

# A MODERN, SUSTAINABLE DEFENCE FORCE MATCHED TO NEW ZEALAND'S NEEDS



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## Significant increases to defence funding

This paper outlines the significant changes to the NZDF's operating baselines which the Government has made as part of the 2001 Budget. The increase in defence expenditure will not be immediately apparent in the 2001 Budget documentation, due to Government-wide decrease in the rate of capital charge, the continuation of the East Timor deployment, and one-off expenses in 2000/01.

### Changes to Defence Baselines

Decisions incorporated in the 2001 Budget increase the net operating funding available for the NZDF (ie excluding capital charge and one-off expense appropriations) by over \$300 million over the next five years and around \$700 million over the next ten years. As the NZDF's baseline funding does not cover deployments, the 2001 Budget (as in 99/00 and 00/01) will also provide additional funding in 2001/02 for the East Timor deployment.

The following table itemises the significant decisions incorporated in the 2001 Budget that increase the net operating funding available for the NZDF.

	New baseline funding – excluding East Timor funding (\$million, GST inclusive)					
	2001/02	2002/03	2003/04	2004/05	2005/06	Annually in outyears
Service personnel remuneration	18.45	18.45	18.45	18.45	18.45	18.45
Sustainable capability baseline	25	37	24	16	16	16
Light Armoured Vehicles	0	3	31	39	39	39
<b>Total</b>	<b>43.45</b>	<b>58.45</b>	<b>73.45</b>	<b>73.45</b>	<b>73.45</b>	<b>73.45</b>

In addition to the above new funding, the Government's decision to disband the Air Combat Force frees up around \$400 million over the next five years and \$870

million over the next ten which has been retained within NZDF and applied to upgrading the quality of the other defence capabilities.

The 2001 Budget also incorporates a number of significant technical changes to the NZDF operating baseline as follows. (These changes do not affect the net operating funding available to the NZDF to deliver its defence outputs).

<b>Technical changes to NZDF baseline (\$million)</b>	2000/01	2001/02	2002/03	2003/04	2004/05
Government-wide Capital Charge reduction (10% to 9%)	0	(37)	(37)	(37)	(37)
Capital charge reduction due to ACF write-down	0	(35)	(35)	(35)	(35)
Other expense appropriation for write-down of Air Combat Force aircraft	104	-	-	-	-
<b>Total</b>	<b>104</b>	<b>(72)</b>	<b>(72)</b>	<b>(72)</b>	<b>(72)</b>

## 2001 Main Estimates

The information in the following trend table will appear in the 2001 Main Estimates for Vote Defence Force.

Appropriation Type	(\$million, GST inclusive)					
	1996/97 Actual	1997/98 Actual	1998/99 Actual	1999/00 Actual	2000/01 Actual	2001/02 Projection
<b>Operating Flows</b>						
Classes of Outputs to be supplied	1,558	1,577	1,577	1,597	1,666	1,598
Other Expenses	-	-	5	77	104	-
<b>Capital Flows</b>						
Purchase or Development of Capital Assets	39	39	41	-	2	-
<b>Total Appropriations</b>	<b>1,597</b>	<b>1,616</b>	<b>1,623</b>	<b>1,674</b>	<b>1,772</b>	<b>1,598</b>

The decrease in total appropriations between 2000/01 and 2001/02 is largely due to changes in capital charge reducing total appropriations in 2001/02, and a one-off "other expense" increasing total appropriations in 2000/01. This "other expense" is a technical adjustment. It is the cost of writing-down the remaining book value of the Skyhawk and Aermacchi fleets and their associated assets.

## Capital Injections

Implementing the Government's decisions on the future force structure of the NZDF will involve a series of capital acquisitions across all three armed services

to achieve the required capability upgrades. Although the capital acquisition plan has yet to be finalised, it is anticipated that capital injections of around \$1 billion over the next ten years may be necessary, with the bulk of it likely to be required within the next 5 years. The actual amount will depend on the specification and timing of individual projects, the contracted prices, and the prevailing exchange rate at the time of purchase.

### **Funding Implications of the Air Combat Force**

The table below compares the NZDF funding increases (excluding capital charge and funding for the East Timor deployment) set in the 2001 Budget with those that would have been required if the Air Combat Force had been retained.

#### **New Baseline Funding to maintain Sustainable Capability (excluding Capital Charge and Deployments)**

<b>\$million, GST Inclusive</b>	01/02	02/03	03/04	04/05	05/06
Without Air Combat Force	43.5	58.5	73.5	73.5	73.5
With Air Combat Force	98.5	158.5	184.5	190.5	190.5
<i>Further increases that would have been required to retain the Air Combat Force</i>	<i>55</i>	<i>100</i>	<i>111</i>	<i>117</i>	<i>117</i>

Consequently, had the Air Combat Force been retained, the Government would have been required to find an extra \$500 million over the next five years (or \$1.2 billion over 10 years) for operating expenses. The operating savings available for redistribution within the NZDF as a result of disbanding the ACF (\$400 million over the next five years or \$870 million over 10 years) however are less than this because funding for the Air Combat Force is currently at a basic level that could not be sustained on a long term basis.

In addition, by disbanding the Air Combat Force, the Government will avoid the significant capital costs involved in replacing the current A4 Skyhawks. It is unlikely that this capital could have been completely funded off the NZDF balance sheet, and therefore would have required a substantial capital injection from the Government.

## 2001 Budget and Economic Fiscal Update

The Budget and Economic Fiscal Update (BEFU) contains a breakdown of government expenditure into 14 “functional groups”, one of which is Defence expenditure, and includes forecasts out to 2004/05 (unlike the trend table that appears in the estimates that only goes out to 2001/02). The Defence expenditure functional group is further broken down into “NZDF Core expenditure” and a number of other expenses lines.

The total of the NZDF expenditure lines do not directly compare to the NZDF’s total appropriations (as in the main estimates) as the series contained in the BEFU are exclusive of capital charge, excludes departments GST expenses and make adjustments for inter-departmental activity.

### Defence Expenses BEFU Table -

(\$million)	1997/98 Actual	1998/99 Actual	1999/00 Actual	2000/01 Projection	2001/02 Projection	2002/03 Projection	2003/04 Projection	2004/05 Projection
NZDF Core expenditure	955	986	996	1055	1055	1065	1078	1080
NZDF Other expenses <sup>1</sup>	-	5	77	104	-	-	-	-
NZDF East Timor deployment	-	-	22	26	30	-	-	-
WINZ East Timor deployment <sup>2</sup>			17	22	19			
Other Departments Defence expenses <sup>3</sup>	34	31	51	32	35	34	34	32
GST on Defence Acquisitions <sup>4</sup>	76	8	84	41	14	52	39	-
<b>Total Defence Expenses</b>	<b>1065</b>	<b>1030</b>	<b>1247</b>	<b>1280</b>	<b>1153</b>	<b>1151</b>	<b>1151</b>	<b>1112</b>

The NZDF Core expenditure line shows an overall upward trend, while the Total Defence Expenses line is affected by the inclusion of one-off expenses. By adding together the two lines “NZDF core expenditure” and “Other Departments Defence expenses”, however, a truer picture of the underlying trends in overall defence expenses is seen as this excludes:

- One-off expenses such as NZDF Other expenses, GST payments on Acquisitions and the East Timor deployment; and
- changes in capital charge expenses.

<sup>1</sup> E.G. write down of Air Combat Force

<sup>2</sup> Allowance payments to service personal in East Timor

<sup>3</sup> E.G. Ministry of Defence expenses

<sup>4</sup> E.G. GST payments when a new frigate arrives in the country (very irregular amounts and timing)