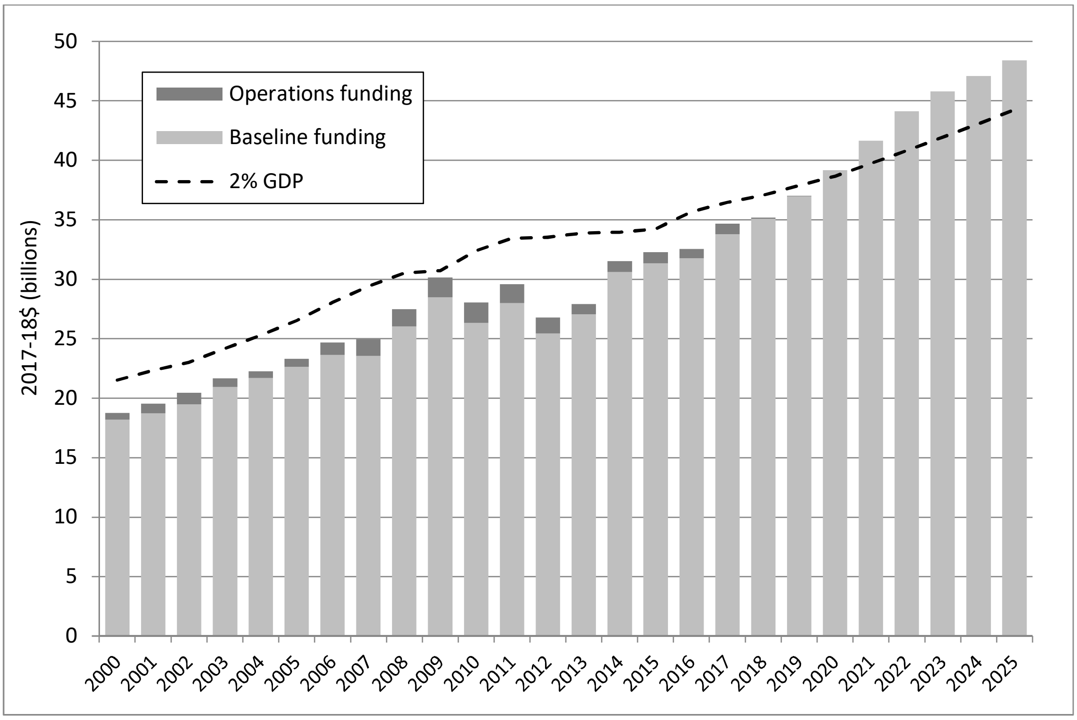
Executive summary

Defence Budget 2017	
Defence funding 2017-18:	$34.7 billion
Share of GDP:	1.9%
Share of Commonwealth spend:	7.3%
Real growth on prior year:	6.5%
Expenditure shares	
Investment:	$11.6 billion (33.4%)
Personnel:	$11.7 billion (33.7%)
Operating:	$11.4 billion (32.9%)
Cost of deployments	
Afghanistan & Middle East:	$735 million
Border protection:	$23 million
Key budget measures	
+$38 million adjustment for foreign exchange	
-$318 million in efficiency dividends	

In the 14 months since the release of the 2016 Defence White Paper, the government has fulfilled its funding promise, and Defence and industry have gotten on with building a stronger ADF. Challenges lie ahead, but, for the moment at least, things are largely on track.

Defence spending in 2017-18 will be $34.7 billion, representing 1.9% of GDP—a 6.5% real increase on last year. The hallowed benchmark of 2% of GDP is projected to be met in 2020-21, three years earlier than promised in 2013 (but only because GDP forecasts declined markedly in the interim). The next few years will see spending increase by an average of 4.7% per annum in real terms, with investment in new equipment the main beneficiary. In, 2015-16, the year preceding the White Paper, defence capital investment amounted to $9.2 billion. By 2020-21 it will reach $16 billion, and by 2025-26 it will exceed $23 billion.



Note: 2015 = 2015-26 etc.

There are two risks to defence funding. On the supply side, current and future governments are likely to find it hard to placate a fractious electorate that evinces little interest in national security. With an election in 2019 and a planned return to surplus the year after, the test will come soon enough.

On the demand side, the risk is that the planned growth in capital investment will outstrip the capacity of Defence and industry to deliver. As the current raft of large off-the-shelf foreign purchases gives way to even larger domestic naval construction programs, the risk of underspending will grow. Back in the 2000s, anything more than a 5% per annum increase in equipment purchases proved unsustainable. Unfortunately, nothing encourages governments to withdraw funding more than handing back money.

But those are challenges for the future. Where are we today?

Let's start with personnel. After struggling to maintain its numbers a few years back, the ADF workforce looks to be in better shape today. For the most recent year reported, 90% of the recruiting target was met, compared with a historical average of 86%, and the separation rate was 8.3%, compared with a historical average of 10.8%. Even so, the ADF currently has 333 people fewer than budgeted for, from a workforce of around 59,000. But that's a much better result than the shortfalls of 1,000–2,000 experienced from 2012 to 2015.

If only things were looking that good for Defence's civilian workforce. This year, civilian numbers fell 600 positions below the budgeted figure (from a workforce less than a third of the size of the ADF). And recent internal surveys have revealed disappointingly low civilian morale. In a survey from March 2016, 41% of civilians rated their workplace morale as 'low' or 'very low', while only 17% of ADF personnel were similarly disaffected. Having not had a pay rise since 2013, and being offered an increase below that awarded to ADF members (breaking a quarter-century practice), low morale is understandable. With the government predicting economy-wide wage growth of 2.5% to 3.0% in the budget, now is the time to stop treating civilians as second-class members of the Defence workforce and to restore parity with military wage increases.

It's been an exciting 12 months for Australian defence industry. While many previous defence industry policies have gathered dust, the 2016 policy statement led to a flurry of action. We now have a dedicated Minister for Defence Industry, and the three key components of the government's decade-long $1.6 billion defence industry program are up and running, including the Centre for Defence Industry Capability, the Defence Innovation Hub and the Next Generations Technologies Fund. More importantly, and in a departure from its 2016 defence industry statement, the government has adopted an avowed 'buy Australian' policy. To quote the Prime Minister 'I am determined that every dollar we spend on defence procurement as far as possible should be spent in Australia…'.

Whether it's the lucrative $195 billion of projects up for grabs, or the 'buy Australian' policy, international defence firms have spent the past 12 months redoubling their investments in Australia. New offices and research centres have been popping up in South Australia and elsewhere, new global supply chain agreements have been signed and existing agreements renewed. The government could not have asked for a better response from industry.

Progress continues on the centrepiece of the government's vision for Australian defence industry; continuous naval construction split between SA and WA. Although construction won't start until 2018 for the Offshore Patrol Vessels, 2020 for the frigates, and 2022 or 2023 for the submarines, initial work is well underway. Requests for tender have been released for both the Future Frigates and the Offshore

Patrol Vessels, and a design and mobilisation contract has been signed with our submarine design partner DCNS. By mid-2018, more than $446 million will have been spent on submarines and $297 million on frigates.

The government's long-awaited Naval Shipbuilding Plan was released in mid-May. And while there are still many unknowns that will only be resolved by future decisions, the Plan provides useful information. For one, we now know that the government will own the naval shipbuilding infrastructure in SA and WA, and plans to invest substantially in both locations over the next several years. There was also further information about schedules, though some of the numbers did not make sense, and there seemed to be a hint that the Future Frigate project will be delayed. On the critical question of contractual arrangements, we remain in the dark. Finding a way to drive value-for-money in the monopoly shipyards that are being created is a key challenge that government is yet to address.

Within the vast Defence enterprise, reform is going well. Two years on from the First Principles Review (FPR), 63 of 69 recommendations have been completed, and the vast bulk of recommendations are expected to be signed off by mid-year. A health check by the FPR oversight board is presently underway, but signs are that reforms have been successful; structural rearrangements are complete, new committees are well-established, and new processes are being refined. Indications are that the implementation of the FPR has been a case study in careful and systematic change management.

Nowhere have the changes been more transformative than in the capability life cycle, particularly the capability development process. A key metric for the new arrangements is the approval of new projects in line with the demands of the 2016 Integrated Investment Plan. However, after years of uninterrupted transparency, the government has ceased disclosing what projects it approves.

While that could be taken as a sign that things are not going well, that's probably not the case. As best as can be estimated, although approvals look to be running somewhat behind schedule, it's not by much. If anything, the recent pace of project approvals has matched or exceeded historical rates. I had anticipated that the disruption wrought by the new arrangements would result in severe delays. I was wrong.

What I failed to appreciate, but now understand, is that the reforms to capability development were really just a dismantling of the Kinnaird reforms of 2004. Acquisition and sustainment are now back within Defence, internal contestability has been re-established, Finance gets a seat at Defence's capability committee, and the detailed paperwork introduced under the Kinnaird reforms has been pared back substantially. Everything old is new again. We've even gone back to the 1990s 'buy Australian' policy.

For all the talk of 'smart procurement', what's really happened is that we've reverted to the old balance between expediency and risk, with the emphasis now on the former. The Kinnaird process sacrificed time to retire risk; the new approach shifts the balance back. While some unnecessary work has probably been eliminated by recent changes, so too have many of the checks and balances introduced by Kinnaird. When was the last time you heard about a mandated military-off-the-shelf option? There is no magic formula that allows essentially the same group of people to somehow make better decisions in less time.

Those observations are not made as criticisms; our current strategic situation justifies an elevated tolerance of procurement risk. But if that's what we are going to do, we need recognise it and adjust accordingly. Most importantly, we need to marshal sufficient resources to manage the risks we are shouldering. Given the massive scale and manifest risk of the planned program, we could devote substantial additional resources to its management and be confident of a positive return on investment. The danger is that the recent reforms to Defence have stripped away program management capacity just at the point when the opposite should be happening.

Even if everything goes to plan—that is, the government continues to meet its promises and defence and industry deliver capability on time and within budget—a crucial question remains. Are we doing enough?

The scale and timing of today's plans for the ADF are the consequence of an ad hoc decision to spend 2% of GDP on defence by an arbitrary date. To pretend otherwise is to mistake numerology for strategy. What's more, the capabilities sought in the 2016 White Paper are little more than a re-hash of the Rudd government's abandoned 2009 plan. Not only did today's plans have their genesis in far less challenging times, but we are starting seven years late.

In case you've missed it, the world is going to hell. In January this year, a report from the normally staid US National Intelligence Council pointed to 'deep shifts in the global landscape that portend a dark and difficult near future'. It went on to say:

> The next five years will see rising tensions within and between countries. Global growth will slow, just as increasingly complex global challenges impend. An ever-widening range of states, organizations, and empowered individuals will shape geopolitics. For better and worse, the emerging global landscape is drawing to a close an era of American dominance following the Cold War. So, too, perhaps is the rules-based international order that emerged after WWII.

Yet we continue as if it's business as usual, squabbling about whether defence industry jobs will be created in one electorate or another.

Current plans will only strengthen Australia's defences slowly. For example, the first of our aptly named 'future submarines' won't enter service until the early 2030s, and we won't have twelve boats until the early 2050s. We need to do more, and we need to do it now.

The quickest and most cost-effective way to strengthen our defence would be to enhance the readiness and sustainability of existing capabilities. Stockpiles of munitions and spare parts should be made consistent with requirements for prolonged independent operations, and additional personnel signed-up to increase the availability of existing platforms for deployment.

We should also explore keeping selected existing assets in-service past their planned retirement, and even examine the feasibility of rapidly acquiring new high value capabilities, such as combat aircraft.

Think of it as an insurance policy—a contingency plan—with any final decision contingent on a further deterioration in the strategic outlook. In the meantime, we should bolster our diplomatic capacity, reinforce our national resilience, and hone our crisis decision-making.

The proposal set out here might seem overwrought. But we currently plan to spend close to $450 billion on defence over the next decade. If that is the scale of spending needed to keep us safe in the 21st century, surely we can afford to spend a little more in response to the 'dark and difficult near future' we confront today.