

Media release

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Expert report estimates \$20 billion direct expenditure boost to the national economy if subs are built in Australia and a \$29 billion hit to the national economy if subs are built overseas.¹

An interim report has been released that compares the relative economic merits of buying locally built or imported submarines to replace the Navy's Collins Class vessels.

The report, commissioned by the South Australian Economic Development Board, compares two scenarios:

- Scenario 1: Build all 12 submarines overseas, with Australia retaining only the light maintenance
- Scenario 2: Build all 12 submarines in Australia with both heavy and light maintenance being undertaken locally over the 40 year life of the project.

"Initial indications are that importing Australia's next generation submarines would be an economic mistake", Chair of the EDB, Mr Raymond Spencer said today. "Not just for South Australia but for Australia as a whole".

"And I emphasise that we have taken a very conservative view of the relative costs and benefits".

Key results for scenario 1: Build overseas

- It is estimated there would be a \$29 billion negative impact on Australian GDP over the 40 year life of the project (\$730 million annually).
- Government debt would have to increase by at least \$20bn to pay for the overseas submarines with minimal return to the local economy. These funds could otherwise have been used for domestic projects.
- Adding to job losses in the auto industry, importing submarines is likely to result in 260,000 man years lost to Australian workers over the 40 year project.

Key results for scenario 2: Build locally

- It is estimated that building locally will still have a negative impact on the Australian economy because the direct import content of the submarines is about one third of the total cost, compared to negligible imports for current government expenditure. However, the size of that negative impact is estimated at \$8.2 billion on Australian GDP over the 40 year life of the project (\$200 million annually).

¹ at current exchange rate

- Adding to job losses in the auto industry, building submarines locally is likely to result in only 140,000 man years lost to Australian workers over the 40 years of the project.
- Detailed cost data on building overseas and locally has been gathered and checked with numerous Australian and overseas experts. The overwhelming conclusion is that it will cost no more to build locally. This is partly because Australia has a unique set of operating environments and requirements - there is no off-the-shelf solution available, and partly because there are only four potential international partners to build the submarines (Germany, France, Japan and Sweden) and they are all high cost countries.

In conclusion, if the submarines are built locally instead of being built overseas, Australia will be better off in terms of:

- **A \$20 billion net contribution to net GDP over the life of the project**
- **120,000 man years of additional jobs in the economy over the life of the project.**

“From this it is clear there are significant economic benefits to be gained if we build the next generation of submarines here in Australia”, Mr Spencer said.

For further information contact:

For comment:

Raymond Spencer, Chair, Economic Development Board: (08) 8303 2528 - Catherine Jamieson

For analysis of the model:

Prof Göran Roos, member, Economic Development Board: +61 0477 361 746

The following assumptions were made in the development of the model:

- All \$ figures are 2014 AUD unless otherwise stated.
- The figures in the report are based on the assumption of fixed public sector deficit targets requiring cuts in government expenditure domestically to fund the overseas purchase of the submarines.
- Light maintenance is undertaken in Australia under both scenarios.
- Heavy maintenance, including upgrading as new technology becomes available, is undertaken in Australia only if the submarines are built here, creating the required technical capability.
- A 40-year program life is assumed in both scenarios. It is necessary to model the full program life to pick up the full impact of creating the domestic capability to undertake heavy maintenance.
- The total cost of construction and maintenance in Australia is assumed to be the same as that of overseas construction, namely, \$20bn.
- AUD exchange rates of 0.92USD have been used in the calculations. Assuming that the AUD is currently overvalued, the benefits of local production will be increased if this exchange rate normalises to purchasing power parity. Conversely, at a more competitive exchange rate of 70 cents per \$US, the impact of an overseas build could be up to 30 per cent worse.
- Under Scenario 2, for every one percent increase over the budgeted cost, the net benefits are reduced by one percent. This means it would have to cost twice as much to build in Australia compared to building overseas before it would be equally beneficial to build overseas.
- Construction is undertaken at Techport in Adelaide, South Australia and all the heavy maintenance at Henderson in Western Australia, but goods and services are drawn from many Australian and overseas regions.
- The loss of automotive construction in Australia generates enough surplus capacity in the Australian labour market economy to ensure that the Australian economy does not hit any capacity constraints from undertaking local construction of submarines (Scenario 2).
- A slowdown in mining-related construction in WA also generates enough surplus capacity for the Henderson program. (The model includes an estimate that Scenario 2 would utilise only 11.4% of the surplus capacity created by auto sector closures.)
- Because virtually no capacity constraints are anticipated in the labour market, the program is not expected to stimulate additional wage increases. For this reason, the Australian 567-local government region input-output model has been used, rather than a computable general equilibrium model.
- There is a "knowledge spillover" effect from the increased range of competencies of local firms that result from domestic construction. For example, Professor Gunnar Eliasson² has estimated that the JAS 39 Gripen multi-role combat aircraft project in Sweden generated a spillover multiplier of 2.6 on the development component alone. For the purposes of this report, a conservative multiplier of 0.7 has been applied to the local R&D and material spend. This means that \$7 billion spent on Australian R&D and materials will increase GDP by \$5bn. Using total local expenditure on the submarines as the base, this result is consistent with a spillover multiplier of 0.4. There are numerous cases, from the Collins program of Australian companies developing new technologies and new capabilities that indicate the \$5bn number underestimates the spillover effects.

² Eliasson, G. (2010) *Advanced Public Procurement: The Aircraft Industry as Technical University*, Springer