

Easier said than done:

At the six-year mark in remaking the ADF

Mark Thomson

The basic statistics from this year's Defence budget are easy to recount. A total of \$17.5 billion of taxpayer's money will be expended on our defence next financial year. This is around \$880 million more than last year, and represents just less than 1.9 per cent of GDP. New funding measures include \$420 million for our expanded and continuing role in Iraq, \$300 million for extra capital investment next year and \$192 million over four years for improved security, including two additional Armidale class patrol boats earmarked to protect oil and gas infrastructure on the North-West Shelf.

As impressive as this all sounds, it tells us little about what's actually going on below the surface. In particular, these figures give no indication of the progress, or otherwise, towards transforming the Department of Defence and the Australian Defence Force (ADF) to meet the challenges of the future. And that is what really matters given that over the last six years they have both been undergoing a profound transformation on two fronts.

The first concerns the shape and posture of the defence force, and the second involves the internal management of the broader Defence organisation. As it happens, this year's Defence budget brought news on both fronts; some encouraging, some not so. To properly understand this year's budget, it's necessary to go back to the late 1990s to see how the imperative for change arose.

Two transformations

At the end of the last decade, the ADF was well and truly 'fitted for but not with'. After more than fifteen years of defence funding being held effectively constant in real terms, the force was hollow, poorly prepared and badly in need of equipment modernisation. Throughout the 1990s Defence strived valiantly to free up money for capital investment and logistics through efficiency initiatives – the Commercial Support and Defence Efficiency Programs in particular. But the rising cost of personnel and equipment soon outpaced the money made available through these measures.

Even under the prevailing strategic guidance of the era – which assumed that any major challenge would come with sufficient warning time for the force to be built up in time to

face it – this was a poor state of affairs. Indeed, while the guidance of the day identified the need to hold sufficient forces ready for 'short-notice' contingencies it is debatable whether this was actually achieved in practice.

In early 1999 it became clear that Australia would probably be called upon to make a significant contribution to a UN operation in East Timor later in the year. Urgent steps were taken to boost the preparedness of the ADF – and not before time. As history played out, by September of that year we found ourselves leading a UN-mandated mission to restore peace and security to the nascent state of East Timor. At the peak of the operation, around 6,000 ADF personnel including three battalions of troops were deployed. It's fair to say that the success of the operation resulted as much from the ingenuity and perseverance of those involved as from the ADF being in a high state of preparedness, especially as far as the long-neglected area of logistic support went. East Timor was the wake-up call that led to the 2000 Defence White Paper.

Defence 2000, as the White Paper was called, made four key changes: First, it explicitly rejected the notion of 'fitted for but not with' and instead directed that the ADF be made up of 'fully developed capability' that was ready to deploy at shorter notice. Second, it set a new goal for the size of the ADF; an expansion to 54,000, rather than a reduction to 50,000 as had been planned following the 1997 Defence Efficiency Review. Third, it set out a \$50 billion decade-long program of capability development called the Defence Capability Plan. Fourth, and most critically, it made a commitment to 3 per cent real growth in defence spending across the decade. As a package, this represented the largest single force modernisation and expansion program since the mid-1960s build-up during the Vietnam conflict.

Unfortunately, the goals of *Defence 2000* soon proved to be easier said than done. The first year of implementation saw Defence left with around \$800 million lying idle in the bank – hardly an auspicious start. There were two reasons for this. First, Defence's internal financial management was in a state of profound disarray. This was the result of several factors including the faltering introduction of new management information systems, the transition to accrual accounting and

an effective collapse of the internal budget process. Second, the rapid growth in capital investment that was envisaged by *Defence 2000* was proving much harder to deliver than first anticipated. This reflected not only shortcomings in the acquisition process but also the practical constraints of what industry could deliver in the short term.

Although no announcement was ever made, around 2003 a second transformation program began for Defence; a transformation from chaotic financial management and ineffective acquisition processes to disciplined stewardship of the defence dollar. This was not simply a matter of tighter management for its own sake. In many ways, the ability to move from being ‘fitted for but not with’ to ‘fully developed capability’ was, and remains, contingent on substantial improvements to higher defence management and procurement processes.

Around this time the strategic environment was more demanding, and more uncertain, than for several decades. This saw the ADF sustain a high operational tempo through Afghanistan and Iraq while troop numbers in East Timor only slowly declined. Then, in mid 2003, the deployment to the Solomon Islands in support of the federal police placed further demands on personnel and assets. This period also saw extra money flowing to Defence above the funding delivered by *Defence 2000* and beyond the (fortunately now mostly) routine supplementation provided for operations. This included a substantial boost to logistics of around \$400 million per annum plus extra money for the ADF’s expanded role in domestic security amounting to around \$200 million per annum. The latter was part of the Government’s much larger whole-of-government program of strengthened security that will see more than \$6 billion spent across the current decade. For Defence, this included additional personnel and resources for its intelligence and counter-terrorism response capabilities.

It was against this challenging and rapidly changing strategic environment that the goals of the 2000 Defence Capability Plan began to look more and more elusive. For three years in a row, Defence found itself unable to spend the money it had available to deliver projects, while at the same time the cost of individual projects began to rise significantly making the plan unaffordable in any case. To make matters worse, the strategic priorities of the 2000 White Paper had not been updated following the events of 9/11 and the strategic upheavals that ensued. Indeed, although the Minister for Defence released a strategic update in February 2003, it gave absolutely no indication of how the size and shape of the ADF might change. Thus, it was no exaggeration to say that by 2003 that the Defence Capability Plan was undeliverable, unaffordable and uncertain.

Two reviews

In that same year, two major reviews were undertaken to get the Defence Capability Plan back on track. The first was the Defence Capability Review that examined the current and

planned structure of the ADF. Central to this was a rewrite of the Defence Capability Plan in light of changed priorities, rising project costs and the practical constraints of what could be delivered. The second was the Defence Procurement Review that asked what was wrong with a system that too often delivered defence capability late, above budget and below specification.

The results of the Defence Capability Review were released in late 2003 and backed up with a new Defence Capability Plan in early 2004. Key changes to the existing force included the early retirement of two FFG frigates, the mothballing of two newly acquired mine hunters, and the early withdrawal of the F-111 fleet from service in 2010 rather than 2020. On the plus side was the decision to acquire main battle tanks for Army and a hefty boost to the size of new amphibious vessels planned for the Navy at the end of the decade. The new Defence Capability Plan also changed a lot. While some new projects were added, the overall thrust was a deferral of when new capability would enter service. This was unavoidable given the dual pressures of rising individual project costs and what turned out to be a reduced funding envelope in the near-term.

The reduced funding for capital investment in new equipment was not the result of budget pressures (the same cannot be said of the cuts to existing naval and air capabilities). Rather, it reflected the realisation that Defence’s acquisition agency – the Defence Materiel Organisation (DMO) – was simply unable to deliver the original package of capability according to schedule. Moreover, the spending was not actually cut; it was rescheduled into the future where it was hoped that the DMO’s capacity to deliver new capability would be improved. All up, around \$2 billion was deferred from the first part of this decade to beyond 2008. In absolute terms this was not a major chunk of the \$50 billion decade-long program, but it was \$2 billion worth of capability that the ADF would have to wait even longer for nonetheless.

To make sure the DMO would be able to deliver the goods, the Defence Procurement Review (often called the Kinnaird Review after its chairman) recommended a widespread reform program to change the way the DMO operated and to improve the way in which projects received approval. Both areas were equally important – many of the problems with defence procurement in the past reflect poor decisions during development and approval processes more than a failure by those tasked with delivering the projects.

Of the procurement reforms, two stand out. On the acquisition side, the DMO was to be re-established as a quasi-autonomous ‘prescribed agency’ (under the Financial Management Act) to encourage a more commercially-oriented culture. On the project approval side a new and strengthened process was introduced to ensure that proposals are only approved once adequate work is done to refine project risk, cost, schedule and specification.

In the lead up to this year’s budget, and as moves got under way to get the acquisition process back on its feet, Defence’s financial management took a tumble when its

financial statements were again qualified by the Auditor-General. Soon the newspapers were filled with lurid (and inaccurate) headlines about eight billion dollars worth of missing equipment. To the casual reader, it no doubt appeared that Defence's financial management had finally hit the wall head on.

Ironically, the opposite was more the case. Over the preceding two to three years, good progress had been made in tightening-up Defence's budgeting and internal management. If anything, the qualification of the accounts reflected greater vigour by the auditor than any substantive setback within Defence. The fact is that the decision to slavishly adopt commercial-style accrual accounting in government agencies was always going to take years for a large and diverse entity like Defence to achieve, especially with billion of dollars worth of property and equipment to account for. Even now, it will probably take another two to three years before the auditors are satisfied.

The 2005 budget

More important than any of the specific measures in this year's budget is what it said, albeit implicitly, about the ongoing changes to Defence's internal management and the transformation of the ADF itself.

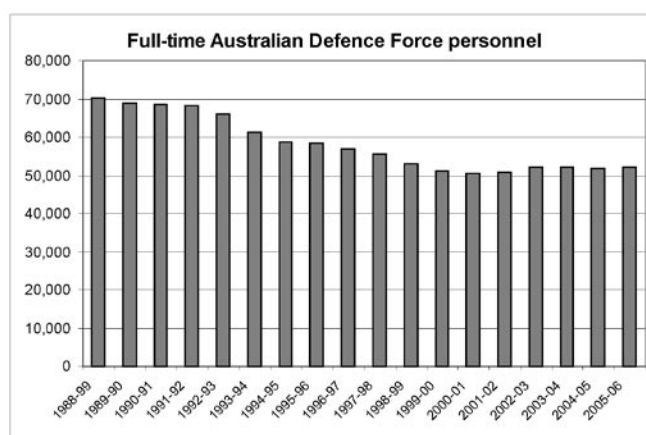
On the financial management side things are looking up. To start with, the de-merger of Defence and the DMO recommended by the Procurement Review is on track to occur on 01 July 2005. This in itself is not an inconsiderable feat. Moreover, the de-merger will put the day-to-day, mainly base-level or rear-area, repair and maintenance of Defence's diverse equipment holdings on a much more business-like footing. In effect, the three services will buy sustainment services from the DMO via agreements that specify the level of support and its cost. This is a big move away from the old soviet-style centrally planned approach. Over time, this should deliver both improved visibility of cost and performance while greatly boosting accountability for results and spending. This is arguably the biggest change to the way Defence goes about its business since the Defence Reform Program of 1997.

In a round about way, the budget also contained an important sign of more robust financial management being in place when Defence was given \$440 million in savings measures to deliver across four years. Extracting savings and efficiency dividends from agencies is a routine part of good housekeeping by the Government. It stops public agencies that are insulated from the rigour of the market place from becoming complacent and inefficient. The fact that Defence is in a situation to be able to deliver these savings (and they indeed are) shows that significant progress has been made since the chaotic days of 2002 when financial outcomes for the organisation were a roll of the dice.

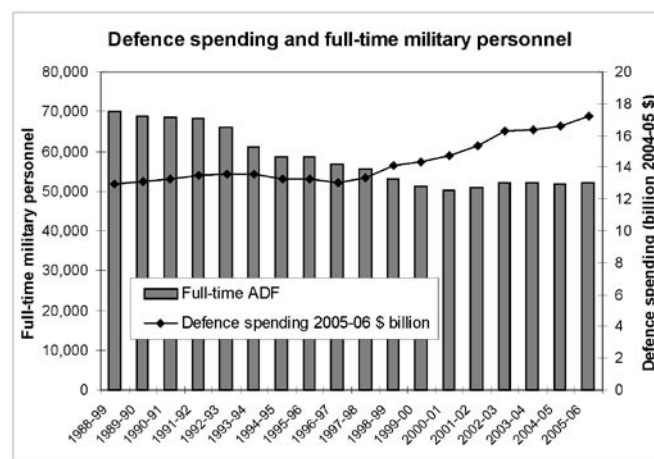
While these signs of progress are encouraging, more important was the opportunity afforded by the budget to

judge the progress in delivering an ADF that meets the strategic goals of the White Paper. Unfortunately, here the news here was mixed.

Buried deep in the budget was an alarming fact. For two years in a row the ADF has fallen in size. While the reduction is small – less than 200 people over two years – it comes at a time when the ADF is trying to grow as new capabilities are being delivered. In fact, the average funded strength for this financial year was almost 1,000 personnel below the target set in May 2004. The problem is not spread evenly. The Air Force is in the best position having posted historically low separation rates. The Navy is in a less comfortable position although it is better off than in recent years. The largest deficit is in the Army where progress towards five full-time infantry battalions and a full-time commando regiment has stalled.



This comes after four years of focused spending on recruitment, retention and, to an extent, improved conditions for Service personnel. In total \$400 million has been spent over the last four years and another \$100 million will be spent this year. This includes specific initiatives to address the challenge of recruitment and retention next year. Let's hope they work. Unless something happens to turn this around, the ability to recruit and retain personnel will become the Achilles' heel of delivering a larger and stronger defence force.



Every bit as important as personnel is the delivery of the new equipment needed to modernise the ADF. Here again the budget had mixed news.

On the positive side, the reforms to the DMO appear to be gaining early traction and the results are showing. The DMO is set to exceed its spending target this year and \$300 million dollars of previously deferred investment money has been reinstated into the budget for the next financial year. This is the best news we've had since the Defence Capability Plan was first released. Having said that, our optimism needs to be tempered with the fact that investment spending is planned to rise steeply over the next several years at a time when industry capacity is being stretched in several areas. Thus, while things are looking good, we may not be out of the woods yet.

Unfortunately, while the ability of the DMO to spend money has taken a turn for the better, the rate at which projects are approved has reduced to a trickle. At this point in time, only sixteen months after the revised DCP was released, the approval of projects is at least a year behind schedule. And if projects are not approved on time, it is very unlikely that they can be delivered on time.

There are probably several reasons for this delay, of which two stand out. First, the new more-rigorous process of project approval is taking a long time to establish. Hopefully, this represents a one-off delay as the new procedures are bedded down in the Services, the bureaucracy and at the political level. But even if this is the case, it may mean that more people and resources will be required to maintain the flow of projects in the new system. To the extent that this is the source of the current delay, it is probably a burden worth carrying (for a while at least). It is better to take more time prior to the approval of a project than to rush in and suffer cost blowouts and delays down track.

The second probable cause of delay is that our strategic priorities are once again up in the air. Indeed, only a year and a half after the Defence Capability Review, a campaign is being fought within defence and strategic circles, and in wider public debate, over the merits of a 'networked and hardened' Army rather than the predominantly light-scales land force we now have. Until this is resolved, the priority, cost and details of many projects in the existing Defence Capability Plan will remain uncertain and therefore unapproved, especially if the overall defence budget is not increased to cover the improved land force capabilities proposed.

Whatever the reasons, the disappointing result is that the ADF will probably have to wait even longer for the capability it needs. The best we can hope for is that once the new project approval process is up and running, we will be able to catch up a little. In the meantime, the revised Defence Capability

Plan is growing more obsolete by the day as unapproved projects pile up.

The bottom line

There's more than a hint of Groundhog Day about the current situation. Just as in 2002 and 2003, we face big uncertainties over the direction and feasibility of rebuilding the ADF. But in at least one respect the situation is worse. We are about to commence the fifth year of the 'golden decade' of 3 per cent real growth in defence spending and, despite vague hints in the media, we are yet to see any guidance on the level of defence funding past 2010. A year or two ago this was untidy, but we are rapidly reaching the point where the uncertainty hampers coherent long-term planning for the ADF. New capabilities can take more than a decade from conception to initial delivery. As a result, it is simply not possible to properly plan or sustain a program of ten-year long projects within a five-year funding horizon.

Of course, deciding on the level of long-term defence funding cannot be done in isolation. Even in just strategic and defence terms it depends critically on the priorities for the ADF and on the specifics of the Defence Capability Plan, and vice versa. The time has come to sort this out. Three things must occur in tandem:

First, we need some clear direction on the future roles and capability priorities for the ADF. The Minister for Defence

has said that there will be a new strategic update. We can only hope that it comes soon. Moves are already afoot that stretch

the envelope of existing strategic guidance, in particular, the push by the Army to become 'networked and hardened'. Neither *Defence 2000* nor the 2003 strategic update included such a vision for our land forces. If such a fundamental shift is going to occur, it needs to be part of a clearly articulated strategic policy.

Second, we need a new Defence Capability Plan that reflects the clarified roles and priorities of the ADF and takes into account what can be achieved given the time needed to approve and deliver projects under the new arrangements. At the same time, the impact of rising project costs – and there are some – needs to be factored into the new plan.

Third, we need a renewed commitment from the Government on long-term defence funding. As things stand, the only guidance Defence has past 2010 is that the budget will be held constant in real terms. For anyone who knows the history of defence spending in this country, the phrase 'constant in real terms' sends a chill down the spine. That is how we got to the situation in the late 1990s where our defence force capabilities were so hollow, where modernisation was always a promise for the future, and the ADF was anything but prepared for the challenges that soon followed before it was really ready.

Does this amount to a new White Paper? Not necessarily. The challenges and uncertainties that need to be resolved today are little different from those of recent years, or indeed of those we might expect in the future. The underlying problem is that there is no routine, annual, disciplined process for whole-of-government assessments of our strategic position, which would then flow on to updates of Defence's strategic guidance, capability plan and long-term funding profile.

Indeed, while good progress is being made to improve both financial management and the delivery of capability by the DMO, Defence's core strategic and capability planning

processes remain ad-hoc affairs, and not as integrated with a wider whole-of-government process as they should be. Now that the financial and procurements areas within Defence are getting their act in order, it is high time for strategic and capability planning to catch up. Otherwise it's inevitable that the much needed and long overdue transformation of the ADF will continue to suffer delays, with all the wider strategic and operational risks this entails. ♦

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Conference Calendar

ADA members and other Defender readers may be interested in the following public conferences and activities:

- **Defence Materiel Organisation Defence & Industry Conference 2005**
Getting Down to Business (with the DMO as a prescribed agency)
20-22 June 2005, National Convention Centre, Canberra
Enquiries: (02) 6266-0247 or www.defenceandindustry.com.au
- **Land Warfare Studies Centre Rowell Seminar 2005**
Confronting Asymmetry: Military Conflict in the Early 21st Century
23 June 2005, Telstra Theatre, Australian War Memorial, Canberra
Enquiries: (02) 6265-9624
- **UNSW-University of Melbourne-QUT Homeland Security Summit & Exposition 2005**
Safeguarding Australia
12-14 July 2005, National Convention Centre, Canberra
Enquiries: (02) 9420-2020 or www.safeguardingaustraliasummit.org.au
- **King-Hall Naval History Conference 2005**
Sea Power Ashore and in the Air
21-22 July 2005, National Convention Centre, Canberra.
Enquiries: (02) 6127-6514 or seapower.conferences@defence.gov.au
- **RAAF History Conference 2005**
Masters of Air Power
12 August 2005, National Convention Centre, Canberra
Enquiries: (02) 6266-1355 or airpower@defence.gov.au
- **Chief of Army Conference 2005**
Facing Complexity: New Dimensions in Strategy and Warfighting in the 21st Century
22-23 September 2005, National Convention Centre, Canberra.
Enquiries: (02) 6265-9828 or www.defence.gov.au/army/lwsc
- **DSTO Land Warfare Conference 2005**
Warfighting in the 21st Century: New Threats, New Technologies, New Solutions
04-07 October 2005, Gold Coast Convention and Exhibition Centre
Enquiries: (08) 8259-5873 or www.dsto.defence.gov.au/corporate/conferences/landwarfare
- **Chief of Army History Conference 2005**
Coalition Warfare: The Challenges for Junior Partners
13-14 October 2005, National Convention Centre, Canberra.
Enquiries: (02) 6266-4248 or emma.robertson@defence.gov.au
- **Australian Institute of Professional Intelligence Officers 14th Annual Conference**
Intelligence: Truth and Accountability
03-04 November 2005, Four Seasons Hotel, Sydney
Enquiries: www.aipio.asn.au/
- **Royal Australian Navy Seapower Conference 2006**
Challenges Old and New
31 January – 02 February 2006, Sydney Convention and Exhibition Centre, Darling Harbour,
Enquiries: (02) 6127-6514 or www.seapower2006.com