

Final Report

Defence Capability and Resourcing Review (DCARR)

Presented to the Ministers of Defence, Finance, and
State Services in February 2005

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Executive Summary

- 1 In December 2003, the Ministers of Defence, Finance and State Services commissioned an assessment of the optimum capability configuration and resource requirements of the NZDF to undertake the roles and tasks set out in the government's statements of defence policy, and in the Defence Long-Term Development Plan (LTDP). The assessment was also to examine the capability of the Ministry of Defence to support government policy processes.
- 2 This report presents the findings of the Defence Capability and Resourcing Review (DCARR), which was undertaken by a multi-agency team during 2004. It identifies the key issues that the NZDF and Ministry of Defence face in delivering the capability outcomes that are required by the government. It further identifies options by which the NZDF's operations may be configured to deliver on the required capability, and addresses in broad terms the additional resources that may be required to achieve the desired outcomes.
- 3 DCARR concluded that as a result of many years of under-investment, and notwithstanding the implementation of the LTDP, capacity and capability in some areas is below the requirements of government policy:
 - a. personnel numbers in the three services, Headquarters NZDF, and Headquarters Joint Forces New Zealand are below the levels required, and cannot be rapidly increased to the required levels;
 - b. in some trades the number of personnel and their trained state is deficient;
 - c. some major weapons platforms require upgrading or replacement, although the LTDP will address this;
 - d. some military equipment (other than major weapons platforms) no longer meets the required standard;
 - e. contingency reserve stocks (ammunition, fuel, and spares) are depleted;
 - f. there is a backlog of maintenance and capital expenditure in the Defence Estate, which cannot be addressed fully in the short term; and
 - g. aspects of corporate management capability are depleted.
- 4 There are a number of reasons for the capability gaps. The most significant were:
 - a. a prolonged period of fiscal constraint throughout the 1990s;
 - b. a higher operational tempo since 1998;
 - c. equipment continuing in service beyond its economic life;
 - d. a strong labour market affecting the ability to recruit and retain key personnel; and
 - e. a reduction in NZDF Headquarters and support capabilities due to the high and prolonged operational tempo.
- 5 DCARR nevertheless determined that it is possible to maintain the present operational tempo (the combination of what capability is delivered, and how much) while the NZDF builds its capability to the levels required by government within the constraints of the pace at which capability can practically be regenerated, future planned upgrades and the likely available future funding. Doing so will require a recovery programme spread over several years.

- 6 In line with Ministerial guidance, senior NZDF, Ministry of Defence and Treasury officials worked with the DCARR to develop a ten year Defence Funding Package (DFP) that DCARR considers will enable the NZDF and Ministry of Defence to build capability to the level required.
- 7 The detail of the DFP, together with the NZDF's proposals for the implementation and monitoring of the recovery plan, should be addressed as part of the FY 2005/06 Budget Round. A proposal in respect of the DFP will be placed before Cabinet in February 2005.

PART 1 - Background

- 1.1 The New Zealand Defence Force (NZDF) has been working at a high operational tempo for more than six years, yet since the end of the Cold War (1989) defence funding has declined - most significantly during the 1990s. These events have stretched the NZDF resources (people and equipment) and have affected capabilities.
- 1.2 In keeping with the government's commitment in the 2001 Defence statement to provide financial certainty for the NZDF, in December 2003, the Ministers of Defence, Finance and State Services commissioned an assessment of the optimum capability configuration and resource requirements of the NZDF to undertake the roles and tasks set out in the government's statements of defence policy. Ministers wished to better understand the underlying issues in matching the NZDF's capability and the capability required by government policy, and understand the resource implications of resolving any mismatch.
- 1.3 The Defence Capability and Resourcing Review (DCARR) was established to conduct the assessment, and to deliver a comprehensive resourcing plan for the Ministers that identified key capability, capacity and output issues, and options on how Ministers might wish to consider those issues over a five to ten year horizon. The DCARR was also tasked to assess the capability of the Ministry of Defence to support government policy processes.
- 1.4 The DCARR was overseen by a Steering Group made up of the Chief Executives (or their delegates) of the Ministry of Defence, NZDF, Treasury and the State Services Commission. The Review Team was comprised of members of those organisations, under the direction of a Project Manager.
- 1.5 Between February and October 2004 the DCARR undertook a detailed study of the NZDF, its operating environment and its future requirements, and reviewed the policy capability of the Ministry of Defence. The key deliverable required by the Terms of Reference was a resourcing plan for Ministers that identified key capability, capacity and output issues, and provided options for Ministers to consider. In line with Ministerial guidance, senior NZDF, Ministry of Defence and Treasury officials worked with the DCARR to develop a ten year Defence Funding Package (DFP) that DCARR considers will enable the NZDF and Ministry of Defence to build capability over time to the level required.

PART 2 - The Operating Environment

- 2.1 The government's Defence Policy is set out in a number of documents:
- a. the *Defence Policy Framework*, published in June 2000, which lays out the five defence policy objectives, and the eighteen required roles and tasks for the NZDF;
 - b. the May 2001 government Defence Statement, *A Modern, Sustainable Defence Force Matched to New Zealand's Needs*, which sets the direction to attaining a sustainable and affordable force structure to meet those roles and tasks; and
 - c. the *Defence Long-Term Development Plan* (and subsequent revisions), which addresses the capital investment requirements necessary to achieve the government's objectives.
- 2.2 The main components of the Defence Policy are:
- a. a joint approach to structure and operational orientation;
 - b. a modernised Army with two motorised battalions, capable of deployment in smaller task forces, and a special forces capability;
 - c. a practical Navy fleet matched to wider security needs;
 - d. a refocused and updated Air Force; and
 - e. a funding commitment to provide financial certainty.
- 2.3 The government has also endorsed structural reform, through the establishment of the Joint Forces Headquarters, decisions consequent on the Review of Accountabilities and Structural Arrangements between the Ministry of Defence and NZDF (RASA), and the establishment of the Capability Management Framework (CMF) to ensure effective oversight of investment decisions in defence capabilities.
- 2.4 The DCARR was required to establish the likely future tasking of the NZDF over the next ten years, in the context of the government's existing strategic policy guidance. Tasking is not solely related to operational deployments – but relates also to the development and maintenance of a “force in being”, capable of undertaking a range of operations if required. The assessment of likely tasking involves both what will be performed and how much will be performed.
- 2.5 The nature of deployments has changed markedly in the last 15 years. Throughout the 1990s, the NZDF generally deployed small numbers of land forces to a range of missions, while sea and air forces have also conducted operations overseas. From the early 1990s to 1999, the level of commitment of personnel to operational deployments ranged between 2% and 6%, including deployments to Bougainville, and frigate deployments to the Multinational Interception Force. This low level of commitment helped to conceal the extent to which capability was declining.
- 2.6 Since 1999, the continuing strain on capability has become more evident as the level of deployment to peace support operations has ranged between 14-25% of the regular force, with the Army at times having deployed 35% of its regular force complement. Following on from large-scale (battalion) operations over a number of years in Timor Leste, the NZDF has continued to deploy significant numbers of land forces, albeit split over a number of locations, to peace support and humanitarian operations, and in support of the international campaign against terrorism which has been ongoing since late 2001. At the same time, sea and air forces have been deployed to multiple locations. In the future, there will be new ships, and upgraded

aircraft, and the continued introduction to service of a range of new equipment for the Army, including new weapons and transport.

- 2.7 Over the last fifteen years, higher operating tempo, fiscal constraints and declining personnel numbers have slowly increased pressures on the NZDF. The outcome is that capability in some areas is below the requirements of government policy. It is a measure of the quality of the personnel of the NZDF and the Ministry of Defence that they have continued to achieve operational and policy successes despite those pressures. It is clear however that if current trends persist, the risk of operational failure will increase. The range of issues facing the NZDF is outlined in Part 3 of this report.
- 2.8 Over the coming years, the NZDF will be simultaneously involved in preparing force elements for deployment, undertaking operational deployments (sometimes at very short notice), and reconstituting force elements which have been deployed. Additionally, it will be developing new capability for some force elements, either through implementing government approved acquisitions on the LTDP, or through training and development of its personnel. It must also continue to manage itself as a corporate entity. In doing so, it will be drawing from a finite pool of resources, and therefore will need to maintain an appropriate balance of effort between the various tasking streams.
- 2.9 Government priorities will vary from time to time, having regard to New Zealand's sovereign interests, treaty obligations, international relationships, and commitments to international institutions such as the UN. Typically, the government's priorities will be influenced by the geographical location of the theatre of operations, and the size and immediacy of a perceived threat or benefit. In very general terms, priority is likely to correlate with proximity – the closer the threat, the higher the priority. It is also true that in general, the further away the deployment, the greater is the cost of deploying and sustaining the deployed forces.
- 2.10 The Government's Defence Policy Framework established its primary defence interests as protecting New Zealand's territorial sovereignty, meeting shared alliance commitments to Australia and fulfilling obligations and responsibilities in the South Pacific. The wider Asia Pacific strategic environment, of which we are a part, is also relevant.
- 2.11 A balance must also be achieved between the contingent benefits of maintaining forces on standby for local requirements, against the benefits of committing them to United Nations and other multinational operations. A significant long-term deployment overseas creates a risk of being unable to meet contingencies closer to home; on the other hand, maintaining forces in New Zealand limits the options available to meet broader foreign policy objectives.
- 2.12 In summary, DCARR notes that the NZDF should have the capacity to be able to conduct essential tasks in and about the South Pacific, to continue to be committed to a number of small scale military operations, and to be able to commit a larger force to medium intensity deployment(s) within the agreed response time.
- 2.13 Given the existing level of organisational stress that the DCARR investigation has revealed and that is reported in more detail in Part 3, there are significant challenges in managing an operational tempo while simultaneously reconstituting force elements that are below the required levels of capability and developing planned capability as set out in the LTDP. Those challenges must be met in the context of a tight labour market and ongoing fiscal restraint.

- 2.14 In Part 4 of this Report, options for managing the NZDF, and its future operational tempo, are set out, and related to the government's fiscal strategy.

PART 3 – The Condition of the NZDF and Ministry of Defence

- 3.1 The initial DCARR analysis was divided into eight functional areas, addressing particular areas of capability and resourcing.

Human Resources

- 3.2 Human resources (HR) are the most important resources available to the NZDF and Ministry of Defence – without people, even the most sophisticated military equipment will be ineffective. The continued availability of people to the NZDF itself depends on the supply of resources to the organisation- financial resources, land and facilities, and equipment – which provide the wherewithal for the people to combine into an effective Defence Force.
- 3.3 There has been a long-term decline in personnel numbers. Annual Reports of the NZDF show that total number of personnel has fallen from 20,785 in June 1991 (14,634 regular force and civilian, 6,151 territorial and reserves) to 15,512 (11,669 + 3,843) in June 1998 and 12,889 (10,684 + 2,205) in June 2004.
- 3.4 These changes have resulted from a number of factors, including the disbandment of the Air Combat force and the reduction in the frigate fleet, contracting out support services such as the naval dockyard, catering and base maintenance, and the implementation of efficiency and effectiveness initiatives. Limits on personnel numbers have also been imposed by the Chief of Defence Force (CDF) as a response to funding constraints.
- 3.5 Workforce “demand” describes the number of personnel required to carry out the military roles and tasks required by the government, as well as the number of personnel (both military and civilian) required to carry out the day to day tasks of the NZDF. The number of military personnel includes those deployed, those who have just been deployed, those being trained, and those who are carrying out essential non-deployed tasks. Both the Navy and Army include reserve and territorial forces in their calculations of required personnel.
- 3.6 Single services have models to estimate the numbers of personnel required to support military tasks (the NZDF’s Personnel Capability Planning Model), and also detailed “stocks and flows” models to calculate the numbers of personnel by ranks and trade required to sustain the structure a service into the future. These models were reviewed by NZIER Ltd as external consultants contracted to the DCARR, and were found to be suitable for their purpose.
- 3.7 The required numbers and structures predicted by these models have not been attained. Continuing financial constraints on the NZDF have led to directed limits on “paid strength”, which are substantially below the required levels. The DCARR concluded that the shortfall between the numbers required to deliver the currently directed level of capability (DLOC) required by the government without risk is around 2,500, although the exact number fluctuates as personnel leave or join the NZDF, and will vary as management decisions are taken with regard to new organisational structures and future capabilities.
- 3.8 Current shortages are particularly significant in the Army and in HQ NZDF, but all services and both Headquarters are affected. The Army is unable to sustain a motorised battalion in the near term, and has critical shortages in a number of trades. The Air Force has identified a need for significant increases in logistics support personnel, including flight safety, to support planned future introductions of

aircraft. The Navy is currently looking to recruit appropriate personnel to ensure the full crewing of the Protector fleet from 2007 onwards.

- 3.9 Shortages are particularly severe in some trades, and there are also shortages at some rank levels. The Headquarters NZDF, in particular, is affected by shortages of middle and senior ranking officers (senior Major and Lieutenant Colonel equivalents), due to the need to deploy these ranks operationally. While the experience gained on these deployments is beneficial, this shortage has been a significant contributor to the erosion of management capability in the Headquarters NZDF.
- 3.10 Workforce “supply” describes both the external supply of recruits from the labour market, and the internal supply of trained personnel. The NZDF typically recruits untrained personnel into its ranks, and then trains them over a period of years in the varied skills required for their chosen speciality. While there are opportunities for lateral recruitment of civilians, and also in some cases for skilled immigrants from overseas armed forces, the military workforce is predominantly “home grown”.
- 3.11 The NZDF has a significant investment in training infrastructure (people, land, facilities and equipment), but in the absence of suitable recruits, that training infrastructure may not deliver fully trained personnel to meet all requirements. Given current demographic trends in New Zealand, and the continuation of a tight labour market, the NZDF will face growing competition for recruits, as other prospective employers in the public and private sectors value the same skills in a diminishing pool of potential workers. The availability of territorial forces to provide back up to regular forces is also diminished, although the 2004 Volunteers Employment Protection Amendment Act addresses concerns in this area.
- 3.12 The NZDF faces a significant additional concern in that it is developing a highly trained workforce, which is itself a target for other employers seeking to acquire trained staff. With the current low level of unemployment in the New Zealand economy (reported at 4% in late 2004), the NZDF represents a particularly attractive source of trained staff, given that it is not necessarily able to compete with prevailing market rates of pay. There are high profile opportunities outside the NZDF for several kinds of trained personnel, but in general the risks to the NZDF workforce affect all ranks and trades.
- 3.13 While the Navy and Air Force attrition levels are close to the historic averages of 13.6% and 11.9% respectively, the Army is suffering significant attrition, at around 18% or around 750 per year, compared to its long term average of 14.9%. This requires the Army to increase its training throughput just in order to retain its current level of capability, at a time when skilled personnel – the potential trainers – are being targeted by civilian employers. The need to provide trainers further diminishes the ability to deliver operational capability in the short term.
- 3.14 All services have managed to stay close to directed levels of personnel, but those directed levels place at risk the NZDF’s continued ability to deliver the government’s required level of capability. As noted above, the NZDF as a whole remains significantly short of the number of personnel needed to deliver the capability required by government policy.
- 3.15 ***In view of the particular situation of the Army, the DCARR recommends that the NZDF, in conjunction with the Ministry of Defence, should undertake a special study to establish how the Army should be configured to best***

maintain its operational capability during the next few years as it builds its capability towards the level required by government policy.

- 3.16 The DCARR emphasises the critical importance of workforce management to the future capability of the NZDF. Building personnel numbers to the levels required will take time and it is as important both to stem the outflow of skilled personnel as to increase the intake. Effective workforce management will require the development and implementation of a comprehensive Strategic HR plan and additional financial resources.
- 3.17 Strategic HR management has been poorly resourced in the NZDF in the past, but the CDF has directed the development of a single NZDF HR Strategy document, which is now in preparation. That strategy will address the demand, supply and retention of the personnel needed to enable the NZDF to deliver the capability that the government requires. It will be integrated with an overall NZDF Strategic Plan, which the CDF has also directed will be prepared.
- 3.18 ***The DCARR recommends that strategic HR Policy be closely aligned with the LTDP, to ensure that the future HR implications of equipment purchases are given appropriate focus at all times.***

Management Systems

- 3.19 The NZDF is a substantial organisation by New Zealand standards, directly employing 12,889 people as at 30 June 2004, with a current budget in excess of \$1.5 billion. In order to evaluate the NZDF's management systems and processes, the DCARR commissioned Deloitte to undertake an assessment.
- 3.20 Deloitte's key observation was to confirm the acknowledged weaknesses in decision support systems for strategic management. These weaknesses are highlighted by the lack of an overarching NZDF Strategic Plan. The systems that do exist tend to be operationally biased, being focussed on output delivery rather than organisational capability.
- 3.21 One important cause of this situation has been longstanding funding constraints that have prompted a movement of resources from "tail to teeth". This is an acceptable option only in the short-term and becomes unsustainable over the long-term.
- 3.22 The impact of the funding constraints is manifest in the personnel shortfalls in HQ NZDF, with trained senior personnel being withdrawn from strategic positions to fill operational, staff and command roles. In principle, such positions should be able to be filled from existing resources. In practice, those resources are not available. As noted above, the NZDF is critically short of a number of ranks and trades, and this shortage has consequences through to the strategic management capability of the NZDF as a whole.
- 3.23 ***A number of initiatives are already underway within the NZDF to address the acknowledged weaknesses in management systems. The DCARR recommends that certain projects currently under way should be given priority and should be adequately resourced. These include:***
- a. the creation of a Planning Branch to coordinate the strategic planning and programme management capabilities of the HQ NZDF, and to monitor progress of the organisational activity arising from the DCARR and RASA;***

- b. continuing development of the Capability Management Framework processes to integrate the implications of capital acquisition planning into strategic decision making; and**
- c. the roll-out of enhanced frameworks for corporate planning, risk management, performance management and knowledge management across the NZDF.**

3.24 Given that HQ NZDF is already critically short of personnel with the relevant skills, additional resources will need to be made available to give effect to these initiatives.

Equipment and Reserves

3.25 The NZDF's operational capability depends on the equipment used by its trained personnel. Equipment ranges from major capital assets such as ships, aircraft, vehicles and information systems, down to individual weapons and tools. The LTDP addresses the major equipment requirements of the NZDF over the 10 years from 2002, and implementation is well advanced. By 2012, the NZDF's major weapons platforms should be aligned with the current requirements of government policy. Smaller capital items and consumables are expected to be provided from the NZDF's depreciation funding and operating budgets.

3.26 Equipment must be maintained using stocks of spare parts, replacement items and consumable items. The level of stocks that must be held and the rate at which they are consumed depend both on the level of preparedness required and the level of activity undertaken. Where activity levels demand, it is acceptable to draw down heavily on those stocks, but ultimately they must be replenished or there will be a risk of capability failure.

3.27 All three services suffer from shortages in contingency reserve stocks of key items - ammunition, rotables, and spare parts. The Army alone estimates that it will need to spend \$170 million on such stocks over the next ten years.

3.28 Continuing funding constraints have led to under-expenditure on replenishing both equipment and reserves. As a result, stocks have fallen well below appropriate levels. This has an impact on the readiness and effectiveness of force elements. The DCARR has estimated that a total of \$690 million would be required to fully fund minor equipment upgrades and replacements over the next ten years.

Information Systems

3.29 Good systems for command, control, communication and intelligence have always been cornerstones of the effectiveness of any military force. The information age has hugely increased that importance; modern trends in war fighting have introduced the concepts of net-centric warfare and the knowledge-edge force, that act as force multipliers, enhancing the effectiveness of traditional force elements.

3.30 Information systems are critical to the NZDF for managing the organisation, managing its military forces and communicating with security partners. However, the DCARR has identified that funding constraints have resulted in a significant under-investment. The DCARR estimates \$210 million will need to be spent over the next ten years to modernise existing systems, and keep pace with requirements, especially in the need for an NZDF-wide information management system.

Defence Estate

- 3.31 The “Defence Estate” describes the properties and bases from which the NZDF operates. Most of the estate was originally developed in the mid-20th century, during and after the Second World War, and has been subject to periodic redevelopment since then. It ranges from purpose-built military assets, through standard commercial and office accommodation, to residential housing, with accompanying services and infrastructure. It is valued at \$1.016 billion, and costs approximately \$115 million per year to hold, manage and maintain.
- 3.32 The DCARR commissioned OPUS International Consultants Ltd (OPUS) to provide an overview of facilities management within the NZDF. OPUS reported that, while there are many good aspects to the NZDF’s facilities management, the existing management structures might lead to sub-optimal resource allocations in the medium term.
- 3.33 In general, the estate is fit for its intended purpose, but the DCARR identified a need for significant up-front investment and ongoing expenditure to restore some facilities, and to maintain them at an appropriate standard. The DCARR estimates that a total of \$302 million would be required for upgrades and replacements over the next 10 years, with a further \$148 million to repair and restore existing infrastructure. The NZDF does not have the management capacity to undertake a major upgrade programme in the short term, and any restoration must be undertaken over a period of years.
- 3.34 The DCARR concluded that:
- a. the existing infrastructure is adequate to support increases in personnel required for the Navy to support the Protector fleet;
 - b. the Air Force infrastructure, developed as envisaged in Project Takatini (the consolidation of Air Force operations at Ohakea) is adequate; but
 - c. army infrastructure is inadequate to meet the increases in numbers needed to meet capability requirements. New investment will be required as Army personnel numbers increase.
- 3.35 There are two major and interrelated policy issues that need to be addressed. The first is the establishment of a clear over-arching strategic direction to guide the long term development of the estate to match the future requirements of the NZDF. The 1997 Real Estate Review and subsequent Real Estate Consolidation Strategy have been partially implemented, but there remains a clear gap in the strategic direction available to property and facilities managers.
- 3.36 First, policy decisions are required on the future of the NZDF housing portfolio (2548 houses, with replacement value of \$264 million), and on the future uses of the Army bases at Papakura, Waiouru, Linton and Burnham. These decisions will have significant impacts on personnel and may affect recruitment and retention in the future.
- 3.37 Secondly, policy decisions are required on the condition and standard of maintenance of the Defence Estate. Although the overall responsibility for policy and planning lies within the HQ NZDF Resources Branch, real estate decision-making is not embedded within high-level NZDF resource allocation processes.

- 3.38 Property management standards and approaches have differed across the NZDF. Constraints on capital funding have skewed expenditure towards operating funding (that is, towards the maintenance of existing buildings and away from the capital expenditure associated with replacement or redevelopment). It is apparent also that there is a disconnection between a top-down resource allocation process, and a bottom-up, locally-based needs assessment process.
- 3.39 The recently formed Joint Property Forum is a positive step that can be strengthened by having a formal mandate. Implementation of the Integrated Land and Facilities Management System and the consolidation of Property Management within the Joint Logistics Support Organisation should bring further improvements. The DCARR considers that real estate and infrastructure management can be further improved, provided that an overarching Real Estate Strategy is formulated within the overall NZDF Strategic Plan.
- 3.40 Existing practices run the risk of inefficiencies in resource allocation and facilities use. In order to reduce this risk, the DCARR considers that expenditure and investment in the management of the Defence Estate should be considered as “mandatory” not “discretionary” – that is, as an inescapable consequence of owning real assets, not a deferrable option. As such, it should be guided by the same principles that govern the management of all other investment and expenditure decisions in the LTDP and the Minor Capital Programmes. Managing life cycle costs is just as relevant to the defence estate as it is to major items of military equipment.
- 3.41 ***The DCARR recommends:***
- a. ***that the NZDF should develop a comprehensive Real Estate Strategy aligned to its over-arching Strategic Plan; and***
 - b. ***in the context of the Real Estate Strategy, a comprehensive housing and accommodation assistance policy needs to be developed, which clarifies the intent of housing assistance and identifies future requirements for defence owned accommodation.***

Efficiency Opportunities

- 3.42 As part of its review, the DCARR sought to identify ways by which the NZDF could absorb costs within its baseline, without reduction in quality and quantity of outputs. The government has already determined what its policy objectives are, and what the NZDF’s force elements and major platforms will be to achieve that policy. International standards and expectations govern the management of “military” capability. Accordingly, the DCARR concentrated on “corporate” activities, and the high-level opportunities for efficiencies.
- 3.43 The NZDF has been actively pursuing cost reducing efficiencies as a means of coping with cost pressures over many years. The DCARR noted, however, that these initiatives are unlikely to deliver cash savings from the baseline; they are instead being used to maintain current capability within the existing resources. The initiatives include the property rationalisation programme, the establishment of the JLSO in 2005, the development of the Joint Information Systems Agency (JISA), and the further embedding of the Capability Management Framework (CMF) in respect of procurements.
- 3.44 Further initiatives may be undertaken – for example in supply chain management improvements, and in shared military services – but given competing priorities,

resources are not currently available to undertake all these projects immediately. In common with the other efficiency initiatives described above, there will be an initial resource cost to establish the programmes that will eventually realise the efficiencies.

- 3.45 ***The DCARR endorses the initiatives already in place to manage cost pressures, and recommends that the NZDF continue to pursue opportunities for further efficiencies.***

Policy Advice

- 3.46 Defence policy is developed by the Secretary of Defence in consultation with CDF. The Ministry has specific responsibility for advice on defence and international defence relations at governmental level, and for purchase advice on NZDF output policy effects. The Secretary and the CDF also have a number of joint responsibilities for which the Secretary, to discharge his share of those joint responsibilities, requires a policy advice capability.
- 3.47 The Terms of Reference required the DCARR specifically to assess the capability of the Ministry to support the government's policy process. The DCARR commissioned external consultants to canvass the views of stakeholders and report their own conclusions. The DCARR also drew on previous internal and external reviews in making their assessment.
- 3.48 The consultants reported that stakeholders generally acknowledged recent improvements in the quality of policy advice. The most significant issue for stakeholders was the shortage of experienced analytical staff within the Ministry's Defence Policy and Planning Unit (DPPU). This shortage fell into two general categories:
- a. the imbalance between the numbers of junior and senior analysts in the area of strategic policy; and
 - b. the absence of certain specific technical policy capabilities; including expertise in areas such as military technology, cost modelling, cost-effectiveness analysis and strategic HR modelling.
- 3.49 ***The DCARR recommends that the Ministry of Defence should act to strengthen its policy capability to provide "purchase advice" to the government on the policy effects of NZDF outputs, including strategic planning, the alignment between outputs and policy, the assessment of capability choices in terms of their contribution to policy and their value for money and the strategic level allocation of resources to outputs.***

Output Classification

- 3.50 As part of its review, the DCARR examined the existing output classification, and the history of its development since 1991, in order to determine whether an alternative structure might better reflect the nature and scope of service to be provided by the NZDF. The existing "force element" based structure has evolved gradually since 1997/98, after a number of earlier structures had been tried and found to be inadequate.
- 3.51 The DCARR considered two alternatives, a reduced set based around security challenges, and an alternative set based on "capability groupings". These were assessed against a framework of accountability, parliamentary control, aggregation,

usefulness to Ministers' purchase decisions, risk, and usefulness to effective management. Account was taken of the likely impacts of pending changes to the Public Finance Act.

- 3.52 The DCARR concluded that the alternatives were not superior to the existing model, having deficiencies in relation to accountability, the management of costs and alignment with command responsibilities.
- 3.53 The DCARR also concluded that there is scope for improving the way in which current output plans reflect the deployment histories of the force elements associated with each output class, so that the readiness requirements placed on them reflect the realities of the deployment cycle and the time needed for regeneration.

PART 4 – Capability Gaps, Funding Options and Implementation

Capability Gaps

- 4.1 Capability is measured both by the availability of force elements, and their preparedness for the required tasks. Maintaining high levels of preparedness is costly, in terms of personnel and equipment, reducing opportunities for reconstitution and training, and increasing the use of materiel. The NZDF therefore seeks to hold the majority of its forces at an intermediate stage of preparedness, the Directed Level of Capability (DLOC), which enable it to deliver an Operational Level of Capability (OLOC) within agreed timeframes when required. Operationally deployed forces, and those required for short notice deployments in New Zealand and the South Pacific, are held at OLOC.
- 4.2 As identified in Part 3 of this report, the DCARR concluded that there is a gap between government policy intentions for capability, and the current state of the NZDF.
- a. Personnel numbers in the three services, Headquarters NZDF, and Headquarters Joint Forces New Zealand are below the levels required, and cannot be rapidly increased to the required levels;
 - b. In some trades the number of personnel and their trained state is deficient;
 - c. Some major weapons platforms require upgrading or replacement, although the LTDP will address this;
 - d. Some military equipment (other than major weapons platforms) no longer meets the required standard;
 - e. Contingency reserve stocks (ammunition, fuel, and spares) are depleted;
 - f. There is a backlog of maintenance and capital expenditure in the Defence Estate, which cannot be addressed fully in the short term; and
 - g. Aspects of corporate management capability are depleted.
- 4.3 The DCARR was required to determine an appropriate level of operational tempo (the combination of what capability is delivered, and how much) which would enable the NZDF to recover capability to the levels required by the government, within the constraints of the pace at which capability can practically be regenerated, future planned equipment upgrades, and the likely available future funding. In doing so, the DCARR took account of the likely future operating environment, which is set out in Part 2 above, and specifically the required capabilities set out in paragraphs 2.1 and 2.2.
- 4.4 Table 1 attached [Appendix 1] to this report sets out the DCARR's formulation of an operating tempo which will allow the NZDF to continue to deliver the outputs required by government policy while also building its personnel numbers and trained state, restoring the Defence Estate, and accommodating the introduction to service of significant new weapons platforms and equipment. The table is adjusted over time to reflect the availability of major platforms and the expected increases in the capability of the NZDF.
- (NB: Table 1 attached [Appendix 1] is a classified document and has been withheld from public release).
- 4.5 As a key element of the process of capability-building, the NZDF will need to invest in corporate management, so that it has the ability to oversee the implementation of

the initiatives needed to achieve it. At the same time, and in recognition of its key role in defence policy, the Ministry of Defence will need to develop its policy capability.

Funding Options

- 4.6 The DCARR was required to consider a range of funding options, and to provide proposals which could be included in the strategic phase of the 2005/06 budget round. In September 2004, following preliminary advice on the DCARR findings, the Ministers of Defence, Finance and State Services gave additional guidance for developing those options. In broad terms, they indicated that the DCARR should examine the implications of a range of funding options, between the current baseline and a funding track involving compounding increases of 5% of baseline annually for the next ten years.
- 4.7 The DCARR considers that NZDF capability in some areas is below the requirements of government policy, and that the NZDF can not satisfy all government output and capability policy requirements within its current baseline. This is true not only because the current baseline is insufficient to meet the full costs of current outputs, but also because past budgets over the last 15 years have been insufficient to meet the costs of past outputs.
- 4.8 The funding package should therefore be enough to do three things:
- a. fully fund current output;
 - b. build capability to the level required by government policy; and
 - c. eliminate the backlog of deferred expenditure and restore depleted reserves.
- 4.9 In considering funding options, the DCARR had regard to some basic realities relating to defence expenditure:
- a. a substantial proportion (90%) of defence costs are fixed in the medium to long-term, and the marginal cost of changing operational tempo is small in the overall budget – but, in consequence, a small change in overall funding will impact most strongly on the ability to carry out marginal activities;
 - b. the NZDF is already facing expenditure increases (“pipeline increases”) which are unavoidable for legal, contractual or operational reasons;
 - c. the NZDF is subject to military inflation – that is the increasing cost of defence personnel, equipment and technology globally – which is generally higher to underlying price inflation in the New Zealand economy; and
 - d. any significant operational deployment will require additional funding for materiel and personnel, to move force elements from DLOC to OLOC, and to sustain the deployment over time.
- 4.10 In line with Ministerial guidance, senior NZDF, Ministry of Defence and Treasury officials worked with the DCARR to develop a ten year Defence Funding Package (DFP) that DCARR considers will enable the NZDF and Ministry of Defence to build capability over time to the level required.
- 4.11 Table 2 attached [Appendix 2] to this report identifies the expenditure categories for which additional funding would be made available under the DFP.

Implementation

- 4.12 A significant work programme will be required by the NZDF and Ministry of Defence in order to build both military and organisational capability to the level required by government policy. The DFP is intended to provide the financial resources to support that work programme.
- 4.13 The staged development of military capability will occur over a ten year timeframe. Early priorities include:
- increasing personnel recruitment and improved retention;
 - implementing capability acquisition decisions already made by government;
 - reviewing the optimal configuration of the Army;
 - developing the capability of HQ NZDF; and
 - developing a real estate strategy and policies for housing and accommodation assistance.
- 4.14 While rebuilding military capability is recognised as the key outcome of the work programme, the success of the DFP is contingent on the development by the NZDF and Ministry of Defence of improved corporate management systems and processes. These systems would oversee the application of resources against policy directions, and should ensure the sustainability of the funding package over its ten year timeframe. They would also support the development of comprehensive reporting by the NZDF and Treasury against the targets contained in the DFP.
- 4.15 A three phased approach has been developed by the DCARR, and senior NZDF and Ministry of Defence management to support the proposals contained in the DFP. This approach recognises the importance of first improving corporate capability, as recommended by the DCARR (see Para 3.23).

Stage 1	Stage 2	Stage 3
March to June 2005	July 2005 to June 2006	July 2006 and beyond
Initial scoping work by an 'Establishment Team' to determine the systems and processes required to implement the recommendations of the DCARR;	Based on the results of the initial scoping work, the roll out of enhancements to the NZDF corporate capability including performance management and strategic planning capabilities;	Corporate enhancements become business as usual and support strategic planning cycles;
Oversight of progress by NZDF, the Ministry of Defence and Central Agencies (DCARR Steering Group);	Roll out of the enhanced Ministry of Defence role to participate in strategic and purchase advice;	The Ministry of Defence participates in strategic planning cycles;
Report back to Joint Ministers on recommendations in June 2005.	Key Processes to support Budget Initiative for FY 2006/07 in place by November 05	If satisfied with progress, DCARR Steering will sign-off on changes and disband;
	New corporate systems manage the recovery phase of military capabilities;	Annual reporting on progress to Joint Ministers;
	Continued oversight by DCARR Steering Group.	Mid point review at 2009/10 to include a post implementation review of corporate capability enhancements of NZDF and MOD.

- 4.16 Initially, the NZDF will create a high level establishment team to scope the changes required to implement the DCARR recommendations. This team will include representatives from the Ministry of Defence and central agencies, and will draw upon external advice as required; it will be guided by the current DCARR Steering Group. The NZDF and Ministry of Defence will report back to Ministers by June 2005 on the key planning and performance management requirements, and on the implementation strategy.
- 4.17 Thereafter, the NZDF and Ministry of Defence will jointly implement the planning and performance management frameworks, with key processes in place to support the Budget Initiative process for 2006/07. The full implementation of these systems will be complete by June 2006, with the Defence Planning Framework, the NZDF Programme Management Office and the NZDF Corporate Performance Management framework all in place as integral parts of mainstream management processes. These systems will collectively enable the NZDF to demonstrate its performance against operational and organisational capability objectives, as part of the annual strategic planning and budget round.
- 4.18 The final proposed stage of implementation is a formal review at Year 5 of the DFP (2009/10) which will document the adequacy of changes made, and will report to joint Ministers on the effectiveness of the DFP in support of building the NZDF's military and corporate capability.

PART 5 – Conclusions and Recommendations

- 5.1 The DCARR concluded that as a result of many years of under-investment, and notwithstanding the implementation of the LTDP, capacity and capability in some areas is below the requirements of government policy:
- a. personnel numbers in the three services, HQ NZDF and HQ JFNZ are below the levels required, and cannot be rapidly increased to the required levels;
 - b. the number and trained state of personnel in some trades is deficient;
 - c. some major weapons platforms are not yet aligned with the government's intentions, although the LTDP will address this;
 - d. some military equipment (other than major weapons platforms) is below the required standard;
 - e. contingency reserve stocks are depleted;
 - f. there is a backlog of maintenance and capital expenditure in the Defence Estate, which can not be fully addressed in the short term; and
 - g. aspects of corporate management capability are depleted
- 5.2 There are a number of reasons for the capability gaps. The most significant were:
- a. a prolonged period of fiscal constraint throughout the 1990s;
 - b. a higher operational tempo since 1998;
 - c. equipment continuing in service beyond its economic life;
 - d. strong labour market affecting the ability to recruit and retain key personnel; and
 - e. a reduction in NZDF Headquarters and support capabilities due to the high and prolonged operational tempo.
- 5.3 The DCARR nevertheless determined that it is possible to maintain the present operational tempo (the combination of what capability is delivered, and how much) while the NZDF builds its capability to the levels required by government, within the constraints of the existing condition of the organisation, future planned equipment upgrades, and the likely available future funding. This will require the recovery programme to be spread over several years.
- 5.4 The DCARR made a number of recommendations which address key aspects of capability.
- a. *In view of the particular situation of the Army, the NZDF, in conjunction with the Ministry of Defence, should undertake a special study to establish how the Army should be configured to best maintain its operational capability during the next few years as it builds its capability towards the level required by government policy.*
 - b. *Strategic HR Policy should be closely aligned with the LTDP, to ensure that the future HR implications of equipment purchases are given appropriate focus at all times.*
 - c. *A number of initiatives are already underway within the NZDF to address the acknowledged weaknesses in corporate management systems. Projects currently under way should be given priority and should be adequately resourced. These include:*

- 1 *the creation of a Planning Branch to coordinate the strategic planning and programme management capabilities of the HQ NZDF, and to monitor progress of the organisational activity arising from the DCARR and RASA;*
 - 2 *continuing implementation of the Capability Management Framework processes to integrate the implications of capital acquisition planning into strategic decision making; and*
 - 3 *the roll-out of enhanced frameworks for corporate planning, risk management, performance management and knowledge management across the NZDF.*
- d. *The NZDF should develop a comprehensive Real Estate Strategy aligned to its over-arching Strategic Plan.*
 - e. *In the context of the Real Estate Strategy, a comprehensive housing and accommodation assistance policy needs to be developed, which clarifies the intent of housing assistance and identifies future requirements for defence owned accommodation.*
 - f. *The DCARR endorses the initiatives already in place to manage cost pressures, and recommends that the NZDF continue to pursue opportunities for further efficiencies.*
 - g. *The Ministry of Defence should act to strengthen its policy capability to provide “purchase advice” to the government on the policy effects of NZDF outputs, including strategic planning, the alignment between outputs and policy, the assessment of capability choices in terms of their contribution to policy and their value for money and the strategic level allocation of resources to outputs.*

5.5 DACRR endorses the intent of the ten year Defence Funding Package (DFP), developed by senior NZDF, Ministry of Defence and Treasury officials in conjunction with DCARR in line with Ministerial guidance, that will enable the NZDF and Ministry of Defence to build capability to the level required.

Table 2 [Appendix 2]: Distribution of Increased Appropriation in first Five Years

Expenditure Category	Major reasons for Increased cost
Naval Combat Forces	The Canterbury is withdrawn in 2005, in the out-years savings are offset by upgrades to the Anzac Frigates.
Naval Support Forces	Introduction of the Multi-Role Vessel and later replacement of Endeavour.
Naval Patrol Force	Introduction of Inshore and offshore Patrol Vessels.
Land Combat Forces	Increased personnel and life cycle costs of replacement equipments.
Special Forces	Replacement equipments.
Air Patrol Forces	Major platform upgrade and increases in support personnel and associated costs.
Fixed Wing Transport Forces	Major platform upgrade and increases in support personnel and associated costs.
Rotary Wing Transport Forces	Major platform replacement and increases in support personnel and associated costs.
NZDF Operational Capability	Improvements in joint capability particularly in operational CIS.
HQNZDF Corporate Capability	Expansion of corporate personnel and improvement of management systems.
NZDF Infrastructure	Replacement and improved maintenance of the Defence Estate.
NZDF Pay Increases	Implementation of the 2004/05 planned pay increase.
NZDF General Capability	General increases in NZDF and Single Service Capability.
Reducing Depreciation Baseline	Source of funding from the annual reduction in baseline depreciation that occurs due to existing assets being withdrawn from service.
Asset Revaluation after 5 years	The treatment of revaluation is to be reviewed after five years therefore the cost for the second five years is included.