Which industrial capabilities are vital for the ability of the ADF to field forces and must be located in Australia?

Executive Summary

A tailored approach to the future structure of the Australian Defence Industry is advocated in this submission. As such, the Defence Industry should not be considered as one, but needs to be segmented into specific sectors, each with their own unique challenges and opportunities. This tailored model recognises that Government may deem sectors of the industry vital, and as such needs to commit to these sectors and acknowledge that these chosen, vital sectors will require an element of dedicated, long term support. A long term, partnering, more inclusive approach is advocated here. Other sectors of the industry, identified as being existing areas of key competence, would need to operate on a free market basis and be competitive. In order for this to happen, Government needs to remove barriers and impediments in this sector and undertake a more long term, inclusive, consultative and open approach with local industry. Sustainment is an area where Australian Industry can make a real difference and should be nourished and encouraged through programmes and incentives—but ultimately this sector of the industry needs to be profitable to investors and an efficient choice for Government. The re-lifing and refurbishment of assets could be an area where local industry, backed by Government strategy could ensure that Defence is not on the bleeding edge of innovation, but has a breather between acquisitions to test, develop, innovate and stretch asset life, allowing unrushed and sensible new asset acquisitions.

Introduction

“The essence of the relationship between defence industry and the defence community can probably best be defined as the timely delivery of essential capabilities to the Australian Defence Force and the importance of a sustainable defence industry that provides value for money.” Minister for Defence – Australian Business Industry Group 21 August 2014.

Australia’s Defence Industry’s raison d’être is to support Defence capability. It is not the function of Defence Capability to support an entire industry incapable of standing on its own. Currently, Australia’s Defence Industry is in dire straits with jobs shrinking amidst the Australian Government’s determination to obtain the best assets at the best price, even if this means looking outside of Australian Industry. This shift in policy should be considered against a brief history of the Defence Industry’s development in Australia in recent years and a biopsy of Australia’s current defence spend. Existing Defence Industry key capabilities should be measured against those industrial capabilities determined vital to Australia’s ability to defend her Sovereignty. Future trends in Defence and Industry need to be understood in order for Australia to choose a model which best postures Industrial capability to meet Defence needs. The current Government wants a sustainable defence industry which has the ability to provide improved capability, endurance, functionality and innovation. It is however not prepared to pay for this at any cost.
History

The Australian Defence Industry has grown since the emergence of the Australian Submarine Corporation (ASC) which surfaced in 1985 and was contracted to build Collins Class Submarines to a value of 5 billion AUD. This corporation was 51% private and 49% Government (IDC) owned. In the 1990’s the Australian Defence Industry moved away from the model characterised by public sector dominance to one dominated by the private sector. This culminated in full privatisation by 1999. The next decade saw the increased encouragement of local defence industry by government. In the latter period of the decade, industry consolidation occurred resulting in an industry with only 6 local companies whose annual revenue exceeded 300 million AUD. The balance comprised small and medium enterprises.

Composition

The Australian Defence Industry now comprises a handful of local companies with revenue sufficient to support the large investment required to enable them to be considered as a prime for major defence acquisition and sustainment efforts. The balance of the industry is made up of small to medium size enterprises. The Defence Industry provides employment for more than 25000 people and, apart from few exports, services one Customer.

Defence Spend

Acquisition
Three quarters of Defences acquisition spend finds it way outside of Australia with only a quarter spent on local companies. Only a very limited spend of the quarter spent inside Australia is on product, with the majority being on services, systems, design and projects.

Sustainment
The reciprocal fraction spend is true for sustainment where about three quarters of the spend finds it’s way to local businesses.

The Stockholm International Peace Research Institute (SIPRI) lists that the largest customer of Military products and service, the U.S, spends around 4.8 percent of their GDP on military hardware. China spends 2.1 percent of their GDP.

Underinvestment in Australia’s defence by the previous Labour Government resulted in an underfunding of 30 billion AUD and a resultant gap in Australia’s long term defence planning. The Abbot Government has committed to increasing the Defence spend to 2% of GDP within the decade. It is therefore positive for the Australian Defence Industry that Defence spending will increase in the next decade. The question is, how much of this spend will be directed locally?

Key Capabilities

Key capabilities which have emerged in the Defence Industry and which could be considered drivers for future local defence spend include:
• Ability to supply product more sophisticated than merely a commodity. We can effectively produce commodities locally which are competitive.
• Ability to manufacture limited modern war equipment e.g. Air Warfare Destroyers (AWD), Phased Array Radar Technology and the Bushmaster Protected Mobility Vehicle.
• World class capability in enterprise architecture, systems integration as well as the design of support systems.
• Developed and robust integrated logistics capabilities.

Key Weakness

Areas of weakness/risk and where the Australian Defence Industry has failed to deliver, now induces the Government to look externally. These areas require attention and need to be addressed by both industry and government:

• Commercial, schedule and cost failures. These problems, such as with the AWD program, have left the Government somewhat disillusioned with the ability of the local ship building industry to meet its targets. Currently the project is almost 2 years overdue and has run 360 million AUD over budget.
• Productivity failures. High productivity means producing more valued goods and services per unit of labour, capital and natural resources, or producing the same output with fewer inputs. The Australian Defence industry is not producing enough per unit of labour, capital and resource to be competitive in the global market.
• Skills shortages. Competitive industries are attracting skills away from the Defence sector.
• Technology limitations and high barriers to entry are keeping Australian Defence Industries out of many markets.
• Investment climate (Rate of return). Returns in the defence industry are not great enough to attract additional investment and Defence Industry companies are forced into diverse industries in order to survive and deliver suitable returns.
• Uncertainty in the Defence Industry Market translates into poor confidence and limits investment.
• Lack of collaboration, co-operation and early engagement between defence and industry.

Vital Industrial Capabilities

Which capabilities are then vital for the ADF to field forces and which by necessity are required to be located within Australia? Given Australia’s position on the world stage and our strategic alliances it is hard to imagine a situation where there is any product, vital for this purpose that needs to be produced inside Australia, that can not be effectively acquired elsewhere, other than activities related to the sustainment of war fighting capability.
Having said this, there are local capabilities which would be advantageous to our ability to force posture as required. The advantages to providing such local capability would include:

- Economic advantage

If an item can be locally efficiently produced then there would be an economic advantage to producing it locally. This advantage would be in the form of job creation and general economic advantage which would accrue from the provision of inputs and services. This however is an economic decision and should be made independent of any decision made on the basis of being vital to Defence.

- Cost benefit

Any output of Defence Industry which can be made locally and which results in a product which meets and/or exceeds that required by Defence should be produced locally.

- Security and Sovereignty

Any product which is vital to national security and sovereignty and for the same reason can’t be produced outside of Australia should be produced locally. Included under the heading of Security is the Capability gap (Valley of Death) and protecting Australia from losing capability. On the other side of the coin, Australia’s defence industry could be seen as a key component of our national defence capability. From this view, Australia’s Defence Industry is seen as a fundamental element of the country’s national security infrastructure which needs to be retained and developed. This is a strategic decision and once decided needs to be maintained in the long term.

Somewhere between these two polarised views exists the defence industry ideal. It is important however not to consider the Defence Industry in isolation or the present, but consideration needs to be given to the medium to long term challenges and risks.

**Future Trends/Risks**

In order to understand what type of Defence Industry might be required in the future it is important to understand what forces in the future could influence that requirement. The following influencing trends have been identified which could well have an impact:

- Internationalization of production and Globalization.

- Communications technologies

- Demand changes

- Increasing importance of IT companies within the Defence Sector.

- Privatization of Services previously provided by the Military.
• Unclear Strategic direction
• Increasingly less competitive Australian Industry
• Defence Industry requirement to demonstrate that it meets an acceptable benchmark for cost and productivity
• Barriers to competitiveness-domestic and international
• Increasing Defence Budget

Future Defence Industry Model

The future Australian Defence Industry model would benefit from Industry segmentation or tailoring and an acknowledgement that there is no “one size fits all” industry approach which will suit Australia’s requirements into the future. An intelligently tailored and segmented Industry would have the following characteristics:

• The future defence Industry model should be one that builds on current Industry strengths and limits exposure to weaknesses. There should be further concentration on sustainment and enterprise architecture, systems integration as well as the design of support systems and our integrated logistics capabilities. The Defence Industry can add value to Defence by providing high value added elements of acquisition.

• Because we are good at sustainment and enterprise architecture, systems integration as well as the design of support systems and our integrated logistics capabilities, there exists a real opportunity to extend the life of older equipment rather than buying new. Many Defence systems can be re-lifed or refurbished instead of being disposed of. Disposal itself comes with a high cost. The local Defence Industry and indeed other industries within Australia would benefit from partaking in refurbishment and re-lifing. As an example, the current Blackhawk fleet could be refurbished/relied at a fraction of the cost of the ARH project and could well provide a more suitable capability, providing Australia with a first class working platform. This would provide a capability that could leap-frog the ARH platform and require a new replacement capability only in the future.

• The industry will have to compete locally and internationally for projects and win these on a level playing field. This could well require a substantial shake up of the industry with a focus on productivity and effectiveness. Barriers to productivity need to be removed. This is where Government can assist. Only when we are able to compete with the best in the world can we be assured of winning contracts. This is the key to sustaining a local defence industry. Industry support programmes should shift away from the current tranche and focus more on productivity and areas of the industry that are targeted to grow and that we know we have superior competency.
In addition, those industrial capabilities that are deemed to be vital to defence should not necessarily be expected to compete in an open market. We need to acknowledge that any component of the Defence Industry which is considered key to our defence capability will require Government support and Investment. This however needs to be quantified, stated and measured and reviewed.

A transparent approach to strategic planning between Defence and local Industry is fundamental to an ongoing and workable Defence Industry model.

**Benefits of Segmentation and Tailoring**

A segmented industry would benefit from solutions tailored to meet specific needs. Instead of applying a blanket policy to the entire industry, the Government could make smart decisions which suit certain aspects of the industry whilst encouraging or protecting other areas which it considers sensitive or vital. This tailored approach will promote the following benefits:

- Encourage and grow areas of the industry which are noted for being particularly successful. This will foster innovation.
- Maintain and protect particular areas of the industry where, although not particularly competitive, are deemed to be vital and strategic.
- Closure of the capability gap. An acknowledgement that certain vital industries can not compete in the free market, but are worth retaining at a cost, will ensure that Australia maintains capability that would otherwise be lost.
- Increased productivity. By focusing on key competence areas where Australian Defence Industry is currently world class, productivity growth can be fostered.
- Reduced costs. Costs can be reduced (which will boost productivity) when Government focuses on specific vital industries through the removal of red tape and incentives.
- Increased confidence through greater transparency and a longer term view. Greater transparency between Defence and Industry will bolster industry confidence and allow investment and planning to take place.
- Technological advances in areas of key expertise and innovation. Through targeted concentration on key areas of competence, technological advances and innovation will develop.
- Increased competitiveness. Increased productivity, reduced costs and transparency will translate into a more competitive industry.
In order for these tailored segments of Defence Industry to flourish current incentive and support programmes need to be re-aligned with new programmes tailored towards encouraging identified key concern areas of the newly tailored segments.

Current programmes include:

- The GSC program. This program aims to facilitate access to opportunities in the global supply chains of multi national defence companies.
- AIC program. This aims to identify work opportunities on Defence projects.
- Priority Industry Capabilities. This program identifies capabilities vital to Defence which should be Australia based.
- PICIP. A form of repayable grant for small to medium enterprises for innovation.
- Future Submarine Industry Skills plan. This is aimed at improving skills and productivity in vital capability areas.
- NACC-ISP. This is aimed at supporting and developing improved capability to win work on production and sustainment for the Joint Strike Fighter Program.
- Scorecards. This is a reporting tool which scores performance of DMO contracts.

The new suite of programmes would be a mix of existing programmes, reviewed for effectiveness and new programmes concentrating on the tailored and segmented industry approach.

**Conclusion**

A tailored approach to the future structure of the Australian Defence Industry is advocated, which focuses upon identifying firstly those areas where, for the purpose of sovereignty, Australia requires particular industry. These identified areas need to be committed to by Government and partnered with. Other areas of existing excellence need to be pursued by the private sector and encouraged through Government removal of barriers to productivity. It is suggested that Government needs to implement a strategy of asset refurbishment where practical which would allow breathing time between consecutive asset acquisitions and allow logical, considered and unrushed acquisitions to take place.
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