

2009/10 DEFENCE BUDGET ANALYSIS

Culture of economy puts the onus on Defence to pay for its own capability development

Trevor J Thomas/CANBERRA

Budget night 2009 saw the Treasurer, Wayne Swan, framing his opening speech in the context of 'a downturn in global economic conditions unprecedented in our lifetimes'. He told Parliament virtually every advanced economy was expected to suffer a deep recession in 2009, and went on to profile an economic vision whereby GDP would fall by half a per cent in the coming financial year, whilst the unemployment rate would increase to 8.5% by June 2011.

Faced with such an outlook, Swan said the Government had moved several times over the past nine months to stimulate the economy, with successive initiatives predicated upon large domestic consumption and infrastructure spending, all financed by a substantial borrowing program that he conceded would push the underlying cash deficit to \$57.6 billion (4.9% of GDP) in 2009/10.

In an environment where substantial amounts of money are being freely appropriated in the Federal Budget, Defence spending in the 2009/10 Budget papers first appears to have been spared any savage cuts, in light of the Rudd Government honouring its pre-election commitment to sustain the growth of military spending in the near term years at similar levels to that of the former Howard government (ie: 3% real per annum).

There is a twist, however. While total Defence funding of \$26,641.5m in 2009/10 shows a healthy increase of 14.9% over the estimated actual for 2008/09 (of \$23,169.3m), the subsequent year's increase is only 1.45% (2010/11) to \$27,028.0m. After that, the funding level falls further, \$27,001.7m in 2011/12, and \$26,337.9m in 2012/13. How can this be so when the Prime Minister and Defence Minister Fitzgibbon have hailed their new Defence White Paper as being of generational significance?

Force structure review

The answer lies in the build up of pressures upon Defence managers over the next few years to really get on and deliver substantial savings and efficiencies across the Department, in order that funds can be freed up to pay for the new military capability ambitions outlined in 'Force 2030'.

While Defence is said to have undergone significant change over the past two decades, the White Paper concluded further reforms are needed in areas such as procurement, the quality of advice provided to the Government, and financial management to align defence with evolving best practice. The Government has accordingly endorsed a Strategic Reform

Program (SRP) designed to fundamentally overhaul the entire organisation, with the aim of driving efficiencies and creating savings that will be reinvested into remediation and new capability for the ADF.

Indeed, the expectations for savings and efficiencies are so great (ie: \$20 billion over ten years), that if they are not achieved, little of the major 'Force 2030' re-equipment program could be afforded unless the Government of the day subsequently agreed to put in fresh money. At this stage, the Rudd Government is not indicating it will be in a position to do so.

Eight 'Companion Reviews' - information & communication technology, logistics, preparedness personnel & operating costs, estate, workforce, science & technology, capability development & industry capacity - were commissioned as part of the development of the White Paper, as well as an Intelligence Capability Review (Bradley Review).

The Companion Reviews analysed the 'backbone' of the business of Defence against a backdrop of emerging commercial, technology and business trends out to 2030 to position Defence to meet future needs and improve capability outcomes for the ADF. The SRP then came into play in harmonizing the recommendations of a Defence Budget Audit, with the recommendations of the Companion Reviews and the Bradley Review combining to create a comprehensive reform package.

The Strategic Reform Program (since endorsed by the Government), is said in the Budget papers to comprise "a comprehensive set of reforms that will fundamentally overhaul the entire organisation, driving efficiency and creating over \$3 billion of savings across the Budget and Forward Estimates." These savings incorporate and build upon those already identified for reinvestment as part of Defence Minister Fitzgibbon's own Defence Savings Program.

Returning to the 2009/10 Budget, in one fell swoop, the decade-long record of expansion of annual Defence expenditures stretching back to the Defence 2000 White Paper has been erased from the official papers and, subject to release of the new 'Force 2030' Defence White Paper, financial accounts moving forward will be based on a new long-term funding model for Defence predicated upon the new strategic assessment and military capability enhancement vision.

Every dollar spent on defence will either have to be saved or borrowed

Reflective of these shifts, the new funding model outlined in the 2009/10 Defence Budget papers is nevertheless presented by its authors as providing greater certainty and stability for the Defence budget in the long term - assuming major savings are realised from proposed reform programs.

Clearly, the implication is Defence managers will be squeezed over the next few financial years to hunker down and deliver major savings, which will be immediately quarantined into the new Defence Strategic Investment Reserve, and not returned to the Department until mid-way into the next decade.

The new long-term funding commitment and the change to Defence indexation has to date been sold by the Government as providing Defence planners with a stable, clearly defined envelope within which resourcing decisions can be managed. Over the next decade, the new funding model is said in the Budget papers to provide Defence with total funding of \$308 billion. Over the period to 2029/30, additional new funding of \$146.1 billion is promised for Defence (as against funding projections set at the time of the February 2009 *Updated Economic and Fiscal Outlook*), by:

- continuing the commitment to grow underlying Defence funding by 3% on average in real terms to 2017/18, with 2.2% average real growth per annum thereafter to 2029/30;
- providing fixed indexation at 2.5% each year to 2020/30, which accords with the target for consumer price inflation agreed by the Australian Government and the Reserve Bank of Australia, for the purposes of Defence planning;

- implementing a comprehensive program of reform, efficiencies and savings, generating around \$20 billion worth of savings over 10 years;
- reprogramming existing capital acquisitions to meet the new strategic assessment and timetable in the 2009 Defence White Paper; and
- instituting a commitment by Defence to meet any shortfalls in the White Paper through further internal efficiencies within Defence.

The new funding model applies from 1 July 2009, with increases resulting from the new indexation approach over the forward estimates being returned from 2016/17 onwards, in line with outer year funding demands for Defence's 'Force 2030' acquisition timetable. Defence funding will transition to the new long-term path over 2013/14 and 2014/15.

To enable this, Defence funding has been set \$1 billion below the new long-term funding path in 2013/14, with a further \$500 million withdrawal in 2014/15, after which higher funding levels begin to be phased in. The Budget papers then indicate such amounts will be added back to the Defence budget from 2016/17 onwards.

The Forward Estimates accordingly show that savings of \$2 billion over three years from 2010/11 (ie: -\$100m, -\$200m & -\$1,700m) will be withdrawn from the Defence Budget, and not planned for return until the period beyond 2015/16 to meet funding pressures building in relation to new acquisitions being undertaken to deliver the military capability enhancements set out under 'Force 2030'. More accurate timings on these shifts are not expected to achieve visibility until publication of the 2009-2019 Defence Capability Plan (DCP), later in 2009.

Defence reforms are thus envisaged to deliver gross savings of around \$20b over the mid to latter years of the decade. SRP savings are expected to be supplemented by further savings initiatives, reprogrammed funds and by new funding from Government to provide nearly \$45b in total for investment in new initiatives.

At least \$30b of this will be more immediately invested to 'fill holes' in the Defence budget, fix critical equipment and capability gaps, and remediate the enterprise backbone. Of the remaining \$15b of savings across the decade, a net \$1.6b will be returned to the Budget (comprising \$2b returned over the Forward Estimates and repayments commencing in 2016/17), with the balance (\$14b) funding new capability acquisitions and other new initiatives.

Projects up for 'first'-pass approval

In the mean time, the Government has listed the following significant DCP projects that will be considered for 'first'-pass approval over 2009/10, on the proviso that such projects will only be progressed to Government approval if quality data can be provided (as required by the 2003 Kinnaird Review):

Sea 1439, Phase 6 - Collins Sonar Replacement: This project was first listed in the 2004-14 DCP, and proposed to upgrade for \$350-450m the original Thomson sonar system in the 'Collins'-class submarines. Phase 6 was scheduled for first-pass approval over 2008/09.

Sea 1448 Phase 4A – 'Anzac'-class frigate Air Search & Further Capability Enhancements: This project was first listed in the 2006-16 DCP and proposed to replace for \$350-450m the SPS-49 long range volume air search radar, and electronic sensor systems on the subject frigates that were not updated under Sea 1448 Phase 2.

Sea 1442 Phase 4 - Maritime Communication Modernisations - Tranche 1: This project was first listed in the 2001-10 DCP and proposed \$200-250m to enhance the Maritime Tactical Wide Area Network (including expansion of MTWAN into Fleet units) not provided for in earlier phases. It also intends to integrate capabilities being delivered to maritime platforms

by other approved communications projects, and will consider the replacement of radios, antennas and other systems to enhance maritime communications.

Air 9000 Phase 8 - Future Naval Aviation Combat System: This project was first listed in the 2006-16 DCP, and proposed to replace for \$2.5-3.5b the Navy's S-70-B-2 'Seahawk' helicopter fleet (and cancelled project Sea 1411 'Super Seasprite' helicopters), with one new helicopter type missionised for anti-submarine and anti-surface warfare.

Air 5276 CAP 2 - AP-3C Capability Assurance Program 2: This project was listed in the 2006-16 DCP and proposed to replace for \$75-100m the AP-3C Data Management System (DMS), which is the centre of the AP-3C mission system. An updated DMS will ensure that follow-on systems sought under CAP 3 (to upgrade the radar, mission simulator, acoustic system, data links and electronic support measures in the AP-3C) will have a robust and modern core to facilitate the task of integration and through-life support. CAP 1 is equipping the 'Orion' fleet with 'StarSafire III' electro-optic/infra-red sensors, a high data-rate communications system (ie: tactical common data link), and a replacement video recorder system to support the provision of real time information and high-speed streaming of data.

Air 5438 Phase 1A - Lead-in-Fighter Capability Assurance Program: This project was first listed as phase 1 in the 2006-16 DCP and proposes to provide for \$350-450m the project Air 6000 New Air Combat Capability (ie: Joint Strike Fighter) with an effective lead-in fighter trainer capability by upgrading the 'Hawk' Lead-in Fighter to incorporate sustainability modifications and a range of capability enhancements.

Air 8000 Phase 1 - Battlefield Airlift - Additional C-130J: This project was first listed under in the 2006-16 DCP and proposes to refurbish or replace for \$750m-\$1 billion the C-130H fleet. Two additional C-130Js are now to be acquired to transition the Special Forces air deployable rigid hull inflatable boat (RHIB) capability, which was originally installed in the 'H'-model aircraft. The 2009 Defence White Paper scheduled the 12 'H'-models for retirement.

Joint Project 2044 Phase 3A.1 - Project Eagleye (Defence GEOINT Capability): This project was first listed as phase 3 in the 2001-10 DCP and proposed to acquire for \$50-\$75m a new high resolution, cloud penetrating, synthetic aperture radar imagery satellite for mapping, charting, navigation and targeting data. A more contemporary cost for this capability is in the order of \$400m.

Joint Project 2044 Phase 4 - Digital Topographical Systems Upgrade (Defence GEOINT Capability): This project has not previously been listed in the DCP.

Joint Project 2065 Phase 2 - Integrated Broadcast System: This project was first listed in the 2004-14 DCP and proposes to upgrade for \$30-50m the Australian Integrated Broadcast System (IBS) to maintain compatibility with allies and introduce new system capabilities. The IBS system disseminates directly to deployed forces the tactically significant information produced by Australian and allied intelligence, surveillance, reconnaissance and Blue Force tracking systems. The project's vision includes an information management centre that manages and bridges information between computer networks and satellite components with suitable gateways to real-time tactical data links.

Joint Project 2072 Phase 2A - Battlespace Communications System: This project was first listed in the 2001-10 DCP and proposed for \$450-650m (2006 DCP) to continue the rollout of modern communications infrastructure to high readiness land formations and units of the ADF. This phase aims to replace ageing analogue combat radios, trunk radios and switching infrastructure in the land environment. It will also provide the capability 'bricks' to achieve the ADF's Network Centric Warfare milestone of the Networked Brigade. A contract with General Dynamics to design and build the battlespace communications network for Army was terminated by Defence in late-September 2007.

Joint Project 2080 Phase 3 - Defence Management Systems Improvement: This project was first listed in the 2004-14 DCP and proposed for \$30-50m (2006 DCP) to upgrade the core financial and personnel management information systems of Defence to ensure they

continued to provide effective support to the Australian Defence Organisation. This in turn will ensure the ongoing sustainability of Defence Enterprise Resource Planning Systems to support Defence capability and decision-making requirements.

Joint Project 2090 Phase 1C - Combined Information Environment: This project was first listed in the 2006-16 DCP and proposed for \$30-50m (2006 DCP) to upgrade, augment and enhance Defence's existing fixed and deployable network infrastructure and services used to support electronic exchange of information with key allies and coalition partners across national and coalition security boundaries. This capability is important for Defence to enable it to support both the planning and conduct of operations and the day-to-day business of Defence with other nations.

Joint Project 2085 Phase 2/3 - Explosive Ordnance Warstock: This project was first listed in the 2004-14 DCP to purchase reserve explosive ordnance stocks to satisfy work-up and some concurrent contingency requirements. Phase 2 was valued at \$250-350m (2006 DCP), while Phase 3 similarly intended to purchase for \$250-350m critical reserve explosive ordnance stocks for remaining concurrent contingency and all safety stock requirements. Phase 3 will particularly address stocks of newer weapons such as the 'Excalibur' 155mm precision guided munition, and SMARt 155 sensor-fused munition.

Joint Project 2097 Phase 1B - Enhancements to Special Operations Capability (REDFIN): This project was first listed as phase 1 in the 2004-14 DCP and proposed to acquire for \$350-450m (2006 DCP) new special operations vehicles, direct fire support weapons, chemical, biological, radiological and nuclear protective response equipment, and night fighting equipment. It seeks to further acquire a networked command, control and communications (C3) capability, a data up-link to provide target information to strike platforms and 'stealthy insertion methods'.

Projects up for 'second'-pass approval

Projects scheduled in the 2009/10 Defence Budget papers to receive 'second pass' approval consideration over the year include:

Air 5416 Phase 4B.1 - C-130J Radar Warning Receiver: This project has not previously been listed in the DCP.

Air 5416 Phase 4B.2 - C-130J Large Aircraft Infra Red Counter Measures: This project has not previously been listed in the DCP, however, a US Defense Security Cooperation Agency notification to Congress indicated the RAAF's C-130J tactical transport fleet would be fitted with Northrop Grumman's AN/AAQ-24(V) LAIRCM system for an estimated cost of \$125m.

Air 5440 Phase 1 - C-130J Block Upgrade Program 7.0: This project was not previously listed in the DCP.

Air 6000 Phase 2A/2B - New Air Combat Capability (3 Squadrons): This project was first listed in the 2001-10 DCP and intends to acquire for \$12-14b the first tranche (72 aircraft) of the multi-role F-35 'Lightning II' Joint Strike Fighter, to replace the RAAF's F/A-18 'Hornet' fighters as they are withdrawn from service.

Air 9000 SCAP 1 - Seahawk Capability Assurance Program: This new project has not previously been listed in the DCP, but was flagged in the 2007/08 Defence Annual Report. 'First pass' approval to advance SCAP 1 was given during the third quarter of calendar 2008. This project will ensure the current level of 'Seahawk' anti-submarine capability is optimised until introduction of the Future Naval Aviation Combat System under phase 8 of project Air 9000, mid-next decade.

Sea 1397 Phase 5A - Nulka Missile Decoy Enhancements: This project was not previously listed in the DCP, but was scheduled for first pass approval over 2008/09.

Land 75 Phase 3.4 - Battlefield Command Support System: This project was first listed in the 2001-10 DCP and flagged a \$75-100m further rollout of the (Saab Systems) Battlefield Command Support System, and acquire an interim Battle Management System (including a fleet of digital combat net radios) capability to equip a Battle Group. Phase 3.4 is an element of the combined tender for Army C4I, known as 'Land 200'.

Land 125 Phase 3A - Soldier Enhancement Version 2 - Command, Control, Communications, Computing and Intelligence Component: This project was listed as phase 3 in the 2006-16 DCP and intended for \$450-600m (as a combination of C4I, lethality and survivability) to introduce incremental enhancements to the ADF's Close Combat Capability through limited integration of mature military-off-the-shelf technologies in C4I.

Land 125 Phase 3C - Soldier Enhancement Version 2 – Lethality: This project was first listed as phase 3 in the 2001-10. The SEV spiral development methodology was adopted mid-last decade after cooperation with the US Army 'Land Warrior' program (in which Australia was partnered), was practically abandoned. Phase 3C intends to introduce incremental enhancements to the ADF's Close Combat Capability through acquisition of the enhanced 'Austeyr' F88 SA2 integrated (incorporating the Rifle Input Control device) rifle system and better night/day surveillance capabilities.

Joint Project 2070 Phase 4 - AP-3C Light Weight Torpedo Integration: This new project (phase) has not previously been listed in the DCP. The EuroTorp MU90 Lightweight Torpedo was acquired under phase 3 of JP 2070 to equip the ADF's AP-3C 'Orion' maritime patrol aircraft and S-70-B-2 'Seahawk' helicopters with an anti-submarine capability. Phase 3 is also establishing an Australian manufacturing and support capability for the MU90 torpedo, and will deliver a number of reserve stock rounds. Integration of a lightweight torpedo to the Orions was first canvassed in the 2000 Defence White Paper, with the intention of them being operational by 2002. Defence Minister Fitzgibbon was reported in June 2008 to have scrapped the project, citing perceived high systems integration risk involving old aircraft.

Joint Project 2008 Phase 3H - Military Satellite Capability Ground Stations: This project phase was not previously listed in the DCP. The new ground stations will relay communications data from the Wideband Global SATCOM (WGS) constellation, enabling the next generation of ADF military capabilities - air warfare destroyers, amphibious ships, multi-mission manned and unmanned aerial vehicles and land platforms - to operate in a network centric environment. Under Phase 4 of the project, Defence partnered with the US Air Force and is acquiring the last (of six) WGS satellites. The first satellite (with a footprint over the Pacific Ocean) has been providing operational capability to Australia since June 2008. The second satellite is expected to provide operational capability from August 2009. Planning and monitoring tools will be installed in the Defence Network Operations Centre by December 2009 to provide real-time management of WGS resources allocated to Australia under the partnership.

Joint Project 2089 Phase 2B - Tactical Information Exchange Domain (Data Links): This project was first listed as phase 2 in the 2004-14 DCP, and intends to deliver for \$100-150m tactical data links to legacy platforms of the ADF, and the infrastructure required for supporting tactical data exchange at the force level. Link 16 and Variable Message Format (VMF) will be implemented in the 'Anzac'-class guided missile frigates, and VMF on the F/A-18 'Hornet' aircraft. Ground based elements, including the project Air 87 'Tiger' Armed Reconnaissance Helicopter and tactical air transport may also be included in the project.

JP 154 Phase 1 - Joint Counter Improvised Explosive Device: This project has not previously been listed in the DCP, albeit previous Defence Budget papers have referred to Defence and DSTO operatives working on rapid capability acquisition programs, as well as collaborating with US and other allied nations on counter-IED technologies.

Joint Project 2110 Phase 1A - Chemical, Biological, Radiological, Nuclear Defence: This project has not previously been listed in the DCP, but was scheduled for first pass approval over 2008/09. Australia's CBRNE capability was re-constituted after originally being

disbanded following the 2000 Sydney Olympics. Units are now integrated with the Incident Response Regiment.

Supplementary 2009/10 Defence Budget Initiatives

The 2009/10 Federal Budget also included funding for a number of other smaller initiatives related to implementation of changes to defence-industry policies.

Global supply chain opportunities: The Government will provide \$15.3m over four years from 2009-10 to assist Australian small and medium enterprises to compete for domestic and international Defence contracts. This will be achieved through training and mentoring industry with the goal of it becoming more competitive, more capable and with increased capacity to be able to compete for and win global supply chain opportunities. The cost of this measure will be met from within the existing resourcing of the Defence Materiel Organisation.

Australia's commitment to Afghanistan: The Government will provide \$1,269.4m (including \$1.8m in 2008-09) primarily for the net additional cost of an expanded commitment to Operation 'Slipper' - Australia's military contribution to international stabilisation and reconstruction efforts in Afghanistan. The expanded role will be part of a whole-of-government approach, including the eight-month deployment of an ADF taskforce to assist with the conduct of elections in Afghanistan. Australian Federal Police officers will also assist Dutch Military Task Force Oruzgan with the delivery of its police training program. This measure is also expected to lead to a reduction in revenue of \$58.3m over two years as deployed personnel are taxed concessionally on their base pay and allowances while on deployment.

ADF Military presence in Iraq: In line with the Government's commitment to reduce Australia's military presence in Iraq, the Australian Defence Force's embedded personnel commitment in Iraq will cease by 31 July 2009. The Government will provide \$2.2m to meet the cost of this operation until its cessation. The Government will also provide \$73.5m over three years for the net additional cost of Operation 'Kruger', the ADF security detachment protecting the Australian Embassy in Baghdad, until June 2010.

Land operations in complex environments: The Government will provide \$70.8m over four years (including capital funding of \$29.1m) from 2009/10 to increase the Army's capacity to deploy specialists to conduct field intelligence and information operations in support of land operations in our region. The cost of this measure will be met from within the existing resourcing of the Department of Defence. The Government will provide \$87.5m in 2009/10 to the ADF to improve efficiency in operations by consolidating support assets within the Persian Gulf region.

Priority Local Industry programs: The Government will provide \$9.2m over four years from 2009-10 to establish Priority Industry Capability (PIC) Centres of Excellence. Defence will work with industry to investigate and develop initiatives, including skilled workforce development and technology incentives that improve defence industry capability or capacity. The cost of this measure will be met from within the existing resourcing of the Defence Materiel Organisation.

The ADF in Timor-Leste: The Government will provide \$211.1m over three years for the net additional cost of extending Operation 'Astute', Australia's military contribution to maintaining stability in Timor-Leste, until June 2010. This measure is also expected to lead to a reduction in revenue of \$12.9m over two years as ADF personnel are taxed concessionally on their base pay and allowances while on deployment.

Finance to Manage Microsoft Licenses: The Government has decided that the Department of Finance & Deregulation will manage a volume sourcing agreement (VSA) made with Microsoft for the supply of its products to Australian Government agencies. The centralised VSA provides an opportunity to achieve savings by utilising the Commonwealth's combined purchasing power and reducing administration costs. Savings will be retained by agencies. The Department of Finance & Deregulation will receive funding from agencies to cover the cost of the across government VSA.

National Security Adviser Group: The Government will provide \$17.9m over five years (including \$0.7m in capital funding in 2008-09) to establish the National Security Adviser Group within the Department of the Prime Minister & Cabinet. The new Group will support implementation of the recommendations of the Homeland & Border Security Review conducted by Ric Smith, including improvements to strategic leadership and coordination of national security in Australia.

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13 May 2009