



Waiting for Defence Budget 2011/12: Third of the *Canada First Defence Strategy* Budgets

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The Main Estimates 2011/12: Up 1% to \$21.293 billion

On Mar 1, 2011 the Government of Canada tabled the *Main Estimates* for Fiscal Year (FY) 2011/12. The Main Estimates will be followed by the tabling of the Budget on March 22, 2011.

The Main Estimates show, contrary to widespread fears of major cutbacks, that the DND budget for FY 2011/12 will actually increase by \$ 191 million, or 1% from \$21.102 to \$21.293 billion.

Within that figure the Capital Budget (Vote 5) will decrease by 4% to \$4.664 billion, or 21% of the total budget. The Operating Budget (Vote 10) will rise 2% to \$14.965 billions. And Statutories (mainly contributions to employee benefit plans), will rise 3.7% to \$1.423 billions.

Breaking Out the Defence Budget

Faithful readers of CDA Commentaries will recall that *RPP 2010-11* included a substantial change in breaking out the Programme Activity Architecture.

We now have five Strategic Outcomes which this Commentary will describe as Resources, Force Generation (or Readiness), Operations, the CF and Society, and Internal Operations.

***Resources* includes**

- Equipment (\$3.498 bn),
- Recruiting Training (\$1.417 bn),
- Property (\$0.666 bn), and
- Science (\$0.327 bn).

***Force Generation* includes**

- Maritime Readiness (\$2.189 bn),
- Land Readiness (\$3.630 bn),
- Aerospace Readiness (\$1.884 bn), and
- Joint Readiness (\$2.237 bn).

***Operations* includes**

- International (\$2.028 bn),
- Continental, (\$0.198 bn),
- Canada (\$0.283), and
- Situational Awareness (\$0.637).

***CF and Society* includes**

- CF Personnel support (\$0.761 bn),
- Canadian Identity (\$0.354 bn),
- Environment (\$0.134bn), and
- Non-Security Support (\$0.007bn).

Internal Services (\$1.044 bn)
is not broken down further.

Shifts in Budget Priorities

- Recruiting training: +134% to \$1.417 bn
- Maritime Readiness: +11% to \$2.189 bn
- Equipment: +8% to \$3.498 bn

- Aerospace Readiness: - 17% to \$1.884 bn
- International Ops: -14% to \$2.028 bn
- Canadian Ops: - 13% to \$0.283 bn
- Defence Science: -10% to \$0.327 bn
- Land Readiness: - 10% to \$3.630 bn



Budget 2011/12 and the Canada First Defence Budget Yardstick

Table 1 table shows the evolution of the *Total Planned Spending* on defence (*Main Estimates* plus *Supplementary Estimates* plus other Treasury Board funds not reflected in the Estimates) over the period of the Martin and Harper administrations, from a *Total Planned Spending 2005/6* figure of \$14.1 billion to a *Total Planned Spending 2011/12* figure of \$22.0 billion.

So we can safely conclude that the Martin and Harper administrations have kept and considerably exceeded their promises to expand the Canadian defence budget by 2.7% annually based on 2.1% for inflation and 0.6% for real growth (though the Main Estimates 2011/12 have trimmed these figures to 2% inflation and 0.5% growth).

The shifts between Budget categories already cited seems to have the look of a return to the original aims of the Canada First Defence Strategy determination to rebuild the

Fiscal Year	Total Main Estimates (bns)	Supp Estimates (A) (bns)	Supp Estimates (B) (bns)	Supp Estimates (C) (bns)	Total Planned Spending (bns)	Change Y/Y Total Planned Spending
2004/5	\$13.3	\$0.6	\$ 0.19	NA	\$14.129	NA
2005/6	\$13.4	\$1.3	\$0	NA	\$14.8	4.4%
2006/7	\$14.8	\$1.1	-\$0.001	NA	\$15.9	7.8%
2007/8	\$16.9	\$1.6	\$0.001	NA	\$18.4	16.3%
2008/9	\$18.3	\$0.5	\$0.4	\$0.003	\$19.5	5.9%
2009/10	\$19.2	\$1.3	\$0.002	\$0.004	\$20.8	6.5%
2010/11	\$21.1	\$1.4	\$0.4	\$0.7	\$22.0	6.8%
2011/12	\$21.3	?	?	?	?	?

Table 1—from the Reports on Plans and Priorities FY 2004/12

This represents a total increase of 55.7%, or an average annual increase of 7.59% over the six year period.

And the portion of Canada`s defence budget devoted to equipment recapitalization rose to the 23% range—an increase which has allowed the acquisition of such platforms as the C-17 heavy airlifters, the CH-47 medium airlifters, the Cyclone maritime helicopters, the M-777 air-portable medium howitzers, the Leopard-2 main battle tanks, and a variety of other platforms.

forces now that the Afghanistan operation is winding down to a smaller training mission. Maritime readiness gains a bit as inter-service readiness rebalances and international and Canadian operations reduce. Recapitalization, both physical capital and human capital, now becomes more important

Budget 2011/12 and the NATO Yardstick

A traditional yardstick for comparing national defence efforts has been the



percentage of GDP which is devoted to defence spending since such a yardstick is not subject to exchange rate vagaries. NATO has produced a common yardstick which has a specific formula for calculation and the NATO wide results are published annually.

In past years Canada has been criticized, sometimes quite sharply, for a weak defence effort which, by the end of the Chretien administration, had reached a low point of 1.1% of GDP.

The latest NATO figures are for 2009 and show that the Canadian defence effort had climbed to 1.5%, and had now surpassed that of Germany, which had reached 1.4% of GDP. Since then we have seen a substantial increase in 2010/11 and now a slight increase for 2011/12, while our European partners have announced very substantial decreases.

Clouds on the Horizon?

The Main Estimates look only one year into the future. However, the Report on Plans and Priorities, which is the detailed business plan for the Department, contains a four year rolling forecast which includes the Year just past, the upcoming year reflected in the Main Estimates, and the planned figures for the two following years.

Table 2 contains the four year summary of the FY just ended (Forecast 2009/10), the upcoming FY (Planned 2010/11), and the two forward years (Planned 2011/12 and 2012/13).

What was worrying was the revelation in last year`s RPP that the Main Estimates for 2011/12 were projected to drop \$1.266 billion and the Adjustments to drop by \$0.127 billion for a Total Planned Spending drop of \$1.393 billion. Instead we received the pleasant surprise that the Main Estimates would actually rise by 1%.

Worriers will eagerly pounce upon this year`s RPP to see what the current forecasts for FYs 2012/13 and 2013/14 will be.

The 2010/11 Budget materials contained the ominous phrase "Restraining Growth in National Defence spending" which was further explained in the statement that "... as part of measures to restrain the growth in overall government spending and to return to budget balance in the medium term, the Government will slow the rate of previously planned growth in the National Defence budget. Budget 2010 reduces growth in National Defence`s growth budget by \$525 million in 2012/13 and \$1 billion annually beginning in 2013/14."

The 2012 Main Estimates are consistent with that statement since growth is slowed but not reversed..

Some media stories also trigger concerns. A December 28, 2010 Globe and Mail piece titled "Military Sets Out to Trim All but Essential Civilian Staff" reported that "Finance Minister Jim Flaherty last spring asked DND to reduce its annual budget increase from 8% to 2%."

Other sources have suggested that personnel costs are rising as a percentage of the overall budget, that full time Class B

Year	Forecast 2009-10	Planned 2010-11	Planned 2011-12	Planned 2012-13
Main Estimates	\$19.239	\$21.102	\$19.836	\$19.337
Adjustments	\$1.499	\$0.726	\$0.599	\$1.756
Total Planned Spending	\$20.738	\$21.827	\$20.435	\$21.093

Table 2— from Report on Plans and Priorities 2010/11



Reservists numbers are likely to be reduced from the 11,000+ that is the current situation, and that equipment projects keep coming in over budget.

Technical Notes

Sources

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

The Budget

This 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 Main Estimates

These have a one-year timeframe, focused on the following Fiscal Year but 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 Report on Plans and Priorities (RPP)

This forecasts the planned spending in much finer detail using a four year timeframe of previous year, current year, next year, and the year following that. It normally appears after the publication of the *Budget* and the *Main Estimates*.

Those forecasts are organized on the basis of a *Budgetary Main Estimates (Gross)* figure, which is then reduced by including re-spendable revenues, to arrive at a *Total Main Estimates* figure. This is the planned baseline figure for the Department.

However, there will also 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.

This document can be found on the DND website in the Reports and Publications portion of the VCDS section.

The Supplementary Estimates

The fourth, fifth, and sixth documents are the *Supplementary Estimates (A), (B), and (C)* (which provide spending authorities to deal with items which were not included in the *Main Estimates*). They use the same one-year timeframe as the *Main Estimates*, which, in effect, they amend.

Supplementary Estimates will normally appear later than the *RPP*. *Supplementary Estimates (A)* and *(B)* appear in early and late Fall, and *Supplementary Estimates (C)*—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 Departmental Performance Report (DPR)

This document provides the final accounting in detail of where the money was spent and the actual total spent. It is the definitive historical budget 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.

The Annual Reference Level Update (ARLU)

This 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.

Accrual Accounting and Budgeting

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

The biggest effect in DND 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 us to recapitalize 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," at www.cda-cdai.ca/cda

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