

THE CENTRE OF GRAVITY SERIES

WHAT THE NEXT DEFENCE WHITE PAPER SHOULD DO ABOUT THE BUDGET

Dr Andrew Carr & Dr Peter Dean
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ABOUT THE SERIES

The *Centre of Gravity* series is the flagship publication of the Strategic and Defence Studies Centre (SDSC) based at The Australian National University's College of Asia and the Pacific. The series aspires to provide high quality analysis and to generate debate on strategic policy issues of direct relevance to Australia. *Centre of Gravity* papers are 1,500-2,000 words in length and are written for a policy audience. Consistent with this, each *Centre of Gravity* paper includes at least one policy recommendation. Papers are commissioned by SDSC and appearance in the series is by invitation only. SDSC commissions up to 10 papers in any given year.

Further information is available from the *Centre of Gravity* series editor Dr Andrew Carr (andrew.carr@anu.edu.au).



ABOUT THE AUTHORS

Andrew Carr is a Research Fellow in the Strategic and Defence Studies Centre at the Australian National University. His publications include work on Australian foreign and defence policy, middle power theory and Asian security. He is the co-editor of *Australian Foreign Policy: Controversies and Debates* (2014) and *Asia-Pacific Security After the Pivot* (2014). Dr Carr is an editor of the peer-reviewed journal *Security Challenges*. He is a frequent media commentator for both Australian and Southeast Asian press. Andrew previously worked as Associate Editor for the Lowy Institute for International Policy.



Dr Peter J. Dean is a Fellow at the Strategic and Defence Studies Centre, The Australian National University. He is the Director of Studies for the Centre and also lectures in the Military and Defence Studies Program at the Australian Command and Staff College. He is the author / editor of four books including *Australia's Defence: Towards a New Era?* (Melbourne University Press, 2014). Peter is the current Fulbright (DFAT) Scholar in Australia-US Alliance Studies, the Series Editor (with Dr Brendan Taylor) of the Melbourne University Press Defence Studies Series, managing editor of the journal *Security Challenges* and a contributing editor and board member of the journal, *Global War Studies*.



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EXECUTIVE SUMMARY

- In 2012-13 Gross Domestic Product (GDP) was used to measure and define the debate over Australia's Defence spending.
- While GDP has some uses, it can be highly misleading as a form of comparison and analysis.
- A better approach is to follow the established literature by examining the interests of the nation, the environment it finds itself in, and the nation's financial capacity.
- A return to an orthodox strategic approach will better protect the nation, do so more efficiently, and help sustain long-term public support.

POLICY RECOMMENDATION

- The Abbott government should abandon its pledge to spend 2 percent of Australia's GDP on Defence and return to an orthodox strategic planning approach, allocating financial resources as appropriate.

'Strategy without funding is not strategy' – Sir Arthur Tange

Sir Arthur Tange's maxim is simple and prophetic. For many its wisdom was clearly evident at the release of the last Australian Defence White Paper in 2013; a document that skimmed over budget issues in less than two pages. Yet Tange's adage also applies in reverse – funding without a strategy is not strategy. This is a major risk that Australia now faces with the recent bipartisan fixation on increasing defence spending to 2 percent of GDP.

In the last two years 2 percent of GDP has emerged as *the* 'magic number' for defence budgeting, a benchmark that has become an entrenched part of the discussion. Instead of a much-needed broad dialogue about Australia's strategic policy, this single type of measurement has come to dominate, define and distort the national debate.¹

The use of GDP to measure defence spending is in many ways neither surprising, nor automatically harmful. Politicians regularly use simplified measures to communicate policy approaches across most portfolios. In the Howard and Rudd years the most persistent financial pledge to Defence was achieving an annual 3 percent 'real growth' in their budget. Given the cuts under the former Government, many in Australia's defence community welcomed the emergence of a 2 percent of GDP policy target as a clear sign of a much needed long term financial commitment to defence.

However there are a significant number of analytic and practical difficulties associated with using a nation's GDP as a way of both analysing and, in particular, driving defence policy.² These include: the false sense of 'security' that comes from outsourcing strategic policy to a GDP funding ratio; the unpredictability and potential inaccuracy of GDP as a policy target; the inapplicability of GDP as a measurement of historical comparisons or comparisons between countries; and the fact that we don't have any idea whether or not 2 percent GDP will be too much or too little to spend on defence over the next decade. That is a judgement that can only be predicted with any accuracy by rationally assessing Australia's strategic environment and its interests and objectives balanced against the amount of risk that the Government is willing to accept.

The current 2 percent of GDP target for defence funding is also highly improbable as a policy objective. To achieve the Government's promise of 2 percent of GDP the Defence Budget would require approximately 5.3 percent per annum of sustained funding growth over the coming decade. As Paul Dibb and Richard-Brabin Smith have noted 'there is no precedent for such sustained growth, except in wartime or acute international crisis, and even then

not for such an extended period.'³ In addition if Greg Sheridan is to be believed then there will be no additional funding for defence in the 2014 Federal budget and as such the per annum funding target will have to rise even more if the Coalition's aspirational pledge is contracted to nine, rather than ten years.⁴ The Government's ambitions are further complicated by the current growth in unemployment, the loss of the car manufacturing sector and problems in the airline industry, which all indicate an uncertain financial outlook for the Australian economy; in addition to continuing scepticism surrounding the global economic outlook.⁵ These factors mean that there will most likely be even more pressure on the Federal Budget in the years to come and this raises uncertainty as to future increases in defence funding. The Government has conceded this point with the Defence Minister, David Johnston, noting that 'It's going to be extremely hard', while remaining committed to the 2 percent pledge, stating that 'we are going to do it.'⁶

This paper argues that maintaining the 2 percent target will lead to poor public policy development and potentially wasteful spending. For these reasons the Abbott Government should abandon its pledge and return to a more orthodox approach to defence funding which is based on marrying strategy and finance through a considered analysis of the needs and requirements of the defence establishment in the contemporary strategic environment.

The Rise of GDP Spending for Defence in the Public Debate

The rise of the use of GDP to measure and assess Defence's budget can be attributed to a number of factors, but primarily it was an eye-catching comparison between Australia's defence budget in 2012 and 1938 that struck a public nerve.

In the lead up to the 2013 Federal election there were growing concerns about the size of Australia's defence budget. The reason for this includes; the rise of China, the US 'pivot' or 'rebalance' to the Asia-Pacific and the corresponding push for increased alliance burden-sharing, the continual deferral and cuts to the funding outlined in the 2009 DWP after the global financial crisis and leadership instability in the Rudd-Gillard-Rudd era.

The GDP benchmarks for funding defence started to emerge alongside criticisms of Labor's defence spending failures. The first major use of the 1938 comparison, based upon similar GDP spending was by Tony Abbott in his budget reply speech of 10 May 2012. Thereafter many prominent analysts and journalists including Paul Kelly, Greg Sheridan, Peter Hartcher, Jim Molan, Dennis Shanahan and Ross Babbage picked it up.⁷

This is a particularly powerful analogy, linked as it is to a retrospective view of a specific period of Australian history in the lead up to the onset of a global war. The spectre of 1938 allowed the public, policy community and commentariat to conjure up images of a period commonly associated with defence unpreparedness during an era of intense escalating international threats. In this respect, it was a rather effective rhetorical tool. However as a point of historical comparison and form of analysis of Australia's contemporary strategic environment and defence spending it is a gross distortion and misrepresentation.⁸

The power of this analogy, however, had unexpected consequences. While highlighting the chaos within the Labor Government's defence policy it also started to narrow the debate to the sole issue of spending at the expense of discussions of strategy, capabilities and the strategic environment. So strong was the focus on GDP spending as the measure of defence credibility that both major political parties moved to identify clear GDP based budget aspirations for this portfolio as virtually their sole defence election platform.

“ Maintaining the 2 percent target will lead to poor public policy development and potentially wasteful spending. ”

After months of GDP being used to measure defence spending, in early 2013 it evolved to become a driver of policy. On 7 February, then Shadow Defence Minister David Johnston announced that ‘we believe that two percent of GDP is the place to be and we want to get there with three percent real growth’.⁹ On 17 February the ALP’s Defence Minister Stephen Smith dismissed the 1938 comparison as ‘overblown’ yet suggested, similar to Johnston, that ‘I have an aspiration — I would much prefer to be closer to two percent of GDP than I am at 1.6.’¹⁰ By the time of the election Tony Abbott, Julia Gillard, and the re-crowned Labor leader Kevin Rudd, had all adopted the 2 percent pledge.

Why GDP is a Poor Way to Plan Defence Spending

During the election campaign expressing funding ambitions for Australia’s defence spending as a percentage of GDP had the advantage of providing sound-bite ready historical comparisons and easily identifiable funding targets. Yet now that the Coalition is in government, it confronts several significant arguments against measuring and organising defence budgeting via a nation’s gross domestic product. These include the fact that there is no automatic link between the security of a nation and the percentage of its GDP spent on defence; the unpredictability and potential inaccuracy of GDP; and that the GDP variable is highly misleading as a form of historical and regional comparison.

The focus on the use of GDP is an inherently un-strategic approach. By starting defence policy with nothing more than a funding ambition this approach contradicts strategic planning logic. As Mark Thomson has stated while ‘from a political perspective, the promise to spend 2 percent of GDP on defence allow[ed] the Abbott Government to claim the mantle of being ‘stronger on defence’... from a public policy perspective, it makes the cardinal error of putting financial inputs above policy goals.’¹¹ In the end there is no logical link between a nation’s security and its spending on defence as a percentage of GDP.

While more spending on security issues probably helps the nation defend itself, it is not automatic or inevitable. Higher spending may be directed towards the wrong threats as the United States found in 2001. Higher defence spending may also come at the cost of the nation’s overall economic strength, as the USSR found to its detriment in the 1980s. GDP as a measure can also provide false positives. For instance the Howard Government doubled defence spending – from \$9.9 billion in 1996 to \$19.9 billion in 2007 – yet an assessment based on proportion of GDP over this period would actually suggest Australia was increasingly at risk because the GDP figure trended down from 1.87% to 1.60%.

The reason being that the economy grew faster than defence spending. The only time Australia’s defence spending has significantly moved up toward 2 per cent over the last decade (reaching 1.94% in 2008-09) was during the Global Financial Crisis (GFC). Yet no one would assume that Australia was more secure during the austere period of the GFC than in the more prosperous years before.

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The use of GDP is just as potentially misleading when used to make comparisons across regions and extended periods of time. Australia today accounts for 8% of regional defence spending at a cost of 1.60% of its GDP, while Singapore has to devote 3.7% of its GDP to purchase just 3.1% of the total regional spend on defence.¹² Without context these factors suggest an absence of concern (Australia) or fear (Singapore), when an analysis of their internal debates may suggest otherwise; the use of GDP as a comparative measure also blatantly ‘disregards differences in the efficiency of forces’ between nations.¹³

If GDP is poor at comparing two different states, it is equally poor at comparing two eras within one country. In 1938 Australia’s military forces included 10,885 full time personnel compared to 58,645 today. The Department of Defence in 2013 included 21,217 Australian Public Service (APS) civilians; in 1938 it consisted of only 57! The only thing that is comparable in Australia between 1938 and 2013 is that in both years the Opposition had alleged that the Government was failing to show leadership in regard to urgent national problems and in particular its handling of Defence; however in 1938 it was a Labor Opposition attacking a Conservative Government.

GDP measurement also introduces an uncertainty into the portfolio's spending. What Defence can purchase in 2023 with 2 percent of GDP could change significantly depending on the rate of growth in the Australian economy. This makes it less dependable than budgeting around specific figures or rates of annual growth. It is also the case that Defence (like any public agency) will attempt to spend its entire budget allocation. By establishing an effectively random budget ambition, it will ensure inefficiencies if not waste.

Despite claims by some, there can never be a 'magic number' of spending that ensures security. Together these arguments strongly suggest that the use of proportion of GDP as a method of analysis and policy development hinders more than it assists the development of strategic policy and strategy. It is often misleading as a form of analysis, it will not make up for a strategic deficit and it will be almost impossible to achieve in practice. So what should the Abbott government replace it with?

So what should the next Defence White Paper do?

What a nation needs to spend on its defence to ensure its security is a function of the threats it faces, the interests and objectives it seeks in order to develop a sufficiently flexible planning capability and military posture and the level of risk it is willing to absorb.¹⁴

As a wide variety of scholars and practitioners have advocated, the best practice for defence spending involves a considered process of assessment, negotiation and policy judgements. It requires a deliberation between the strategic environment the nation faces, the strategic interests it wishes to protect, the risks it is willing to bear, the strategic objectives it seeks to achieve, the necessary and desired capabilities for achieving these interests and objectives and the nation's overall budgetary situation.¹⁵

“ Arbitrary targets like 2 percent of GDP won't be able to sustain long term public support. ”

To allow one of these factors to over-rule all others is to distort the analysis and can result in poor judgement and policy. Sometimes the accusation is made that governments allow a desire for a smaller defence budget to influence their willingness to acknowledge the true nature of the strategic environment.¹⁶ This wayward analytic distortion is just as troubling in the less common case when a nation indulges its defence budget and therefore again finds it's spending and purchases out of alignment with reality.

Now in office, the Abbott government can take advantage of both time, and the full resources of the Australian national security community to implement a better approach to defence policymaking. It has an opportunity to establish rigorous principles for governing Australian defence policy over the long term.

Given the present uncertainty about the nature of the changes in the Asia-Pacific, it is not entirely surprising that quantifiable issues like budgets have become a preferred point of partisan debate in place of fuzzier and sensitive strategic questions. Yet a discussion of the strategic environment, and Australia's core interests and objectives within it must remain at the centre of Australia's public discussion of defence and national security.

There is one further step that recent experience has proved vital. As Tange insisted, the elevation of official statements about the changing region to the level of 'strategy' depends upon connected funding. But the government can only achieve this if it has enduring public support for its approach. If the long and heavy struggle to create a new Defence White Paper is to be meaningful, the Abbott government needs to not only carefully develop a strategy and the budget to fund it, but to explain, in depth, its choices to the Australian public. Only if the Australian public accepts the strategic rationale for continued or higher Defence spending will any promises of funding for Defence be sustainable. Arbitrary targets like 2 percent of GDP won't be able to sustain long-term support, only a coherent strategy the public understands and accepts will suffice.

The Australian Government should quietly abandon its funding-first approach to defence policy. It should develop a clear strategic rationale for the Australian Defence Force, do so in a manner that the public understands and supports, and then establish a consistent funding level over the medium to long term that can provide for those requirements. Only in this way, can Australia's security be credibly pursued in the coming century.

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Endnotes

- 1 This Centre of Gravity Paper is based upon analysis contained in Andrew Carr & Peter J. Dean 'The Funding Illusion: The 2% of GDP furlphy in Australia's Defence Debate' *Security Challenges* Volume 9 Number 4 (2013), pp. 65-86.
- 2 Notably, the Australian Department of Defence does not publish its funding as a proportion of GDP. For this reason the authors have largely had to rely on the work of the Australian Strategic Policy Institute, cross-checked against the work of Joan Beaumont, *The Australian Centenary History of Defence. Vol. 6, Australian Defence: Sources and Statistics* (Melbourne: Oxford University Press, 2001) to identify and verify GDP figures used.
- 3 Paul Dibb and Richard Brabin-Smith, 'Australian Defence: Challenges for the New Government', *Security Challenges*, Volume 9, Number 4 (2013), pp. 45-64.
- 4 Greg Sheridan, 'New white paper urges doubling of defence spending to \$50bn', *The Australian*, 27 February 2014
- 5 Michael Janda, 'Unemployment jumps to 6 per cent for first time in a decade', *ABC News Online*, 13 February 2014.
- 6 David Johnston, as quoted in Brendan Nicholson, 'Pledge for defence spend at 2pc of GDP', *The Australian*, 1 March 2014.
- 7 There was a push back against this measure by Andrew Davies, Mark Thomson, Alan Kohler and Bruce Haig. For a full timeline on the use of the 1938 comparison, see the authors Security Challenge Article
- 8 For details see pages 73-4 of Carr & Dean (2013) The Funding Illusion.
- 9 David Johnston, 'Doorstop with Senator David Johnston, Defence funding, Coalition commitments, military superannuation', *Defence Alert*, 7 February 2013, <<http://www.defencealert.com>> [Accessed 13 November 2013].
- 10 Quoted in AAP, 'Smith would rather defence at 2% of GDP', *Australian Associated Press General News*, 12 February 2013.
- 11 Mark Thomson, 'Funding Australian Defence', in Peter Dean, Stephan Frühling and Brendan Taylor (eds), *Australia's Defence: Towards a New Era?*, Melbourne, Melbourne University Press, 2014.
- 12 'Asia: Military Modernisation Continues', chapter 6, *The Military Balance* (London: International Institute for Strategic Studies, Routledge, 2013), pp. 245-352.
- 13 Ellen Hallams and Benjamin Schreer, 'Towards a 'Post-American' Alliance? NATO Burden-sharing after Libya', *International Affairs*, vol. 88, no. 2 (2012), p. 315.
- 14 Colin S. Gray, 'Strategic Thoughts for Defence Planners', *Survival*, vol. 52, no. 3 (2010), pp. 157-178
- 15 This strategic planning logic is evident throughout the history of Australian strategic policy. For the period from 1945-1976 see Stephan Frühling, *A History of Australian Strategic Policy since 1945*, (Canberra: Department of Defence, 2009). In the period from 1976 see the various Defence White Papers and reviews at <<http://www.defence.gov.au/oscdf/se/publications.htm>>. The following academic studies investigate various elements of this logic in both Australia and overseas: P. H. Liotta and Richmond M. Lloyd, 'From Here to There: The Strategy and Force Planning Framework', *Naval War College Review*, vol. 58, no. 2 (Spring 2005); Terry L. Deibel, *Foreign Affairs Strategy: Logic for American Statecraft* (New York: Cambridge University Press, 2007); James Fallows, *National Defense* (New York: Random House, 1981); Colin S. Gray, 'Strategic Thoughts for Defence Planners', *Survival*, vol. 52, no. 3 (June-July 2010), pp. 159-178; Hugh White, 'The New Defence White Paper: Why We Need It and What It Needs To Do', *Lowy Institute Perspective*, Lowy Institute, Sydney, April 2008; Hugh White, 'Strategic Interests in Australian Defence Policy: Some Historical and Methodological Reflections', *Security Challenges*, vol. 4, no. 2 (Winter 2008), pp. 63-79; Robert Ayson, 'Understanding Australia's Defence Dilemmas', *Security Challenges*, vol. 2, no. 2 (July 2006). Of course these strategic documents are all conceived within a political environment see Peter Jennings, 'The Politics of Defence Defence White Papers', *Security Challenges*, vol. 9, no. 2 (2013), pp. 1-14.
- 16 Neil James, 'Beyond the once-over analysis and partisan waffle', *The Strategist*, 9 May 2013, <<http://www.aspistrategist.org.au/beyond-the-once-over-analysis-and-partisan-waffle/>> [Accessed 13 November 2013].

CONTACT US

Dr Andrew Carr
Centre of Gravity series editor

Strategic and Defence Studies Centre
ANU College of Asia and the Pacific
The Australian National University

T 02 6125 1164

E andrew.carr@anu.edu.au

W <http://ips.cap.anu.edu.au/sdsc>



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