

ARF Security Policy Conference

Agenda Item 4: Regional Defence and Security Implications of the Global Economic Crisis

Speaking Notes

Background

- Recent IMF forecasts are for the global economy to shrink by 1.3 percent this year, and only sluggish growth next year. The contraction is even greater amongst advanced countries, with economic activity in the United States and the European Union forecast to shrink by around 3 percent and Japan by 6 percent.
- New Zealand is now in its sixth quarter of recession. In response, the Government has introduced a fiscal stimulus package equivalent to 5 percent of GDP. The large budget surpluses of the last ten years are gone. Preliminary forecasts point to recurring operating deficits of around \$10 billion annually over the next ten years.

Regional context

- The impact of the global economic crisis on defence and security will differ across countries and regions. How governments respond will also differ.
- As regional economic activity contracts there is potential for social and political unrest as governments are forced to cut social spending, leading to job losses and diminished social services.
- In countries where the government subsidises food and fuel, the potential for widespread unrest is greatest.
- The World Bank, for example, estimates that the poorest 20 percent in South and Southeast Asia spend nearly a third of their household income on rice. High prices last year led to protests in India, Indonesia, the Philippines and Timor-Leste.
- While commodities prices, including the price of oil, have since fallen, declining tax revenues may cancel any benefit as governments are pressured to cut subsidies, pushing basic items beyond the reach of the most vulnerable.
- As more and more communities are excluded from the formal economy, resentment and dissatisfaction will grow, providing fertile ground for extremism and communal violence.
- Ironically, for countries on the margins of the global economy, such as the small island nations of the South Pacific, the impact of the financial crisis on the most vulnerable will be less severe. In this region, many

households, particularly the poorest, are not actively engaged in the formal economy, relying instead on subsistence agriculture and remittances. They also access few government services.

- For countries better able to weather the crisis, budgetary constraints will force governments to review spending.
- Nations that have committed considerable resources to operational deployments and equipment programmes will find future military budgets pressured by the need to spend more on other domestic priorities.
- Within our region, this could potentially change the strategic weight of nations, as some countries are forced to lower their expectations in line with current fiscal settings, while others continue their equipment programmes unchanged.
- We are unlikely, however, to see a repeat of the deep, across-the-board cuts of the 1980s and 1990s where the post-Cold War peace dividend was withdrawn, banked and then spent elsewhere. The reasons for this are three-fold:
 - The deferral of major capital investment in the 1990s meant many of region's defence forces approached the new century facing block obsolescence of key items of equipment. Significant new investment was required.
 - Secondly, the cost of replacing capability is increasing as equipment becomes more sophisticated, and the need to maintain interoperability with our partners demands that we keep pace. This is compounded by long lead-in times and a military inflation rate which is 3 to 4 percent higher than regular inflation.
 - Thirdly, policy planners will need to balance pressure to reduce military expenditure to help curb spending; and increasing military spending in response to an unstable threat environment and the demand for operationally deployed forces which is likely to remain high.
- While significant change is unlikely in the short to medium-term, governments are focused on improving value for money. This is the right thing to do. The perception of the new administration in New Zealand is that persistent government surpluses since 1999 have created an element of moral hazard within the public sector, including in Defence.

New Zealand context

- What then of New Zealand's response?
- New Zealand went into the financial crisis in a comparatively strong position. Our banking and financial system is sound and unemployment was low at 3 percent.

- **Both major political parties went into last year's election with the intention to undertake a major review of defence policy, leading to a defence white paper.**
- **White Papers are the culmination of a process of consultative review and public debate. They chart a policy direction for the foreseeable future, provide guidance to policy planners, and signal a government's security intentions.**
- **The global economic crisis has strengthened the case for a comprehensive review of defence policy. In difficult economic times, the drive to find efficiencies and deliver value for money, without a thorough review of defence priorities and commitments, is unlikely to lead to better policy outcomes. It is not therefore a question of once again reducing defence expenditure, but of ensuring that money is spent where it is needed.**
- **Terms of reference for the Review have been released. The Review will:**
 - **recalibrate defence policy priorities and strategies, and develop a range of costed options for aligning policy, capability and force structure; and**
 - **examine options for improving the administrative and organisational capabilities of the Defence agencies.**
- **The beginning point for a review of any nation's defence policy is their security environment. There is a broad consensus in New Zealand that our defence policy should reflect our independent assessment of its security environment.**
- **Key questions include:**
 - **How does the present and future strategic environment impact on the security of New Zealand?**
 - **How does Defence contribute to the security of New Zealand, Australia, and the South Pacific?**
 - **Is the current operational tempo sustainable?**
 - **How well do the current Defence outputs meet our actual needs now and in the near future, and how does our acquisition programme align to those outputs?**
 - **What are the key issues around Defence personnel, including training, recruitment, and retention?**
 - **What are the best financial management procedures to meet the long term defence funding requirements?**

- The Government has indicated that it wants a Defence Force that has a sufficient range of capabilities to deal with any reasonable foreseeable contingency within our region and to build security within the South Pacific.
- Outside our region, we are best suited to providing high-quality contributions that are focused and specific.
- The Review will not assume that more resources are required. Rather, the Government will be given a range of funding options against which it can make capability decisions, particularly over the next decade.
- Defence planning should not be the product of a secret, cloistered society. Ideally, it should be a strategic, open, and flexible process which builds support for, and confidence in, military forces that have the capabilities and training to achieve clearly established objectives. We intend to follow this model of best practice.

Conclusion

- The strategic effects of the global economic crisis will depend on its duration and depth, neither of which will be uniform across countries and regions.
- The global economic crisis is forcing all countries to re-evaluate the why, what, where, who and how of their defence policies. While approaches will differ, it is important that we proceed in way that is open and transparent.
- This last point is central. Transparency is an important confidence-building tool which can contribute to domestic and international security goals, particularly during difficult times. The act of revealing ones policy intentions, capabilities, force development goals and defence spending builds trust and heightens mutual understanding.
- New Zealand has long supported regional defence-related confidence building measures under the auspices of the ARF. The ability to exchange information on defence planning and encourage greater interaction and familiarity between defence establishments are positive. Building on this dialogue will enhance the region's ability to navigate through this especially dynamic period of international relations.

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