

Dissenting Report by Government Senators

1.1 The draft report into the Economics References Committee's inquiry into the Future of Australia's Naval Shipbuilding Industry strikes a discordant note. On the one hand, the report recommends that the Australian Government should conduct a competitive tender process. It makes this recommendation largely based on evidence that an open tender process is required to get the best value for money, and fitness for purpose, for the Australian taxpayer. Yet, on the other hand, the report seeks to limit this tender process to ignore the potential of some options (such as the Japanese Soryu class) and restrict it in favour of Australian shipbuilders regardless of the impact on Australia's defence capability. It is as if the committee has boldly declared that a limited tender process would be the defence of equivalent of having our left hand tied behind our back; only then to declare that we should instead tie our right hand behind our back.

1.2 Coalition Senators support the government conducting a competitive evaluation process but do not support putting arbitrary restrictions on such a process. The restrictions that the committee has recommended are naïve and fail to consider the evidence that the committee received on the complexities of defence contracting in general, and the realities of the Future Submarine contracting process in particular.

1.3 First, defence contracts involve a high level of complexity and are beset by the problems of asymmetric information. In theory a competitive tender process can lead to the lowest price for government and potentially value for money. In practice, the contractor almost always has more information than the government about the costs and risks of a project. In addition, the contractor a strong bargaining position, once the contract is signed. In such an environment, a contractor can bid for a low price *ex ante*, but then claim that there have been cost overruns *ex post*. The government has limited ability but to agree to the overruns given that the government can hardly switch contractors mid-contract. The long history of cost blowouts in defence contracts, both here and overseas, is testament to this point.

1.4 With that in mind before a contract is signed, the government can instead enter into contracts that allow for more of a partnership between contractor and the Defence Department. Sometimes such contracts are known as an *alliance* contract. These contracts create more incentives for the contractor to share information with the Government and help reduce the problem of asymmetric information.

1.5 As a result, having a competitive tender process *before* a contract is signed is not sufficient to ensure a competitive outcome *after* a contract is signed. The committee's focus on the tendering process exclusively is an incomplete consideration of the issues that beset defence contracting.

1.6 Third, Coalition Senators support the Government's position that defence procurement decisions should not compromise Australia's defence capabilities so as to meet economic development objectives. Decisions about this next generation of submarines need to be made on the basis of what is best for our national security, our

Armed Forces and for the personnel who will serve in them in the future—not what is best for a particular region or what might be best for a particular company in Australia. Of significant concern is that the committee has not made a clear statement on this crucial principle.

1.7 Fourth, the delays in establishing the Future Submarine project have put time constraints on when decisions must be made without creating a dangerous security and capability gap for Australia's defence forces. It is a matter of record that under the former government, while some work was done on the Future Submarine project, the level of achieved progress was very limited. Over the last six years, Defence spending dropped to levels not seen since 1938 – a cut or deferral of some \$16 billion.

1.8 The delays were clearly a matter of concern. Mr King noted, for example:

I was worried about our lack of progress on Future Submarine over many years. I was worried about how we were going to break the deadlock of progress. I was very worried about how we were going to come up with solutions to meet Australia's needs.¹

1.9 Finally, as a general point, it is notable that the Executive Summary of the report, while containing extensive quotes from various participants to the inquiry, neither quotes nor mentions Mr Warren King the Chief Executive Officer of the Defence Materiel Organisation. To ignore the evidence of so impressive and authoritative a witness in this key section of the report is a serious error and the entire report is weaker for it.

1.10 **Response to recommendation 1.** The draft report calls for a competitive tender limited to between two and four participants.

- A tender process that arbitrarily limits participation on the basis of a quota rather than merit is not consistent with achieving best outcomes for Navy and for the taxpayer.
- A broader examination of the global market is a more reliable method of ensuring decision makers have visibility of the full array of options available and will thereby ensure the best outcomes for Navy and the taxpayer.

1.11 **Response to recommendation 2.** The draft report calls for a competitive tender process for the Future Submarine program to be initiated immediately. It claims that there is enough time to facilitate this process without the threat of a capability gap arising if that tender goes to market immediately. Furthermore, it claims the timeframe only offers the flexibility to do this on account of the work undertaken by the previous government in respect to the Future Submarine program.

- The assertion concerning the work undertaken by Labor is not supported by testimony at the inquiry.

1 *Committee Hansard*, 30 September 2014, p. 40.

- This is a disingenuous claim for credit in circumstances where the opposite is true. Labor delayed the Future Submarine program by two full White Paper cycles. This leaves the Future Submarine program in a position of heightened urgency than would otherwise be the case.

1.12 **Response to recommendation 3.** The draft report calls for an Australian build at all costs. This could give rise to national security outcomes being compromised by a prioritisation of industry policy over defence policy and it could force the taxpayer to underwrite an economically uncompetitive project.

- While we want to see the Future Submarine contract awarded to Australian shipbuilders, it must also be the result of a competitive tender process and it must be awarded on merit. This will ensure that Navy receives a fit for purpose product of the highest standard while Australian tax payers receive the best possible value for money.
- The committee heard evidence from Dr John White that an open tender was the best way to stress test claims by manufacturers that they are able to meet Navy's requirements while constituting the responsible expenditure of taxpayers' money.
- It is therefore both unwise and entirely unnecessary to compel that special consideration be given to Australian-based tenderers. Recommendation 3 effectively relegates national security policy to second place behind industry policy.
- Recommendation 3 also compels government to commit to an Australian based sustainment programme even though the Prime Minister is already on the record doing exactly that.

1.13 **Response to recommendation 4.** The draft report calls on government to formally and publicly rule out a MOTS option for the future submarine and for government to limit its energies to a new design or a son-of-Collins option and to suspend any investigations elsewhere.

- Being unnecessarily prescriptive by publicly discounting certain options might send signals to the market that reduce price competition in a tender process.

1.14 **Response to recommendation 5.** The draft report calls for Government to take responsibility for cultural reform in the Australian Defence industry so as to 'engender a co-operative environment in which industry is encouraged to marshal its resources in support of Australia acquiring and building a highly capable fleet of submarines'.

- It is my view that Australian shipbuilders must be competitive in their own right. To impose upon Government a responsibility to oversee a program of cultural reform within private sector shipbuilders represents a quasi-nationalisation of the industry.

- Industry representatives, unionists and interested parties assured the committee that Australian shipbuilders are globally competitive, meet productivity standards and have the capacity to offer world's best practice in the submarine building space. Imposing direct managerial oversight by government would be counter-productive to maintaining these competitive efficiencies.

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