



**Joint Standing Committee on Foreign Affairs,
Defence and Trade Inquiry into Government
Support for Australian Defence Industry Exports.**

AMWU Submission, July 2014.

Introduction

The Australian Manufacturing Workers' Union welcomes the opportunity to make a submission to the Joint Standing Committee on Foreign Affairs, Defence and Trade Inquiry into Government Support for Australian Defence Industry Exports.

The Australian Manufacturing Workers' Union (AMWU) represents approximately 100,000 members working across major sectors of the Australian economy. AMWU members are primarily based in manufacturing industries, in particular; metal, vehicle, and food manufacturing, but also in the industries of mining, building and construction, printing and graphic arts, repair and service and laboratory and technical services. We have thousands of members at all Australian naval shipbuilding yards, as well as numerous other defence manufacturing firms and their suppliers.

The AMWU has a long and proud history of fighting for the interests of workers in all areas of manufacturing. As well as doing this through ensuring workers receive fair pay and conditions, we have played an active role in policy debates that directly and indirectly affect our members.

The AMWU has recently conducted a dedicated campaign aimed at ensuring Australia maintains a strong naval shipbuilding industry. We fear that the fast approaching drop off in contracted work to Australian shipyards places not only the jobs and livelihood's of thousands of workers, but the future capacity and viability of the entire industry in grave jeopardy. Without the bringing forward of shipbuilding projects by the government, the loss in employment, skills and industry capacity will represent a unprecedented blow to our naval shipbuilding industry, with obvious implications for the export potential of businesses involved in this sector.

The AMWU feels that the shipbuilding situation is just one example of the broader challenges facing the defence sector, namely a lack of government support for Australian defence manufacturing. For obvious reasons, every nation's defence export success depends on the strength, ingenuity, skills and capacity of its domestic defence industry. Any attempt to assess and improve our defence export potential that ignores the broader challenges facing the sector is doomed to be severely handicapped and ultimately ineffective.

Defence as a strategic industry

More than any other industry, countries around the world have historically and continue to identify their defence industry as a strategic capability. Practically, what this recognition

means is these countries have refused to allow the laws of economics to determine the fate of their domestic defence industries. This can be seen in the former Soviet Union countries, the USA, China, the EU and all the centres of major defence production.

As a result of the strategic nature of the defence industry, defence procurement decisions are not subject to restraints by trade agreements, whether bilateral or multilateral. Such restrictions would deny the strategic nature of these industries and would place restrictions on the level and type of support governments can provide these industries. For obvious reasons, no nation has been willing to place such restrictions on their defence industries.

Defence industries are supported directly by governments, through defence procurement programs, law and regulation. This support serves two purposes; to ensure a strong domestic industry and to limit competition from overseas defence suppliers. Unlike Australia, other countries are explicit and make no apologies about this support. As an example, the USA Department of Defence, Defence Procurement and Acquisition Policy states:¹²

access to the U.S. defense market is complicated by many laws and rules that prevent or discourage DoD use of non-U.S. products (e.g., Berry Amendment restrictions, Buy American Act, and Small Business Act preferences) or prevent or impair the ability of non-U.S. entities to perform defense work (e.g., national disclosure policy, export controls on information and technology).

This is just one example of what is the norm in all countries, with the possible exception of Australia. Defence industries the world over are heavily protected and explicitly supported by national governments. This is a fact that Australia's policy makers seem to ignore.

Australia's approach to defence procurement

While Australia's defence procurement policy is not subject to restrictions imposed by trade agreements (unlike general government procurement) and is not subject to the Department of Finance and Deregulation's Government Procurement Guidelines, it is clear that the Department of Defence and Department of Defence Material share that guideline's focus on contract cost minimisation. This is evidenced by both longer term trends in defence procurement and recent examples of specific procurement decisions.

¹ Available at: <http://www.acq.osd.mil/dpap/cpic/ic/about.html>

² For a comprehensive list of import and other restrictions placed on US defence procurement, see: http://www.acq.osd.mil/dpap/cpic/ic/restrictions_on_purchases_from_non-us_sources.html

According to the Australian Business Defence Industry Unit,³ from 2007 to 2012, the proportion of defence procurement contracts that were awarded to Australian companies fell from 80 per cent to just over 50 per cent, representing a loss of \$8 billion for our defence industry over just these 5 years.

The AMWU is in no doubt that this trend has been driven by the strength of the Australian dollar over the same period,⁴ which has made Australian businesses seem uncompetitive relative to overseas businesses. The post float average Australian dollar/USD exchange rate sits at 76 US cents per Australian dollar. The average exchange rate over the period July 2007 to September 2012 was over 92 US cents. That represents an appreciation of over 21 per cent compared to the long run average exchange rate level, which means a hit on Australian defence industry's competitiveness of over 20 per cent.⁵

However, it should be noted that the actual cost of Australian businesses has not been inflated in an absolute sense due to the strength of the dollar, only their relative cost when compared to businesses which are based overseas.⁶ It is important to note that the driving force behind these decisions has not been a fall in Australian industry's capacity to meet defence requirements or an absolute increase in costs. It is simply the result of decisions being made on a cost of contract basis in an environment where the Australian dollar has been at historical highs, making overseas sourcing options seem relatively cheap. Importantly, the sustainability of defence industry capability has not featured as a significant enough reason to arrest this trend.

More recent procurement decisions indicate that this longer term trend, rather than abating, has intensified under the new government.

Perhaps most alarming is the example of the replacement supply ship tender for the HMAS Success and Sirius. This tender has gone exclusively to Spanish and South Korean suppliers, without even the possibility of Australian shipbuilders winning this work. At a time when Australia's naval shipbuilding capacity is suffering a fall in work orders that places its very existence in jeopardy, this decision is nothing short of disastrous, not only for our future

³ Available at: <http://www.nswbusinesschamber.com.au/News-Media/Latest-News/Media-Releases-2013/Analysis-reveals-Federal-Government-exporting-Aust>

⁴ Itself the result of the mining investment boom.

⁵ This is a phenomenon that isn't restricted to the defence industry but is responsible for the broader pressures facing the manufacturing sector the nation over.

⁶ This is important to note as the Australian Government also receives revenue in Australian dollars, so its ability to afford the products of Australian industry has not been hurt by the appreciation of the Australian dollar.

shipbuilding capacity, but also for the thousands of workers, their families and their communities that rely on this industry.

While this may be the most alarming example, others abound, including the overseas building of material from patrol boats to boots.

In the AMWU's view, the approach of the Australian government to procurement decisions broadly is misguided by a false equating of contract price with value for tax payer's money. We agree value for taxpayer's money should be at the forefront of government procurement decisions, but the sole focus of procurement decisions on contract price does not represent a true assessment of value for money.

Such a focus ignores the benefits of sourcing locally by ignoring flow on tax returns and significant industry capability benefits such as improvements in skills, technological development and innovation. An equation of contract price for value for money neglects half of the determinant of true value for money, namely the economic benefits of procurement decisions. A true assessment of value for money would incorporate not only the contract price as a cost, but would assess the economic and social benefits of each option, where the economic benefits of local supply would typically outweigh the benefits of foreign supply.

This one sided approach to general government procurement is a long standing policy error that needs to be corrected. A similar approach to defence procurement borders on the criminal as it denies and neglects the strategic industry capability that should form a central concern in defence procurement decisions, and in doing so places Australia's long term national security interests in jeopardy.

Not only should defence procurement also take into account economic benefits from potential contract options, they should take into account longer term national goals around the supply and support of Australia's defence needs, both in times of peace and in times of conflict. For an island nation like ours to allow our navy to be entirely reliant on foreign supply, or our army to rely on foreign supply for ammunition, is irresponsible from both an economic and a national security standpoint. And yet this is the trajectory on which we currently find ourselves.

The nature of the defence export market

The Australian government's approach to defence procurement decisions has led some in government to believe that other countries also treat their defence industries as just another, internationally competitive private marketplace. This is clearly not the case.

Defence industries are strongly supported and protected by their national governments by strong regulatory barriers to foreign participation, as the US example above shows.

These barriers not only ensure that foreign defence firms have privileged and often exclusive access to domestic defence business, they also ensure that any Australian defence industry growth plan that is centred on exports as the driver of growth is unlikely to succeed, regardless of the policy mechanisms put in place domestically. The lack of access to international defence markets is an issue that has been cited by industry over many years, and will no doubt feature in submissions from industry into this inquiry. The submission of H.I. Fraser Pty. Ltd is an example in point.

The real driver of significant and broad defence industry growth and capability can only be through supplying the Australian Defence Force (ADF). It is through supplying the ADF that companies can develop their capabilities and establish their credentials that can then lead to some export business.

This does not mean that defence exports are not a good thing and should not be encouraged. Indeed they are and they should be, but as long as nations all over the world identify their defence industries as strategic capabilities that need to be protected and supported, an export growth model for Australia's defence industry will remain naive.

Policies to support defence industry exports.

As the analysis above makes clear, the most important policy to support defence industry exports is the support of our defence industries domestically. This is how Australian industry can best improve its experience, skills, capabilities and technological know how; all essential to significantly increase exports. In order to expand exports, Australian industry needs to further develop and build on existing capabilities. This is best done through the provision of strategic direction in determining our priorities and ensuring these capabilities are matched with active government and Defence support.

Putting to one side the role of Australian government defence procurement and capability development, several other aspects of the international defence industry are worth noting in the context of supporting defence exports.

As with many other areas of manufacturing and other sectors, the global defence industry is dominated by a handful of defence multinational companies. These companies employ vast international supply-chains to support their businesses across the world.

The most promising avenue for defence industry firms to export is as suppliers to these dominant 'primes'. For strategic and national security reasons, the companies that dominate the industry in Australia and our potential export markets are US and EU/UK based.⁷

Recognising that the best opportunities for Australian defence firms to expand exports was through joining the supply chains of these primes, the former government introduced several reforms aimed at increasing Australian business access to these supply chains. These programs included the Australian Industry Capability Program and the Global Supply Chain program.

The Australian Industry Capability (AIC) program requires the winner of a contract over \$20 million to complete an AIC plan that outlines how the procurement will enhance Australian industry capabilities and provide opportunities for Australian defence businesses. While these programs fall short of requiring Australian defence industry involvement, they do represent a step in the right direction. In the AMWU's view, this program should go further by requiring project proponents to provide sub-contract work to Australian businesses if Australian businesses are shown to be capable potential suppliers to the project.

Both of these programs were seen to deliver some results and were replicated to the non-defence manufacturing sector by the last government, before these extensions were abolished by the current government.

The AMWU strongly holds the view that these programs should not be abolished as their civilian counterparts have been, but should be well resourced and expanded so they can assist Australian businesses expand their business to include supplying into global defence supply chains.

In addition to these programs, the Export Finance and Insurance Corporation (EFIC) provides significant support for defence exports, especially through its national interest account. This support is also crucial and should be expanded rather than diminished in a search for budget savings.

Finally, programs aimed at supporting the growth of innovative and high tech businesses should not be removed but expanded. The AMWU and others were extremely disappointed

⁷ Companies such as BAe Systems, Boeing, Raytheon, Lockheed Martin, General Dynamics, Thales and others.

to learn of the government's decision to abolish both Commercialisation Australia and Enterprise Connect. Both of these programs directly and demonstrably supported the growth of new businesses, the improvement of competitiveness in existing businesses and the diversification of businesses into new markets, including into defence. Their abolition is a large step backwards in terms of the support provided to high growth potential businesses facing barriers to growth, and will not only hurt future defence exports, but the future prospects of the entire manufacturing industry.

Conclusion

Australia's defence industry has had several successes in recent years, notably the awarding of F-35 tail fin work to Marand Engineering, who have subcontracted significant work to Quickstep Holdings, another Australian firm. However, it should be acknowledged that these wins have been accompanied by significant state and federal assistance to both companies. These and other successes such as the Bushmaster vehicle demonstrate that Australian industry does have the skills, technology and ingenuity to succeed and compete on a global level. However, the very nature of the defence industry means this success needs to be nurtured and directly supported by the ADF and our own defence procurement policies. If we are to retain this crucial industry, its skills, capabilities and jobs, we need to support its inclusion in global supply chains but more crucially, we need to support it for the economically and strategically crucial industry it is through our own defence acquisitions.