

Additional Comments by Senator Nick Xenophon

1.1 I welcome the Senate Economics References Committee's report, Part III, into the future of Australia's naval shipbuilding industry, in particular long-term planning, and endorse its recommendations.

1.2 This inquiry was brought about due to serious concerns about the Government's decision-making process on Australian naval shipbuilding since coming to office in September 2013.

1.3 A key part of the planning for naval ship building for Australia must be recognition of the wider economic, employment, taxation and social benefits of carrying out shipbuilding in Australia.

1.4 Finance Minister Senator Mathias Cormann was asked at the most recent Budget Estimates Committee hearings whether this was a factor in the Government's planning for naval ship building.¹

1.5 I asked the Finance Minister on six separate occasions whether the wider economic effects, through additional employment multipliers, taxation and economic activity, was factored-in when the Government was weighing decisions as to where to build the Navy's future ships and submarines.

1.6 While the Finance Minister said he 'understood the point' that was being raised, he declined to confirm whether the Government took these factors into account when making major defence procurement decisions.

1.7 Reputable think tanks such as the Royal United Services Institute of the UK (RUSI-UK) has estimated that approximately 40 per cent of defence spending in that country is returned to the UK Government through taxation and other benefits. This does not include, as I understand it, the broader multiplier effects on an economy by such local procurement.

1.8 As a comparison, the Bracks Review of the auto sector in 2008 found that for each direct job in auto-manufacturing there were six jobs created in support roles.

1.9 These benefits would be similar in Australia for naval ship building.

1.10 It is baffling and unacceptable that the Government won't recognise and take account of this benefit in making defence acquisition decisions.

1.11 I understand there is nothing in the Commonwealth Procurement Rule per se, which would prevent it from taking account of these wider factors. However, if the Government believes this is the case, then the Rules should be revised to make it clear that such factors are real and to be recognised.

1 Budget Estimates, Finance and Public Administration Committee, 27 May 2015.

Recommendation 1

1.12 The Government take account of the wider economic benefits and employment multipliers when deciding whether to build navy ships and submarines in Australia.

Recommendation 2

1.13 That the application of the Commonwealth Procurement Rules be urgently reviewed to determine whether the wider economic, employment and taxation benefits of local procurement are being taken into account in decision making; if they are not then the Rules should be revised to explicitly require Government departments and agencies to do so.

1.14 It appears the Government is continuing to talk-down the naval ship building industry in Australia.

1.15 The Finance Minister told the media in Perth on May 22 that an Australian-built Air Warfare Destroyer was 'costing \$3 billion a ship, when equivalent ships in other parts of the world would have cost us just \$1 billion a ship', endorsing a front page story that appeared in The Australian that day.²

1.16 While denying the Government leaked the story to The Australian to coincide with the launch of the first AWD in Adelaide the following day, the Finance Minister stood by his comments about the per-ship cost of the AWDs under questioning in Budget Estimates.

1.17 As the head of the AWD Alliance, Rod Equid, said on Adelaide radio on the morning of May 22, but before the Finance Minister's press conference in Perth, the cost comparison was a case of 'some pretty strange mathematics' to arrive at a per-ship cost three times that of an overseas build.³

1.18 Mr Equid explained:

Principally because of the other costs that are included in the \$9 billion, which includes facilities, other defence costs, purchase of missiles, the training systems, the technical publications etcetera. So the unit price of ships is not nine divided by three.

1.19 The Finance Minister's comments were inaccurate and appear designed to damage the reputation of ASC and Australian naval ship building more broadly. This is a curious course of action for a minister who is technically the owner of ASC on behalf of the tax payers.

1.20 I maintain that the Government is continuing to trash its own submarine builder, and run down the wider naval ship building sector, so that the public are 'softened up' ahead of a Government announcement later this year, or early next year, to build the \$50 billion Future Submarines overseas, probably in Japan.

2 Senator Cormann transcript, 22 May 2015,
<http://www.financeminister.gov.au/transcripts/2015/0522-doorstop.html>.

3 Rod Equid, ABC 891 radio Adelaide, 22 May 2015.

1.21 The Finance Minister said he would provide the factual basis for his comments to the Committee on notice. I look forward to seeing this, if it, in fact, exists.

1.22 In fact, as the Government-commissioned RAND Corporation report in April on the future Australian naval ship building and other experts have estimated, the 'cost premium' for building complex naval ships in Australia is approximately 30-40 per cent.⁴

1.23 The Defence Minister cited the RAND report, which found that this premium could be reduced if the following factors were addressed:⁵

- Establishing a consistent production and build demand.
- Selecting a mature design at the start of the build and limiting the amount of changes once production begins.
- The necessity of ensuring a well-integrated designer, builder and supplier team.
- Matching the industrial base structure to demand.
- Ensuring there is visionary leadership provided by company management.

1.24 It's clear that the first four of these factors have been and continue to be in the control of the Government.

1.25 The first relates to a 'continuous build' of ships and submarines so that Australian ship builders aren't forced to expand and contract as Government contracts come and go. The necessity for a continuous build has been repeatedly highlighted by the Defence Teaming Centre's Chris Burns, both to the Committee and as part of its broader public campaign:

A sustainable shipbuilding industry is one that has a reliable and continuous flow of work as a result of a long-term strategic defence acquisition plan that industry trusts and will invest against. When you have a long-term commitment from government and investment by industry, you foster innovation and develop efficiencies that make you competitive in the global marketplace.⁶

1.26 The second and third items from the RAND report relate to the key lessons learnt on the AWD project, as set out in the ANAO report of March 2014⁷ and the

4 RAND Corporation http://www.rand.org/pubs/research_reports/RR1093.html.

5 Defence Minister media release 16 April 2015, <http://www.minister.defence.gov.au/2015/04/16/minister-for-defence-release-of-the-rand-corporation-report/>.

6 Committee hearing Adelaide, 14 April 2015, Hansard, p. 27.

7 ANAO, Air Warfare Destroyer Program, report number 22, 6 March 2014, <http://www.anao.gov.au/Publications/Audit-Reports/2013-2014/Air-Warfare-Destroyer-Program>.

later White-Winter report (while the Government has kept the White-Winter report secret, some of its contents have been reported).⁸

1.27 The fourth item relates to successful industrial policies applied to naval ship building, which is not what we are seeing from this Government.

1.28 Both sides of politics have failed to properly manage naval shipbuilding in the past decade, resulting in the 'valley of death' which is engulfing the sector now. Both BAE Systems in Melbourne⁹ and Forgacs in Newcastle¹⁰ have announced further job losses in recent weeks due to the failure to provide adequate naval shipbuilding contracts.

1.29 As William Saltzer, Director Maritime, BAE Systems Australia, told the Committee in Adelaide, the industry can't build if the Government isn't buying:

BAE Systems agrees that a continuous and efficient production of naval vessels will benefit all parties, especially the Australian taxpayer. But the industry can only produce when the government purchases. We do not want to build ships that are not needed just to support this industry. The Royal Australian Navy will need many new ships and submarines over the coming years. A number of them should have been ordered already to replace vessels that are too old and are costing too much to maintain, but the fact that they have not should not be a reason to delay further. It should be a call to action now. Since there already seems to be agreement across party lines on the most important points, can you not come together and work in cooperation with industry to make it happen now?¹¹

1.30 Besides the broader problems highlighted by RAND Corporation and others, three specific naval acquisitions have been mishandled by successive governments to arrive at the Valley of Death. They are:

- The previous Labor Government's delays in deciding on the process to acquire the Future Submarines and the continued delay and confusion around this project by the present government.
- The Government's decision in mid-2014 to send the \$2 billion supply ship tender overseas, to be competed between South Korea and Spain.

8 '2000 jobs at risk in Air Warfare Destroyer project chaos', Cameron Stewart, The Australian, November 28 2014, <http://www.theaustralian.com.au/national-affairs/defence/jobs-at-risk-in-air-warfare-destroyer-project-chaos/story-e6frg8yo-12271375246644>.

9 'Hundreds of shipbuilding jobs under threat at BAE Systems in Melbourne', ABC News 16 June 2015, <http://www.abc.net.au/news/2015-06-16/hundreds-of-shipbuilding-jobs-at-bae-systems-under-threat/65496422>.

10 'Forgacs to lay off 160 Tomago workers', Newcastle Herald July 1 2015, <http://www.theherald.com.au/story/3166074/forgacs-to-lay-off-160-tomago-workers/?cs=122>.

11 Committee hearing 14 April, Hansard p. 16.

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- The Government's decision to leave the decision for the future Pacific patrol boats project until 2017 – the reason for BAE Systems Australia's decision not to tender for the \$600 million project.¹²

Recommendation 3

1.31 That the Government:

- **Commit to an Australian build of the Future Submarines, as per its commitment at the last election, partnering with the most competitive naval capability offered by either France, Germany, Japan or Sweden following a bona fide competitive process.**
- **Cancel its decision to offshore the supply ships tender and award it to Australian naval shipbuilders as soon as practicable.**
- **Bring forward the Pacific patrol boats acquisition to this year so as to prevent the damaging shrinkage of naval ship building capacity in Australia, resulting in the future high cost of ramping-up the industry when the Government decides to purchase more navy ships.**
- **Review up-coming naval warship requirements and bring forward projects and award them to Australian ship builders, where practicable.**

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12 'Hundreds of shipbuilding jobs under threat at BAE Systems in Melbourne', ABC News 16 June 2015, <http://www.abc.net.au/news/2015-06-16/hundreds-of-shipbuilding-jobs-at-bae-systems-under-threat/6549642>

