



**THE DEFENCE SUB-COMMITTEE OF THE JOINT STANDING
COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE
INQUIRY INTO THE BENEFITS AND RISKS OF A BIPARTISAN
AUSTRALIAN DEFENCE AGREEMENT**

Submission from the South Australian Government

September 2017

Introduction

The Australian Government referred an inquiry into *the risks and benefits of a Bipartisan Australian Defence Agreement as a basis of planning and funding Australian Defence capability*, to the Defence Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defence and Trade (JSCFADT).

This submission will consider each of the Terms of Reference and offer observations and recommendations as to whether a bipartisan agreement should include the role and responsibilities of other agencies that contribute to Australia's foreign policy, intelligence and security and Defence architecture.

Executive Summary

The South Australian Government supports the current policy architecture of regular updates to the Defence White Paper and supporting documentation, such as the Integrated Investment Plan (IIP). There is however significant additional detail required in the IIP, such as a more detailed scope and precise timings of milestones (e.g. First Pass, Second Pass, Request for Tender), to provide the confidence to industry to make key investment decisions. This added level of detail also increases the transparency of the process and assists in holding the Department of Defence and Federal Government accountable for timely execution of taxpayer-funded defence programs.

Given the extended timeframes for development and execution, the South Australian government strongly supports the development of a bipartisan framework to support the Naval Shipbuilding Plan. This will avoid 30 - 50 year shipbuilding programs being unduly impacted due by the three-yearly federal electoral cycle.

Background

Since the early 1980s, Australian political parties have broadly agreed on a clear Defence framework: build a force that can defend the nation, continue our alliance with the US, and cooperate with Southeast Asian nations and security frameworks to promote regional stability. This position has been espoused throughout updates of Australia's Defence White Paper.

Response to the Terms of Reference

- 1. The efficacy of Australia's existing strategic planning processes and associated documents including – but not limited to – the Defence White Paper, Integrated Investment Plan, force structure reviews, Sovereign Defence Industry Plan and Naval Shipbuilding Plan – to deliver the best and most capable Defence force that Australia can afford.**

The South Australian government is broadly supportive of the planning process for the Defence White Paper and supporting documentation. There is however significant additional detail required in the IIP, such as a more detailed scope and precise timings of key milestones (e.g. First Pass, Second Pass, Request for Tender), for these documents to provide the confidence to industry to make key investment decisions.

Defence industry policy development also requires improvement, particularly in relation to strategic and sovereign defence capabilities.

Since the release of the 2016 IIP and Defence Industry Policy (DIP), there has been a significant increase in the confidence within the defence industry. This has resulted in numerous companies seeking to diversify into the defence industry for the first time or existing defence companies investigating options to build capability. As with other industries, major investment decisions within the defence industry require “investment grade” confidence and a supporting pipeline of projects. The Defence industry has raised concerns over the long-term stability of the industry policy, noting the recent history of limited support to Australian industry. The impact of this instability is most acute in industry programs with long development timeframes, such as naval shipbuilding.

Continually changing policy has also damaged Australia’s reputation on the international stage. This has resulted in international companies choosing not to invest in Australian industrial capability. This results in a significant amount of taxpayer funds being diverted offshore to support the development of foreign workforces and industrial capabilities. In some cases, such as small order numbers of large military transport aircraft (e.g. Boeing C-17), this is deemed appropriate. There are however, many other opportunities where these investments can be used efficiently to build Australian defence capabilities.

Given the limited stability and support in the past, Australian industry is also now struggling to ‘ramp up’ in order to capitalise on the benefits of the promised commitments.

There has been much activity by international Primes to position for major contracts, which could provide opportunities for Australian companies and global subsidiaries to grow locally. However, many SMEs are struggling to gain the investment funding needed to meet the expectations of prime contractors. The low risk appetite of the Department of Defence is reflected by the Primes, who are in turn hesitant to work with SMEs who have not previously provided services or products to a Defence prime or project. The requirement for Defence project experience, which has been difficult to obtain due to the lack of continuous work, is a high barrier to entry for SMEs.

In the absence of strong Australian capability, which can only be developed through investment, our Defence projects will continue to flow to established global suppliers.

The 2016 Defence White Paper (DWP16) makes a commitment to continuous naval shipbuilding of submarines and surface combatants. However without bipartisan support, this strategy is vulnerable to future governments reducing funding or failing to implement supporting policies across Defence and other departments. While it is unlikely that a major project, such as the continuous shipbuilding program will be cancelled in the future, other large programs which have not attracted the national attention may be targeted for funding cuts without a commitment by both major parties. This will affect Australian defence companies and international Primes with an Australian subsidiary who are vying for the projects, regardless of whether they are supplying into the shipbuilding program.

Investment in the development of intellectual property to build sovereign capabilities is more attractive if a bipartisan approach to Defence planning and funding is agreed upon. A unified approach will also enable the Defence Science and Technology Group to establish clear priorities, making better use of the government’s limited resources and

obtaining the best value for money from the Next Generation Technology Fund and the Innovation Hub. This coordination, with the requisite investment, may result in increased commercialisation of Australian intellectual property and export of new products.

The DWP16 and IIP provide some confidence that the current government intends to follow through with its strategic Defence plans, however without bipartisan agreement on a Defence strategy, the risk of a change in strategic direction with a change of government remains a deterrent to real investment by international primes and SMEs.

2. The opportunity cost of short-term and shifting Defence priorities.

There has been a lack of commercial investment across various Defence programs, as a result of the industry's historical lack of confidence in forecasted Defence priorities. This impedes Australia's ability to establish low-cost sovereign capabilities and a sustainable Australian defence industry. Any bipartisan agreement must consider:

- **A strategic national infrastructure investment.** Without agreement on investment in significant dual-use infrastructure, there is increased project cost and risk. It is important for states and territories to have confidence in the capital investment pipeline and clarity on decisions that affect the state directly, such as base locations and changes to training areas, major maintenance facilities, and operational staging areas. With this knowledge, state and territory governments can plan more effectively for general infrastructure, water management and land use eg to avoid urban encroachment of air bases.
- **Industrial investment.** Industry amortises the cost of plant, machinery and infrastructure over the known return on investment. If a Prime or an SME is confident of only one short term project, their cost for the project is higher in order to achieve the required return on investment. This disadvantages the company as it can make them non-competitive compared with large overseas companies. The ability to amortise across either many projects or over a very long project (or both) decreases the cost to the customer (Defence), ultimately benefiting the Australian Government.
- **Export investment.** Building relationships in order to secure export business takes significant time and resources. The majority of international countries expect a product to have been sold into a credible market (eg. USA, UK, Australia and Europe), before they will consider importing a product. For Australian companies, this requires home market stability to enable our companies to break into the Australian market. A stable home market is not only a credential, but also provides some assurance that the company be solvent for the life of the product.
- **Skills investment.** Universities and vocational institutions will not invest in developing a defence orientated curriculum unless there is a long term market for the skills and knowledge that students will obtain and importantly, STEM students will not be attracted to a course that does not have an attractive long term career path. Industry will not invest in upskilling their current staff or employ new staff, unless they have confidence in the long term future of the industry.

Figure 2 from the Australian Defence Industry Sentiment Index (3Q2016) highlights a steady increase in overall defence industry confidence that mirrors the sentiment of the general business community. This is evidence for the positive impact of policy announcements.

FIGURE 2:

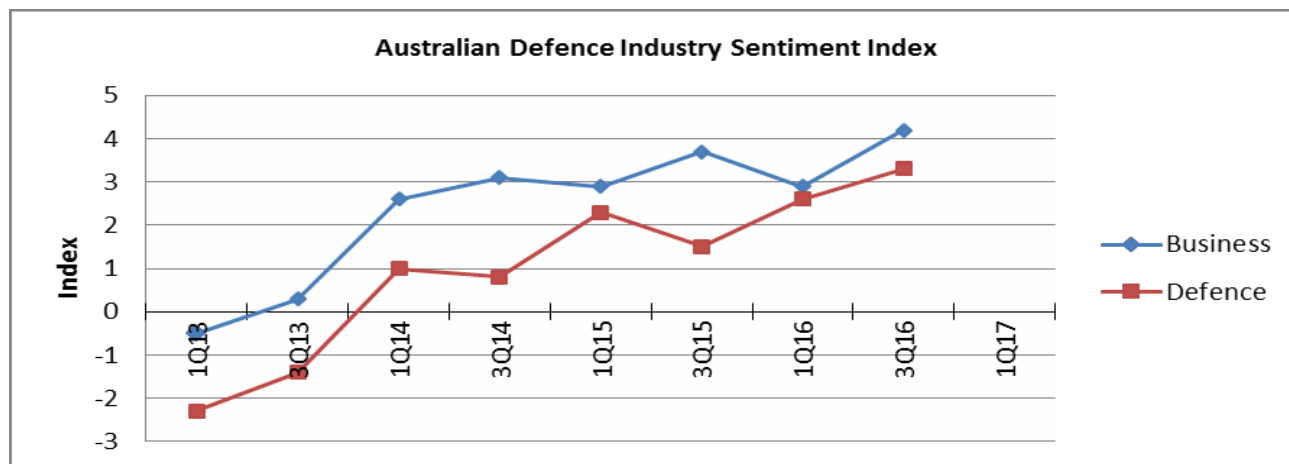


FIGURE 3:

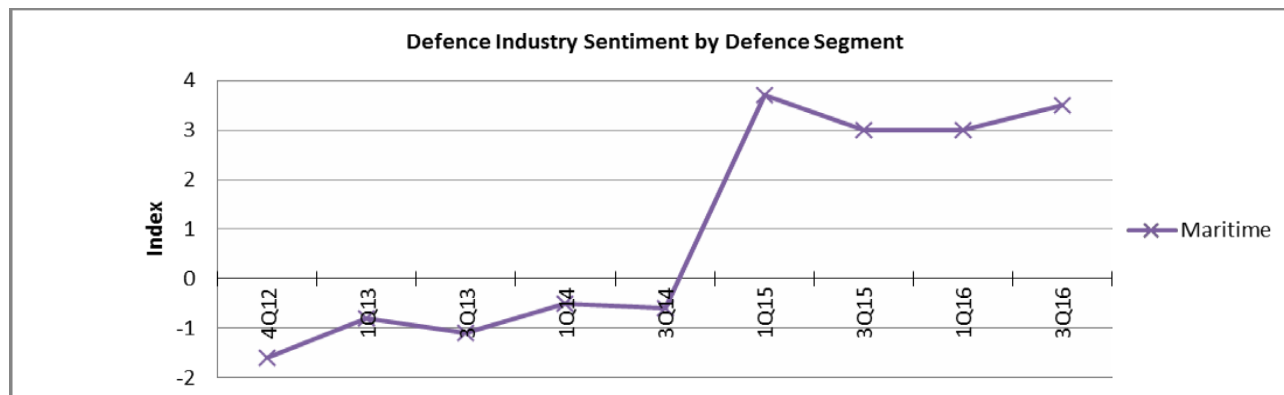


Figure 3 highlights a significant increase in business confidence in the maritime domain in 2014, which coincided with the decision to conduct a competitive evaluation process for the Future Submarines program. It also illustrates the volatility of sentiment and how one announcement can have a significant impact.

A slump in defence industry confidence can amount to lost opportunities. The history of ASC's subsidiary Deep Blue Tech is a good example. Deep Blue Tech was formed in 2007 to meet the then government's strategy for Australia to have a sovereign design capability for future submarines. Initial team members with prior submarine design capability, largely from the European market, were used to build a credible design team by 2013.

Unfortunately, the Abbot Government, through its 'build offshore policy' decided not to support Deep Blue Tech and it was disbanded.

While some of the group's capability was retained through their recruitment into the Department of Defence's Integrated Project Team for Future Submarines, most of the ten years of progress and development undertaken by Deep Blue Tech was lost.

3. Precedents in Australia's parliamentary and political system for both independent and bipartisan inputs to national security.

This is a matter for the Australian Government.

4. Efficacy of bipartisan and / or independent approaches to strategic Defence planning in other nations such as the USA and Denmark.

A good benchmark for long-term strategic industrial planning is considered to be the US Navy's 30-year shipbuilding plan. It is a strategic document that is regularly updated to reflect progress on naval programs, technology changes, industrial considerations and long-term funding priorities. Key investment decisions and training needs can be derived from the forecast fleet disposition over the next 30 years. It is endorsed by both parties. Whilst it may not be appropriate for other domains, it is considered to be an essential document for managing strategic industrial capabilities.

5. The principles of a process to achieve a Bipartisan Australian Defence Agreement that would be effective within Australia's Westminster form of executive government.

Potential bipartisan processes for the Senate Standing Committees, provide an opportunity for the development and integration of both independent research/analysis and bipartisan endorsement of the conclusions and recommendations reached. These processes could be adapted to help achieve a Bipartisan Defence Agreement, although it is accepted that the funding of defence procurement will always be subject to the effects of geopolitical changes and unforeseen budgetary pressures, which the government of the day must manage.

6. Make observations and recommendations on whether a Bipartisan Defence Agreement should include the role and responsibilities of other agencies that contribute to Australia's foreign policy, intelligence and security, and Defence architecture.

The development of strategic policy documents involves collaboration and negotiation with many agencies and stakeholders across government and the supporting industrial base. This is considered to have been successfully managed over many decades to deliver a well-considered document.

The key element currently missing is the translation of this strategic view into long-term industrial plans and policies which provide transparency to industry and facilitate investment decisions.

Conclusion

The South Australian Government supports the concept of Bipartisan Australian Defence Agreement as a mechanism to ensure consistency and longevity of defence funding and projects regardless of which party is in power. The State believes that this planning will need to be developed jointly with the states and territories.

The certainty of an agreed bipartisan approach to Defence planning and funding would provide the industry, state and territory governments with surety to invest in research and development, infrastructure and skills and education programs. This investment is critical to build Australian sovereign capability, not just in our ability to manufacture platforms and equipment, but for the longer term sustainment of our sovereign defence industry. Relying on overseas companies to manufacture our platforms and equipment is costly, inefficient and impacts the employment and development of Australian workers.