



**Submission to the Senate Foreign Affairs, Defence and Trade Committee
enquiry into
*Procurement procedures for Defence capital projects***

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This submission is made by Andrew Davies and Mark Thomson in their personal capacities. ASPI does not have an official view on this or any other matter. We give permission for our submission to be published along with our names. Following a short introduction, our submission addresses each of the enquiries terms of reference in turn. Because we have written extensively on this subject in the past, our submission refers to a number of prior works that are publicly available.

We are eager to provide any further information or assistance that the committee might find useful.

Background

The acquisition of defence capital equipment has a number of special characteristics that make it especially difficult (Ergas 2003 and 2007). So it's not surprising that Australia's problems with defence procurement are mirrored in that of the United States (GAO, 2011) and United Kingdom (Gray, 2010). While encouraging progress has been made as a result of recent reviews (Kinnaird 2003, Mortimer 2008) we believe that further opportunities for substantial improvement exist.

Matters arising from the terms of Reference

A. Assess the procurement procedures utilised for major defence capital projects currently underway or foreshadowed in the Defence White Paper, including the operations of the Capability Development Group and its relevant subcommittees;

While current arrangements for defence procurement are broadly appropriate, there are six key actions that should be taken.

1. Stop the over-prescription of equipment solutions in Defence White Papers and the Defence Capability Plan

Governments should have the latitude to make trade-offs between risk, schedule, cost and capability as information becomes available during the development of projects. To ensure this, future Defence White Papers and Capability Plans should focus on the broad capability being sought rather than prescribe a narrow equipment solution. Present practice risks locking the government into courses of action long before they have the information needed to make an informed judgment. For example, the Air Warfare Destroyer project was announced in the 2000 White Paper and finally approved at well over twice the original estimated cost. The new submarine project (SEA 1000) is a contemporary case in point.

2. Engage industry earlier in the capability development process

Industry needs to be involved in the early stages of capability development to ensure that planning is informed by a clear understanding of what's available technologically and commercially. The risible suggestion in the 2009 White Paper and subsequent DCP to replace the Navy's current patrol boats, mine hunters and hydrographic ships with a single class of vessels (SEA 1180) demonstrates the risk of planning in an information vacuum.

3. Continue to drive reform in the Defence Materiel Organisation (DMO)

The reforms that emerged from the two recent reviews of defence procurement (Kinnaird 2003, Mortimer 2008) should continue. In particular, DMO needs to attract and retain individuals with commercial acumen and technical knowledge, including by paying private sector salaries where necessary. Reliance of short-term military appointments to projects should be minimised. To the extent possible, private sector incentives and sanctions should be used to drive performance. For this reason, the current degree of separation between DMO and Defence central is probably useful. However, DMO should not be made an executive agency. Further separation from Defence would impose transaction costs in excess of the benefits that greater independence could deliver.

4. Professionalize the Capability Development Group (CDG)

At present, projects are conceived and developed by relatively junior military officers on short-term postings from field units (see figure 10, Mortimer 2008). The results speak for themselves. While military input is absolutely essential to the capability development process, a core of experienced professionals should be developed. This would probably include retired military officers and ex-project managers.

5. Reintroduce contestability into capability development

Up until the late 1990s, the capital investment program and the projects within it were subject to independent scrutiny and analysis (by what was then known as the Force Development and Analysis division). This should be reinstated as a matter of utmost urgency. (See Davies, 2010)

6. Include an off-the-shelf option until second-pass project approval

A recent analysis of defence projects (Thomson, 2008) identified that adverse project outcomes were correlated with four factors: development work, software development, Australian uniqueness and local production. In contrast, off the shelf purchases from overseas tend to deliver on time, on budget and to specification, with poor schedule performance being strongly correlated with project complexity (Davies & Layton, 2009). Recent examples of successful off-the-shelf acquisitions include the C-17 transports, F/A-18 Super Hornets and Abrams tanks. Each and every proposal put to government should include a *bona fide* off-the-shelf option from an existing production line. Although this was a clear recommendation in the 2003 Kinnaird review, Defence has watered it down to mean either local construction of an off-the-shelf design (as with the Air Warfare Destroyer) or in some cases just a hypothetical off-the-shelf benchmark.

B. Assess the timeline proposed for defence modernisation and procurement outlined in the Defence White Paper.

Despite concerted attempts to obscure the planned schedule for the acquisition and entry into service of capabilities set out in the 2009 Defence White Paper, it was clear that things were slipping behind schedule as early as May last year (Thomson, 2010). Since then, the situation has deteriorated further. ASPI plans to reassess progress once the May 2011 budget becomes available. We will update the Committee at that time.

Several factors have led to this situation:

- The government has deferred substantial defence funding to beyond 2012-13, presumably to hasten a return to surplus for the Commonwealth.
- Some projects have been displaced by the bringing forward of projects to assure force protection for our troops in Afghanistan.
- Bureaucratic delays in Defence have caused the approval of projects to proceed much more slowly than anticipated, especially in the case of first-pass approvals.
- Industry has failed to deliver capability to the contracted schedule across a large number of projects.

Given the mounting delays, it looks increasingly unlikely that the program of modernisation can be achieved on schedule. To make matters worse, the deferral of funds to beyond 2012-13 has created a five year period where spending will need to grow in real terms by 6% a year to regain the promised '3% real growth over the decade'. On past experience, this is unlikely to be feasible especially in light of capacity limitations at almost every step of the process, from initial approval to industry delivery.

Moreover, the level of funding promised (5.5% nominal growth to 2017-18 and 4.7% nominal growth thereafter) is unlikely to adequate to maintain let alone expand the force as planned. See (Thomson & Davies 2008), (Lyon & Davies 2009) and (Thomson 2010).

C. Assess proposals arising from the Defence accountability reviews, including, the Mortimer Review, the Pappas Review and the McKinsey Report (2010), in regards to enhancing accountability and disclosure for defence procurement.

Because the government is both the customer and owner of the defence enterprise, it is not possible to impose institutional responsibility on Defence or its component parts. In principle, individual accountability for defence procurement planning and execution could be improved by introducing private sector style rewards and sanctions. As suggested above, to the extent that this is possible it should be pursued—but the difficulty of doing so in a public sector employment framework is significant.

On the broader question of accountability in Defence, two research works are currently in preparation which will be made available to the Committee as soon as they are complete; (Ergas and Thomson 2011) and (Thomson 2011)

D. Make recommendations for enhancing the availability of public information and parliamentary oversight and scrutiny of defence procurement in the context of guaranteed 3 per cent real growth in the Defence budget until 2017-18.

A comprehensive examination of the disclosure of capability planning information was undertaken by ASPI in 2009 (Purnell and Thomson, 2009). Unfortunately, the government only partially accepted the recommendations. As a result, Defence continues to avoid scrutiny by obscuring costs and timings.

Although Defence capability development is probably subject to more scrutiny than any other area of government spending—including by the Senate FAD&T Committee and the Australian National Audit Office—greater involvement by the Senate FAD&T Committee is justified given the cost and importance of defence procurement.

Bibliography

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Appendix

Procurement procedures for Defence capital projects

Terms of Reference

That the Senate Standing Committee on Foreign Affairs, Defence and Trade inquire into and report by 30 November 2011 upon procurement procedures for items identified in the Defence White Paper, *Defending Australia in the Asia Pacific Century: Force 2030* and in particular:

- a. assess the procurement procedures utilised for major defence capital projects currently underway or foreshadowed in the Defence White Paper, including the operations of the Capability Development Group and its relevant subcommittees;
- b. assess the timeline proposed for defence modernisation and procurement outlined in the Defence White Paper;
- c. assess proposals arising from the Defence accountability reviews, including, the Mortimer Review, the Pappas Review and the McKinsey Report (2010), in regards to enhancing accountability and disclosure for defence procurement; and
- d. make recommendations for enhancing the availability of public information and parliamentary oversight and scrutiny of defence procurement in the context of guaranteed 3 per cent real growth in the Defence budget until 2017-18.