



Waiting for Defence Budget 2010/11: Second of the *Canada First Defence Strategy* Budgets

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The *Canada First Defence Strategy* Budget

2008 saw the tabling of the *Canada First Defence Strategy* (CFDS). An unusual aspect of the CFDS was the inclusion of a long-range funding formula which had three key elements.

First, a promise of 2.7% “Nominal” growth, which included an expected inflation factor of 2.1%, and therefore a 0.6% “Real” growth in the defence budget’s Total Main Estimates.

Second, a promise that future expeditionary, or “major,” operations would be provided with supplementary funding on top of the Total Main Estimates baseline to cover the incremental costs of those operations.

Third, a shift from “Cash Based” to “Accrual Based” accounting.

Defence Budget Mechanics

Each year’s *Report on Plans and Priorities* provides a rolling three-year forecast of future defence spending.

Those forecasts are composed of a Budgetary Main Estimates (Gross) figure, which is then adjusted downward to include re-spendable revenues, to arrive at a Total Main Estimates figure. This is the planned baseline figure for the Department of National Defence (DND).

However, there will be changes made to this figure to incorporate a variety of Adjustments, some of which have been made in past budgets, as well as those in the current one. When added to the Total

Main Estimates they produce the Total Planned Spending figure, which is what the government actually plans to spend on defence for the following year.

This Total Planned Spending figure will adjust upward (or occasionally downward) as a result of additions and subtractions made in the *Supplementary Estimates*, but these sums do not usually become part of the “baseline” defence budget reflected in the Total Main Estimates figure.

Defence Budget 2009/10

Defence Budget 2009/10 was the first of the annual CFDS budgets.

The Main Estimates increased from \$18.3 billion in FY 2008/9 to \$19.3 billion in FY 2009/10, representing an increase of \$1 billion or 5.5%, which was substantially in excess of the CFDS nominal growth figure of 2.7%.

Once the Planned Adjustments of \$1.8 billion had been added in, the Total Planned Spending rose to \$21.1 billion, a total increase of 11.6% over the previous year.

Of that \$1.8 billion a total of \$822 million was incremental funding for the Afghanistan mission and \$205 million represented incremental funding for DND participation in the Vancouver 2010 Olympics mission.

Other adjustments had to do primarily with the sequencing and/or re-profiling of strategic capital investments which moved money into the 2009/10 fiscal year.

Late in the year media reports indicated that Vote 1 funds were being re-profiled to areas of greater importance, though specific details were not provided. Since the re-profiled funds resulted in cutbacks in

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Reserve training and cancellation of Reserves full-time employment contracts, the moves caused some public outcry. Some media commentators suggested that the ongoing global financial crisis had finally impacted the defence budget.

Presumably, there will be a *Supplementary Estimates (C)* for budget 2009/10, where some of these questions may be answered.

Nonetheless, Defence Budget 2009/10 must be viewed as meeting and substantially exceeding the targets set out in the CFDS.

The 2010/11 Budget Context

The table shows the evolution of the defence budget over the Martin and Harper administrations, from a Main Estimates 2005/6 figure of \$13.4 billion to a Main Estimates 2009/10 figure of \$19.3 billion, an increase of 44.0%, or an average annual increase of 11.0% over the four years.

Each year's *Report on Plans and Priorities (RPP)* includes a three-year rolling forecast. The *RPP 2009/10* forecasts for defence budgets 2010/11 and 2011/12 are included in the table in the shaded area.

**Defence Budget 2010/11:
Forecast \$20.6 billion—down 2.3%**

As can be seen, the *RPP 2009/10* forecast shows an actual decline in Total Planned Spending for each of the next two years.

In part, this decline stems from a decrease of \$0.1 billion in the 2010/11 Total Main Estimates. The promised CFDS annual increase would have amounted to about \$500 million at this level so this decline appears puzzling.

However, since the 2009/10 Main Estimates increase was \$1 billion instead of the expected \$500 million, this drop may simply be a return to the long-term planned CFDS increase track.

In any event, the most significant part of the decline can be found in the Adjustments, which drop from \$1.8 billion in budget 2009/10 to \$1.4 billion in 2010/2011, and subsequently to \$500 million in 2011/12.

Thus, the latest figure that we have for forecasting the Total Planned Spending for Defence Budget 2010/11 is that it will be approximately \$20.6 billion—based upon \$19.2 billion in the Main Estimates and \$1.4 billion in Adjustments.

Within the Adjustments, Defence Budget 2010/11 will lose the \$205 million adjustment for the

2010 Olympics, and add \$120 million for the Afghanistan mission, and see additional sums moved as part of the normal re-profiling process.

**Defence Budget 2011/12:
Initial Forecast \$19.7 billion—down 4.4%**

The figures for Defence Budget 2011/12 contained in *RPP 2009/10* do not appear to include the CFDS annual increase of 2.7% or around \$500 million. This increase should probably be picked up in the 2010-2011 *Annual Reference Level Update*, which is the annual process where three-year forecasts are revised and agreed upon by Departments and

Fiscal Year	Total Main Estimates (bns)	Planned Adjustments (bns)	Total Planned Spending (bns)	Actual Change Year over Year
2005/6	\$13.4	\$1.3	\$14.7	
2006/7	\$14.8	\$1.1	\$15.9	8.2%
2007/8	\$16.9	\$1.1	\$18.0	13.2%
2008/9	\$18.3	\$0.6	\$18.9	5.0%
2009/10	\$19.3	\$1.8	\$21.1	11.6%
2010/11	\$19.2	\$1.4	\$20.6	-2.3%
2011/12	\$19.2	\$0.5	\$19.7	-4.4%



the Treasury Board Secretariat. Since we do not have access to this document we cannot make any further speculative guess as to what it actually will contain.

The major cause of the massive drop in Adjustments for Budget 2011/12 is the consequence of the planned withdrawal from Afghanistan, which will result in a drop of \$765 million, from \$943 million to \$178 million.

In addition, there will be moves of funds in according with the needs for re-profiling as various projects more quickly or slowly than originally planned

At the moment then, we are forecasting a 2011/12 Defence Budget of approximately \$19.7 billion, rising to \$20.2 billion if the 2.7% CFDS increment comes through.

Impact of the Financial Crisis

Many defence watchers have expressed fears that the measures taken to deal with the financial crisis would result in reductions to the defence budget. This fear may be unwarranted since the bulk of the defence budget is spent in Canada and a withdrawal of that spending would reduce economic activity.

Capital projects involving purchases from non-Canadian sources may have more difficulty and could experience “slippage” during the procurement process.

The government has followed a recent pattern of making no comments with respect to the defence budget during the annual Budget Speech, even though the actual increases to the defence budget during that period have been quite substantial.

It may be that during this year’s Budget Speech, which will concentrate on the way in which the government plans to deal with the massive budget deficit, the government may mention that the planned withdrawal from Afghanistan will result in savings of approximately \$1 billion annually.

Sources

There are six key documents which defence budget analysts have to pore through in order to figure out the Canadian Defence Budget.

The first is the *Budget*, which details in broad terms the intention of the Government spending plan over a five-year timeframe, with greater detail for the nearer years. It normally appears with great political fanfare around the beginning or middle of February.

The second is the *Main Estimates*, which has a one-year timeframe, covering the following Fiscal Year. It will normally include the current year’s figures for comparative purposes. In previous years, the *Main Estimates* usually appeared following the Budget speech, in many cases quite closely. In 2006, and again in 2007, however, the *Main Estimates* appeared before the Budget Speech. These can be found on the Treasury Board website.

The third document is the *Report on Plans and Priorities (RPP)*, which breaks out the planned spending in much finer detail and uses a four-year framework—previous year, current year, next year, and the year following that. It normally appears after the publication of the *Budget* and the *Main Estimates*. This document can be found on the DND website in the Reports and Publications portion of the VCDS section.

The fourth and fifth documents are the *Supplementary Estimates (A)* and *(B)*, which provide spending authorities to deal with items which were not included in the *Main Estimates*. It uses the same one-year timeframe as the *Main Estimates*, which, in effect, it amends.

Supplementary Estimates will normally appear later than the *RPP*. *Supplementary Estimates (A)* traditionally appeared in late Fall, and *Supplementary Estimates (B)*—which is usually a “housekeeping” or “cleanup” document shifting relatively minor amounts around—in the February timeframe. The *Supplementary Estimates* can be found on the Treasury Board website.

The last document is the *Departmental*



Performance Report, which is the final accounting in detail of where the money was spent and the actual total spent. It is the definitive historical document. It comes even later, usually around November of the following year. It too can be found in the Reports and Publications area of the VCDS section of the DND website.

This Commentary also refers to the *Annual Reference Level Update (ARLU)*, which is an annual process where three-year forecasts are revised and agreed upon by Departments and the Treasury Board Secretariat.

A Reference Level is the current dollar balance of funding available to an organization (typically a department or agency) for each year as approved by Treasury Board and/or statutory estimates related to statutes of Canada. It is the aggregate of all approved funding levels for the organization and may include some or all of the following; program, operating, capital, non-budgetary expenditures, grants and contributions and revenue credited to the vote.

The ARLU updates the forecast of expenditures for approved programs to provide a base for the development of the Main Estimates and the government's expenditure plan as outlined in the Budget. These are not normally available to the public and we did not have access to them.

Technical Note: Accrual Accounting and Budgeting

The Government of Canada made the decision to shift over to standard accounting practices in about 1995, and all government departments have been involved in working out the transition since that time.

The big effect will be felt in defence capital budgeting. Up to now, when a piece of equipment was purchased the cash cost paid would be "expensed" entirely in the year of purchase. Under the accrual accounting system the total cash cost will instead be shown as an asset on the

Department's Balance Sheet and will be amortized over the actual service life of the equipment in the form of an annual "depreciation" charge.

The effect is to make a limited capital budget go a lot further since we are "expensing" only a small percentage of the capital cost of the equipment each year. Eventually it will stabilize as the total annual capital amortization charges approach and equal the annual capital budget; in the intervening time frame it can allow for the recapitalization of the Canadian Forces a lot faster than would be the case under the previous "cash-based" accounting system.

Since the *Canada First Defence Strategy* is currently looking at a capital acquisition programme of about \$57 billion to cover the big items already announced, the ability to spread those capital dollars further is potentially a very valuable development.

Some material is presented in the Departmental *Annual Performance Report* for budget year 2008/9, which is available on the Treasury Board website.

Since the adoption of the accrual budgeting process is still in development this *Commentary* does not make further reference to it.

For a more cautious view of the impact of Accrual Accounting and Budgeting, see Brian MacDonald, "The Canada First Defence Strategy of 2008 And The 20 Year Defence Budget," available at www.cda-cdai.ca/cda

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