The.Firm **EMBARGOED**

From: The.Firm [the.firm@internode.on.net]
Sent: Wednesday, 6 July 2005 2:59 PM
To: 'The Hon Peter Costello, Treasurer [pgaetjens@treasury.gov.au]'; 'Office of the Treasurer [dalexander@treasury.gov.au]'
Cc: 'Senator the Hon Nick Minchin, FINMIN'; 'Senator the Hon Robert Hill <ministerfordefence@defence.gov.au>'; 'David Johnston, Senator'; 'David Fawcett, MP <david.fawcett.mp@aph.gov.au>'; 'The Firm Distribution List'
Subject: SLICING AND DICING THE 'COMMON' WEALTH

***Our Reference**:* **606/01/05 Pt1 (65) - Opt**

Dear Treasurer,

As was said in the pre-amble to my question at the Wakefield Forum on Saturday last, I and my Industry colleagues agree with your assessment that some groups are focused on '*slicing and dicing*' the '*common*' wealth in ways which are not necessarily in the best interest of our Nation.

The current plans of the Department of Defence in relation to the New Air Combat Capability (NACC) and related projects fail to satisfy basic national security requirements and even rudimentary tenets of value for money. These plans will result in an air combat capability far less than what is currently available to Australia. Such lesser capability has other problems – higher costs and high risks; less real return to Australian Industry and the Australian economy; and, high through life upgrade costs - the result of buying early production variants of a new aircraft type. All of these issues have been trivialised, distorted and seriously misrepresented to the Parliament so it would be fair to conclude the same for representations to the NSC and Cabinet.

In the JSF Program alone, the Department is spending in excess of A$100,000 per day pursuing the purchase of a second tier capability which is unlikely to be fully operational before 2015 and then only a semblance of what Australia could and should have as its air combat capability. Purchasing low rate initial production (LRIP) aircraft means one acquires early and, therefore, untried and immature versions of the aircraft's systems at the high cost end of the production cycle which, in turn, makes costly after-market modifications and upgrades inevitable.

When, in 2001-02 and in keeping with the Government's Team Australia ethos, the Department was shown these risks, they chose to ignore them along with the risk mitigation strategies that had also been provided from Industry. Instead, they embarked on their own, again, less capable, more costly and higher risk plans that also see Australian Industry sidelined and additional unnecessary strains placed upon the Australian economy. I refer here, of course, to the reversal of the well researched policy in the Government's Defence 2000 White Paper that had the F/A-18s retired well before the F-111s.

The resulting additional expenditure, in present value terms, of the "*more than A$4.5bn*" outlined in our letter of the 29th of March owes its origins to these plans, alone. A further calibration of this significant cost difference and unnecessary expense may be found in the Defence Capability Plan (DCP) and the Department's submission to Parliament in June last year, entitled 'Air Combat Capability' (copy attached). Figure 2 and the related Table 1 of the latter presents what the RAAF calculated to be the total cost of ownership for the F-111 capability out to 2020. Discounting this expenditure profile to present value terms, using an annual 8% discount factor for the period, shows a present value comparative cost of A$2,224.5m. This cost is for all the capital projects listed in Table 1 as well as the total projected operational, maintenance and logistics costs (including contracted support). For the period to 2015, the similarly derived present value comparative cost is A$2,023.0m. Applying the same methodology to the capital projects in the DCP that are planned to enable the F/A-18s to reach 2015 results in a comparative cost figure of A$2,137.7m. This is for major capital projects only and, unlike the RAAF's total cost of ownership for the F-111 capability, does not include the costs of operations, maintenance or logistics support – contracted or otherwise.

The Defence Annual Report of 2000 (DAR 2000) states the annual total operating expenses (ATOE) for the F/A-18 Tactical Fighter Group as A$782.2m (presumably in FY_00 dollars). Using the same methodology, same discount factor and assuming no escalation of this 2000 figure over the period 2004-2015 results in a present value comparative cost of some A$5,894.7m for the group's operations, maintenance and logistic support. Combining this figure with the comparative cost for the planned major capital projects makes the total projected cost of ownership of the Tactical Fighter Group capability some A$8,032.4m in 2004 present value terms and the unnecessary expense figure of A$4.5bn somewhat understated – by about A$1.5bn.

These data and the supporting analyses have been ignored by the Department's senior leadership, despite many and varied attempts to engage with them in professional discourse and debate into Australia's air power and air superiority needs. To better understand why this is the case, I refer you to our Parliamentary Submissions entitled '*What Ails Defence, Today*' and '*Farewell to Arms, Revisited*'. For your convenience, these may be viewed on the APA on-line journal at http://www.ausairpower.net/apa-analyses.html and http://www.ausairpower.net/policy.html, respectively.

As to a way forward, the directing governance level of the Department could task the executive level of Defence to produce an expenditure profile for the F/A-18A capability along the same lines as that shown for the F-111 (see annotations in attached extract from the RAAF submission to Parliament). Alternatively or additionally, the Department be encouraged to engage with us and other Industry Groups, openly under the Team Australia ethos, to determine the most capable, most cost effective and least risky air combat capability that provides the best returns to Australia, both now and for the future.

Finally, a more rigorous approach to the analysis above would be to apply escalation factors to the DAR 2000 figure for the Tactical Fighter Group ATOE, prior to discounting back to present value.

A factor of "*6% per annum compounding*" was stated by the RAAF as the historical figure that was used in their analysis of the total cost of ownership of the F-111 capability. As demonstrated in '*Farewell to Arms Revisited*', the application of a 6% per annum compounding figure to the F/A-18 Tactical Fighter Group ATOE would underestimate the real expenditures by some degree. However, doing so results in a projected aggregate ATOE for the period of some A$9,921.0m, making the total projected present value cost of ownership of the F/A-18 Tactical Fighter capability for the period 2004 to 2015 some A$12,058.7m. ***In present value terms, this is almost six (6) times the RAAF calculated total cost of ownership of the F-111 for the same period – including the investment required to take the aircraft out to 2020! In actual expenditure terms, the figures take on the appearance of international dialling telephone numbers.***

If nothing else, the results of the analyses outlined above demonstrate that the military justice and administrative review systems are not the only areas where the Department could do with some assistance from outside experts. Moreover, they demonstrate the need for a much closer and independent look at the bases of the recommendations made to Government that have resulted in the current plans for Australia's air combat capability.

I hope you will agree with me that the brave, dedicated and hard working people within the ADF and the Department, the Australian taxpayer, and future generations of Australians, deserve nothing less.

A signed copy of this E-Letter is attached. In keeping with E-mail based communication protocols, an acknowledgment of receipt would be much appreciated.

Yours sincerely,
In the interests of national security and the economy,

Peter Goon
Australian Flight Test Services

06 Jul 2005

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***Attachments*:**

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