

Prospects for an Australian defence industry fund

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April 22 2023

Note: This article appeared in *The Diplomat* on April 22 2023.

Formally announced in March this year, the AUKUS nuclear-powered submarine deal is widely touted as Australia's most important defence acquisition since World War II. Its budget is in no way disproportionate to its significance. Up to \$368 billion is expected to be spent on the deal over three decades.

This figure, moreover, could well be regarded as an appetizer. The submarine deal, while the most important and expensive part of the AUKUS arrangement, will be the precursor of more procurements needed to bridge the wide gulf between Australia's capabilities and the strategic needs of its evolving forward defence doctrine, and keep the nation at the forefront of the sector's rapidly accelerating technology race. Those capabilities – some of which will soon be announced through the public release of the Defence Strategic Review – are likely to include hypersonic missiles, missile defence systems, multipurpose sea and airborne drones, space capabilities, cyber, electronic warfare, and battlefield integration capabilities, and, potentially, new aerial and naval surface platforms.

Questions are being raised as to how Australia can afford these procurements. But a more specific concern in the defence sphere is that big-ticket acquisitions are coming at the expense of other important defence priorities. Such fears were recently revealed in a report by the *Australian Financial Review (AFR)*, where insiders and experts warned that 'hatchets' were being taken to 'frontline budgets' in the areas of operations and maintenance (O&M) that could 'cut into capability' and combat readiness.

The risks of such cuts are being highlighted daily in Russia's botched invasion of Ukraine. Reduced maintenance and equipment siphoning or cannibalization, as well as inadequate training and coordination, have had a catastrophic impact on the attrition rates of Russia's military hardware – not to mention the casualty rates of their users.

In part this problem is a product of Australia's current budget predicament and rising cost of living concerns, which is making rising taxes and lateral funding shifts from other government services a hard sell. But another issue lies in Australia's defence budget policies themselves. It is becoming increasingly difficult to reconcile the impromptu needs, tight acquisition schedule, and enormous cost fluctuations associated with a growing volume of vital high-cost procurements with the regimentation and relatively consistent trajectory of year-on-year spending volumes. As a result, the needed consistency of O&M budgets is being undermined by irregular procurements, with the timeliness of the latter being conversely compromised by the forced need to even out budgets.

What can be done to overcome this conundrum? A potential model Australia could learn from is Taiwan's new approach to funding defence procurements, and in particular its use of 'special budgets.'

Taiwan's defence spending: Addressing competition between O&M and procurements

During the tenure of Taiwan's incumbent President Tsai Ing-wen, Taipei, like Canberra, has announced ambitious plans to transform the nation's defence capabilities. Included in its plans have been a long series of high-ticket procurements and weapons development programs – including its own Indigenous Defence Submarine (IDS) program, estimated to [cost](#) about US\$16 billion. As with Australia, Taiwan's plans have been accelerated by fears that the timeframe for their being engaged in conflict – in particular, an invasion of the island from China – may be sooner than previously forecast.

Yet a review of defence spending under the Tsai administration makes for interesting reading. As a percentage of GDP, Taiwan's main defence budget actually shrank over Tsai's ongoing tenure, from 1.82 percent in 2016 to 1.63 percent in 2022. Only in 2023 has the figure again risen above 2 percent on the back of a massive 12.9 percent hike in funding – the first time it has hit this target in 10 years.

Taiwan's regular defence budget, which is typically pegged to a percentage of government spending (just over 16 percent until 2023), nonetheless rose steadily (roughly 3 percent on average) over Tsai's tenure due to robust GDP and expenditure growth, and by 2022 had increased 16.85 percent to NT\$374 billion (roughly US\$12 billion). This could be considered modest in comparison to the scale of Taiwan's acquisitions, and China's 50 percent defence budget increase over the same period (to 1.44 trillion yuan, or US\$230 billion, in 2022 – and 1.55 trillion yuan in 2023).

Given the scale and frequency of Taiwan's recent acquisitions, one would perhaps expect that the majority of this rise would have been eaten up by procurements, resulting in a lower percentage carve-out in the defence budget for O&M. However, this has not been the case. In fact, O&M spending, which competes with the categories of 'personnel' costs and 'investments' (which covers procurements and research, development, test & evaluation, or RDT&E) for a carve out of the regular budget, increased a whopping 38.03 percent between 2016–2022. It even grew its share of expenditure from 24.13 percent in 2016 to 28.51 percent in 2022.

Procurement/RDTE spending over this period, by contrast, only grew 2.17 percent, following steep drops in 2017 (-11.75 percent) and 2018 (-5.26 percent), and its share of overall spending fell roughly 6 percentage points. These drops were to an extent an after-effect of the spike brought about by the 2015 acquisitions flurry, which saw Washington agree to sell a raft of missile systems (including Javelins, TOWs and Stingers), and amphibious vehicles. Yet far more significant upgrades have been made in the years since, including purchases of 108 M1A2T Abrams battle tanks, 66 F-16V multi-role fighters, a massive increase in Taiwan's torpedo and missile arsenals, launchers, drones, logistics vehicles, control stations, and a big boost in training and capability upgrades.

On top of these have been a raft of indigenous development programs, led by the Indigenous Defence Submarine (IDS) program, which is on track to deliver its prototype as early as 2023, while last year Taiwan took delivery of its domestically made, 10,600 tonne [Yu Shan](#) amphibious warfare ship.

How has Taiwan achieved such a high volume of big-ticket procurements without having made any sacrifices in its O&M funding? The answer is that Taipei funded some of its high cost items – in part or in full – using a unique budgetary mechanism: Taiwan's 'special budgets' (特別預算).

Special expenditures and defence procurements

Special budgets are for urgent and temporary spending needs that require funds 'that cannot be adequately covered by budget reserves,' according to Research and Practice and Analysis in the Budget Act, published by Taiwan's Budget, Accounting and Statistics (BAS) Coordination and Development Society. [Article 83](#) of Taiwan's Budget Act states these budgets can be deployed in response to only four scenarios: 'national defence emergency provisions or war,' 'an unforeseen event with a major impact on the national economy,' 'a major disaster,' or 'an irregular or once-in-many-year major political event.' To be enacted, they must pass through a third reading in Taiwan's Legislative Yuan.

Since the turn of the millennia there have been a total of 30 special budgets. Most were in response to natural disasters, public health emergencies (i.e., COVID-19), and economic downturns, such as that caused by the

2008 Global Financial Crisis. The act only started to be used for military acquisitions specifically during Tsai's tenure.

The first such special budget, whose English title is the 'Special Act for New Fighters Acquisition,' is a six-year expenditure plan (2020–2026) for up to NT\$250 billion (US\$8.2 billion) that was passed in late 2019 for the acquisition of 66 US F-16V Block 70 multirole fighters, as well as associated equipment/support and upgrade costs. The second, announced in late 2021, was for a broader package called the 'Sea-Air Combat Power Improvement Plan,' to be spent between 2022–2026 to a funding ceiling of NT\$240 billion (US\$7.9 billion). This special budget covered eight items, including naval vessels, missiles and drones, and was the first to provide funds for the production of domestically designed and manufactured weapons systems (including the Wan-Chien air-to-Ground missile system).

To align with the Budget Act, the expenditures were described in their respective acts as responses to defence emergencies. However, other rationales are evident in the acts' public reports. For instance, the Legislative Yuan report on the Fighters Acquisitions act also notes 'since [the acquisition] involves United States' administrative procedures, cost estimates and procurement processes and timeframes, the purchase from the United States can't be incorporated in the 2020 general budget in time.' The Sea-Air Combat special budget, in contrast, cited a need to 'quickly raise and inject funds into the large scale production of armaments' to both respond to threats and support Taiwan's 'defence self-reliance' policy, targeting the 'win-win goal of enhancing national security and creating economic benefits.'

Lessons for Australia?

Whether or not this mechanism could be applied in an Australian context, it is worth looking into how it functioned to overcome challenges similar to those faced by Australian policymakers.

The Fighters Acquisitions budget was proposed partly in view of the unique context of Taiwan's procurements. Due to pressure from China, Taiwan is exceptionally limited in its choice of weapons suppliers, relying inordinately on the United States for its advanced weapons. This means that Taiwan's acquisitions are heavily conditioned by what Washington is willing to offer, as well as the terms the latter sets out in relation to procurement schedule and price (with Taiwanese [anger](#) over the F16V price tag being an example).

Australia, by contrast, has a wider market from which to choose its suppliers. However, Australia's pursuit of greater interoperability with the United States, and its predicted access, through AUKUS, to cutting-edge US technologies and expertise not on offer to other nations, and on occasion subject to special US Congressional or State Department approval, means that Australia's acquisitions also face a number of factors beyond its control – namely, the pace or ultimate outcome of US legislative or executive action, unstable production timeframes, seeding requirements and cost adjustments, and more. These factors could create immense problems for an Australian procurement package based on a static expenditure plan.

Another similarity can be found in the Sea-Air Combat package. Like Taiwan, Australia is pursuing an ambitious defence industry self-reliance agenda, whose details will soon be revealed in the long-awaited release of the new Defence Industry Development Strategy. Acquisitions from this domestic industry – the most prominent of which are to be domestically built nuclear-powered submarines – will thus need to come hand-in-hand with a more immediate investment in industry capacity building. Similarly, again, this is being touted as having both defence and broader economic benefits, with Defence Industry Minister Pat Conroy recently announcing that Australia's new defence and industry strategies 'will grow Australia's defence industry, which supports 61,600 Australian jobs and contributes more than [AU]\$10.6 billion to the Australian economy.'

It is unclear to what extent defence budget expenditures will cover this capacity building investment in their entirety – although it has already been stated that workforce development for this growing sector will be approached through 'a sustained, whole-of-government approach... working with state and territory governments.' But if the cost threatens to overburden the defence budget, while producing benefits beyond the defence sector, an integrated funding package that approaches these factors holistically, and that would obviate the usual horse trading between state and federal governments, might present a more optimal path forward.

But perhaps the most important similarities involve the fundamental reasons for the defence procurement special budgets: the need to invest large amounts of money to deter or prepare for increasingly pressing threats, and do so without slashing O&M and degrading combat readiness. At the same time, Taiwan's approach offers an antidote to both nations' longer-held concerns about procurements deficiencies.

Acquisitions funded through special budgets must go through the wringer of the parliamentary process and be accompanied by detailed public submissions – and as a result face intense media and expert scrutiny. This exposure disincentives procurement stakeholders from conflicts of interests, supplier favouritism, laxity of process, or soliciting ill-thought-out white elephants. Ensuing debates on costs and benefits invites heightened budget scrutiny – perhaps above and beyond that which applies to big-ticket expenditures blended into a general defence budget – that put political sponsors of special budget bills under pressure to ensure budget estimates were realistic and justifiable.

The big question is whether a similar arrangement, or one that performs similar functions, could be viable in Australia, and what it would look like. One option would be to set up and seed a defence acquisitions and industry development fund, perhaps similar in some ways to the [National Reconstruction Fund](#), but with limited discretion in the case of vital procurements, that could seek to eventually balance foreign procurement losses with returns on investments in a defence-grade commercial technology export industry.

This fund would, of course, need to be substantial, and perhaps prohibitively so, in view of the scale of funds being talked about in relation to the AUKUS submarine acquisitions. Yet even if it were to be employed to partially fund major procurements, it may help perform the key function of not letting big-ticket items eat into the O&M budget.

The legislation side might be even more difficult. Setting up a parliamentary framework would most probably require faith in the budgetary discipline and discretion of the government of the day. But if there is a way forward, Australia's current national defence anxieties arguably create an ideal crucible for its fruition.

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