



Australian Industry & Defence Network Inc (AIDN)

Submission to the

Joint Standing Committee on Foreign Affairs, Defence and Trade

on the

Inquiry into Government Support for Australian Defence Industry Exports

10 July 2014

Introduction

The Australian Industry & Defence Network (AIDN) welcomes the opportunity to make a submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade on its inquiry into Defence Exports.

The inquiry is appropriate and timely, noting that it provides an opportunity to offer constructive views on the state of, and additional measures to improve, support to Australian Defence related small and medium enterprises (SMEs) with exporting.

Executive Summary

Australian SMEs find it extremely difficult to export their products/capabilities because more often than not the Defence Department's Value for Money (VFM) criteria only considers the short term acquisition costs and this drives procurement often to an overseas supplier. A more holistic "Whole of Life" VFM criteria would ensure a more realistic appraisal of competing bids. In addition, the administrative processes to procure internally via the Foreign Military Sales (FMS) process is so streamlined when compared to the overly bureaucratic and risk averse process of procurement direct in country, hard-working public servants will, naturally, take the easier path. The bottom line is, the Australian SME has extreme difficulty

establishing a reference purchaser in our own country, thus placing us at a large disadvantage when competing in the global market, even with a better product.

Successive Governments have championed a healthy Australian defence industry, including the need to foster essential in-country industry capabilities for defence self-reliance. AIDN welcomes this as an ongoing, desirable policy commitment but sees little progress or adherence to the current Industry Policy in a practical sense, noting this government has yet to finalise its industry policy and signs are encouraging.

As one AIDN member pointed out: 'Australia is in the grip of a "lowest possible cost acquisition" mindset where cost is the primary driver. Supporting a strategic industry is a difficult argument to make in the current cost constrained environment. It is just too hard to argue against a dry economic argument with a qualitative guess on what the monetary value is of the possibility of needing defence industry in the future. It is clear to see that the Department of Finance and Deregulation (DOFD) and the Department of Treasury have a significant influence on the current decision making process.

Specific Points of Concern

High Dollar

The current high value of the dollar is impacting negatively. SMEs are finding it a hurdle to be able to compete in global markets. It is critically important for the survival and growth of defence companies, including SMEs that measures are taken URGENTLY around improving productivity, reducing the company tax rate, lifting investment in skills and supporting exports and innovation.

Australian Industry Capability (AIC) Plans

When DMO procure Military-off-the-Shelf (MOTS) or Civilian-off-the-Shelf (COTS) equipment acquisitions, whether via Foreign Military Sales (FMS) or tender, they include the requirement for Australian Industry Capability plans where the procurement is over \$20 million. To date there has been very little evidence that this program is working in relation to supporting Australian industry. In fact there is evidence to show clearly that the policy is being "bypassed" or perhaps ignored by various procurement agencies in Defence. This means that overseas companies are able to supply goods to the ADF without engaging with Australian companies who could become part of their Global Supply Chains.

Free Trade Agreements (FTA)

Australian industry doesn't believe that it is given a "fair go" with the various FTAs that the Government has negotiated over the years. In order to support Australian defence exports it is essential that these FTAs provide a level playing field for Australian industry. Defence should be entitled to exemptions from FTAs as most countries, other than Australia, use these exemptions to institute indigenous industry policies that make it almost impossible for SMEs to compete in global supply opportunities directly. Unless this imbalance is addressed, FTAs have no value to Australian Defence SMEs. Indeed, most Australian SMEs find it impossible to participate in the Defence Global Supply Chain initiative as a result.

Not a level playing field

An AIDN member noted that “exceptional” Australian businesses are often competing overseas and losing to inferior locally protected by law companies because other nation's governments understand the consequences of not having a robust defence industry. Other nations do not openly encourage or welcome the same scrutiny that Australia seems to afford its Defence spending. Please refer to the AIDN Australian Industry Participation Plan provided separately for further details of the AIDN view of this issue.

The Customs (Prohibited Imports) Regulations 1956, Schedule 13 Part 2 Item 1

This regulation was amended in December 2012. The amendment and subsequent enforcement has placed a huge paper work burden on SMEs who import defence related products (note a large number of these products are dual use and are used in the commercial world ie aerospace). It is believed that some of these imports are incorporated into Australian built products and then exported. AIDN recommends that this policy and implementation be reviewed with regard to removing the red tape and allowing these thriving Australian SMEs to continue to thrive.

Australian and overseas Defence Trade Shows and Trade Missions

DMO in general and Team Defence Australia (TDA), in particular, are supported initiatives in the quest to grow Australian SMEs into the Global Supply Chain. However, there needs to be a clear commitment to applying the appropriate Defence and DFAT resources and teaming towards supporting such activities if SMEs are to see the VFM in their participation.

For example, at two recent TDA exhibitions there has been no defence administration staff provided, which diluted the showcasing of Australian innovative SMEs as those supporting the stand didn't know anything about the companies exhibiting.

An AIDN member has experienced how a burgeoning and well developed DMO effort was withdrawn with little apparent strategic justification, just as relationships and visibility were being gained by these markets in relation to Australian offerings.

Support must be sustained and planned – to expect that results will accrue from entering into a trade mission campaign over the course of two years is naïve. These efforts must be sustained. An example cited has been the excellent work done by the now defunct DEU in relation to Defence trade missions to South America. The relationships built up and the momentum gained over two years appears to have been discarded, with little explanation, just as Australian industry was gaining a much needed visibility and trust in the region.

Skilled Migration Visas

There are problems with the skilled migration program concerning the 489 visa. The issue here is that a member had an opportunity to sell specialist consulting services to a company in the UAE in the defence sector but was unable to do so due this visa restriction. This situation would not be so bad for a domestic business opportunity, but this is an opportunity in an international market that would bring export income to Australia. This particular visa has a restriction known as '8549 - MUST STAY IN DESIGNATED AREA' and the Department of

Immigration basically stuck to the bureaucratic position that the individual could not leave the country for a period of more than a few days. The particular engineer had unique skills relating to military vehicle design, which do not exist elsewhere in Australia. AIDN recommends a review of these restrictions as significant defence expertise from countries such as the US seem able to travel unimpeded across the globe to further their markets.

CTD and UIP Programs should receive substantially more support

To encourage industry to put time and effort into R&D, to provide the war fighter with innovative equipment, the Capability and Technology Demonstrator (CTD) Program should continue to be funded but at a higher level. If the project is successful then there shouldn't be any impediments put in place to prevent this technology being sold to our allies.

Unsolicited Innovative Proposals (UIP) - over the last 4 years, AIDN has been advised that there have been no successful UIPs from those submitted to the DSTO. AIDN understands that the issue is that there is no funding for this program and if the ADF want the innovation they need to fund it out of their current budgets. Another golden opportunity for Australia to lead the technology push is missed.

Defence and industry must continue to learn from the lessons associated with defence export successes and failures, and make the changes necessary to avoid future problems.

Recommendations

AIDN makes the following recommendations to the Joint Standing Committee on Foreign Affairs, Defence and Trade Committee Inquiry into Government Support for Australian Defence Industry Exports:

1. Acknowledge that Australian design, development and construction of new equipment for the Australian Defence Force (ADF) is a first order policy priority for government, which is necessary to sustain defence industry's ability to support new equipment through its whole life, including mid-life upgrades and to enable SMEs particularly, to export;
2. When negotiating Free Trade Agreements and defence procurements Australia should insist on a better deal for Australian industry. This could be achieved by adopting the 'Buy Australia' policy i.e. the US Small Business Administration mandates that a percentage (23%) of prime contract dollars must go to SMEs. For more background information on this issue please refer to the AIDN Australian Industry Participation Plan provided separately;
3. Reconsider the implications of the Customs (Prohibited Imports) Regulations 1956, Schedule 13 Part 2 Item 1 to enable ease of imports without the tremendous paperwork not associated with this regulation;
4. That when DMO undertake trade shows that they provide the administrative support required and that they also consider targeted and well researched trade missions in conjunction with key global trade shows;

5. That DMO sponsored trade mission efforts be strategically planned and sustained, not just a 'flash in the pan'. Australian suppliers cannot rely on unpredictable DMO behaviour in this sense.
6. Reconsider the 489 visa restrictions when an Australian company can demonstrate that they are undertaking a training program in another country;
7. Invest in R&D early in the Capability Development process, with DSTO and industry working fully in partnership to realise the benefits;
8. Assess the success to date of the Global Supply Chain program and other industry support programs administered by Defence, and other agencies, including recommendations for improving the opportunities for Australian defence companies, including SMEs, to participate;
9. There must be a whole of Australian Government support for defence exports to assist with niche Australian exporters to play on a level playing field globally;
10. A whole of life Value for Money assessment should be made on procurements by government in general and Defence in particular to level the field for Australian innovators;
11. It is critically important for the survival and growth of defence companies, including SMEs that measures are taken URGENTLY around improving productivity, reducing the company tax rate, lifting investment in skills and supporting exports and innovation;
12. There be a review of the Australian Skilled Migration restrictions to align with those of our allies; and
13. The CTD and UIP programs receive substantially more support.

Conclusion

Defence exports are essential for SMEs in Australia to remain productive and viable because the local market is too small to support them. It is a 'dog eat dog' world in the defence global market and SMEs especially need all the assistance and support they can get to remain sustainable.

There is no level playing field in any extant FTA that supports the sustainment and growth of the indigenous defence industry. Partner countries to FTAs can freely bypass the FTA in defence and allow their skilled workers to travel to Australia unrestricted. In addition, programs that have been established to ensure the sovereignty interests of Australia in safeguarding its Defence capability are not enforced.

A FTA that continues to allow this uneven playing field is not in the best interests of the Commonwealth or the Australian Defence industry and does not provide whole of life VFM to the taxpayer.

Attachment A – Quickstep submission

RESPONSE TO THE PARLIAMENT OF AUSTRALIA JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE INQUIRY INTO GOVERNMENT SUPPORT FOR AUSTRALIAN DEFENCE INDUSTRY EXPORTS.

PREAMBLE

Quickstep has rapidly developed an advanced composites production capability based primarily on the opportunities for production of Joint Strike Fighter parts offered by Lockheed Martin, Northrop Grumman and BAE Systems which would not have been possible without Australian Government participation in the Joint Strike Fighter program and the financial support provided by both the Commonwealth and NSW governments. The development of the Quickstep facility at the former Boeing Aerostructures site at Bankstown NSW also enabled Quickstep to win a contract to produce Lockheed Martin C130J Wing Flaps. The contracts to produce parts for these military aircraft provide an excellent, but insufficient, base workload for what is now developing into a world-class composites facility. The manhours and revenue that the current programs generate at full rate of production will, over the next 2-3 years, have to be almost doubled if this Australian capability is to remain viable and competitive in the global marketplace.

GLOBAL COMPETITION

The emergence of sophisticated advanced composites production facilities in low-cost countries in the past two decades has seen competition for commercial aerospace work increase exponentially. As a result manufacturers in Australia, with higher labour costs and a strong dollar, have found it extremely difficult to compete. In addition, enormous investments in commercial aircraft programs by large international corporations and their governments significantly reduce opportunities for smaller suppliers. Original Equipment Suppliers such as Boeing, Airbus and Bombardier typically require risk-sharing on a major scale as a prerequisite to contracting at a first tier level, whilst first tier suppliers increasingly rely on lower tier suppliers from low-cost countries to provide their overall financial competitiveness. It is recognized that smaller producers in higher cost countries, without a clear technical advantage, have little chance of competing for commercial contracts. Quickstep is focused on developing its own technology to provide a competitive position. However, qualification lead-times for Aerospace work are very significant and it is vital to have an established manufacturing capability as a base.

As a result the emphasis for such smaller suppliers has shifted substantially to Defence contracts for which alliances, partnerships and government procurement provide opportunities not available to all-comers. Even then the competition is significant and suppliers from many countries enjoy advantages courtesy of their governments' policies and support.

DEFENCE INDUSTRY SUPPORT

The Defence Industry suppliers in many countries enjoy significant Government support which sees Australian suppliers at a considerable disadvantage. Offset policies provide mandatory work and have been very effective in developing the capabilities and scale of in-country suppliers. In satisfying offset demands OEMs are left with a reduced ability to subcontract to suppliers in countries without offset policies, whilst at the same time the industries in countries receiving offset contracts grow and enjoy the advantages of scale in competing on the global stage. The various government offset policies are on the public record and a brief discussion follows. The Australian Department of Defence published a survey in 2010 detailing the offset policies/arrangements of these and numerous other countries.

(Note that some countries also have offset policies for commercial aircraft procurements although these are not discussed here.)

The defence offset policies of a selection of countries that have defence manufacturing capabilities similar to those of Australia include follow. Note that the defence offset “policies” of some nations are not law, but remain mandatory if the government is to purchase equipments

Austria: Formerly a minimum of 100%, frequently up to 200%, offset was limited to 100% in 2009 when Austria signed the voluntary EU ‘ Code of Conduct on Offset’. Offset notably applied to EADS Eurofighter Typhoons purchase in 2002.

Belgium: A minimum of 100%.

Brazil: Minimum of 100% emphasizing technological development.

Canada: Requires that prime contractors place subcontracts and investments in high-tech sectors – usually 100%.

Denmark: Minimum 100%.

Finland: Minimum 100%.

Germany: Has an official position that offset arrangements are economically counterproductive in defence trade. However, Germany applies a policy of “industrial balances” based on 100% of the contract value.

India: Offset 30%.

Israel: Minimum 35% but Israel is the largest beneficiary of US Foreign Military Funding and therefore benefits enormously.

Italy: The public position is that Italy has no offset policy, but in fact the minimum offset is 70%, generally 100% and concentrates on export opportunities for Italian defense companies.

The Netherlands: Minimum 100%.

Norway: Required level 100%.

Poland: Typically 100% or above – the offset for the 2003 sale of F-16's by Lockheed Martin was 170%.

Portugal: Minimum 100%.

South Korea: Offset 30%.

Spain: Guidelines not public, but typically 100%.

Sweden: Typically 100%.

Turkey: Minimum 50%.

United Arab Emirates: Typically 60%.

Government support enjoyed by suppliers in many countries is not limited to offset policy. Investments by Government in production development and facilities is often significant. Examples include Turkey's investment (approaching \$100 million) in facilities and development for TAI and others for the JSF program, India's enormous investment in both the commercial and defence aerospace industries, Malaysia's significant investment in the aerospace industry, Norway's significant investment in its 50%-owned Kongsberg Gruppen and others, Denmark's current intent to bring a 'huge' capital investment to the Danish defence supplier base and to demand 100% offset from the makers of the competing aircraft. Whilst many of the recipients of these investments are wholly or partially government-owned the investment often far surpasses what private companies could expect to invest. Canada, however, is an excellent example of significant support to private companies via government grants and loans.

AUSTRALIAN GOVERNMENT SUPPORT

The DMO Global Supply Chain initiative has been a limited but valuable success, with the value of contracts for Australian companies introduced to prospective customers through the GSC stated to be in the order of \$300 million. Whilst some of the OEMs who have committed to the GSC have been active and have provided introductions leading to contracts with companies who would have otherwise remained unknown to Australian suppliers, there has been little contracting with the OEM's themselves for supplies of products and services associated with procurements by the Australian Government. If the levels of work achieved by suppliers in countries with offset policies and significant government support are a reasonable measure of the potential of Australian Industry, the outcomes expected with such a policy would be measured in billions of dollars, not hundreds of millions. Having said that, GSC is an excellent initiative by the Australian Government as it opens up a total supply chain. It would

be beneficial if GSC was able to exert greater influence on OEMs to open up opportunities and to require OEMs to show cause when Australian companies are not selected.

Hidden barriers remain in respect to qualification for work by new suppliers to OEM's and it could be said that some OEMs continue to apply an "Australian Risk" premium. For many countries these barriers are overcome by the Offset Departments within the OEMs.

It is reasonable to suggest that offset in Australia has a dubious reputation primarily because of the significant costs and poor outcomes associated with projects conducted in prior eras. Too often Australian defence equipment users demanded unique equipment capabilities whilst the administrators of the offset policies and programs saw in-country production and assembly of specific components and platforms as appropriate and valuable to the defence of Australia and to its economy. All too often the resultant work for Australian industry was complex and low volume with just the Australian equipments or elements of the equipments undertaken in Australia. Too often the price paid was excessive. The scenario today, with global supply chains, is very different. The JSF industrial participation is illustrative of what can be achieved at low cost to governments and companies when compared to the industrial participation of yesteryear. In respect of offset in aerospace for example, less emphasis on the unique features of the defence platform and greater emphasis on the baseline aircraft (eg, Poseidon and the 737) would yield far wider and more valuable opportunities in the global supply chain and provide a significant return to the Australian taxpayer over time.