology areas of software development and the rest of it we are not going too far.

Mr Tonkin—The rolling bits of steel are a small component of the total cost. The big cost items nowadays are in the IT related technical end of equipments. In Australia, there is substantial expenditure on those sorts of items as well as on simply bending steel.

Mr BEVIS—At some point I think we should look at it. I take what Rob Tonkin has said and do not dispute any of it, but I think the chairperson's comment about other aspects being involved is clearly the case. It goes also to project management, design capability and a whole lot of other things that I think are important and should, in the context of this inquiry, be examined at some stage. At a time when there is a shake-up in the defence industry worldwide and when in Australia we are seeing what there is of the Australian defence industry either aggregating or being put on the market for who knows what outcome, I think it is particularly appropriate that these issues be put in place, hopefully in advance of the rest of the world changing and us just following. There are a number of asset sales on the books and a number planned under the defence efficiency review program. Will the proceeds of all of those assets be retained by Defence without any offset requirement?

Mr Tonkin—Yes, we would be obliged to meet the cost of clean-up, for example, if that was an overhead involved in preparing a property for sale, but the net proceeds, free of those costs, are under the current arrangements retained in the Defence budget.

Mr BEVIS—The DRP—and there is some mention of that in the submissions—was the subject of a range of questions during the Senate estimates and I was wondered whether, since the Senate estimates, you might be able to provide us with greater clarity on what precisely constitutes the DRP? Where are the savings precisely? I do not want to go through the *Hansard* of the Senate estimates and go over all those questions. I am sure they are fresh in people's memories.

Mr Tonkin—The defence reform program in its generality does pick up a range of existing initiatives. A simple example is the commercial support program. All commercial support program targeted activities which had not come to contract formed part of the savings we realised from the defence efficiency review and the reform program that follows. Another example is ACEPS, achieving cost-effective personnel services. That is a study, which is under way across government, which involves a number of lead departments, including Defence, in looking at the ways in which we can change the way we manage civilian personnel to rationalise pay and allowances, to reduce the overhead and to try to approach industry best practice. That initiative had been going for a period. The review incorporated that.

The other part of the relationship goes to the question, which was explored at estimates, of the boundaries of the reform program. The reform program, in many ways, empowers a lot of the other initiatives. It funds them. If you want to take the restructuring of the army as an example, the resources that are required to support the restructuring of the army, which might not have been available internally within army, are issues which

become a consideration for the resources that flow out of DRP and facilitate that policy outcome. We certainly do not look at each of the initiatives in Defence having boundaries attached to them and saying, 'This has its own little bucket and this is something else.' The aim of the reform program is to try as efficiently as we can to weave these things together.

Mr BEVIS—The DRP flows from the defence efficiency review. The defence efficiency review is a document that, in one form or another, has been released to the public and everybody who wants to can read it and know what it says. Are you able to provide this committee with a submission or an exhibit that would constitute the DRP, which is, as I understand it, the government's determinations based upon the DER?

Mr Tonkin—The defence reform program involved the initiatives which were announced by the Minister for Defence on 11 April. The minister made a press statement at that time. There were attachments to that. We can provide you with those. There was a summary of the key features of the reform program. There were about a dozen or more fact sheets which go to that. The minister has indicated his intention to make a statement in parliament, which I understand will take place in the relatively near future, on the defence reform program which will build on that material. So we can certainly provide the committee with the minister's statement of 11 April and the summaries which were attached to that. There was the minister's statement, a press release, a summary of key features and a pile of fact sheets which provide fairly comprehensive documentation.

Mr BEVIS—I am not sure they do provide fairly comprehensive documentation. You have mentioned here today that the DRP is intended to provide some hundreds of millions of dollars in recurrent savings. We are not talking here about a small enterprise and the best that is on offer are some press releases, is that what you are telling us?

Mr Tonkin—As I said at the estimates hearing, the defence reform program is the second leg of initiatives. The defence efficiency review looked at the opportunities to take greater efficiency out of Defence. It produced a series of findings and recommendations—70 in total. Because of the nature of that review process they were very general. They were directed towards points of policy and principle.

To translate that into the detailed production of efficiencies requires a great deal of work across the total organisation. The detailed material undertaken by the subsidiary review teams added up to about 180 different proposals running right across the eight Defence programs. What we have been embarking on since the reform program was announced is doing a fair bit of detailed work to ensure that we have a very clear and understood baseline on which to go forward. The review was based upon taking our resources as they stood at the 1996-97 budget—that is, before the review was announced.

We need to get a very clear view in very fine detail of what the nature of our activities was at that point and how these proposals relate to those so that we can translate

our organisation from old to new, so that we can work out precisely which of the new areas should generate which efficiencies and how much and over what time. As you can appreciate, it is a very big organisation and therefore a very complex undertaking. We want to do that once and once only to get a very clear basis. We do not want to have another debate in two years time about, 'What did it really mean?' We want to have that debate and that consideration now. That is what we are in the process of doing. We have programs in place. We are developing implementation plans. It is a progressive thing. There is no large scale piece of paper that I can present to this committee today which says, 'This is in very fine detail the reform program,' because it is going to evolve.

Mr BEVIS—I would accept something better than press releases before we got to the very fine detail.

Mr Tonkin—As I said, the minister is going to make a statement in the House on the subject.

Mr BEVIS—When we maintain budgets in real terms, I understand there is a formula agreed between Defence, Finance and Treasury and whoever that is the calculation to translate one year to the following year, and I think that is a formula which is unique to Defence.

Mr Tonkin—I think it is in the terms that we are the only department—perhaps apart from the ABC and SBS—which gets a real growth calculation. It is spelt out in one of the introductory pages of the annual budget measures statements.

Mr BEVIS—Has that formula remained the same in recent years?

Mr Tonkin—It is not quite a formula; it is more a process of ons and offs. What is incorporated in it depends upon the nature of particular initiatives. For example, when we were engaged in large scale peacekeeping activities for the Gulf War, we got supplemented for various things. That is reflected in the calculations and so on.

Mr BEVIS—But there is a specific calculation formula?

Mr Tonkin—There is a specific table of ons and offs and adjustments which reflect compensation for price and exchange.

Mr BEVIS—Has the on and offs table remained the same in recent years?

Mr Tonkin—In broad principle, yes.

Mr BEVIS—In fine detail, what?

Mr Tonkin—What has changed?

Mr BEVIS—Yes. You said, ‘In broad principle, yes.’

Mr Tonkin—Because the things which are in the table may vary from year to year. But if you take the fundamentals, which are adjustments for price and exchange, they have remained common, with the only exception—to pick up the broad principle point—being that Defence does not get supplemented, or has not been getting supplemented, for wage and salary increases. We used to get supplemented for that. No department gets supplemented for that, although there is a provision in the 1997-98 budget for a general base adjustment for a slice of that this year; that has been the big change. We do get exchange rate adjustments. There has also been some variation in 1997-98 in the nature of the price indices which are applied to the way in which Defence’s budget has been adjusted. There has been some rationalisation of a lesser number of indices, which has had—someone will correct me if I get it wrong—no material effect upon the nature of our price indexation.

Mr BEVIS—So in practical terms the formula has remained the same?

Mr Tonkin—Yes.

Mr BEVIS—This is my final question. As to the combined effect of things like CSP and the defence review program and others, how do you factor in the impact on individuals—the industrial relations/personnel questions—as people are moved from military to civilian, still within the Defence framework, as it is an in-house bid, for example, which CSP has picked up? Let me give you a scenario where someone has moved from military, in a CSP in-house bid, to a civilian position and subsequently that contract has not been renewed so they are moved to the unemployment list. There is a whole series of benefits that would otherwise have accrued to that individual, not least of all being super—particularly if they are in the DFRDB scheme. Are any of these personnel/industrial relations type matters factored into any of the considerations?

Mr Tonkin—There is a number of points. Firstly, when we go through a process of any of these change initiatives, there is a process of advice and consultation. There are standing arrangements about the notice periods that apply, advice to unions and advice to staff more generally as to what is proposed so that there is the opportunity for consultation on the nature of these initiatives. Keeping the work force informed is an important aspect of that, and it sometimes becomes difficult to get the full message across as fast as staff would like because you do just not know the detail but you move it progressively.

We provide in our planning for the cost of full entitlement to voluntary redundancy provisions if that is necessary. We seek actively to redeploy personnel to other areas. In the military case, of course, we are trying to move as many people as possible from support functions which are being rationalised to combat and combat related functions.

Again, we factor in the cost of the training, the cost of moving people, et cetera. So we try to take all those factors into account.

The future pension cost is not within the Defence budget. In other words, when someone retires, I believe that comes out of the Department of Finance's allocations. So that is not part of our consideration. But we do go through all those factors. We try to care for our staff as best that we can. So we do try to take those into account.

Mr HICKS—I have a simple question for Mr Tonkin. Who was responsible for the initiation of the defence efficiency review? Whose proposal was it? Was it from government to the department, the department to government or was it joint?

Mr Tonkin—The proposal for a defence efficiency review was contained in the Liberal-National parties' defence policy statement prior to the election. The Minister for Defence initiated it post the election, reflecting that commitment.

CHAIRMAN—I was wondering whether somebody would put on the public record what procedures are in place at present which govern defence expenditure? By that I mean you have a FYDP; you have forward estimates; there was talk some years ago of a 10-year rolling program; you have pink books; you might even have green books for all I know. Could you very simply, for the public record, lay out how you look ahead and how you budget ahead?

Mr Tonkin—One of the features of the defence reform program is the recognition that we need a better longer term planning process to provide us with both a big 'S' strategic and a small 's' corporate strategic set of guidance so that we can manage our investment, our activities and our budget more effectively. That process, which we have in train in terms of developing, will enable us to make broad judgments about shifts in the relative balance of resources between investment and current capability and personnel and between various aspects of our existing or future capability.

The broad balances can be adjusted over time, reflecting changes in strategic circumstances. We perceive that to be important, because if you do not pause periodically—we have done that periodically, through white papers and force structure reviews and so on—to review the balance of your resources against your outputs or required deliverables to government, you can find yourself locked into the perceptions of the past. The shares which were sensible 10 years ago, because you are only fiddling at the margins, are still the shares today, and they may not reflect circumstances. So we want to put an overlay in place for that. Related to that—this is all prospective, and I will come back to what happens now in a moment—is the need to get much more effective performance reporting, to have an organisation which much more rigorously assesses its own thing.

Included in our material is the 'Joint Report of the Department of Defence

and Department of Finance Performance Information Review' which we have just done. That was done to look at the methodology of better preparing ourselves for rigorous assessment of our performance, because we want the organisation in a planning sense to learn from its experience, to say, 'What were we trying to achieve? What were our clearly defined and assessable outputs? What did we do? How can we change to make it better?' So we are building that in.

Below that, there is what is called the FYDP—the five-year defence program, which in fact is only four-years long. It used to be five-years long, but that was in the days when Defence was the only department which had a longer look financial planning regime. We had a budget plus four years, the FYDP, which was borrowed from the Americans in the early to mid 1960s. When the government introduced more structured forward estimates, which was the budget plus three, we adjusted the FYDP to a budget plus three, but we kept the abbreviation because we are creatures of habit, essentially.

The FYDP provides us with our budget allocation and helps us adjust, with decreasing degrees of certainty out into the future, the actual allocations of money. In summary, we have a long-term plan which looks at broad concepts of balance. We then have a FYDP, which is an allocating mechanism, and the budget, which is the actual real allocation for the year. It is not a lock-in for four years, because it evolves every year. Every year, we add a new year and we lose the budget year, so it rolls on.

Subsets of the FYDP are the pink book, the green book and the white book—the white book being the approved major capital equipment program, the pink book being the not yet approved major equipment program and the green book being, perhaps confusingly, both the approved and the unapproved capital facilities program. These are managed centrally on behalf of the portfolio as a whole to give coherence to those investment processes and enable the managers of those areas to balance resources. In the white book, for example, projects go faster or slower, and it is up to the acquisition program to move the money around.

In terms of how we construct the annual budget, we have the guidance we get from government, which is the output of the budget cabinet process, which is where you get this expression of zero per cent real growth. Within that envelope, we construct the Defence budget and the FYDP.

Programs are able to seek additional resources if they believe they cannot accommodate their own internal pressures, ups and downs within their own envelope of funding. We try to run a process whereby programs, firstly, look at their own resources and how they can rationalise their own priorities. Then if they seek additional money for something, they are required in our internal processes to come up with a coherent argument as to why that is critical and what would happen if they did not get that money. They are subject to reviews in a process which rather parallels the process of the expenditure review committee of cabinet. We go through exactly the same internal process

to try to fit our demands inside the budget process. That is the detail.

Each program manager—in our case, there are now 14 programs with the chiefs of service and others—is then responsible for delivering the outcomes against the budget allocated. You see that reflected in the portfolio budget measures statement, which states an objective and a series of deliverables for each program and the programs are then expected to manage their resources to achieve that outcome. Essentially, that is a guide.

CHAIRMAN—Can you table that paper you referred to for the benefit of the committee?

Mr Tonkin—I cannot see why not.

CHAIRMAN—Thank you. Leading on from that point, we have been talking about the savings of between \$500 million to \$1 billion as a result of the defence efficiency program and the DRP. What procedures have you in place to audit that those savings are actually delivered?

That is a very important point, because we have had a number of submissions from groups who essentially are not in favour of spending as much money on Defence. A common theme in all their submissions is that Defence does not maximise the money it gets at the present time. It seems to me that, if you do make a case for increased funding, you at the same time have to have an assurance that that money is well spent, and that demands audit procedures.

Two subjects are very clear in that. Firstly, there has never been an audit of CSP so far as I understand. There have been a lot of lofty claims that \$200 million here and \$500 million there has been saved by CSP, but there has never been an independent audit program for it. Secondly, in the bigger game of the DER and the DRP, it will become essential for the parliament to have an impartial audit as to what degree of savings were actually achieved.

Mr Tonkin—I am not sure that there has not actually been certain external scrutiny of the commercial support program. I thought there had been. We have certainly been required to report to government, and IDCs were established in previous cabinet processes to review progress on things such as the commercial support program to test precisely the questions that you ask.

CHAIRMAN—I think that is an important point. I would want to be corrected on that if I were wrong in that allegation. You are telling me that there has been an impartial audit—external to the Department of Defence—that has assessed the actual dollar savings and that the production of the exercise, whatever it was in CSP, did not diminish in anyway at all the combat capability of the ADF. Is that so?

Mr Tonkin—No, it is not what I said, I do not think. What I said—

CHAIRMAN—Surely that is at the heart of the issue.

Mr Tonkin—My understanding was that we have had the methodology examined. When CSP was brought in, an interdepartmental committee was established with a range of sceptical members who looked each year at whether or not we were delivering what was said to be delivered, and I believe each year we satisfied them to that effect. So I think there has been that inside government process. On the totality of the point you made, there has been no external examination to that effect.

The other point I would make is that, in the conduct of the commercial support program, one of the first requirements was to examine whether or not the targeted areas for commercial support were core or non-core—in other words, whether they related to the provision of Defence capability and such or not. If the activity under consideration was considered to be core to the provision of the Defence function, it was not subject to CSP. We go through a very careful process of determining what are the deliverables of a particular contract or activity, and it has to be clearly demonstrated. You set up a user requirement—you ask, ‘What is this activity supposed to deliver for the benefit of the Defence activity in total?’—and that is a core part of the deliverables.

If you get that right and you define quite clearly what is needed to be provided, then it ought have no effect—in fact, it should have a beneficial effect—upon the clients who are getting that service, because perhaps for the first time you get a much clearer expression of what are the real deliverables of these support functions, rather than generally an amorphous set of ‘what we are doing broadly contributes’. We think in that case it does not detract from capability; in fact it may assist in that relationship. That is essentially what we have done.

We are happy to demonstrate that extent. We run a very tight process inside our own organisation of making sure that these savings are delivered, and we do it in two ways. Firstly, in the case of the commercial support program, we have not to date programmed savings from commercial support until the contract is in place and the clear final position of the realisable savings is demonstrated. In other words, we do not spend speculative savings. Secondly, in respect of all the other initiatives, once the initiative—such as force structure review—has been determined, we take the money off the areas where the savings have come from. They go away. Their budgets are reduced by that amount and they are reallocated.

So it is not within the gift of the programs that are being adjusted to not realise the savings because they are gone. We have done it. In that way, we are confident that we do get the savings that we indicate.

CHAIRMAN—What are you going to do with respect to DRP?

Mr Tonkin—The same. The first thing we are going to do with DRP is complete this base line exercise so we know in fine detail, as I said before, the nature of the functions which are moving from one program to a newer and in some cases consolidated area; we make sure that we have captured the right resources—dollars and people; we make sure that the savings are targeted to the right area; and we make sure that the savings identified by the various teams that work for the defence efficiency review group were validated. In other words, that they are not double counted; that you do not find two or three different groups targeting the same support area and counting the cost three times.

We are in the process of finalising that so that they are real savings that are sustainable. We will do exactly the same thing: we will then program those dollars, take the function, consolidate, in the case of the support function, take the resources given to that support area and reduce them over time phasing to say, ‘That’s your deliverable and you’re now going to provide this outcome with this fewer resources. We’ll take that money and we’ll reprogram you against whatever our requirements are.’ A hard-nosed process will be followed.

Mr SINCLAIR—I know we have run a bit over time so I will not be long. There is one thing that I am not quite sure of in the nature of your present funding. In the determination of your budget, you seem to me to have a number of already determined elements. The amount of money that we are paying for equipment acquired is phased over a period of years. In overseas defence purchases, in a ballpark figure, how much money would you owe per year in that at the moment? Does it vary greatly from year to year?

Mr Tonkin—In terms of overseas, it is 40 per cent of \$2 billion.

Mr White—Yes, 40 per cent of \$2 billion, roughly speaking.

Mr SINCLAIR—Is that varying very much?

Mr Tonkin—It has plateaued at about 35 per cent of our overseas equipment expenditure. It has varied a bit from the past. We used to buy a lot more of our overseas equipment through the American foreign military sales system whereby you paid a deposit and made progressive payments. That has diminished substantially. We were once one of the biggest FMS customers. We are now relatively small scale: a couple of hundred million dollars a year.

Mr SINCLAIR—But we still maintain that couple of hundred million dollars. What would that be with respect to?

Mr Tonkin—That is in respect of, generally speaking, spare parts and things for—

Mr SINCLAIR—FFGs and so on.

Mr Tonkin—FFGs or F18s—that sort of stuff. There is utility in having an FMS acquisition. Sometimes it helps you to phase your money or you get a better unit price because you are part of a big American buyer. We are now often looking for our best case solution. In some cases, it is better to go commercial—straight to the supplier—than it is to go through the American system. We try to pick the best outcome.

Mr SINCLAIR—It is still between 35 per cent and 40 per cent—

Mr Tonkin—Of our capital.

Mr SINCLAIR—Between 35 per cent and 40 per cent of your capital acquisition program is payment overseas. In the forward projection, for example, you mentioned in your submission:

. . . approved projects such as the Airborne Early Warning and Control capability and helicopters for the ANZACs/Offshore Patrol Combatants will be substantial, and no funding provision has yet been made for them.

At what stage do you start looking at providing money for those projects? I was a bit surprised with the comments in your submission. I do not know when the submission was made. You would have already provided funds for the Caymans, wouldn't you? Are they not the ones you are referring to there?

Mr Tonkin—I think the phrase, Mr Sinclair, relates to—

Mr SINCLAIR—It is on page 4 of your submission.

Mr Tonkin—The key words are: increased personnel and operating costs. In other words, we have—in the pink book I talked about, the not yet approved capital program—provisions for the capital costs of such items. What we are addressing there is the fact that these new capabilities bring with them not only a capital cost but also an increased cost of personnel and operating.

Mr SINCLAIR—It provides the capital costs but not the personnel costs. That is what you are saying there, is it?

Mr Tonkin—Yes.

Mr SINCLAIR—The acquisition of the Caymans, for example, is that under an FMS program? How are you going to pay for the Caymans—over what projected period?

Mr White—I do not know. I do not believe it is an FMS sale. That will be a matter of negotiation between the acquisition side and the contractor to work out the schedule. This starts getting a bit technical. When a project is approved, the funding to

cover that project is moved from the pink book—the unapproved—which Vice Admiral Barrie and I look after, to the white book, which Gary Jones looks after. He manages that total sum of money between the wide range of projects that he has running at any one time in order to make the best use of the money to get the projects through in the best possible way.

Mr SINCLAIR—I am really trying to determine when and to what degree you take into account the funding for capital in particular of future acquisition. In determining the types of capital equipment acquired, do you take into account the relative costs to the Defence Force? For example, did you take into account the relative merits financially of acquiring more Seahawks, as succinct from the Caymans, in that you would have one type—less training, same crew requirement and all the rest of it—or was it essentially taken on some other basis?

Mr White—I would like to say a couple of things on that. It is very much the case when we make capital acquisition decisions that we take the whole range of those factors into account. We are improving the methodologies we have for taking the whole of life costings of any equipment option into account before choosing between them. We are looking at the whole range of personnel op costs, training costs, support costs and upgrade parts into account—the works. That is the sort of thing we typically pay careful attention to in decisions like the helicopter decision.

Mr Tonkin—We also break it into two parts: firstly, we consider what capability we require or need to support that particular platform. Once the capability envelope is determined, it then becomes a source selection issue. For example, the committee that Mr White and Vice Admiral Barrie run determines the capability. Secondly, it is handed over to acquisition, which starts the source selection which looks at that capability. It goes out to tender for options which could provide what we want within the envelope of funding.

Mr SINCLAIR—The capability is related to the funding available rather than—

Mr Tonkin—No.

Mr SINCLAIR—That is what I assumed you said.

Mr Tonkin—No. We make a determination of what capability is required. Funding may determine the scale of the number of things that we might be able to provide, but once the capability is determined and a broad envelope of how much we are willing to pay for that capability is established, it then becomes a source selection issue where you then look at what are the potential suppliers or providers of that equipment. Companies bid and you will get a range of price per platform—various bits of equipment in it. We then go through a very detailed and rigorous process to determine what is the best value for money, taking into account all those factors you talked about of sustainability, support, industry, compatibility—all those sorts of things.

Mr White—Let me just say something else. I think it may clarify what you are after. From our side of the house, when we put forward a project for approval we stick a dollar number on it. That is what the government approves. The acquisition side then go forth and try to buy what we are after for up to that sum of money. There is a degree of flexibility in that process. If we find that we cannot meet the capability requirement from the dollars that have been allocated, we go back through our processes and, if necessary, go back to the government and seek additional funding.

Mr SINCLAIR—If, for example, the question is of capability, you can get the capability by two or three different types, which presumably you can, by the list of preferred tenderers. If you decide that you can have six of one type—or 12 of another type—which happens to fit with everything else you have in the fleet and the long-term costs are going to be less, at what stage do you take the decision that you want the 12 and not the six? In other words, do you look at price in relation to numbers related to capability? Obviously, each time you have a preferred tenderer, you do not have one aircraft type in this instance or in vessels or armaments—

Mr White—That would vary with different projects. But, to take an example, in the lead-in fighter that was recently finalised, we sought a training outcome, essentially. It was up to the tenderers to propose how many aircraft they thought would satisfy that requirement. With regard to AEW&C, we are after a quite specific capability outcome, and it is up to tenderers to work out how many aircraft they think they would need to achieve that. But in the case of the ANZACs, for example, a decision was made that the government wanted to acquire eight ships and—

CHAIRMAN—No matter how bad they were.

Mr White—Or how good they were.

Mr SINCLAIR—Or with what they were going to be equipped in order to acquire eight ships. But that is another story.

Mr White—The point being that the government did decide they wanted eight ships. That was, if you like, a fixed component and so that was tendered and processed in a different way than others.

Mr SINCLAIR—What you are really saying then is that money is not the basic determinant in acquisitions. You are given a ballpark figure, but if you do not have enough, you can go back and ask for more. You look at the capability—

Mr White—That is not quite the way we put it. We try to get what we need within the project approval if we can. We work very hard to make sure the initial project approval is rigorous and realistic.

But it is not the case that we tolerate a situation in which we buy second-rate equipment that will not do the job that the ADF needs to have done because somewhere further back in the process we have said you can only have a billion dollars for that and we actually need \$1.1 billion to get the equipment we need.

Mr SINCLAIR—Let me go on a slightly different track. Do you have a present projected percentage of your budget which you see as allocated to capital acquisitions?

Mr White—Asking me that question is a bit like putting Dracula in charge of the blood bank because I am the one who is always arguing for the maximum investment. But we have over quite a few years now, 10 years I guess, looked at a capital investment share of the overall budget in the high 20 per cents, I guess between 27 per cent and 30 per cent. We would aim to preserve that. There is a broad view that that share is about right. If you let it get up over 30 per cent I guess our experience in the past has been, and our sense of the present shape of the organisation is, that that would start to adversely impact on operations and personnel votes to the point where your overall capability would start to drop.

But we feel that in the present environment, particularly if you like, in the environment of technological innovation, which is such an important part of our strategic circumstances, if we let our capital share fall below the high 20s, say 26 per cent, 27 per cent, we would be in grave danger of underinvesting in future capability. We feel that in our strategic circumstances maintaining a high share of the defence budget in investment in future capability is an important part of the government's overall strategic response. So I would guess as a rough proposition we would aim to be maintaining investment at somewhere like that level.

There are always extra things you can invest in, but when it comes to the internal defence examination of its own budget, my bids, if you like, for extra investment funds meet bids from the services for personnel and operating funds and so on. So there is a sort of a process of debate there. I would expect in that debate year by year there will be variations at the margin. But the broad share, I would expect, will remain about the same.

Mr SINCLAIR—Do you in the same way allocate a percentage of your budget for training? Where there are within a fixed budget position necessary additional expenditures—and you have identified some of them in your paper; you have problems about peacekeeping, about which Mr Bevis was asking before—where you have additional demands for one reason or another, I am curious to know how you determine where that additional money is taken from and to what degree it comes from which sector. Presumably wages and salaries are fixed. In fact, you know they are moving up. You have forward commitments under contract which have to be met. So training, essentially, is the only flexible component of the budget, is it?

Vice Adm. Barrie—That attacks the whole dilemma in defence of the trade-off

between the capital investment program and operating cost. Certainly from a services perspective we do not over-invest in operating costs, that is to say in individual and collective training of the force. It would be our judgment in current circumstances that there is not much scope to really haul down on that if we want an ADF that can actually perform on the field. That is a dilemma that faces us every year as there are competing demands on personnel costs, greater demands for capital. If you like, the question that always has to be asked is: what is the sensible balance between those things?

Mr SINCLAIR—But the components, presumably operating costs cum training, can be shifted. Do you shift them between services or do you provide a ballpark figure for each of the three services?

Vice Adm. Barrie—Each service program bids against the portfolio budget for its own requirement. That is taken into account as part of the process. But necessarily at the end of the day it is always going to be a question of balance for the defence management committee to sort out. That is to say, if that is an additional bid over what we have been doing, does that make sense on a priority basis against all these other bids, and then at the end of it, we sign up to the program that we have in front of us.

Mr Tonkin—One of the important initiatives that we are pursuing and will progress over the next couple of years is to try to refocus the way we look at our longer term and then our closer term allocation of resources to express it much more in terms of the outputs of the organisation. What are the deliverables that the government expects defence to provide, including training of the force in being? If we can try to express our allocation of resources not in terms of the navy, army, air force, defence science and so on but in terms of particular types of capability or preparedness that will help us to get to the point you are seeking we can then make broader judgments. What proportion of our efforts should go on training and sustainment of the force in being or particular types of existing capability versus new investment in new capability versus support costs and enable us to bear down on the support costs and increase our opportunity to increase the other areas?

Mr SINCLAIR—Part of my concern is if, for example, you have a peacekeeping commitment where do you get the money to undertake it. I know you eventually get paid back, but that is eventually. If you have these fixed commitments in terms of each of the components of your budget where do you get the money, for example, to send a force to Somalia or Cambodia?

Mr Tonkin—There are two aspects. One is that we get it because there are some offsets from activities which then are not undertaken. So there is money being provided for exercises which cannot be conducted because the force is somewhere else. That is an offset. Where there is a net additional cost, the practice has been, if it is on the scale of Somalia, that we get the money from the government there and then. Then the government gets its slice back from the United Nations, if it is a United Nations activity, over time.

We do not suffer the cash flow problem. The government has funded defence in the current year for that cost, and then the government recovers, if it is a United Nations activity, a proportion in due course when the United Nations pays its bills. They have formulas, which is about half or 60 per cent or something of the cost.

Mr SINCLAIR—So what you are really saying is that within the present parameters of your defence vote there is no flexibility to do anything other than that which is programmed. If there is a demand, you have to supplement financially.

Mr Tonkin—If there is a demand for increased activity, and it is of that nature, we would go back to government for that because again, as the Chairman said at the beginning, this inquiry looks at the current strategic circumstances and, if that changes, the equation changes. Otherwise we have to look at internally how we can restructure our expenditure. We might slow up an acquisition process if that was necessary, although it is difficult to do because of contracts, or we would change our activity rates or something like that. It depends on the scale but we have limited flexibility. One of the things we want to maintain is maximum capacity inside our own budget to move money around to reflect those different requirements. Reforms over time have helped us in that regard.

Mr SINCLAIR—We are running out of time so I will not pursue it, but thank you.

CHAIRMAN—We have run about 25 minutes over time, so I must bring this part of the hearing to an end. There are a couple of important areas that I wish to get into. I will just make a comment, Mr White. I agree with your rationale for staying apace with the technological game, but wouldn't it be very much better to express that in dollar terms rather than in percentage of budget terms? It gives you a stronger negotiating point with government.

I can remember the time in the late 1970s when Defence were arguing that any increase in capital expenditure as a proportion of the budget beyond about 17 or 18 per cent, I think it was then—certainly if it went beyond 20 per cent—would have very harmful effects on preparedness and training. There are those who would argue that at 30 per cent we are suffering grievously. I do not see that it compromises your objectives in any way at all to quote the technological advances in the form of equipment in absolute dollar terms in so far as it can be done rather than a percentage of a variable budget. I would like to thank the witnesses from the Department of Defence very much for attending today. Are you still agreeable to have that document incorporated?

Mr Tonkin—We might just make sure it is not a document that is to go to the minister, if you do not mind, before we do it.

CHAIRMAN—It is not something we are going to leave on the table after the hearing! As a contingency, if it is cleared by Mr Tonkin, I move:

That the defence subcommittee receives as evidence and authorises for publication the submission referred to before by the inquiry into the funding of Defence.

I thank you for your attendance here this morning. Almost certainly we will have to come back when we hear other witnesses and talk to you again. The witnesses are available to return on 21 August and we may well take that date. In due course you will be sent a transcript of your evidence this morning to which you can make corrections to the grammar but not to the fact. Thank you.

[10.47 a.m.]

HARTLEY, Major General John Curtis, Deputy Chief of Army, Department of Defence—Army, Army Headquarters, Russell Offices, Canberra, Australian Capital Territory

LUSH, Mr Peter John, Assistant Secretary Corporate Management—Army, Department of Defence—Army, Army Headquarters, Russell Offices, Canberra, Australian Capital Territory

CHAIRMAN—On behalf of the subcommittee, I welcome Major General Hartley and Mr Peter Lush. You heard the cautions that I gave, because you were here, about evidence being equivalent to being given under oath and our preference that all evidence be given in public, although you have the facility to request that an in camera hearing be held at any time. We have received your submission and we authorise that for publication. Would you like to make an opening statement additional to that submission?

Major Gen. Hartley—Thank you, Mr Chairman. Army's main preoccupation right now of course is preparing to modernise itself while retaining its present level of preparedness. Indeed at a recent committee you gentlemen were briefed on that issue. Modernisation has as its baseline the results of the *Army in the 21st Century* study—the first phase of which, Restructuring the Army, is scheduled to run its course over the next 2½ years. This phase, in addition to seeing the introduction of a number of new capabilities, is essentially about proving a number of new concepts, tactics and organisations, determining the optimum levels of integration between regular and part-time forces and seeing how and to what extent we can use the reserve to play a meaningful role on the modern battlefield. In terms of new capabilities, we expect to see the formation of a regular command or unit, the further development of the Brigade in Darwin and the introduction of additional reconnaissance vehicles, new troop carrying vehicles, aerial reconnaissance and fire support helicopters and a command support system whilst continuing the trials and evaluations I have just mentioned.

I would like to say a few words about the *Army in the 21st Century* study. I believe this study has been misinterpreted or misunderstood in some circles. The study is essentially about establishing a baseline from which further developments can take place. It is essentially about defending northern Australia against a low-level enemy who might strike with little notice. This concept and a number of assumptions clearly need to be constantly reviewed, but the study provides us with a baseline. Already, for instance, we have started to consider the versatility of this force in order that it may be adapted for a wider range of conflict.

Turning to the level of resources, I believe we could usefully examine this issue under two headings: modernisation and sustaining the present force.

In terms of modernisation—and I have already partly described this—we believe we will need a higher level of resourcing. Over the last five years, for instance, in terms of major capital equipment investment, we believe we have somewhere between a half and a quarter less than we currently need, particularly if we are to catch up in the near future. Major equipment is but part of the capability. Personnel, operating costs and sustainability often require at least equal resource levels. Clearly, we will decommission some capabilities, but some of the capabilities we plan to introduce have no precedent and, in any case, experience tells us that new capabilities are often more expensive to run than their older counterparts.

In terms of sustaining the force, we have been under pressure for some time. Traditionally, the Army has reduced its personnel strength and further reduced the readiness levels of units which are already at low readiness. In 1989, for instance, the Regular Army numbered over 31,000. Today, it numbers about 25,500. We also have considerable hollowness in certain stock levels and pressures in maintaining existing stocks. I can, of course, elaborate on these issues more precisely, if asked. That is the opening statement I would like to give.

CHAIRMAN—Thank you very much, Major General. In your opening statement you mentioned—and I forget the first part of the phrase—in the second part of the phrase to what extent the reserves would be involved in the army. The implication I draw from that is that you have an ambivalent view about the place of reserves in the Australian Army, whether or not they will be used in the future. Is that true?

Major Gen. Hartley—I think that is probably making it too black and white. There is little doubt in my mind that, as we increasingly modernise the Army and increase the technological base in which that army is developed, we will need to review some of the previous practices by which we used reserves.

Right now we are going through two trial processes. The first is with 7 Task Force—the opening of which you attended recently—to determine how best we can integrate regular and reserve forces. Quite clearly, those capabilities which require higher levels of training and preparedness best suit regular forces. Other capabilities which may be developed over a period of time equally can best suit reserve forces.

The second study that we are doing is based upon 4 Brigade in Victoria, where we are examining a number of options to improve the recruitment, in particular, the training and also the retention of reserve forces. These two studies will take about 2½ years to run their course. We expect to be in a much better position then to make better judgments about how to use our reserve.

CHAIRMAN—Thank you, Major General, but for the purposes of this inquiry, we really have to get down to a base level. Do you have a base level as to the capabilities that you require from the Australian Army?

Major Gen. Hartley—I think that is a difficult question because, quite clearly, we are evolving in this area. The A21 baseline, as I said, is very much predicated upon the defence of Australia, short warning conflict and low intensity conflict. I think those pretty much constrain the baseline, but at least it establishes a baseline.

Changing strategic guidance—and we heard from the previous speakers that a new version of strategic guidance will probably be announced shortly—may, in fact, have an impact upon the operational outcomes that we require from the Defence Force and, therefore, the capabilities that we need to meet those operational outcomes. Having said that, any force that we develop for the army has to have a degree of versatility to it. It has to be able to operate in a number of different operational environments—offshore, if necessary, and, ideally, in higher levels of conflict.

CHAIRMAN—I accept that but, by putting a tolerance figure on it of maybe 1,000 personnel, surely there has to be some figure that you work to where you say, ‘This is a basic capability that we require for a land force for Australia.’

Major Gen. Hartley—Based upon the current arguments, which are largely contained in the *Army in the 21st Century* study, we believe that figure is somewhere between about 23,000 and 25,000.

CHAIRMAN—Regulars?

Major Gen. Hartley—Regulars.

CHAIRMAN—Out of that figure of 25,000 regulars, how many combat troops would you be able to put in the field?

Major Gen. Hartley—We are working to a figure of 14,500. We are presently about 500 short of that.

CHAIRMAN—So, for everyone in the combat units, you will have about 0.8 of the personnel supporting them? That is rather revolutionary, isn't it?

Major Gen. Hartley—It is a very good ratio in terms of international practice. I think that with a number of the measures which have occurred in recent times—an increasing move towards civilianising non-essential military requirements, with improved communications and, of course, very much supporting this concept, a reserve force—I believe we are very close to achieving that.

CHAIRMAN—Even if we are optimistic and we have one combat personnel supported by one in a rear capability, that is widely at variance with the accepted practice of one in the front for eight behind, surely?

Major Gen. Hartley—I think that is a practice which owes something to the past. I cannot be absolutely certain of this, but I suspect that the United States army, for instance, and the British army are probably getting towards the sorts of figures that I am quoting.

CHAIRMAN—One for one?

Major Gen. Hartley—Correct.

CHAIRMAN—That includes all of your training command and your logistics and all of that?

Major Gen. Hartley—Correct.

CHAIRMAN—I find that quite astonishing. So you have a force structure of about 14,500. That is just a bit over a division, isn't it?

Major Gen. Hartley—That is correct.

CHAIRMAN—What are you going to defend with that? There is a very small force structure, because even though you have 14,500 combat troops, you have people resting and you have people sick and unavailable. So, effectively, the field force that you are going to be able to mount is about three brigades, at best.

Major Gen. Hartley—That is correct.

CHAIRMAN—That is three airfields, isn't it?

Major Gen. Hartley—That is correct. With 14,000 troops, that would be three brigades now, but sustaining that would be an added dimension of difficulty. It is for this basis that we use the reserve.

CHAIRMAN—So, effectively, if you have three brigades of an operational force, you would only be able to support one in the field at any time, wouldn't you?

Major Gen. Hartley—For any lengthy period, absolutely right. Two for a short period, and perhaps three for three months maximum.

CHAIRMAN—You believe you can defend Australia with one brigade then?

Major Gen. Hartley—No, I am not saying that at all. The Army 21 concept, which you are well aware of, ultimately sees us developing something like 7 task forces. Provided we fit within those parameters of short warning conflict but low intensity conflict—and I cannot stress how important that is—7 task forces is the size of the force

we believe to be able to secure all the important strategic targets in northern Australia, but it is against, I stress, a low intensity conflict enemy.

CHAIRMAN—But real life is not like that. People get killed. When people commit armed forces into another country's territory, they do it with determination and in large numbers. Why don't you plan for the worst-case scenario?

Major Gen. Hartley—Certainly from a professional soldier's point of view I would be delighted to do that but, at the end of the day, I think it becomes a question of balance and affordability.

CHAIRMAN—The point I am leading up to is the point that land operations—however much technology might be involved and however much it might advance—are always manpower intensive.

Major Gen. Hartley—Correct.

CHAIRMAN—With the structure that you are proposing of 14,500 combat troops, it really is a token force.

Major Gen. Hartley—Properly equipped, properly trained and, of course, fitting within the sort of mission profile that I have talked about—once again stressing low intensity conflict—it is a potent force.

CHAIRMAN—Over 50 years ago, with a population of about six or seven million we had 10 divisions when we were threatened—a force structure of well over 10 times what you are proposing now. What I am leading to is your opening statement about the ambiguity of needing a reserve force. I would put to you that you do need to seriously maximise the reserve force on the basis that land operations are always manpower intensive.

Major Gen. Hartley—Correct and, quite frankly, that is exactly what we are attempting to do. We are going through this process of determining how we can best do that.

CHAIRMAN—I have read the full documentation on A21 and all that I have been able to get on Restructuring the Army. I cannot find one figure on costing. It is not mentioned. When I raised that with the Chief of the Army, he dismissed and said, 'Oh, that is a political problem.' Is it true that there was no costing done at all for A21?

Major Gen. Hartley—Yes, there was quite extensive costing done, but it is obviously not in that paper. The sort of costing which was done said that in terms of modernising—that is, investment—we probably needed about \$9½ billion.

CHAIRMAN—Over what time span?

Major Gen. Hartley—Initially we had planned to about 2015; so about 17 years.

CHAIRMAN—That is very roughly \$500 million a year going to army?

Major Gen. Hartley—Correct. That is the sort of figure we think that we could reasonably assume.

CHAIRMAN—That makes sense. When this committee did the inquiry into the reserves in 1990 or 1991—somewhere about that time scale—Army's advice to us was that, with the 10 reserve brigades we had at the time, there would be a cost of \$100 million per brigade just to bring it up to a base adequate level of equipment that they did not have at present.

Mr BEVIS—Just following up on the reserve questions, General Hartley: assuming the dollars are available, there is also the question of having the people available who have civilian commitments. What is the situation with respect to addressing the matter of availability of reserves? There has been a good deal of comment made in the army restructure about increased training times, initial recruit training and ongoing obligations; where are things at in respect of addressing the availability of reserves?

Major Gen. Hartley—If I could take the 4 Brigade example—because this is the means by which we are evaluating these concepts—we are looking at a number of different types of initial training regimes. As you are aware, reservists have in the past done an initial training regime of two weeks of recruit training, followed on average by about two weeks of initial employment training.

One of the experiments that we are looking through—in fact, we have trialled this twice now—is to have a six-week up front full-time training period, which is about the same time that a regular now gets at recruit training. The first experiment of that occurred over Christmas where we were able to recruit and train 550 Victorian reserve soldiers.

There are a number of other concepts along those lines which are being trialled, including how we handle the post recruit training process. Do we seek for instance to do more training at home depots; or, as is increasingly the case, are we going to train in proper training establishments—such as Puckapunyal in the case of the Victorians—where equipment and resources are prepositioned, where the training regimes are properly laid out and so on? That is the issue of recruitment and training.

There is also the issue of retaining people and that is a longer-term issue. We are not in a position at this stage to see whether some of the measures that we plan to introduce are in fact taking effect. In addition, we have allocated greater numbers of training days to reservists. On average, they have risen from 36 to 42 and will probably

rise to about 45 training days per year. In relation to increased equipment holdings: the reserve has been starved for equipment for quite some time. There are new equipments coming on board which are entirely applicable to part-time soldiers, with night fighting equipment and special types of training equipment in that sort of area.

The third area in which we are looking to improve the effectiveness is by increasing the regular cadre in reserve units and, as a benchmark, we are looking at roughly 10 per cent of a reserve unit's strength being regular. There are some specialist units where quite clearly that is going to be higher and that already is the case, but about 10 per cent. Probably, although it is not stated in any of the Army 21 literature, the other area where we are I think going to get considerable dividends is by ensuring that the leadership levels of the reserve are enhanced, either by special training or courses, or by feeding more regulars into leadership positions. I think what is happening in 4 Brigade right now where all the indications are positive is, to a great extent, reflected by increased numbers of regular commanders in 4 Brigade. So it is a range of all those issues which we are going to use to bring about an improved reserve force.

Mr BEVIS—You mentioned the success in the recruit training over the Christmas period of 500-odd. Does the Christmas period indicate that most of those people were university students?

Major Gen. Hartley—That is correct. I am sorry I cannot give you the exact break-up but I think more than half were in that category. There was a very deliberate targeting of year 12 students to bring about that outcome.

Mr BEVIS—I would be interested in seeing a breakdown of that figure, if it could be made available at some point. Obviously, it is not critical for today's purposes—

Major Gen. Hartley—In fact, at the last Senate legislative committee hearing, I gave those figures but I can certainly get them for you.

CHAIRMAN—That is probably a reflection, though, of the failure of that section in the force structure review which operated against the university regiments. The reduction of the university regiments to officer training units denied a lot of students who would have been prepared to join the reserve the opportunity to do so because they do not necessarily want to be officers. Anyway, there is a ceiling on the number of posts you can put through the OTUs. One of the failings of the FSR is that it really put the death knell on university regiments in Australia. It was a very short-sighted and silly move.

Mr BEVIS—The question of more regulars in the leadership positions within reserve units; the flip side of that coin presumably is fewer reserves with promotional opportunities. What is the anticipated situation with respect to promotional opportunities for reserves, given what you just said?

Major Gen. Hartley—That is a very contentious issue. I think the answer to that question is that we would only put a regular in command of a reserve unit if there was no suitable reservist available. What has tended to happen in the past is that the best reservist available took the job, and sometimes the best reservist just simply was not up to the requirement.

Having said that, if a regular goes into a reserve unit, very often that regular is also tasked with preparing a successor. So the intention is that wherever possible reservists will command reserve units. Equally, as we move towards a more integrated army—and this is certainly the case in 7 Task Force—there will be a number of sub-units and units with large numbers of regulars which will be commanded by a reservist.

Mr BEVIS—I assume from your comments that you would not be expecting back-to-back appointments of regulars into command positions in a reserve unit?

Major Gen. Hartley—Ideally, absolutely not.

Mr BEVIS—With the increase in the number of days that has been provided for an average from 36 to 42, there are always people in the reserves who, if they had the opportunity, would be there 150 days a year or more. But it is not always the people you want who are the ones that are happy and available to be there for 150 days a year; so the statistics can pretty easily fudge what is the real situation and the real issue in all of this, which is to have available for training those reserves whom you require for their designated tasks.

That goes to the first question I asked, which was: what is the government at the moment doing about resolving the conflict between civilian interests and military requirements on reserves? There has been quite a bit work done on that over a period of some years now. I am really trying to find out what the current situation is with respect to that work. What are the proposals currently under consideration; and what actions, if any, have been taken in the last year to progress any of it?

Major Gen. Hartley—There is a study which is being done within the Australian Defence Headquarters that Captain Sketchley was doing. That study, to the best of my knowledge, is yet to go before the Chiefs of Staff Committee. That study will propose a number of outcomes, some of which will require government legislation.

None of these are satisfactory in terms of having reached a bottom line. You are aware of Dr Jans and some of the work that he is doing. His latest study, which is the fourth study in this progression of studies, relates to employer support. That study I think is complete. In fact I think he has done all the field work. He is actually now writing the study. That study will also come to the Chiefs of Staff Committee in time. At this stage I cannot say anything more than that, I am sorry.

Mr BEVIS—Didn't the Sketchley report have a due date of last August?

Major Gen. Hartley—Captain Sketchley has in fact retired, but I understand he completed his report. I do not know when it was meant to come forward.

Mr BEVIS—Could you check the Sketchley report information? I have in the back on my mind that it was completed last year and has been sitting in a big black hole.

Major Gen. Hartley—I certainly know that he was working on it earlier this year. Whether that was because he has already submitted the first part and it required further work or not, I do not know, but he was working on it earlier this year.

Mr BEVIS—You referred to the 10 per cent of reserve units as a rough figure for being the number of regulars. What is the comparison with like forces—for example, the UK and the US?

Major Gen. Hartley—I think 10 per cent is probably a bit on the high side overall. But the problem is of course that some specialist units have much higher percentages of regulars. I think, too, that the American system is different from ours where many reservists are in fact almost full-time soldiers; they just happen to serve in a reserve capacity. I cannot be precise, but across the board 10 per cent would certainly be at the upper end of the spectrum.

Mr SINCLAIR—If I can follow on from the reserves and then come back to the fundamentals of funding. In the assessment of capability of the reserves to integrate, as I understand it—although you did not state it today—you expect them to be far more ready in terms of service than they have been in the past. To what degree are you targeting those who have been former regulars; in other words, retired regular soldiers as distinct from those who are new recruits?

Major Gen. Hartley—That is a very topical issue. Traditionally we have done very badly with retaining ex-regulars in the reserve. Regular soldiers by and large do not see reserve service as being particularly useful and of course many regular soldiers leave to take up a civilian profession and probably want to get established in that first before committing themselves to almost a secondary career.

Having said that, there are a number of factors that we are looking at. Jans has done a study on just this subject and has put forward a number of motivators which would make regulars find reserve service more acceptable. The second point I would make is that for the future where there will be larger numbers of regulars serving in reserve units and where regulars and reservists will do at least their initial training under very similar circumstances, we think will help break down some of these perception barriers which presently exist.

I think those are two major factors which ultimately—and this has all got to be proven of course—will see regulars find service in the reserve more acceptable. There are also a range of personnel issues which are going to see fewer barriers exist between transferring from one component of the force to the other. I think it is a combination of all those which suggests that in the future we will get a better result, but in the past we certainly have not done well here at all. I think the figure of something like four per cent only of regulars have actually transferred to serve in reserve forces.

Mr SINCLAIR—In the changed package are you looking at superannuation, financial incentives and substantive rank?

Major Gen. Hartley—All those issues are under consideration.

Mr SINCLAIR—I have a few other questions about reserves. I wanted to go back and have a look at just how you operate your funding. We have been given some advice from Defence central about the percentage of budget that is allocated to capital acquisitions. In Army 21 you have given in response to the chairman some indication of the costs of the capital equipment required, but have you looked at your present budget and is Army 21 in part a response to the budget available or is it to the task that you see the Army needs to address that you are going ahead with your army restructuring?

Major Gen. Hartley—Army 21 was initially based without consideration of costing, stressing again that it was a very precisely defined process: the defence of Australia, short-warning conflict and low intensity type enemy. The outcomes of that study were then looked at in terms of what might be a reasonable allocation of resources over the period of time. In other words, I have got spread sheets which show how we could develop those capabilities really beyond 2015 in some cases, recognising that the best we thought that we could assume to have in terms of major capital investment was roughly about half a billion dollars a year. So we have tended to develop our capabilities with that factor in mind.

Having said that, that is a very broad sort of statement and clearly there are peaks and troughs in that process as they relate to specific capabilities. But the concept of how much money would be available—and I have to say that none of this is agreed by the department—certainly was factored into our thinking once we had done the Army 21 study which came up with a list of capabilities, but that list of capabilities was not in the first instance constrained by funding.

Mr SINCLAIR—Your big difficulty in the Army has always been that you are more manpower intensive. What percentage over the past five years of your vote would have been given to capital equipment? Would it be 10 or 15 per cent?

Major Gen. Hartley—It has ranged over the last five years between 8.1 per cent and 13.2 per cent.

Mr SINCLAIR—Do you expect with your \$500 million to add to your present capital expenditure by that amount?

Major Gen. Hartley—Probably it will take it up to about 20 per cent.

Mr SINCLAIR—In your forward projection of the demands on the army you would see then an expectation that, in order to modernise, you are going to have allocate a greater percentage of funds available to capital equipment. Where is the cut going to be made? You make it really in personnel and that is why you are cutting your personnel down, is it not? Or are you going to try and take it out of operational expenses, training, et cetera?

Major Gen. Hartley—Quite frankly, I think the only internal army adjustment we have got is to further reduce personnel. What we are looking for is a greater percentage of the Defence budget.

Mr SINCLAIR—You are saying that within the funds that are now available you cannot really proceed with Army 21?

Major Gen. Hartley—We certainly cannot proceed with anything like the 2015 date being imposed upon us. What will happen is that we will constantly be shifting capabilities to the right of that.

Mr SINCLAIR—If there is for one reason or another in the demands imposed upon you—for example, peacekeeping and the ones we have alluded to in the past—how do you take that into account in your Army 21? Have you projected some flexibility? I know you can switch as we have heard from operating costs into operating for the purpose of a peacekeeping mission.

Major Gen. Hartley—Yes.

Mr SINCLAIR—You more than anybody have been involved in peacekeeping and you have had selected elements taken out rather than a task force. You have had a communications element, an engineering element or a rotary wing element. How do you see that demand being accommodated?

Major Gen. Hartley—If the demand is beyond several million dollars then we seek supplementation and that supplementation comes either from Defence, or in the case of a large commitment, such as the Somalia or Cambodian exercise, from government. If we have to do it internally, then firstly we keep a small reserve and that probably might accommodate for at least part of it.

Secondly, we have to take it out of replenishment. In other words, we do not replenish as many stores as we had planned. We do not refurbish equipment to the same

extent that we had planned so that our repair pools increase. We probably use some of our war stocks in terms of ammunition and we lower activity levels. Some of the lowering of activity levels can be accommodated. For instance, if we sent a Battalion to Somalia, then very clearly much of the exercising that that Battalion would have done had it remained in Australia can be subsumed into that type of arrangement. But it is usually a combination of all those factors. Then we go forward at additional estimates time and attempt to make good where we have taken money from within our base.

Mr SINCLAIR—In terms of war stocks, to what degree are we still dependent upon the Americans for ammunition and general equipment replacement in the army?

Major Gen. Hartley—In terms of ammunition, we internally manufacture two types only, 105 millimetre artillery ammunition and the 5.56 standard rifle ammunition, which is basic weapon ammunition. We are dependent for all other ammunition natures from overseas. I am almost certain that is the case.

Mr SINCLAIR—In terms of war stocks, are they forward contracts that you have entered to have supplied to you at a certain price or quantity, or if there is a demand do you have to then go into a negotiation to acquire whatever it might be to supplement your normal operating training requirements?

Major Gen. Hartley—Yes.

Mr SINCLAIR—At whatever price the supplier might set?

Major Gen. Hartley—That is a fair assessment. It is both. We have a fixed schedule based upon our best assessments of usage rates, but if there happened to be an increase in usage that we had not forecast for, we would certainly have to go through that latter process.

Mr SINCLAIR—Obviously army probably has more real estate than any other element of the Defence Force. To what degree is the army going to be able to retain the proceeds of sale of Defence land?

Major Gen. Hartley—The sale of Defence estate will first of all accrue to Defence. I do not think that we actually own any land today; it is all owned by the Defence estate organisation within a defence context.

Mr SINCLAIR—Don't tell me that the army has given away all those beautiful bits of real estate it had around the country? You surprise me.

Major Gen. Hartley—Yes, it is something that probably surprises all of us, but it has arrived there at this stage. In terms of the sale of Defence estate, certainly the funds for that—

Mr SINCLAIR—They are going to Defence, not to Army.

Major Gen. Hartley—That is right. Of course, we would bid for that in the normal process of supplementation where we could justify our case.

Mr SINCLAIR—The sales of Defence land really are supplementary to any other budgetary program and, if you lose something, so be it?

Major Gen. Hartley—Correct.

Mr SINCLAIR—In terms of your Army 21 program, have you made any separate assessment of the real estate you require? Demonstrably, we have a lot of land that we do not require now, but there is lots of land that a number of us are a bit sad to see go for reasons really related to environment and other purposes.

Major Gen. Hartley—The answer is yes. The issue is confused a bit by the outcome of the second airport decision—that certainly plays a factor. We can see a number of traditional training areas increasingly being encroached upon in an urban sense and becoming less viable than they were in the past. Furthermore, as we modernise the Army, we will increasingly go to a mechanised or motorised force. That in itself imposes different constraints in terms of the size of training areas. That is not to say that much of that cannot be accommodated through forest areas and other areas where we have traditionally sought to get use of land.

We will probably face two major considerations in the future. One is in south-east Queensland where, very clearly, the Wide Bay training area is becoming increasingly urban encroached, which leaves us really only with Canungra. I suspect we will have to look very seriously at the consideration of a training area somewhere in south-east Queensland. Secondly, particularly if Holsworthy becomes a second airport site, the major restrictions—indeed already starting to apply to Singleton by just the usage of that area—probably suggest that we are also looking for another training area somewhere in New South Wales. I would like the committee to please recognise that that is very much my personal assessment. That has not yet translated itself into any official departmental policy.

Mr SINCLAIR—You are going to set up another commando unit. I am not too sure how you have worked this out. As the navy sees itself as a two-ocean navy, has part of the purpose of forming a new commando unit really been a geographic one of trying to spread the present SAS unit, particularly its counter-terrorist role, rather than there being necessarily a requirement for a commando unit in the eastern states?

Major Gen. Hartley—No, I do not think it is any of that really. The Army 21 study identified that we were deficient in a special forces capability. The Special Air Service Regiment has very much a function which relates to medium- to long-term range reconnaissance. It is an intelligence gathering unit. It has also taken on the counter-

terrorist responsibility because there was nowhere else to do it.

The commandoes have essentially a role of being able to recover and secure through shock action by coming in and being deployed from a variety of different areas—by sea and by air, essentially. They have the right sorts of skills ultimately which will suit a special recovery operation, a counter-terrorist operation. So it is really extending the requirement of capabilities as opposed to a geographical location. Having said that, very clearly I suspect that the bulk of counter-terrorist targets are probably on the east coast and certainly, by having the skill on the east coast, it is probably more closely located to where the potential list of targets might be.

Mr SINCLAIR—In the allocation of resources within the restructured army, are you determining the capability required of each of the units and the budget they require? You have these separate task forces, but I am not too sure where the new commando unit fits into the task force concept.

Major Gen. Hartley—We have a special operations group which involves the Special Air Service Regiment, the reserve 1st Commando Regiment and the regular and developing 4th Commando Battalion.

Mr SINCLAIR—Where does 3 Battalion, the parachute battalion, fit into that?

Major Gen. Hartley—It is presently part of the ready deployment force which is based in Townsville.

Mr SINCLAIR—And you are going to retain the ready deployment force?

Major Gen. Hartley—That is correct.

Senator SANDY MACDONALD—Major General Hartley, you said that historically between five and 13 per cent of the Army's budget had been spent on equipment and that the projections to 2010 were that it be increased to 20 per cent. I think that this subcommittee took some evidence from the Chief of Army saying that it would be 25 per cent. What is the true figure, and what is the highest level of expenditure on equipment for the Army that you would be likely to want or would expect as the years go by? Traditionally, as has been stated, it has been much lower than for the air force or the navy.

Major Gen. Hartley—Certainly. The figures that I gave were in the range of 8.1 to 13.2 per cent in the last five years. The Chief of Army may well have said 25 per cent. There are two competing factors here, and it is a balance between these judgments. Clearly, the more we can actually spend, the sooner we can modernise the Army. On the other hand, there really probably is a limit right now to how much we can absorb reasonably, and by that I mean in developing the necessary training to absorb that

equipment; in having in place the processes for its sustainment; and, where necessary and where facilities are involved, in constructing the facilities and developing the training areas and so on.

Our judgment is that probably about half a billion dollars a year represents about the maximum right now that we could absorb as we look into the future. The 20 per cent mark reflects that, but it also means that we will be extending the time over which we do this development increasingly to the right to the future. It is a combination of those two factors.

Senator SANDY MACDONALD—Moving on from there, in relation to Army 21 where you talk about low warning, low intensity conflict, we must also have capacity to operate offshore and possibly be part of a larger operating force. What concerns me a little is that part of defence strategy is to be seen to be able not only to defend yourself but also to be part of our region which is going to be increasingly volatile with very powerful competing forces in the next few years. Will we be seen by our neighbours to have a credible intermediate force that may be able to take part in some form of regional conflict or even a larger peacekeeping role?

Major Gen. Hartley—Certainly. In terms of the last point, very clearly we were able to commit a battalion group to Somalia. Recognising the very low nature of conflict that existed there, that force was able to play a very credible role in a larger coalition type force. Equally, in Cambodia we provided the force communications element which was quite strong and heavy for the size of force and we had the professional ability to do that.

There is a level of commitment that we can do right now. The Third Brigade which is based in Townsville certainly has the ability to operate offshore but it does so in low intensity conflict. Although this is probably not articulated as such in the Army 21 proposal, the First Brigade in Darwin is also increasingly developing the capability in terms of its mobility, firepower and protection to be able to take part ultimately—not yet, say within five years—in a conflict where it could be part of a larger divisional sized structure in a mid-intensity conflict. It is not there yet. That is all part of this process of developing these capabilities.

Senator SANDY MACDONALD—Have the defence review program and the redundancy packages offered caused a glut of resignations from middle ranking officers? Both reserves and regulars need to have a career structure. Has this caused an increased number of middle ranking officers to leave? What concerns might you have about that?

Major Gen. Hartley—No. In fact, it is just the opposite. This is traditionally the case. When there is the possibility of a redundancy program, resignations dry up very quickly. It is just the opposite right now. If you asked me that question in a year's time, it would be very interesting to say whether resignations will have increased or not. The very fact that there is the possibility of attracting a redundancy program means that those

people who had been contemplating resignation would clearly hold off on the off chance of receiving a redundancy. In effect, we are almost embarrassed right now with our retention process. Wastage is not occurring at the rate that we had anticipated.

CHAIRMAN—We are running over time. I have two quick points. General, I was pleased you confirmed that A21 and Restructuring the Army was written without any respect to budgetary restraints, but that leads to a question. How are you going to avoid any efficiency review in the future of the 7 Task Force structure? That is the most expensive way to provide combat power. How are you going to resist in five years time someone coming along and saying, ‘Why don’t you go to a divisional structure because that is the most economic way of providing flexible combat power which you need in a land force’?

Major Gen. Hartley—That is a difficult question. The 7 Task Force structure remains a long-term goal. That is something that clearly we should aim for. I might add that already there is pressure about the concept of a 7 Task Force structure. The 7 Task Force structure was based upon having the ability to concurrently deploy across northern Australia to cover a wide range of strategic targets.

One of the difficulties we saw for ourselves defending Australia was the fact that we have so many potential strategic targets. The 7 Task Force structure was seen as the ability to provide a level of protection that could be accorded to those strategic targets. There will be pressure on us, I have no doubt at all, to constantly review that concurrency argument. In the absence of better strategic guidance, I think that 7 Task Force structure should still remain the long-term goal. We may never get there, but at least it provides us with a vision or a guide to aim for.

The issue about a division depends on who you talk to about a division. We have two divisional headquarters. I have been the Staff Officer grade 1 (Operations), Divisional Headquarters. Essentially, they have been administrative headquarters. They have seldom, if ever, deployed. They have not really got the capacity to conduct operations as such. The second point I would make is that the modern task force, fully modernised and equipped, will have in combat power—that is firepower and manoeuvre—a greater capacity than a World War II division.

CHAIRMAN—That is precisely my point, but you have them in discrete packages. If you aggregate the brigades into a division, you can provide the armour, the artillery and the other slices of combat power that you need for what is a variable scenario. You do not always need to maximise your artillery and armour in a brigade group. That is, therefore, a highly expensive and inefficient way to provide combat power. I do not wish to proceed further with that because of time.

Major Gen. Hartley—Could I just make one point, please. I think what you are saying is right, up to a point. The challenge that faced us in defending northern Australia

was the sheer distances involved. The concept of grouping forces is essentially a European battlefield concept where divisions are placed right next to each other where the boundary between one division and another is quite small. It is interesting that in the Yom Kippur War something like 10 or 15 divisions worth of troops were concentrated between a distance that separates Canberra and Yass. We are now talking about northern Australia having forces separated by several hundred kilometres. Our ability to regroup under those conditions is much reduced.

Having said that though, there is no doubt that our trialling process has got to be able to come up with the result that allows us to concentrate fires in just the way you said. If we cannot do that, then the process of integrating these components within units just simply will not work.

Mr SINCLAIR—It adds to the costs you have. If you have tanks in the north and tanks a long way down here, you do not have enough of them. If you have a division it is one thing, but if all you have is a relatively small armoured unit, it becomes a lot more difficult, doesn't it?

CHAIRMAN—I do not wish to pursue that argument because it points out the fallacy of the defence of Australia. If we are going to fight continental land battles with massed corps on the Australian landscape, we are in very big trouble and I believe the strategy has failed. That leads me to the next point. The most obvious deployment of the Australian land force will be overseas. Apart from Vietnam, we have not had a deployment into a serious land war. During the Gulf War there was no Australian army unit that could be deployed on a modern battlefield. That is almost a decade ago. Given the rate of change, it will probably be another decade before we can move to having one effective land force unit. Is that not a reflection on the professionalism of the officer corps that got us to that position?

Major Gen. Hartley—I take exception to that, Senator MacGibbon. I do not think that has anything to do with the professionalism of the officer corps.

CHAIRMAN—So far as army and navy have units that can be committed to some degree.

Major Gen. Hartley—We have, as I said before, committed a fair number of units at short notice into certain types of conflicts. It is very much our intention to pick up the problems that you are mentioning. In fact, that is the whole basis for modernising the Army of the future. That is why we need these resources to be able to bring about that change.

CHAIRMAN—That is why the question was asked: we want to know what it is going to cost to get that capability. We find it totally unacceptable that we have no land force unit we can commit on a modern battlefield.

Major Gen. Hartley—Certainly; and I am delighted that that is the outcome we are seeking to achieve.

CHAIRMAN—If there are no further questions, I thank the witnesses for their attendance here today. You will be sent a transcript of the evidence for your correction.

[11.40 a.m.]

McCORMACK, Air Vice Marshal Errol John, Deputy Chief of Air Force, RAAF, Russell Offices A-8-38, Canberra, Australian Capital Territory

PRESTON-STANLEY, Mr Anthony David, Assistant Secretary, Resources Planning, RAAF, Russell Offices, Canberra, Australian Capital Territory

CHAIRMAN—On behalf of the subcommittee, I welcome Air Vice Marshal Errol McCormack and Mr Preston-Stanley. I advise you that the proceedings here today are legal proceedings and warrant the same respect which proceedings in the respective houses of parliament demand. Although the subcommittee does not require you to give evidence on oath, you should be aware that this does not alter the importance of the occasion. This subcommittee prefers that all evidence be given in public but, should you wish at any stage to give evidence in camera, you may ask to do so and the subcommittee will give consideration to your request. We have received your submission and it has been authorised for publication. Would you like to make an additional statement or introductory statement?

Air Vice Marshal McCormack—Yes, I would. I would like to expand on the defence submission as it relates specifically to Air Force. The submission mentioned funding pressures on the single services for logistics. In the case of Air Force, funding for logistic support for the RAAF's present rate of effort is underfunded by about \$400 million across the four-year development program. This shortfall is the difference between the assessment of the funding necessary to logistically support the present rate of effort of the present equipment and the funding allocated to that function.

On top of that shortfall, Air Force is facing the increasing cost of maintaining ageing aircraft. Air Force has assessed that there is about a seven to eight per cent per annum compound increase in funding required to support ageing aircraft over that necessary to provide logistic support for a young aircraft fleet. With the major proportion of the RAAF fleet either over or near the 25-year mark, continuing support of ageing aircraft is becoming a major issue for Air Force. These increasing logistic costs for Air Force come at a time when Defence is placing pressures on funding capital investment as well as the additional operating and personal costs of new capabilities planned for introduction, as outlined in the defence submission.

CHAIRMAN—What is the capacity of the air force to spend big blocks of money quickly if the gates opened at Treasury and a river of half a billion dollars became available? How rapidly could you respond to that, efficiently?

Air Vice Marshal McCormack—It takes us a couple of years to gear up to a major change in spending. For example, if we wanted more logistic support, it takes more than one year to organise the ordering of the black boxes and to actually spend the money.

We work on about an 18-month plan to get ahead of the game so that, when the budget comes, we can spend within that year. If it were a large block on capital equipment, that would have to go through the full capital equipment process, which would take more than a couple of years.

CHAIRMAN—The relevance of the question is that it seems to the committee that Air Force with the F18s, the F111s and half the C130 fleet and the Caribou fleet is facing the biggest problem with block obsolescence of any of the three services. What have you done about that? What are the papers you have written? What is the preparatory work you have done about analysing your requirements and preparing Treasury and Finance for this outlay?

Air Vice Marshal McCormack—We have in the pink book our proposals for replacing most of those aircraft over the period. Those submissions have been put into Central, and most of them are now in the pink book as our capital equipment bid.

CHAIRMAN—What expectations do you have?

Air Vice Marshal McCormack—That is where the pressure comes in. We are fairly comfortable with what is in the pink book at the moment. The problem comes in how quickly and how much capability of each is going to be affordable.

CHAIRMAN—Can you quantify the amount of money that you are looking for over a 10- or 15-year time span?

Air Vice Marshal McCormack—I could not put a figure on it.

CHAIRMAN—We have to have a figure, even if it is rubbery. We have to have some approximation of the scale of the outlay.

Air Vice Marshal McCormack—In the F18, for example, depending on what capability you are going for, you are talking about figures between \$5 billion and \$12 billion—just for that capability.

CHAIRMAN—Five billion dollars and \$12 billion?

Air Vice Marshal McCormack—Yes. That is just to replace the Hornets in whatever time frame you want to look at—2005 through to 2015. Somewhere in there, depending on decisions on numbers and type of aircraft, that is the range of figures you are talking about.

CHAIRMAN—You are looking at an F22 and joint strike fighter replacement, or all F22?

Air Vice Marshal McCormack—We have put up papers on the full range of aircraft from more F18s through to F22s. They are just possibilities.

CHAIRMAN—We have two elements to this. We have the platform itself, and then we have the mid-life updates and modifications if you do not go ahead and buy. What is the scale of the mid-life update on the F18?

Air Vice Marshal McCormack—Once again, that is a moving feast on when you want to replace it. The airframe will eventually wear out, and that is a drop dead date. At some stage between, you can say that the airframe is not capable of carrying the gear that you need to be compatible; therefore it becomes a non-viable option to update to a certain level. It depends on what level of update we want. The figures you are talking about there are in the order of \$2 billion to \$5 billion.

CHAIRMAN—Does that allow you to buy a new platform—like a reduced number of EF18s—as you move to the later solution?

Air Vice Marshal McCormack—No. The figure I spoke of before was the EF option which is \$5 billion to \$12 billion.

CHAIRMAN—The EF would only be an interim. It would not be an ultimate air superiority platform, would it?

Air Vice Marshal McCormack—That is a debatable point.

CHAIRMAN—Why?

Air Vice Marshal McCormack—A lot of the new equipment going into the EF is latest technology.

CHAIRMAN—It has no stealth capability. It has no supercruise capability.

Air Vice Marshal McCormack—No, but it has a lot of the avionics that are going in. It depends on how far ahead you want to position yourself. These are just options that being placed. I cannot give any definitive answer, such as ‘Yes, this is the way we are going to go.’

Mr BEVIS—With regard to the cost of relocation, the DER proposes some RAAF facilities that would close. I guess it is a question that is pertinent to all three services. Who bears the brunt of the costs of relocation, if there were to be a closure? For example, if Richmond were to close and you had to relocate out of Richmond, who pays the bill?

Air Vice Marshal McCormack—Any of these Defence Estate things would be done by Defence as a whole, and Defence is conducting a study at the moment on the best disposition of forces around Australia. The outcome of that I am not sure of, but the investment in Richmond is such that I would not see us moving out of there in the very

near future.

Mr BEVIS—Someone in the DER did. The point is that, whether it is Richmond or somewhere else, the upshot of those reviews will be that some bases will close. If they do not, the very funding that underpins most of what the minister has announced is in some serious jeopardy, so some of it has to go. Whatever that asset is that goes, there will be a relocation cost. Who pays the bill for the relocation cost?

Air Vice Marshal McCormack—I think you should be asking Defence Estate that question. It is not a single service issue. It is being done by Defence Central. They are looking at the whole issue of where we should go.

Mr BEVIS—I assume they are making the judgments about which facilities are required for the longer term in consultation with the services?

Air Vice Marshal McCormack—Yes.

Mr BEVIS—Having made that decision, are they also then making the decision as to whom the bill for relocation goes to?

Air Vice Marshal McCormack—Yes, they are. They are taking into account the residual costs of facilities and how much it would cost to set it up again. That is an investment decision for Defence Central.

Mr BEVIS—That is something that I need to revisit with those people, if that is the case. You mentioned logistics and one of the things that sprang to mind was the defence efficiency review focus on positions in logistics across the board. It is probably more heavily the case in Army but nonetheless would apply in the other service. Will the review of the 13,000 or 8,000 positions—I have forgotten how many now—that are largely in logistics facilities impact upon Air Force? What effect, if any, would it have on the shortfall that you referred to? Or maybe the shortfall has an effect on it.

Air Vice Marshal McCormack—Commercial support is the main area that we are talking about in Air Force, where things are moved from Air Force to civilian commercial support programs. That is a program that has been going for quite a while now. The savings from that will continue to be counted in. But it is very early days on the DRP. Logistic support functions have just been amalgamated in Melbourne under Logistics Command Australia, and the outcome of that I am not sure of yet.

Mr BEVIS—But air force logistics are, I assume, part of that DER initiated review?

Air Vice Marshal McCormack—Air force logistics comes under Commander Logistics Australia.

Mr BEVIS—How far can you take CSP in logistics that would save dollars for the accountants but would, for the person in uniform at the front line, reduce survivability?

Air Vice Marshal McCormack—That is a very debatable point at the moment. I am sure some people in the field would show a lot of concern about that and I think some is well founded. We are going to have to work through all those programs to make sure that we have not gone too far.

Mr BEVIS—If it is left to the bean counters, there is a solution that is very easy to identify in the books and there may well be savings. What are the parameters that, from a military point of view, should be considered? If we are looking at dollars, which we are here, you can save dollars by applying CSP to a range of these things; but, in the process of doing that, you might find it works well until the bullets start flying. When the bullets start flying, the people on the front line find that they do not get the logistic services they require. What are the parameters? Are there principles associated with this? Are there no-go areas? What are the security concerns for those in uniform?

Air Vice Marshal McCormack—I can give you some examples. We have agreement that medical support that might have to go forward will remain in the services. The same situation exists with lawyers. We have a requirement to have lawyers with commanders, and there is agreement that that will stay with the commanders. So those sorts of issues are being addressed on a case-by-case basis, so that we do not go too far down the track of having total support in the combat zone on civilians.

Mr BEVIS—Someone said to me in that respect a little while ago, ‘We don’t know why, in any of the services, we should bother with stores and distribution services for basic items including food and whatever, because Woolworths delivers food all around the country every day of the week. They do it better and cheaper. Why don’t we save ourselves a lot of money and let Woolworths, Brambles or any of the major national carriers deliver the food?’ Do you have a view about that?

Air Vice Marshal McCormack—Yes; in a combat zone it would not work. You still need to have ‘blue suiters’ doing the job. They always have secondary duties, such as the protection of units and those sorts of things. It is very important that we keep those.

Mr SINCLAIR—How are you allocating, within your budget, training and personnel requirements? For years they have been the two areas which have been used to provide some fat against that enormous capital bill. Have you had much of a change over the past five years in the percentage of vote allocated for personnel in terms of acquisition, training and so on, plus training through to the point of people being of use to you?

Air Vice Marshal McCormack—Acquisition is no longer an air force funding issue. We only have \$50 million per year in minor capital. Anything else goes into the big

acquisition, which is the just under 30 per cent that we were talking about before. Each year we all put up our budget requests to Capability Development and they are sorted out. I could not give you a percentage on the distribution between training and personnel at the moment, but I could probably get that for you.

Mr SINCLAIR—What is the percentage of the air force budget allocated to new capital equipment?

Air Vice Marshal McCormack—We do not—

Mr SINCLAIR—You do not do that. That is now done in acquisitions and you are not part of that.

Air Vice Marshal McCormack—No; we have input into what we need and that is argued out in the centre against the priorities of Defence and not just of Air Force. Acquisition is now decided on a holistic view of defence requirements and it goes in waves on Air Force, Navy and Army.

Mr SINCLAIR—You have a certain amount of the vote and, if it is your turn, it is your turn.

Air Vice Marshal McCormack—Hugh White would not like to say it that way.

Mr SINCLAIR—But that is the way it works?

Air Vice Marshal McCormack—It tends to come up that way because of expenditure on major equipment. The FA18 or submarine replacement would leave a very big hole in the funding. There must be waves in funding.

Mr SINCLAIR—Some of the items that you are seeking, for example, the airborne early warning system, was around 20 years ago. Everybody knew you needed it. You have deferred acquiring it for various reasons. You had similar problems in relation to the replacement of the Caribou. Everybody knows we have to do it, but you have not found exactly what you want. Do you have a fall-back position if you have to acquire it in a hurry? Do you have some arrangements with the Americans or somebody, so that you can draw on their lines? Or would that have to be negotiated at the time?

Air Vice Marshal McCormack—That would be negotiated at the time on a case-by-case basis.

Mr SINCLAIR—I come back to the training. From your budget, I gather that you are essentially responsible for your training allocation and your operational allocation. Has that varied very much in the past five years?

Mr Preston-Stanley—In terms of the share of the Air Force's internal budget that goes to direct personnel costs, which a lot of training is wrapped up in, the share has not varied a great deal. The number of people that are there goes down, but the unit cost of labour usually consumes most of the savings. The number of hours flown in each aircraft type against training, I believe, consumes roughly the same proportion now as it has done for the past five years or so.

Mr SINCLAIR—If you are making savings in logistics, for example, you are not having that transferred into increased hours of flying in a particular aircraft type?

Mr Preston-Stanley—No; we have not been increasing the number of hours flown by aircraft type at all.

Air Vice Marshal McCormack—The problem with the logistics area is that we assess how much you need now and, in terms of what is available, we have to risk manage on where we spend our money—whether it is on C130 black boxes or whatever. It is not so much across to the training area.

Mr SINCLAIR—I am really looking at what flexibility there is within your budget to swing from one area to another if, for example, you find you do not have enough hours in an aircraft type. Do you have flexibility to draw from somewhere in order to increase the hours of that aircraft type, and where do you find that money when you need it?

Air Vice Marshal McCormack—From logistics. Within our budget we can shift between areas.

Mr Preston-Stanley—If I can give you an example, a couple of years ago we made a judgment to reduce the amount of expenditure on facility operations to pay some personnel related costs and to keep the logistic support share as high as possible. We have recently made a reduction in the share of our budget which goes to minor capital, so that we can keep the personnel and operating costs budget.

Mr SINCLAIR—What do you call minor capital?

Mr Preston-Stanley—It is capital for which the threshold cost of acquisition falls below \$20 million in a particular item. It would generally be something which contributes to the capability of a platform in service or maybe an incoming platform.

Mr SINCLAIR—So it would relate to aircraft rather than to facilities, or could it be either?

Mr Preston-Stanley—More often than not, yes.

Mr SINCLAIR—And as to your capability in that transition, have you more fat in the kitty there?

Mr Preston-Stanley—I do not believe there is any fat in the budget in the Air Force.

Mr SINCLAIR—I knew you would not admit it; I was just curious.

Mr Preston-Stanley—As the Air Vice Marshal has indicated, we believe that over the next few years we have quite a considerable need for, in particular, logistic support.

Mr SINCLAIR—The other thing I was not too sure of was that in the nature of ageing equipment, if it were a civilian configuration you would have a depreciation schedule and you would be trying to set a bit of money aside in order to replace it, but that concept really does not operate in the services, does it?

Air Vice Marshal McCormack—We are trying to go that way with accrual accounting. That is the aim of the accrual accounting system that we are bringing in over the next few years.

Mr SINCLAIR—In a particular aircraft type you would be having some concept of replacement within your annual operating costs, so there would be money going aside. I know that the escalation of costs and when you wish to acquire it is another factor.

Air Vice Marshal McCormack—That is what accrual accounting is supposed to do for us.

Mr SINCLAIR—That is what it is all about. Thank you very much.

Mr HICKS—Air Vice Marshal, formerly the air force trained most of its own technicians, as I understand it, to maintain the aircraft, to keep them flying. Now there is an outsourcing through the civilian support scheme. As I understand it from a little bit of research—not too much, I must admit—a lot of the people who are training air force personnel are formerly air force personnel themselves, and they have gone to private enterprise. Where are the technicians going to come from when this particular generation of trainers moves on? Are there costs associated with that? Will the private providers have the expertise in the future to train air force personnel?

Air Vice Marshal McCormack—I cannot talk about the very long future. We are still training a lot of technicians in the air force and we still have a lot in the air force, and they would be available. Their longevity in the civil sector is a lot longer than in the military sector, because of retiring ages and those sorts of things. So, for example, some people who have retired would expect to work at Wagga for a very long time. I cannot directly answer your question.

Senator SANDY MACDONALD—Have the capital costs of the AEW&C purchase been factored into the forward estimates or allocated in the forward estimates?

Air Vice Marshal McCormack—Yes, they have. You may not have been here when it was discussed this morning. The Deputy Secretary for Strategy and Intelligence said that that is in the budget, but what is not in the budget is the additional operating and personnel costs, because this is a new capability and we have not got a handle on that one. One of our concerns is how we pay for those logistics and operating and personnel costs. Yes, the cost is in the pink book.

Senator SANDY MACDONALD—How difficult is it to estimate the cost of an AEW&C capability, for instance, when there are a number of competing preferred tenderers? I think Vice Admiral Barrie mentioned it before when he said that the problem is put out to the preferred tenderers and they then come up with the solutions as to what number of ships, what number of aircraft or whatever will provide the service that is necessary. But with the AEW&C purchase the competing aircraft are substantially different and the costs must be substantially different as well.

Air Vice Marshal McCormack—Yes, it is, and that is one of the things we have to juggle with. But, of course, we are going not for a number of aeroplanes but for a capability. In other words, with a slower aircraft you might need more of them to give a capability in a certain area. With the lead-in fighter, we did not say that we wanted X number of aeroplanes; we said that we wanted a capability to do certain things. That is what we are saying with the AEW&C: we need a capability to do certain things. That will be a judgment factor on how well each one can do it against that capability. It may mean different numbers of aeroplanes depending on what the solution is. I cannot give you a figure on that now.

Senator SANDY MACDONALD—With the increased training and personnel costs of a program like the AEW&C, unless you get an increase in budget allocation, you will find that money through the defence reform program?

Air Vice Marshal McCormack—It will not cover it. What we have to do is look at reducing other capabilities.

CHAIRMAN—Air Vice Marshal, one of the much quoted principles of Australian defence has been to maintain the technological edge in the region. That principally applies to air force, not to the other two services. You have now lost that technological edge by a wide margin, in so far as we have no AEW capability; we have no effective air refuelling capability, other than a modest training role—functionally useless; and, we have lost our air superiority in so far as we have got longer range and better air superiority aircraft in the region, and, above all, in the air-to-air missile field with the short range and the BVR areas. What is your forecast for the years ahead? What are you aiming for? Are you aiming to get parity with the region or are you aiming to go ahead and try to establish a

technological edge once more? If so, what are the cost implications of this?

Air Vice Marshal McCormack—To start off with, I would like to say that the projects for the air refuelling and missiles—I have already mentioned the F18—are in the program for replacement or enhancement. As far as the region goes, we know that there is a growing sophistication in the region, and it is different in different countries in the region. So this is a very complex mix of relations that we have with these countries, both bilateral and multilateral. Those relations are also at varying levels of development. It is probably not in our interests—I do not believe it is in our interests—to attempt to match capabilities throughout the region. We need to develop a balanced force, and that is what is coming out. We are trying to develop a balanced force that provides options for government across a wide range of possibilities. If we tried to match every capability that came up on the horizon we would probably drive our acquisition system crazy. So what we have got to do is go for a broad range of capabilities that can handle most situations. I do not know whether I have answered your question.

CHAIRMAN—No, you have not. I agree with you that you need a balanced force. That balanced force, though, requires certain fundamentals. One that you do require is an intelligence gathering capability, which can only be mediated through an AEW. Given the geographic nature of this region, you have got to have range, and that does require an in-flight tanking capability. At the end of the day, air superiority is paramount. You cannot live on the surface of the land or on the surface of the water unless you have air superiority. Air superiority is not a matter of training or courage, it is a matter of raw technology or sophisticated technology. You have got to meet that if you are going to have an effective air force.

Air Vice Marshal McCormack—That is true. That is why I say we have in our program air refuelling tankers, missiles and F18 replacements and the AEW&C program. So we are covering all your areas of concern.

CHAIRMAN—Without breaching any of the intensity with which the contractors will be trying to pare prices on their AEW thing, can you give us an idea of the ballpark figure, because we will be writing this report before the tenders are signed for the AEW? Can you tell us whether it is a \$2 billion program or a \$20 billion program? Give us a broad figure.

Air Vice Marshal McCormack—It is closer to \$2 billion than \$20 billion. I am not sure of the figures because, as Senator Macdonald said, there is a very vast range of pricing in the tenders that are coming in and it is very difficult to actually give a figure closer than \$2 billionish.

CHAIRMAN—All right, now let us get to the flight refuelling. Can you give me a price for that?

Air Vice Marshal McCormack—You are talking in the range of a half billion to one billion, depending once again on aircraft types, numbers and capability. It is a military judgment on how much is a capability, of course, and the arguments on that would be wide ranging.

CHAIRMAN—That flight refuelling capability will presumably double up as a freighting capability as well, won't it?

Air Vice Marshal McCormack—Depending on the aircraft type once again. Some aircraft, if you load them up with fuel, cannot carry any freight at all, so you can use them as a freighter when they are not full of fuel. But it once again depends on the aircraft type. For example, the KC10 that the United States air force uses—which is not one of the contenders—can carry fuel and freight as well.

CHAIRMAN—Can you give us a price range again on the air superiority? You mentioned some figures before.

Air Vice Marshal McCormack—I said something between five and 12.

Mr BEVIS—Looking 10 years down the track, would it be possible to get a ground attack and fighter capability in the one craft?

Air Vice Marshal McCormack—That is what we did with the F18. The thing is that these days the aeroplanes are becoming more capable than the crews. Because of the technology, you can very quickly switch between one and the other.

There are some fundamental requirements for the aircraft for ground attack and differences between ground attack and air superiority but, once again, technology in the form of the missiles is taking out the problem. Whereas once you needed a very agile fighter, with helmet-mounted sights and missiles that are coming on the horizon, you do not have to point the aeroplane at it anymore the way you had to in the past. So there are other solutions to the problem of a very agile fighter. For example, the joint strike fighter will have an air to air capability—not as good as the F22, but an air capability. They are the sorts of things they are building in.

Mr BEVIS—Does that same development of missile technology also lead to a situation where we need fewer aircraft to undertake that role and you could in fact have land or sea launched missiles that would undertake the same task for you?

Air Vice Marshal McCormack—For ground attack?

Mr BEVIS—I was actually thinking ground attack, but I guess ground to air or sea to air as well. I was thinking ground attack.

Air Vice Marshal McCormack—There are better and better missiles coming on the market that can do the ground attack. It is the sort of thing that, without the man in the loop, you launch and that is it. They still have not got an automatic pilot system that will do all the things that a human will do. They are tending to concentrate in some areas on the pilotless vehicle, and I can see in the not too distant future that pilotless vehicles will do a lot of the very high risk, early sorties that are fairly simple to conduct—like a reconnaissance run across a target and things like that. But it will be a while downstream before they can do all the tasks.

CHAIRMAN—Again, how much is that likely to involve us in outlays? Importantly, since that is not something that we have an in-house capability for, what is going to be the personnel support cost of it?

Air Vice Marshal McCormack—We have not looked at that in any detail yet. There is some initial study work going on, but it is only setting the scope of where we want to go; it is not in any definitive term. You could go from a thing like a global star, 24-hour, high altitude reconnaissance aircraft right through to a small—almost a toy—reconnaissance aircraft. We are just looking at the scope of it at the moment. We really are not looking at it in the next five-year program. It is well outside the program.

Mr SINCLAIR—One of the things that is apparent is that the ball game in planning and projecting Defence requirements is changing fairly dramatically with downsizing and cost pressures on forces around the world. Obviously, we are going to be dependent, at least in the immediate future, on overseas technology. To what degree are you or people within the defence system involved in trying to parallel our requirements with the development of aircraft types, particularly in the United States but perhaps in countries in Europe?

We all have a similar requirement, and you have a platform requirement as distinct from a missile-cum-whatever you are going to hang off the wings requirement. Are we involved at all in that, or are we essentially looking after the event at what others are doing and saying, 'That'll do us'?

Air Vice Marshal McCormack—With the way technology is going, with the greater and greater user friendliness of computers, we will be able to modify the computers of the aeroplane to suit our specific needs—for example, in electronic warfare, missiles or radars. So we can actually do modifications on it. That is one of the areas where, for example, the new FA18 computers use a commercial language as opposed to the ADA military type languages, and there are more and more people being able to use those languages and modify computers.

If we tried to start from scratch and build an aeroplane, the costs would be phenomenal. But if we could modify the closest aircraft to our requirements to meet our specific requirements in terms of electronic warfare, missiles and all those sorts of things, it would be a big step in the right direction.

Mr SINCLAIR—It is still going to be post-hoc from platforms and others built. I was really getting at whether we are involved. The Americans are obviously going through a process of trying to reassess where they are going and we have a special relationship with them. I suppose it is really more with the Americans than anybody else that we would look to doing it. But we are not having any Australian type requirement taken into account when the Pentagon considers its next generation requirements.

Air Vice Marshal McCormack—No. We keep abreast of it through science and technology and through the representatives in the country. But as far as influencing the next fighter aircraft, no.

Mr SINCLAIR—Similarly with the Europeans?

Air Vice Marshal McCormack—Same thing. We keep abreast of where they are going as much as we can, but trying to put our requirements into an American or European program would be almost impossible.

CHAIRMAN—If there are no further questions, I thank the witnesses for attending this morning. You will be sent a copy of the transcript of your evidence in due course to which you can make grammatical questions. We will break now for lunch.

Luncheon adjournment

[1.08 p.m.]

DOUGLAS, Mr Bryan John, Deputy Director, Australian Electrical and Electronic Manufacturers Association, GPO Box 1966, Canberra, Australian Capital Territory

ROWLAND, Mr Peter, Chairman, Defence Electronics Division, Australian Electrical and Electronic Manufacturers Association, GPO Box 1966, Canberra, Australian Capital Territory

CHAIRMAN—I call the meeting to order and apologise for the late start. On behalf of the subcommittee, I welcome Mr Bryan Douglas from the Australian Electrical and Electronic Manufacturers Association and Mr Peter Rowland from the Defence Electronics Division.

I must advise you that the proceedings here today are legal proceedings of the parliament and warrant the same respect which proceedings in the respective houses of parliament demand. Although the subcommittee does not require you to give evidence on oath, you should be aware that it does not alter the importance of the occasion. The deliberate misleading of the subcommittee may be regarded as a contempt of the parliament.

The subcommittee prefers that all evidence is given in public. But should you at any stage wish to give evidence in private, you can request that the committee does that and we will give full consideration to your request. Your submission has been received and has been authorised for publication. Are there any additions or corrections that you wish to make to that submission?

Mr Douglas—Not at this stage, no.

Mr Rowland—No.

CHAIRMAN—I invite you now to make a short opening statement before we proceed with questions from the committee.

Mr Douglas—I will commence with an opening statement, if I may, and pass on to Mr Rowland, my colleague, to continue that statement. AEEMA represents the strategically important defence electronics industry in Australia. That includes command and control, intelligence, surveillance, signal processing, combat systems and system integration, among others. AEEMA notes that Australia's defence budget is declining as a proportion of GDP, from 2.6 per cent in 1986-87 to 1.9 per cent in 1996-97.

The reduction in defence outlays comes at a time of uncertain strategic circumstances following the end of the Cold War. I can do no better than quote from two eminent authorities in this area, Professor Paul Dibb and Ken Anderson, from a paper they

published last year:

The end of the Cold War has made our regional strategic circumstances more complex, uncertain and demanding, and the expert judgment is that Australia's need for military capabilities remains at least as high today as it has been over the past 25 years.

The reduction in our defence outlay must also be seen in the context of sharply increasing defence budgets among a number of Australia's neighbours in the Asia Pacific. Already we have an example of where Australia has lost its capability edge to an ASEAN country, namely the acquisition of a superior version of the FA18 fighter aircraft by the Malaysian Air Force.

We believe that the reduction must also be seen in the context of Australia's reliance on advanced technology as a key element of its defence strategy. Australia has no option other than to rely on high technology for its defence. It reflects the reality of a small and well educated population defending a large country with a vast coastline and with a limited number of defence platforms. This reliance on leading edge technology, of course, carries with it expenditure implications. AEEMA supports the aims of the defence efficiency review in providing more funds at the sharp end.

The review correctly identifies acquisition as being disproportionately important, not only because it spends the largest single discretionary sum of money, which is \$2.3 billion annually, but because what it buys forms the backbone of the ADF and determines its capabilities for many years. However, it is disappointing that the defence efficiency review overlooked one important aspect of efficiency, and that is the tendering process and the cost of defence tendering. AEEMA considers that very large savings are available to defence from reducing the cost of tendering. This has certainly been borne out in numerous inquiries in recent years.

Mr Rowland—I would like to develop a further point on the efficiency of current defence expenditure, particularly as it relates to industry. AEEMA's view is that it is technology that underpins the combat capability of the Australian Defence Force. The creator and custodian of that technology is, effectively, industry. Industry is required to be able to develop technology specific to the Australian theatre of operations and is required to be able to rapidly modify or adapt that to changing needs in time of threat. That can only be done by an indigenous industry capability. AEEMA's view is that the current defence procurement practices, if not policy, seem to militate against the development and sustenance of such an industry capability, particularly in some of the key technology areas.

CHAIRMAN—Would you repeat that?

Mr Rowland—Our view is that the defence procurement policy seems to militate against the development and sustenance of a technology base in industry because, particularly in some of the key high technology areas which are deemed to be important,

every procurement decision is made on a project by project basis. The department is not required to make any reference to the effect of a procurement decision on the industry base. That is either in terms of fragmentation of the indigenous industry base or in terms of procurement from offshore based companies, where the industry involvement in the ownership of intellectual property will be vested overseas.

So AEEMA's submission is that the efficiency of defence expenditure in terms of creating the technology and technological capacity to support the ADF could be greatly increased by a different approach to procurement decision making.

CHAIRMAN—I want to ask a question about that procurement process, then a couple of general questions on Australian industry. I think it is a very good point that the procurement process militates against a broad technological base in disciplines because it is project based. My question to you, though, is: how do you get that broad base in a small country?

Mr Rowland—The answer has to be by some form of management. The Department of Defence needs to take on board as an objective the management of the industry base.

CHAIRMAN—Is that just in the form of fine words, or does it involve money?

Mr Rowland—It does not have to involve money. A lot of money has been spent already in procurement. What should change, we believe, is that the procurement decisions need to look at what the effect of a decision is in terms of fragmentation of the industry base. In other words, if you already have four shipyards, why give a procurement contract to a fifth?

CHAIRMAN—The answer to that may well be that it is a political body doing the assessment of the tenders. But that may change. You have made quite a thing about the tendering process. I accept that the costs are very high there. But are the costs in relation to competing for a tender in the Department of Defence higher than for, say, what was the old Department of Civil Aviation or in the health services area, for building a new hospital or something like that? In other words, is defence a more difficult department to deal with in respect of tender compliance than any other government department, and indeed with private industry?

Mr Douglas—From AEEMA's experience, unequivocally yes. We represent the telecommunications industry. Certainly it has been our observation that large telecommunications contracts are handled much more expeditiously than a similar defence contract.

CHAIRMAN—Why is that so? Because the defence specifications are far more stringent?

Mr Douglas—It probably comes down to a number of factors. The length of time that the tendering process continues for is a major factor. Defence appears to be inordinately slow in a large number of its tenders compared to tenders elsewhere in the Commonwealth and tenders in the private industry. Certainly that adds significantly to costs. There is also a high degree of probity, of course, in defence tendering. That is appropriate, but we would argue that there are occasions when perhaps there should be less emphasis on probity and more on expedition.

Mr Rowland—I would like to support my colleague. One of the most critical things is the length of time that it takes for a project to come to a decision.

CHAIRMAN—I am aware of that.

Mr Rowland—That really is the difference. One would expect with defence procurement that obviously the tender specifications are rigorous and the over-requirement for information is a risk mitigation strategy by the department where they refuse to believe that a company that has done Defence work before is capable of doing it again in a similar way and look to have every ‘i’ dotted and ‘t’ crossed in the tender documents that tenderers put on the table. That is probably an unnecessary rigour.

CHAIRMAN—I want to come back to this business of probity. What do you mean precisely by a diminution in the requirement for probity? Do you mean that we can take 80 per cent instead of 100 per cent? What do you mean?

Mr Douglas—I think it really comes down to what Mr Rowland has just said. There appears to be an overemphasis on documentation. If there were I guess a more rigorous pre-tendering or pre-qualification process, if there were less requirement on documentation from companies which have demonstrated capabilities in the past, that would be a major step forward and would address some of these probity issues.

CHAIRMAN—How do you maintain competition with new players coming in? I do not want to get into the shipbuilding field, where you made the point about four builders and a fifth coming in, but a lot of the electronic work is in a dynamic environment with new players emerging the whole time. That will increase, given the consolidation of the major electronic firms into fewer and fewer units now in the United States and in Europe. If you say to the old players, ‘You don’t have to go through this business of proving your credentials to the tender evaluation committee,’ yet you say to the new players, ‘You’ve got to go through this ladder to show us that you do have the bona fides,’ then we have an imbalance.

Mr Rowland—I think the issue here relates to trying to define the core of an industry that is Australian based and trying to support the Australian Defence Force. Minister Bishop has indicated some criteria by which companies would be judged to be Australian defence—I cannot remember the term she used exactly—

Mr BEVIS—The ‘Bishop principles’.

Mr Rowland—The ‘Bishop principles’. They are a good way of describing criteria by which you judge companies who have an ongoing commitment to supporting the ADF. Quite frankly, AEEMA’s view is that companies which do not meet those criteria should be discouraged from tendering. If they are going to come here, do one project and go away again, they are not going to contribute to the long-term technology base and capacity to support the ADF in time of need. They are coming here to only make money out of the Australian marketplace on a short-term project basis.

CHAIRMAN—Accepting the place of Australian industry in our defence self-reliance, what are the financial realities of that likely to be? Is it going to cost us more or is it going to cost us less?

Mr Rowland—It should not have to cost the taxpayer more at all. In fact, if you look at some comparative work done with other countries, you will see that the key perhaps is understanding the full use of the term ‘industry’. If you take ‘industry’ to mean a holistic self-sustaining industry which owns technology, and the key to that of course is exports, then in fact the revenue which is generated by exports of the technology and systems can actually subsidise the domestic procurement. I was reading in a study that Dr Susanne Pearce did on international procurement and defence industry policy that in the UK they reckon that some £300 million annually is saved from defence procurement costs by having a self-sustaining exporting defence industry base. So it is quite the reverse: the stronger industry is, the less it can cost the taxpayer to maintain the necessary capability.

CHAIRMAN—There is a difference in scale there between Australia and the United Kingdom, which is I think the second largest arms exporter in the world currently, isn’t it?

Mr Rowland—I think it probably is.

CHAIRMAN—In other words, they have a market share that is very hard to break into.

Mr Rowland—True; but you could make a similar comparison with Sweden, which is, if anything, smaller than the Australian industry. We seem to be buying more Swedish submarines than the Swedish are buying Australian ones.

CHAIRMAN—Again, I think there was a political dimension to that. That leads me to the next point. Are you saying that we need a defence industry policy, a manufacturing industry policy?

Mr Rowland—Yes, and it must recognise that long-term sustainability of defence industry is as much tied up with defence exporting as it is with sensible domestic

procurement—the two go hand in hand—if the industry is going to self-sustain. If it cannot self-sustain, if it cannot make enough money to reinvest in technology, then it deserves to go out of business.

CHAIRMAN—On behalf of the Australian Electrical and Electronic Manufacturers Association, how much of your aggregate budget of all your member companies is spent on research within this country? It is a pretty important question. Frankly, we cannot deal with you if you are just bringing derivative technologies into the country. Unless you are developing with your own research programs new products for our needs, then there is really little point in us preferring you over the XYZ company from the other side of the world.

Mr Rowland—Absolutely; I agree. I am sorry I do not have the figure at hand, but we can supply it.

Mr Douglas—We can take that question on notice and provide that figure.

Mr BEVIS—In your submission, in the paragraph prior to the conclusion, you say:

AEEMA is encouraged that the recent Defence Efficiency Review has emphasised the need for competing the through-life cost of ownership of equipment rather than the cheapest initial acquisition cost.

What is new about that? I just wondered why you got encouraged by the fact that the DER had that to say, when my recollection is that that has been government policy now for about six years—certainly four or five years.

Mr Rowland—I think it has been government policy but I think there has been limited signs in the tender evaluation criteria of that being translated into anything meaningful in terms of estimation of through-life cost. Tenders have been for some time evaluated purely on the acquisition cost plus the cost of the three-year interim support with—

Mr BEVIS—Why do you think that is? This appears to be a principle that is adopted by government every couple of years and heralded every time it is. The observation you have just made I think is a fair one. So why do you think that is?

Mr Rowland—Largely because no-one has had the ability to work out what it really costs to support a piece of equipment once it has gone beyond the three-year interim support period, because generally the equipment would be maintained by uniform personnel in the services. Therefore the cost would not be tracked. So I think the shift is that, as more equipment support is contracted, and particularly contracted at the point of acquisition for 10- and 15-year support periods, you have the ability to actually quantify what the through-life support costs of one particular piece of equipment are.

Mr BEVIS—As suppliers, when tenders are being considered, do your members identify through the sorts of questions they are asked and the requirements placed upon them that there is an effort being made to look at through-life cost or is the focus predominantly on initial contract price?

Mr Rowland—Really the only way in a tender in which you can focus on through-life cost is when you ask the tenderer to quote for an extended period, such as a 10-, or 15- or 20-year support period. That is starting to happen.

Mr BEVIS—Given your industry's interest in leading edge technologies, which are referred to in the paper, do you have a view about the defence industry development program, the DIDP?

Mr Rowland—In the context of what?

Mr BEVIS—My question was more in the context of leading edge technologies, but I guess that is really where the defence industry development program funding went to. It was more risk capital. I just wondered whether you had a view about that.

Mr Rowland—I think the members' view would be that, historically, there has been a problem with defence industry development funding, in that it has been somewhat divorced from the requirements generation. So, while it has been very useful in terms of providing some funding for technology, there was no follow-through in terms of a commitment by the buyer to actually use the fruits of that technology. It is sometimes quite the reverse: DID funding would be used to fund an indigenous development, and then the department would go to tender and import some competing technology.

Mr BEVIS—I assume that is a reason for doing something about making the linkages rather than abolishing the DID program.

Mr Rowland—Exactly. The DID program would have been very useful, had there been a straight linkage where a user in one of the materiel departments had said, 'We need to buy an XYZ. It does not exist on the world market. It is a unique Australian requirement. We will tender for Australian companies to procure this technology.' That way, companies would be more than happy to take the technological investment risk on the basis that, if the technology did not perform as it was required to, they would not get paid. But, if it did, there was some obligation on the user to keep their side of the bargain and buy the fruits of the technology.

Mr BEVIS—In respect of the Australian industry involvement guidelines that were promulgated a couple of years ago, have you noticed any change at the coalface pre or post? Has it made any difference at all, or have the wheels of the system continued to turn as they did before?

Mr Rowland—I think it has in isolation, in that there have been changes in the way in which the AII volume of a tender has been evaluated, but the AII proposal in the tender appears to be ranked fairly low in the criteria. Yes, the rules have made a difference in what it would take to get to the top of the ranking on the AII volume. But getting to the top of the AII volume ranking does not necessarily give you much help in the overall tender selection.

Mr BEVIS—If you won it, you might have won it without it?

Mr Rowland—I think there would be a view amongst the members that if—

Mr BEVIS—Can you think of any occasion on which it may have determined the outcome?

Mr Rowland—No.

Mr BEVIS—That is pretty clear cut. One of the things that those guidelines left the door open for development on was partnership arrangements between Defence and at least key aspects of defence industry. Certainly, at the time, it was in people's minds that that would be in some of the leading edge technologies, particularly the electronics warfare capabilities and other things of that kind, which I imagine your members would have a pretty keen interest in.

What has been your association's perception about the development of partnership arrangements, as distinct from the project-by-project approach? You made reference to telecommunications in answer to an earlier question on a similar point. I assume that in that you are contemplating or thinking about the policy that Telstra, for example, has adopted for its major switching and transmission equipment, where there were three or four suppliers contracted. That was scaled down from five or six a few years ago. That may be a useful model for consideration in Defence.

Mr Douglas—Yes; we believe that certainly the model that is adopted in the telecommunications industry would be useful in Defence and, indeed, in other areas of government purchasing as well. There is the partnerships for development program, of course, for the telecommunications industry, which places certain obligations on the carriers. AEEMA has found that to be highly efficacious in developing Australian technology and a viable Australian telecommunications industry, which is really equal to world's best in its technology. So, there are lessons in that program for Defence. I rest my case.

Mr Rowland—Most of our membership would very much like to see the partnership concept being developed very much along the lines that the telecommunications industry has done—and has done for a long time, even when it was a Telecom monopsony. There was still a lot of partnership and development of indigenous

technology in a way that we see as being quite translatable to the Department of Defence. In fact, we noticed with great sadness the treatment of the concept of partnering by the defence efficiency review, which stated quite categorically that it was not possible and not desired and anti-competitive. We believe that is not true and not correct. A partnership has to be developed if you have a single customer and you want to develop a technology base.

Mr BEVIS—Especially if you want it in a domestic capability. The final question I have is that you made reference to defence exports and the need for a viable defence industry to be able to also export. I guess the other half of that is they also need to be able to commercialise as many of the applications as possible, particularly given the point of my question, which is this. What guidelines do you think should be imposed upon the export of defence and military equipment? Australia has adopted, under both political governments, a fairly strict regime for exports. I notice that the new British government reviewed it and came out with another statement that has been interpreted as meaning nothing or lots, depending on your view of the world. What is AEEMA's view of the sorts of restrictions the government should apply to the export of military sensitive equipment?

Mr Douglas—We have taken a view that the current guidelines are appropriate. We recognise that our community would not accept a wholesale degradation of those guidelines. In the past, we have been critical of the length of time that it does take to approve an export application.

Mr Rowland—I agree with my colleague. The membership is looking for, I suppose, more of an attitude change to exports. At the moment, irrespective of the guidelines, it is likely that the default condition is 'Don't'. Under very special circumstances, we can probably find a country somewhere where, if you really have to, I suppose you can export. That is really not an attitude, as it pervades government—and I mean all of government, through Trade, Foreign Affairs and all the parties that are interested—that really helps boost an export campaign, particularly where you are competing against other companies from other countries where there is a whole of government support and where a number of very positive government-to-government measures are put in place to facilitate companies to export. I do not mean just direct trade assistance. It is a whole of government thing.

Mr BEVIS—Given that in the past year we have reduced the number of Austrade people that we have in a number of regional neighbour countries, and given that the DER announced the decision to close down—not the defence attaches; I cannot think of their title—the people in Defence who were placed there precisely for this reason, how do you go about doing that? How do you say, 'Yes, we should export more,' at the same time as you are reducing the general Austrade people available in the region to do it and abolish the program that had the people with defence and military background in the key neighbouring countries where you thought you had a market?

Mr Rowland—That is a mystery to us as well. Again, it is important for defence

exports. A customer of Australian defence industry will want to know that the government is wholeheartedly supporting the exports of that country. So it sends very serious messages when you do things like that. The customer will think, 'If I buy from Australia, what are the chances that there will be a change of policy or cutbacks?' or 'I won't get support' or 'I won't not get follow through to stuff that I buy from Australia.' It just contrasts so sharply against another country where the government is doing everything it can to help, to facilitate and to make it easy for companies to export.

Mr SINCLAIR—Could I carry on with the question of follow-on benefit of exporting. How do you see commercial domestic sales in not exactly identical but parallel fields? For example, you have identified as high priorities for ADF development high technology systems areas such as data management and signal processing, and command, control and communications systems. Those areas really have quite an extensive civilian field and application. Would you have any ballpark figure of the flow-on benefit and commercial application of the defence contracts that your members might succeed in winning?

Mr Rowland—Not off the top of my head. A number of our members certainly have a thriving non-defence business which is complementary to their defence business. Often you might find that, particularly in communications, the technology flow is actually the other way round because the development time scales in the commercial marketplace are so fast that it is the commercial technology that is actually being applied to defence markets rather than the other way round. We do not have any figures particularly but, whichever way the technology is flowing between the two, the synergy is very important for a number of our members.

Mr SINCLAIR—It is also fairly important in your basic case which is that, when you look at the tendering process and the contract process and recognise the value of Australian contracts, if you are going to justify more money for defence there has to be some perceived benefit. If you had figures that showed both the export benefit and the flow-on domestic benefit, I am sure it would be of considerable advantage. So if you can identify any figures there, I think that might be helpful. What percentage of your members would be Australian companies or Australian owned companies?

Mr Douglas—In terms of the numerical number of our members, it would certainly be in excess of 50 per cent.

Mr SINCLAIR—Would be Australian owned or identifiably Australian.

Mr Douglas—Yes.

Mr SINCLAIR—Would they be the smaller participants or are there some major players?

Mr Douglas—Mostly small and medium, but they do include the major Australians as well.

Mr SINCLAIR—The offset program used to be fairly beneficial, although I am not too sure how it applied in your particular sector. What is the state of play as far as your perception of the offset program; is it beneficial or is it now no longer relevant?

Mr Rowland—Many years ago the offset program was the industry involvement program of the day, which was useful at that time in terms of actually creating an industrial capacity. Without the offsets program, there would not have even been the seed of a defence industry today. But I think the sophistication and the understanding of what keeps an industry going and sustaining, as well as the whole model of development of technology and exporting, has left the offset concept fairly redundant. It was more focused at job creation than it was at creating intellectual property. Very often the technology that was transferred under an offset arrangement was yesterday's technology, which was not something that you were going to be able to take and then re-export at the highest level of international competition, which is what you have to do to stay in business today.

Mr SINCLAIR—The chairman asked you about research and Arch Bevis asked you about partnerships. What sort of an association would your members have with DSTO or perhaps the Telstra research laboratories and other public sector research bodies, even CSIRO?

Mr Rowland—Very close. A number of the AEEMA members have actually signed formal partnership agreements with DSTO for exchange of technology and collaborative research; less so perhaps with the non-defence related institutions like CSIRO, but there are some that have links with CSIRO. There is a growing number of relationships into the cooperative research facilities that exist around Australia.

Mr Douglas—We have direct representation in our Defence Electronics Division from DSTO and from the CRC grouping.

Mr Rowland—I think you will find that Australia is very well placed at the research and development end of the cycle of a sustainable industry. It is in the economic side of domestic and international markets that the model tends to fall down.

CHAIRMAN—Just two quick questions to finish up: reviewing AEEMA's presence in Australian defence industry, what areas do you see as your great strengths?

Mr Rowland—You mean strength as an industry association?

CHAIRMAN—In what areas are you valuable to the Australian Defence Force?

Mr Rowland—As an industry association, I think in facilitating contact between

the Department of Defence and industry in a way—

CHAIRMAN—No, that is not quite the question: what sectors do you see that you can serve the ADF needs that your members can do—without naming companies or getting involved in some internal problems for yourself—what can you offer the ADF; where are you better than manufacturers in other countries, for example?

Mr BEVIS—Your membership in the indigenous industry, how is it able to contribute to defence—better than buying European or whatever?

Mr Rowland—From offshore. First, because it is here so it is here for the long term; it is not here just to sign a contract, supply it and then disappear. One of the key things for the Defence Force is the ability to modify equipment that was introduced to service perhaps five years ago. Often when a situation arises, the equipment is not exactly as planned; so equipment does need some modifications to meet a changing new threat. If those cannot be produced from an indigenous company that has the technology and the understanding of the system, then often money has been wasted because the equipment is just inoperative on the day it needs to be used. That support goes through not only to maintenance and modification but also to training. Obviously, the training, the use of equipment and a close relationship between industry and the ADF in making sure that the equipment use is maximised aid the fighting edge of the ADF.

Mr Douglas—We have an excellent electronics training program in Australia in the sense that we have available to us world-class electronics engineers, and that certainly puts us at the forefront of systems integration in Australia. We certainly have expertise in that area.

CHAIRMAN—What areas would AEEMA see to be priority areas for us from a national point of view in that electronics area?

Mr Rowland—The key areas are those that I think you quoted Professor Dibb—the command, control, communications and intelligence areas. If you read the history of virtually any war, every commander that has been faced with a battle has had very imperfect information about where he was, what the threat was and what he had to deal with it. I think those technologies, which are really information warfare technologies, can make the difference much more so than necessarily the performance of the weapons, because they give you the ability to know where to direct the weapons and how to employ the forces that you have.

Senator SANDY MACDONALD—I can see the advantages in having an indigenous electrical and electronic manufacturers group and the advantages of using indigenous manufacturers. But most of the international companies involved in this, such as Marconi, Thomsons or British Aerospace, are companies which surely have an Australian arm. In an increasingly global market for this high-tech development in

electronics, how strong is your claim to say what level of purely Australian ownership or Australian sources of wherewithal and knowledge is part of your group, and how much of your membership is made up of Australian arms of international companies?

Mr Douglas—The important thing from AEEMA's perspective is what is done in the country, not the ownership. We deem it important that we have a viable industry program which promotes the development of local technologies. That is the distinction we draw. We do not look so much at the pure ownership of a company.

Mr Rowland—It is not true to say that multinational companies which have operating facilities in Australia are necessarily just looking to import material from offshore. In fact, very little that the ADF buys—if indeed anything—is imported and landed into Australia unmodified. Almost every piece of defence hardware which is purchased is significantly tailored to meet the needs of the Australian user—and quite rightly so. It is in those technologies and the blend of the Australianisation that the industry, in both its domestically owned and multinational ownership, has an ability to contribute.

Yes. No-one is suggesting that Australia will ever be able to own all the technology needed to produce all defence materiel, electronic or otherwise. So there will always be a blend of imported technology. The ability to buy and mix and match the best components from offshore, but to harmonise those in Australia to an Australian system suited to Australian needs, is the key skill that is important for the Australian indigenous industry base.

CHAIRMAN—That raises another question of the security matters involved, particularly in electronic systems and the integration of major sensors and fire control systems. When that is done by an overseas country, we pay for the development of it and they use the development that has taken place here to supply Korea, Turkey or somewhere else down the chain. Not only is there a financial implication, but also there is a security implication. Anyway, we will pass that by.

Mr Rowland—I could comment that that is therefore a very good reason for choosing an Australian based company to contract with, where they have to demonstrate an ability to control the technology. While the economics might work exactly the same, at least you will have Australian control about the technology and in what form it might be re-exported.

CHAIRMAN—Any further questions?

Mr SINCLAIR—Your essential basis is that there needs to be redistribution of the money presently available, rather than an increase in money for Defence. Would that be a fair assessment?

Mr Rowland—Yes; and a smarter use of that money in terms of trying to take advantage of the multiplier effect of the export income as well.

CHAIRMAN—As there are no further questions, I thank you very much for your attendance here this afternoon. You will be sent a copy of the transcript of these proceedings in due course, to which you can make corrections. Thank you for your attendance.

[1.55 p.m.]

MEIBUSCH, Brigadier (retired) Ian James, Deputy Chairman, Association of Australian Aerospace Industries, GPO Box 817, Canberra, Australian Capital Territory

MITCHELL, Mr Geoffrey James, Executive Director, Association of Australian Aerospace Industries, GPO Box 817, Canberra, Australian Capital Territory

Chairman—Welcome. I must advise you that the proceedings here today are legal proceedings of the parliament and warrant the same respect which proceedings in the respective houses of parliament demand. The subcommittee prefers that all evidence be given in public; but, should you at any stage wish to give any evidence in private, you may request to do so and the subcommittee will give full consideration to your request. We have received your submission and it has been authorised for publication. Do you wish to make any additions or corrections to that submission?

Brig. Meibusch—No.

Chairman—Do you wish to make a short opening statement before we proceed to questions?

Brig. Meibusch—Thank you very much. We will organise it so that Mr Mitchell gives a short resume of what the association is about and I will talk to the submission, if that is agreeable.

Mr Mitchell—I want to say a few words about the association. It consists of organisations operating in Australia in the aerospace sector. It has been established since the early 1970s. It is a national body and it works cooperatively with state and federal governments in a number of areas. Briefly, I would like to draw a distinction between aviation and aerospace. Aviation is predominantly about air transport, while aerospace as we see it encompasses all the engineering activities of flight. That is the area we are interested in. We do not attempt to cover the general aviation and aviation industries.

In recent years, the association has had a growing interest in the Department of Defence, particularly due to the quite high levels currently and in the future of purchasing for the aerospace sector. There is quite large capital expenditure going on. Our objective has been—and it is increasingly working this way—to try and increase the level of Australian industry involvement in defence purchases.

The aerospace sector worldwide has rationalised, and so it has in Australian over the past few years. There are not many companies in the world operating in the aerospace sector any more and there are not many in Australia. It is fair to say that, at the moment, I do not think any major aerospace company in Australia is Australian owned; it is all

overseas owned. That does not mean that these companies have not got a major presence in the country: they are quite big manufacturers, overhaulers, repairers, integrators and all the rest of it. Having said that, I would like to hand over to Ian Meibusch to continue with our statement.

Brig. Meibusch—Thank you for the opportunity to appear before you today. I start off with an apology, which is always a bad thing to do. I apologise for the absence of our chairman, Air Vice Marshal (retired) Hans Roser, who is interstate on pre-arranged business that he could not get out of.

The Association of Australian Aerospace Industries will be referred to by us all as AAAI. Its written submission to this inquiry is very succinct. In essence it said that defence industry represents a strategically important part of a total defence capability. The nature of the defence industry base needed to support the ADF has traditionally been given low priority by Australian defence planners. This needs to be changed if and where necessary by investing in establishing, maintaining and developing a sustainable defence industrial base. Then we finished with a plea: 'Please take this factor into consideration in your deliberations for funding for Defence.'

We felt that you would get a lot of submissions and that a lot of your time would be taken up with listening to people talking about the needs of the army, the navy and the air force and about the combat capabilities and direct logistic support of those capabilities, but that you might not get very much about the requirements of the fourth arm of Defence—as we would like to think of ourselves—defence industry, and in particular we think in terms of the aerospace industry.

In very general terms, AAAI believes that in modern warfare key industrial capabilities are as important as combat capabilities. The department, in conjunction with Australian industry, needs to define and develop these key industrial capabilities to the same level of detail and with the same priority of effort as combat capability development.

For the bulk of its requirements, Defence is only one customer in a highly developed commercial Australian marketplace. In this sector, no special policy initiatives seem to be required, other than requiring the greatest practical use of this sector by defence buyers. Where no such developed commercial market exists in Australia and where an industrial capability which is as essential to defence capabilities as combat capability is involved, government intervention can be justified on strategic grounds to establish and, more particularly, to maintain that capability.

Some capabilities require only minimal assistance, such as pressuring overseas governments and/or enterprises to allow Australian based companies to freely and openly compete for workload. Others need more direct support, especially for their maintenance. For instance, greater and more pro-active use of the leverage of defence purchasing would provide workload and access to markets and technology for Australian based firms,

especially if you embedded such requirements in contract clauses to meet industry objectives. A very few need to be established and sustained by direct defence funding in the same way as combat capabilities are. Whatever eventuates, whichever category they fall into, there will be a significant beneficial return on the investment, not only in strategic capability terms but also in national economic terms.

AAAI stated in its submission that it does not have the resources to determine which particular industry capability falls into which category or to estimate the resources needed. But we recognise that there were resources needed to manage outsourcing; to be pro-active in the use of defence purchasing leverage; to pressure overseas enterprises to allow free and open competition; to embed and, more particularly, to enforce industry objectives in contracts; and to provide direct funding where that is needed.

Defence is already making considerable efforts to do these things. However, AAAI believes that at present enough resources are not available to it to do it properly. Government and industry should be putting more resources to work in these areas and better utilising their combined resources to meet national goals. That is the essence of our submission.

Mr HICKS—One of the arguments of the car industry in Australia with regard to tariffs is that it should be protected because it is a basic engineering service and, if we do not have the car industry, one of our major industries will disappear. What does your organisation say about whether we should be protecting industries that provide for our defence, that provide a basic service? Do you have a particular view on that?

Brig. Meibusch—When you talk about defence industry, you are talking about a wide range of activities, some of which, as I indicated in my opening remarks and in the submission, are really well established and not particularly critical to the defence function. That is at one end of the spectrum. The parts of the defence industry that I really think of as being part of the defence industrial base are those that are directly related to the combat capability. In certain of those capabilities, I believe that it will be necessary, for defence strategic purposes, for us to pay for them with direct funding. It is not realistic to allow somebody else to have the control of such capabilities. This applies particularly to some of the areas that the AEEMA submission dealt with. We ask for the resources to do that but, more particularly, we ask for the resources to allow the analysis and determination of what industrial capabilities are important for defence and what is the best way of establishing, maintaining and developing these capabilities.

Mr HICKS—Do you have any particular example—without naming names, perhaps some section of the industry?

Brig. Meibusch—The old industry involvement contracting division—I am sorry, I have forgotten what it is called under the defence reform program, but you know the division that I am talking about—commenced an initiative last November to try to identify

these capabilities and make some initial judgments as to whether or not it needed significant support if it was considered strategically important. As an association we contributed to that. It identified in some kind of work breakdown structure—down to about the fourth level, if you understand what I am talking about—the capabilities that were required.

Unfortunately, that initiative is slipping a little bit with all the emphasis on, first of all, the defence efficiency review and now the defence reform program. It is one of the babies that we are fearful will get thrown out with the bath water, as the emphasis is on getting smaller administration costs so that more can be put into combat activities. We believe that in that sector and in that kind of work there is equal importance to be placed on that kind of activity as in developing, sustaining and analysing combat capabilities. We believe also that over the years this has tended to be given a lower priority and fewer resources than it should have been.

Mr SINCLAIR—Could you give me an idea of how the level of activity in your sector from Defence could be measured over the last five to 10 years? Are you getting more or less work from Defence? What is the ballpark perception?

Brig. Meibusch—It is extremely lumpy. If we go back to, say, the FA18 program, there was a big build-up of activity within the Defence aerospace sector. That dropped away. Considerable efforts were made to build the industrial capabilities in the FA18 program. There were some relatively simplistic approaches adopted at that particular time.

I listened with interest to the discussion on offsets that was held earlier. My feeling was that the offsets program and the industry involvement program for the FA18 allowed a number of companies which were prepared to make the effort to establish international track records, which have served us well—but not every company and, unfortunately, not in the areas that were represented by the previous group. There should have been more effort made in the electronics and systems area. However, that did not eventuate and there is a lot of criticism of the FA18 program. I am off the topic. I am sorry about that.

When you look at the current program that is going through to contract stage and the program that will come up to contract in the next few years, it is virtually dominated by aerospace projects. If you think of current programs like the updating of the P3s, the F111 support program, the lead-in fighter program, the AWAC, the naval helicopters, the upgrading of the Seahawks and a number of aerospace simulation projects, there is a lot of work coming down the pipeline for the sector of the industry represented by AAI.

Mr SINCLAIR—What about the alternative within the civilian field? I was a bit surprised to hear you say that there is really no civilian demand. I thought there would have been demand in the maintenance and servicing of domestic airlines like commuter and general aviation aircraft as well as regular airlines. I thought there would have been quite a lot of work for your sector. You are suggesting that there is not.

Brig. Meibusch—In AEEMA there isn't. I shook my head. I wondered if you noticed me shaking my head when that answer was given because the maintenance activity that you have identified certainly does not apply to the aerospace industry. We have quite a spin-off from activity that has been undertaken and track records that we have developed in the civil airframe manufacturers side of the business too.

Mr SINCLAIR—There is a ballpark over your industry. What percentage would be Defence? What percentage would be civilian? What percentage would be export? Would you have any general idea?

Brig. Meibusch—I would have to take that on notice. The trouble is that the code of the Bureau of Census and Statistics does not identify aerospace industry as it is generally acknowledged around the world. The figures that we have are hand compiled, subject to interpretation and a bit hazy. We have a major effort to try to get better statistics. I can quote the statistics for an airframe manufacturing company which has a turnover of around \$200 million of which \$150 million is export. Of that \$150 million, \$120 million of it would be civil work.

Mr SINCLAIR—To what degree are we starting to develop an industry within our region as far as export is concerned? When you talk about exports, is it back to prime manufacture?

Brig. Meibusch—Generally in the aerospace industry it is fair to say that the export into the region is via North America or Europe. Once again, quoting this particular company which I know rather well—I am working for it—we are sole source manufacturers for bits of aircraft which are sold into the region, particularly into China. Every Boeing 737 that is sold into China has a bit of Australia on it. Every Boeing 767 has a bit of Australia on it. In fact, every Boeing aircraft and the majority of Airbus aircraft have a bit of Australia on them.

Mr SINCLAIR—But we are not as yet in your sector of industry involved in trying to contract specifically for regional carriers. In other words, you work through Europe or the United States, but, in your particular field, essentially contracting to the major—

Brig. Meibusch—I was talking specifically about manufacturing. Certainly in the maintenance sector and in the training sector we target specific contracts in the region, and have been relatively successful with it too.

Mr Mitchell—Qantas have been very successful at bringing 737s into this country for overhaul. That is not counted in export statistics either.

Mr SINCLAIR—The other area that worries me is you have said that your sector is virtually all overseas owned. To what degree do you do any original work here?

Essentially, all you are doing is picking up techniques and knowledge from somebody else and applying it locally. Do you do any original work? Do you work with ARDU?

Brig. Meibusch—Let us take a recent example where Boeing was considering doing an extended long range aircraft, an extended 747 type aircraft or the 777 aircraft. I am giving civilian examples because they are the ones that flood to my mind immediately. What Boeing did was say to us, ‘Okay, we’ve seen your track record. We understand your capabilities. We are thinking of a new aircraft with this kind of general design concept. We want you to do this part of it—design, develop and build.’ While we do not build and sell complete aircraft, we certainly design, develop, certify and build essential elements of it.

That occurred in the military field with the C130J. The C130s were having difficulties with the life in service of certain components such as the flaps on the aircraft in US and European service. The original equipment manufacturers went to a number of people around the world and said, ‘We have a problem. We would like you to investigate it and come up with a fix. If your fix, your investigation, is the one that we finish up following, then we will give you a significant order which you can amortise over your costs associated with it.’

We went into competition with the rest of the world and, in that particular project, the Australian aerospace industry. A member of the Australian aerospace industry association managed to win it. Incidentally, they said to us, ‘We want your answer and your completed bit of equipment in a very short time—in one year,’ which was an unheard of time frame for this kind of work. We managed to do it. Now we have an order for 180 shipsets to go around the world for that particular item and that particular aircraft. Assuming we continue to perform as we are performing at the moment, we will get follow on orders. The point I made with those examples from the civilian side and from the military side is that considerable design development activity goes on in Australia. We are internationally competitive in doing it.

Mr SINCLAIR—What I was fundamentally getting to is that, if there were to be an increased Defence involvement through your industry, what benefit would there be for Australia? You can do it now, so you are competing in the civilian world. If you got more Defence work, what would be the Australian benefit of your getting more Defence work?

Brig. Meibusch—We would like to see the other sectors of the industry, particularly the systems integrations sector of the industry, developing to the same standard as the airframe design and manufacture sector of the industry. We would like to see the test and evaluation sector of the industry also develop to get greater self-reliance.

The previous speakers talked about the need to modify equipment, revalidate them, extend their life and do all kinds of things like that that are peculiar to this particular area. In a number of critical areas that I can identify I can see gaps in our capability which, if

we are going to have the degree of self-reliance that people think we have, we need to put some effort into it.

Mr BEVIS—I want to follow up some of the points that Ian was raising and that last comment that he made. What does the industry see as the realistic horizon for Australian aerospace? Are we going to continue to be captive—I think that the word ‘captive’ is right but I did not want to use a pejorative term—to a process of modification, assembly and maintenance, maybe with a bit of component supply in those three areas? Is that our horizon as a nation? Or, if you were sitting down to do a 10-year development plan of aerospace industry, would you look to go beyond simply doing those things a little more?

Brig. Meibusch—Eight years ago, we had ambitions of going a lot further. Various companies took initiatives. Some of them got their fingers burnt. I think it is fair to say that, in the airframe manufacturing sector, they have trimmed back their ambitions. Over the time frame that you are talking about, the objective would be to do more critical components than we do at the present time, so that we get our total input up to something that approximates our share of the world market. We would like to get to the stage where we exporting to these original equipment manufacturers something starting to approximate what we are importing from that particular sector.

I will make a point now that I should have made earlier: it is wrong when we are answering these kinds of questions to think of the aerospace industry as a coherent whole. You have to differentiate between the sectors a bit, and talk about a sector area. As I have already said, there is a need to put more effort into the systems integration area, which cuts across AEEMA’s responsibilities. In fact, a number of members of AEEMA are also members of our association. If Mr Rowland had announced his company, it would have had ‘Aerospace’ in its title. There is a little bit of cross-fertilisation.

In that particular area I would like—and I think the industry would have the ambition—to have an Australian based prime contractor taking responsibility for what are projects of commercially feasible size: say, \$100 million plus, but not the \$1 billion type of thing—that is a little beyond us. If you talk about that particular sector, taking on prime contractorship really means selecting from around the world what is available, seeing whether it fits our particular requirements and, if not, modifying it.

If we are not capable of modifying it, then we should be indigenously developing solutions in niche areas. We should be taking the associated risk of getting the thing in for a fixed price to a fixed schedule, and all the things associated with that.

In the repair and overhaul sector, the ambition is to get more design-approved, contractor status tasks, whereby we take responsibility with less reliance on the original equipment manufacturer for analysing what has gone wrong, suggesting repair schemes, doing the work, recertifying and all that kind of stuff.

Mr BEVIS—Given that the aerospace industry has probably gone through an aggregation of ownership more dramatic than just about any other in the past few years—

Brig. Meibusch—The world aerospace industry.

Mr BEVIS—Yes. Going back to your comments that defence is a significant slice of the domestic aerospace industry, isn't the only way we are going to achieve that is if government policy aggressively pursues a partnership for development program with enforceability requirements?

Brig. Meibusch—And resources to audit it, yes. I have gone on record on a number of occasions arguing that we have to use the leverage associated with these major purchases to get what we want. But first of all we have to know what we want, and I think we have some way to go along that path. What I am asking for is the resources to do that and to do those five things that I listed. All of those things together will get us much further than the FA18 program got us, as good as it was.

Mr SINCLAIR—From what you have said, you are quite happy with the project orientation of the defence acquisition program. Is that correct? You do not see a broader based, forward capital acquisition type of strategy of any necessarily greater advantage to your industry than the present project oriented acquisition program?

Brig. Meibusch—No. If I gave that impression, I am sorry.

Mr SINCLAIR—You mentioned the C130, for example.

Brig. Meibusch—That was an example of something that had occurred. I think we have to have some objective of what we want to achieve and then say, 'Okay, this is where we are heading, and these are the programs that will allow us to build up the track record, the understandings and the technology to get to that particular spot.' For instance—once again, just picking the airframe sector because I know that best of all—Australia has a habit of keeping aircraft in service for longer than other users do. So, ageing aircraft problems are something that I believe we should give priority to.

We have therefore to have structural testing and structural life assessment, and we need to better understand the effect of corrosion. We have a number of projects coming up which will allow us to advance in that area. So long as we have an understandable goal that is filtered down through the tier of people who operate in the field—in contracts, engineering and other areas within the department—as to what we are wanting to head towards, we can do a lot by using the purchasing leverage of the various contracts that are coming up. We do not really have to supply a great number of dollars other than dollars to pay people to make certain it is done properly.

Chairman—There being no further questions, I thank you very much for your attendance this afternoon. We will be sending you a copy of the transcript of your evidence for correction.

[2.30 p.m.]

LYON, Dr Rod, Director, Medley Consulting, PO Box 4144, St Lucia South, Queensland 4967

Chairman—On behalf of the subcommittee, I welcome Dr Rod Lyon of Medley Consulting. I must advise you that the proceedings here today are legal proceedings of the parliament and warrant the same respect as the proceedings of the respective houses of parliament demand. The subcommittee prefers that all evidence be given in public, but should you wish at any stage to give any evidence in private you may ask to do so. We have received your submission and it has been authorised for publication. Would you like to make any additions or corrections to that submission?

Dr Lyon—No, Mr Chairman.

Chairman—I invite you to make a short opening statement before we move to questions.

Dr Lyon—In terms of an opening statement, can I try to direct the subcommittee's attention perhaps to a somewhat wider framework than the afternoon witnesses I have heard have spoken about. If anything we think that, however detailed the terms of reference for this committee's study are, the task of the committee essentially boils down to two central questions: making recommendations about the size of Australia's defence budget and making recommendations about its shape.

On the size issue, let me say, firstly, that we see no grounds for either radical contraction or expansion of the current defence budget. A defence budget is aimed primarily to deal with current and foreseeable threats and it is always something that is structured to address a particular need. We do not see that need contracting despite the end of the Cold War. We believe there is no new world order that has emerged, that nation states are still the dominant international actors and that if you look at the history of warfare beyond the past five or six years you still end up with conflict as a norm of international behaviour. The American academic who did a study of warfare between 1500 and 1975 in fact found that at least one of the world's great powers was fighting 60 per cent of that time, that all of the world's great powers were fighting on nine occasions—that is, about once every 50 years—and that broad historical sweep of conflict still seems to us to be a better guide for what Australia might expect the world to look like in the future rather than a shorter term survey that only looked at the benign international conditions of the 1990s.

We accept that there is some role for a set of international relations that talks about security with states rather than security from other states, but do not accept that that represents a totality of what we should expect. The security with model of international relations is based upon a belief that warfare always derives from misunderstanding and

that is not what we accept. We believe that warfare sometimes results from conflicting national interests and the ability to protect and promote Australia's national interests will remain an important role for the ADF in the future.

Similarly, we see as yet no grounds for expansion of the defence budget. The case for expansion we believe is not proven. It is, in one sense, irrelevant what percentage of GNP we spent on defence in 1987, 1983 or indeed any other year. The defence budget only has to deal with current and future threats; it does not have to deal with past ones. The model that still suits best is one of looking at the security environment and deriving needs from that security environment.

I will move from the issue of size to the issue of the shape of the defence budget. We support the school of thought that says tomorrow's threats are likely to be more worrying than today's. As a consequence of that, in our submission we argue in favour of a lower readiness and sustainability for the current force—that readiness is largely a function of the amount of money that goes into operations, maintenance and training—in exchange for which we would hope to see more money go into research and development and selective procurement and modernisation which should result in a better armed and more ready force for the future.

In our submission we outlined a means of prioritising the different sectors of defence spending, placing research and development and modernisation at the top of the heap and readiness and sustainability at the bottom. In essence, our submission argues for a path of moderation—what we believe to be a sensibly sized defence budget well targeted to address principal needs. I will stop at that point and address particular points with the committee.

Chairman—It was not going to be any part of my question pathway, but since you raised it could I respectfully suggest to you that one of your fundamental propositions maybe is not true. You talk about world affairs from 1500 through to the present and the way major powers are involved. Could I put it to you that we are now in an age that is not characterised by the ending of the Cold War but in a situation that we probably have not seen for 2,000 years, since the days of the Roman empire, where we have one power that has overwhelming political, economic and military power—that is, in the form of the United States.

In world affairs, I cannot think of a situation in the last 2,000 years where such a dominance was bestowed upon one country. I do not wish to develop this argument any further, but I do say that parallels with the past are limited by the new circumstance that we have. While this may well be a force for good in world affairs it also has a level of unpredictability to it that we really cannot predict. That is not an argument that I wish to develop because it is not part of our terms of reference, but I did want to make that point.

You are arguing that we do not need to increase our level of defence expenditure. I

would put it to you that, unlike earlier times, we are in a time of very great technological change and if we are not part of it, if we take a holiday for 15 or 20 years, it might be very difficult to get back on the train, bus or whatever is rolling along. There are lessons to be derived from being part of a process in relation to our particular national interests, our geography, our low density and our affordability of these systems. The development of doctrine and the training of it all mean that we really should be part of it, not an onlooker. To be part of it is going to cost us money and arguably it will cost us more than the earlier technologies that are being replaced.

Dr Lyon—Let me address first of all your unipolar insight. I agree that what you have at the moment on the world stage is one power that is clearly militarily ahead of everybody else. Only one country has the global reach to exercise conventional force anywhere it wants to in the world. The instability and the unpredictability that we see in the future come because we believe that the condition might not last, in particular, given the pace of Asian growth; the removal of some of the artificial boundaries that have constrained major Asian powers in the past—particularly during the Cold War years; the rate of military modernisation by some of those powers; the fact that Asia is not a theatre in which a balance of power has any long-term historical sway as a doctrine for organising the region's affairs; and the fact that in Asia all three of the large regional powers are poorly meshed into security arrangements—for Japan, China and India.

All these things portend a more worrying Asian strategic balance, and it is a region that has long believed in imperialism rather than a balance of power doctrine as the fundamental way of organising the world. Constructing a stable balance in Asia will be difficult. So I do not believe that the unipolar moment lasts, and in particular I do not believe it lasts in Asia.

On your second point about technological change, let me say that we are not at all advocating anyone taking a holiday for 10 to 15 years. We are advocating that the money goes precisely into those areas that show the fastest rate of technological change. It is critical that Australia stays within range of where US forces are going to be during the coming years so we can work together as allies when we need to fight together in whichever theatre that turns out to be.

If we are going to be spending money on research and development and pushing the technological barriers and trying to apply the revolutions and technology into our own area, the money is going to have come out of the areas that it can safely come out of because current threats are low, and that is essentially the areas regarding readiness. Lower readiness comes at a cost for us. It means that, if there is a sudden need to fight a war in the near term, we will do it less well. But the return for that is we should fight better in the longer term over a war that is much more likely to be vitally important to us.

Chairman—I accept your point about readiness. I think it is a hugely disproportionately expensive capability to build into a defence force. But unless you have

within all three services some units at a high level of readiness, you never ever know what is involved. You do not appreciate the training effort, the support efforts, the stores, the war stocks and the rest of it you have to have.

I was enormously attracted to your thesis about research and development because I have a scientific education. I deplore the low level of involvement in science in this country at all levels. I find it incredible that we have got rid of virtually all the physics departments in the Australian universities—the very heart of scientific education. It has been substituted with laser. You might as well have neon-sign departments if you are putting laser departments in as a substitute for physics departments.

Putting that aside, I want to go back to this business of staying with the technological change. The biggest problem we face, as I see it, in a defence area is the business of anti-missile defences. The theatre ballistic missile is the great threat. We have a couple of countries in the region that are actively developing these missiles and exporting them. Their accuracy is going up, their range is going up and their affordability is coming down. You would be well aware of those suppliers of those materials flooding into Iran and all the rest of it.

The business of providing against theatre ballistic missiles is one of the great things that the ADF must be involved with in the next 10 years. This is a very complex business. It is the detection of the launch. It is the interception of them at the boost phase, in the cruise phase and in the terminal phase. Hugely complex mathematical and command problems are involved there.

There is the transmission to all the units involved in real time of all the data associated with this. This is something that probably is the biggest technical challenge defence forces have faced since the bow and arrow days. I do not see how we can be cruising along at a present level of expenditure where we have no excess capability to look at these things without an increase in our budgetary allowance.

Dr Lyon—The point I made earlier was that I favoured no radical increase or no radical contraction. You can make arguments for tinkering at the edges in both directions depending upon where your political preferences lie. In terms of the percentage of the budget now that we throw towards research and development, it seems to me to be too small. For example, DSTO gets about two per cent of the current budget. Even were we to double that, we are still only talking about four per cent of the budget. But it is a doubling that could give us technological leverage when we need it.

On your point on ballistic missile defence, I agree that that is going to be a challenging area—not merely for Australia, but for lots of other countries as well. Fortunately, it is an area in which Washington is also engaged. Certainly the current administration is more interested in doing theatre range ballistic missile defence than actually defending continental USA. They see it as the area in which they are most likely

to have to use such defences against rogue states, and they see them as being the sorts of defences they need most in order to protect forward deployed US troops and installations. Working with the US on that area should give us our best return of being able to find some counter to theatre range ballistic missiles. But I agree with you; it is far from an easy solution.

Mr BEVIS—What should we do the research in? If we are going to increase the R&D in defence related matters, what should it be in?

Dr Lyon—There are probably two things that are going to be important to the future. There are two things at the moment that make the US stand out from other countries—that is, their ability to tap into space based systems and their ability to process large amounts of information quickly and distribute it to troops. Being able to work in that field is, I think, where the future lies. Future battles are going to be fought almost in real time. You have to be able to know what is happening on the battlefield, even though that battlefield covers hundreds of thousands of square kilometres. You have to know it almost as it happens. So things that give you good command and control and as precise a knowledge of the battlefield as you can devise is where the leverage comes.

You can find countries all around the Asia Pacific region that are buying into more complex weapons in terms of longer range which will go faster and will be harder to counter. But those countries are going to face a fundamental problem in that using a missile with a range of 200 kilometres is only useful if you know what is 200 kilometres away.

Mr BEVIS—Don't those sorts of developments simply shift the point of vulnerability? The system vulnerability then becomes an information warfare question and you can disorient, in some senses, more easily an aggressor who relies upon that.

Dr Lyon—It does give you a different vulnerability and it requires an opponent fighting you to target that vulnerability but, even if he is successful in doing it, the best he can do is re-establish equal terms.

Mr BEVIS—So we need R&D in that as well?

Dr Lyon—You need R&D because, in terms of being able to fight the war with what is always going to be a small population and a relatively small force, you have to get the leverage that comes from being able to use the force most effectively. I do not think you can just play the numbers game.

Mr SINCLAIR—I found your thesis interesting. I think we are all in favour of research and development; it is like motherhood. You made the point in your paper about decision making in regard to equipment purchases and two major costs. I see that as the same real criticism that you can apply to those areas that you have identified.

Obviously we have an advantage in piggybacking on what others are doing. There is no point in duplicating it. I suggest that in the field of information systems and generally in the field of IT there is a great deal of work being done. My real worry in your thesis is a little different—apart from having to pick where you go—in that we have always had this problem of development costs. The real difficulty is not finding something; it is proving that it will work and then developing the parameters within which it can work and the way in which you are going to deliver it. In that, I think, we have an enormous problem.

I would accept that we have to spend more money on R&D, but I am a little concerned as to where that money is spent. Is it in DSTO? Is it by a few more CRCs? Is it by piggybacking and sending a few more Australians to work overseas? Whichever way you go, it is that development—or whatever the new technology is—that really is going to be our predominant difficulty. Without all those other systems that you want to pull back on, I do not know if we are going to be able to apply that new technology sufficiently to prove that it is worth while.

Dr Lyon—The point you identify is a valid one in the commercial world as well as in the defence area. Picking up breakthroughs in science, picking up research effort and translating it into product is always difficult. Devising the structures that do that is something that I certainly am not an expert at, but it does entail very close cooperation between defence industry and the research centres.

Mr SINCLAIR—I suppose that is where I worry about total reversion of your processes. While everyone accepts that tomorrow's wars are not going to be the same as today's or yesterday's, I think that, unless you have a force in readiness which is capable of fighting today's wars, tomorrow will never come and you are going to be in a position where your deterrent capability at the conventional level is less and, consequently, your vulnerability higher. Therefore, the total need of national commitment to defence is likely to be greater rather than less.

Dr Lyon—I guess I am not a strong believer in conventional deterrence at the best of times as it seems to fail so very frequently throughout history. However much people denounce nuclear deterrence, it does seem to hold. Conventional deterrence does not seem to deter very effectively. I think the best thing you can still do is analyse your strategic environment. I do not see where the level of threat is to Australian interests in the next 10 years. While you have that benign environment, even though it will not last, you have to take the opportunity to prepare for tomorrow's war and not for today's.

Mr SINCLAIR—I noticed in your paper you have suggested that we should not give priority to peacekeeping. Surely there is a problem in our region of knowing to what degree—in a number of the contingencies that are immediately foreseeable, whether it is the Fiji of yesterday, the Bougainville of today or potentially a range of the other difficulties in other neighbouring countries—you see the priority for developing a

capability to play some role in those types of offshore exigencies. Do you really support the Dibb thesis that we ought to have, as we have at the moment, essentially a defence force oriented towards low-level defence threats?

Dr Lyon—I think you have a defence force aimed at whatever you think the level of threat you are most likely to encounter, and the one most important to you. Peacekeeping missions will have diplomatic importance for Australia, but they will not usually have a security importance. Often, even if a peacekeeping mission does not go ahead at all, it does not drastically affect Australian security.

Given the plethora of peacekeeping missions that are probably in the wind—the UN, while it has shrunk away from a lot of the over commitments of the early 1990s, is still going to be doing peacekeeping missions around the world—we will have to have the forces that can contribute to those missions. We have to spend money on training them to work with regional partners in such areas. We do not want to have to train them on the ground in particular cases. I do not regard it as a priority in determining defence spending. It is an incidental cost, I guess, that the defence forces pick up. It is done more, I think, in the name of diplomacy than in the name of defence.

Mr SINCLAIR—You do not have a view about the Paul Dibb theory?

Dr Lyon—I do not think that low-level contingencies should be the guide to Australian defence structure. I am of the view that Australian security is still set at some distance from our shores and not close to our shores. One of the fallacies I think that we still have is that we have designed a defence force that starts with the homeland and then works out.

There are good logical reasons to do that. Because you have a large continent and a small population, you are naturally worried about doing your first mission of securing the homeland and then you start to see where threats to the homeland might come from. I think Australian security interests are not just about protection of the homeland. They are in essence about maintaining a stable balance of order in the world. The reason we went and fought in the Gulf against Saddam Hussein is that we believed he would disrupt that order.

Had you gone around to Australian politicians in July 1990 and asked them where the ADF would next be committed in an operational theatre overseas, almost none of them would have said the Middle East. But that is where we went. I still think if you go and ask them the same question today—where will the ADF next field in an operational theatre?—a lot of them might not say the Middle East, but I suspect it might still be the answer.

Mr SINCLAIR—Whether or not it is the answer—I will not go into the obvious training advantages of peacekeeping—it seems to me that even though you wish to change

priorities, if you are not going to increase defence spending, I find it difficult to achieve the outcomes that you seek. Each time you tease out one or other of the ideas, there is a consequence which essentially means that we need to be more capable—either in research and development, in modernisation or whatever it might be in the order that you have set—than we are now. Do you really think we can achieve that within our present budget?

Dr Lyon—It is my view that we can achieve it within the present budget or within only the most marginal of increases, simply because a lot of the share of the budget now goes towards personnel, readiness, operation, maintenance and training. I admit: you cannot chop all of those things too hard, but you might be able to chop them enough.

Chairman—There being no further questions, I thank you very much for your attendance, Dr Lyon. We will be circulating the transcript of the proceedings this afternoon to you for your grammatical correction. I thank you all for your attendance.

Subcommittee adjourned at 2.58 p.m.