



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

FOREIGN AFFAIRS, DEFENCE AND TRADE REFERENCES
COMMITTEE

Reference: Defence Materiel inquiry

THURSDAY, 10 OCTOBER 2002

BENDIGO

BY AUTHORITY OF THE SENATE

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **<http://www.aph.gov.au/hansard>**

To search the parliamentary database, go to: **<http://search.aph.gov.au>**

SENATE
FOREIGN AFFAIRS, DEFENCE AND TRADE REFERENCES COMMITTEE
Thursday, 10 October 2002

Members: Senator Cook (*Chair*), Senator Sandy Macdonald (*Deputy Chair*), Senators Hogg, Johnston, Marshall and Ridgeway

Substitute members: Senator Bartlett for Senator Ridgeway

Participating members: Senators Abetz, Bartlett, Boswell, Brandis, Carr, Chapman, Coonan, Denman, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Forshaw, Harradine, Harris, Knowles, Lightfoot, Mackay, Mason, McGauran, Murphy, Nettle, Payne, Stott Despoja, Tchen, Tierney and Watson

Senators in attendance: Senators Hogg, Johnston and Marshall

Terms of reference for the inquiry:

To inquire into and report on:

1. Whether the current materiel acquisition and management framework of the Department of Defence is effective in meeting the organisation's equipment requirements.
2. In considering this matter, the committee is to examine and report on the following issues:
 - (a) whether the current materiel acquisition and through-life support system is meeting, and will continue to meet, the needs of Defence and Defence industries in a timely, cost-effective and qualitative manner;
 - (b) the impact of the Defence Materiel Organisation acquisition reform program on materiel acquisition and management;
 - (c) the current status of major equipment projects in meeting the organisation's requirements;
 - (d) the impact of the creation of decentralised System Program Offices on materiel acquisition and management; and
 - (e) any other issues relevant to the effectiveness of the current acquisitions framework which arise in the course of the inquiry.

WITNESSES

ELLIS, Mr Barry M, Chairman, Bendigo Manufacturing Group; CEO; Keech Castings Australia Pty Ltd.....	123
GIBBONS, Mr Stephen William, Federal Member for Bendigo	123
MacBEAN, Dr Ian Thomas, Director, Centre for Sustainable Regional Communities	123
PAUL, Mr Andrew William, CEO, City of Greater Bendigo	123
RODGERS, Mr Ged, Regional Manager, Industrial Supplies Office (Victoria) Ltd	123

Committee met at 9.06 a.m.**ELLIS, Mr Barry M, Chairman, Bendigo Manufacturing Group; CEO; Keech Castings Australia Pty Ltd****GIBBONS, Mr Stephen William, Federal Member for Bendigo****MacBEAN, Dr Ian Thomas, Director, Centre for Sustainable Regional Communities****PAUL, Mr Andrew William, CEO, City of Greater Bendigo****RODGERS, Mr Ged, Regional Manager, Industrial Supplies Office (Victoria) Ltd**

ACTING CHAIR (Senator Hogg)—I declare open this meeting of the Senate Foreign Affairs, Defence and Trade References Committee. Today the committee holds its third public hearing into the Defence Materiel Acquisitions and Management Framework. The terms of reference set by the Senate are available from the secretariat staff and copies have been placed near the entrance to the room. Today's hearing is open to the public. This could change if the committee decides to take any evidence in private.

Witnesses are reminded that evidence given to the committee is protected by parliamentary privilege. It is important for witnesses to be aware that the giving of false or misleading evidence to the committee may constitute a contempt of the Senate. If at any stage a witness wishes to give part of their evidence in camera, they should make that request to myself and the committee will consider that request. Should a witness expect to present evidence to the committee that reflects adversely on a person, the witness should give consideration to that evidence being given in camera. The committee is obliged to draw to the attention of a person any evidence which, in the committee's view, reflects adversely on a person and to offer that person an opportunity to respond.

Witnesses will be invited to make a brief opening statement to the committee before the committee embarks on its questions. I welcome our first group of witnesses.

Mr Paul—On behalf of the city, I welcome you to Bendigo and thank you for taking the time to come to Bendigo, hear our submissions and inspect some of our facilities during the course of the day. Can I begin by saying that our interest in this matter is largely one of self-interest. I say that in the sense that we have a very strong community relationship with our key manufacturing industries. As a city, we endeavour to support them in their business and activities to the best of our ability.

Our involvement in this issue relates primarily to our relationship with Australian Defence Industries or ADI, but is also in support of other businesses such as Australian Defence Apparel—ADA—and other businesses, some represented here today, that play an important part in supporting those industries in their participation in the Australian Defence Industry generally.

Our initial interest with regard to ADI really relates to delays we believe have been experienced in terms of bringing to fruition what is commonly known as the Bushranger project, which I think involves the Bushmaster defence vehicle. Our initial submission was made at a time when that project was somewhat in limbo despite the initial contract, as we

understand it, being awarded for the manufacture and delivery of that vehicle to the Australian Defence Force having been made some three or four years ago.

There was a significant period of uncertainty following the initial awarding of that contract and prior to getting, some months ago, what I would call a qualified go-ahead for the project. I call it a 'qualified go-ahead' because I understand there are still a number of hurdles to be overcome. Our initial concern with the project was really the delay between the awarding and the commencement of manufacturing, and what that meant for the company and for the work force in particular here in Bendigo. The delays resulted in a substantial amount of uncertainty as to whether the project would eventually come to fruition and, from our perspective, whether or not the company could hang on long enough and continue to employ the work force required to manufacture the vehicle whilst in this period of uncertainty.

With respect to that delay and the slowness of the process, we also expressed some concern to both the government and various other bodies about what I would call the process of trialling and testing the vehicle. It is our understanding that, throughout the world, with any new vehicle manufacturing program—and this is a new vehicle manufacturing program—it is unlikely or certainly not common practice for all the bugs and technical difficulties that might arise to be ironed out before the commencement of production. It is our understanding that generally, with most new vehicle programs throughout the world, when new production commences there is a period of grace, or an initial contractual period, when bugs and problems with the vehicle are rectified. That was just one of the points that I believe caused the substantial delays, and which we believe almost brought about the complete failure of the project. That has certainly been of significant interest to us.

ACTING CHAIR—Could I just stop you there. Do you think that was a problem with the systems within Defence or part of the problem with ADI?

Mr Paul—I am not looking to apportion blame. I do not know the answer to that—as to where the responsibility really lies. I suspect that there were problems on both sides of the fence, but it seemed incongruous to us that an acquisition program could take that long between awarding a contract and commencing production.

ACTING CHAIR—The reason I asked—I was not trying to get you to attribute blame—is that, as an outsider looking in, you were obviously feeling the frustration that you are expressing to us now, so I was curious as to whether you had a view on that.

Mr Paul—I do not really have a view that is substantiated by any hard evidence, it is fair to say.

ACTING CHAIR—Please proceed.

Mr Paul—We believe that in a regional economy industries such as ADI play a very longstanding and important role in our community and that it is important that such industries be supported by our defence purchasing and equipment development programs. It seemed again somewhat incongruous to us that there were these delays in the delivery and development of the Bushmaster vehicle whilst at the same time the United States Army was moving very quickly to purchase another vehicle through ADI. I think it is called the high mobility engineering vehicle

and it is another vehicle developed and manufactured here in Bendigo. Ironically—the timing could not be better—you will see in today's local *Bendigo Advertiser* newspaper an article relating to further discussions occurring between ADI and the United States defence industry regarding the purchase and development of further engineering vehicles.

The basis of our submission is to ensure that defence purchasing practices are such that they do not, in the process, nearly remove the capacity to actually deliver an outcome whilst they work through what appeared to us from the outside a longwinded process. We recognise that industries such as ADI play a very important economic role in our community and that we need to sustain those types of industries. I think we demonstrate, just by the article in today's paper, that when supported these industries really do have the capacity to deliver quality products to the defence industry of Australia and the defence industries of other countries.

ACTING CHAIR—To what extent have other local industries experienced delays with defence in contracts? Is it something that has been a regular feature of negotiations?

Mr Paul—I am not in a position to answer that. The only one that I have been closely involved in relates to the dealings with ADI, particularly with respect to the Bushmaster vehicle.

Mr Gibbons—I am happy to associate myself with Andrew's comments. I think one of the best ways of illustrating some of the problems is the fact that we have the contract for the high-speed mobility engineering vehicle, which is the subject of a story in the paper today. My understanding is that that vehicle was trialed for about 12 months from the time it arrived there and a decision was made to purchase it shortly after that. That illustrates perfectly the problem we face with defence purchasing. The American army is a very hard market for anybody to crack; yet in a period of 15 to 16 months the deal was completed. With respect to the Bushmaster and other defence materiel manufactured in Bendigo, it took some four years for our own Defence Force and the department to even get close to resolving the situation. So why is it that we can produce a vehicle, designed and built in Australia here in Bendigo, trial it with the American army—which is one of the toughest markets for defence manufacturers in the world—and bring it to a successful conclusion in under two years, yet with our own defence purchasing and defence requirements, it has taken four years for the Bushmaster contract and we are still not through the total process? As Andrew has pointed out, it is of major concern to the economic viability of Bendigo—and Mr MacBean will elaborate on that shortly.

The other problem we see is that ADI took a particular business decision to gear up for vehicles, and we almost lost that contract. Had we lost that contract, or if we lose that contract, I think it is fair to say that we will lose that plant in Bendigo completely—there is no doubt about that. The Bushmaster contract is very crucial to the future wellbeing of this region's economy and, in particular, to ADI and its work force. Until August 2001, ADI Bendigo were the preferred tenderers for the replacement patrol boat main gun mounts. I understand that that situation has changed—an Israeli company called Rafael is now the preferred tenderer. That would have been a contract worth around \$50 million for ADI Australia, probably in Bendigo. I acknowledge that, under the guidelines, Rafael will have to contract manufacture of that equipment to Australian companies, but that does not provide any work for Victorian companies. I also have some serious concerns about a major Middle East defence manufacturer getting a contract in the current political climate we are involved in.

That is just another example of how difficult it is for Australian manufacturers to deal with this defence purchasing arrangement. There are long delays and, in some cases, those delays can cause the companies to fold completely. I have no doubt that that will be the case if ADI is not able to manufacture the Bushmaster vehicle, as it has been awarded to do.

Mr Ellis—I support the comments of the previous speakers. To see how important manufacturing is to a place like Bendigo—I have lived here for only about six years—one only has to see how many people are employed in manufacturing within Bendigo. The commitment by the council to form the Bendigo Manufacturing Group to assist manufacturers in furthering their business and making the area a better place in which to manufacture tells us and you gentlemen that we are here and ready to fire. We can do what we have to do. We can make any sorts of products the government want. There is a huge infrastructure here of support industries to companies like ADI and ADA. As a steel foundry, we are less than a mile from ADI. We are capable of making any steel casting that they want. I believe that Bendigo is capable of making anything that the defence industry wants. It may not come as the cheapest item but it will certainly produce a quality product.

Just last night I read an article about complaints from the American steel foundries against Mexican steel foundries that have labour rates of \$US2 with no on-costs. Our basic hourly rate is around \$13 with probably about 50 per cent on-costs. That is a standard of living that Australians want and that is good. But I think the government has to support industry in Australia and allow us to make those quality products. I believe we are competitive. We may not be the cheapest but we are certainly competitive and I believe we can make the highest quality products. We just need the opportunity to make them.

ACTING CHAIR—As a group, do you liaise with the Defence Materiel Organisation?

Mr Ellis—No.

ACTING CHAIR—Is there a reason why you should liaise as an organisation?

Mr Ellis—I cannot think of one reason why not.

ACTING CHAIR—That is what I am interested in. I would imagine that there are individual members of your manufacturing group who have a relationship with Defence Materiel. But it would seem to me that sometimes the collective voice can be as effective, if not more effective, than just a voice in isolation in dealing with Defence Materiel. What I am hoping to find out today is whether there was a relationship with Defence Materiel or its predecessor, and what sort of relationship might have existed. Do you know that from any of your people?

Mr Ellis—No. Through the officers of the ISO, we may have some conduit there but the manufacturing group has been operating just on a year next month. So we have been directing ourselves to things more local than contracts and so forth. The thoughts of quoting—using the Bendigo manufacturing as a cluster—on government tenders et cetera has not been addressed, but it can be and I am sure it will be discussed.

Mr Rodgers—I am the regional consultant for the Industrial Supplies Office. I do not know if you know our organisation.

ACTING CHAIR—I know it very well.

Mr Rodgers—We have certainly been pretty involved over the years with the *Anzac* ship project and most lately, in Bendigo, with the Bushmaster project, trying to assist at the industry participation level at a coalface level with the contracts and engineering staff of ADI just to expose local capability to that organisation. That is not easy. There are a number of obstacles with that. It is a complex project, and there are some interrelationships between the various elements of the design. That means that smaller companies find it very hard to focus on what is required. So there is probably the need for an organisation such as ours to interpret, from an engineering point of view, where the opportunities lie. There is a real technical task of unscrambling what appears to be an unwieldy and complex project into basic elements. ADI give us opportunities, and then we have to try to unscramble what that actually means in reality for a prospective local manufacturer.

ACTING CHAIR—And most of those would be SMEs, wouldn't they?

Mr Rodgers—They would be. I am really talking about down past the big-ticket item, once you start getting down past the engines and the major steelwork to things like upholstery. The wheels case was interesting. We were very close to getting an alternative to an American supplier. Really, the delay that happened over that project was probably against the local manufacturer. After that delay, I think ADI became quite concerned not to change the specification and not to take the risk of looking at the local alternative that probably would have met their requirements and perhaps at a lower cost. The contractual delays actually stopped some of this flow of opportunities to local companies. That is one of the points I wanted to make. The other thing that I did during this particular project was to try to assist small local companies untangle the documentation load that they had. They are quite complex documents that they have to sign off on. Most small SMEs are not used to that level of sophistication in contracts.

ACTING CHAIR—This is the documentation load from ADI?

Mr Rodgers—Yes, but that would reflect the major contract as well. There were certainly documents in there that—

ACTING CHAIR—Yes, we accept that.

Mr Rodgers—So we had to sit down for some hours to give a level of confidence to the local supplier that he understood his obligation and could sort out the quite complex requirements into their basic requirement. So there was an element of delay and complication that caused the industry participation plan to slow up. I think that also left a residue of doubt in the local community about whether they would ever do it again.

Mr Ellis—The cost of proceeding through a tender process et cetera is quite high for companies. As Ged mentioned, for support industries to supply castings or whatever parts to companies like ADI, the requirements are quite onerous. Often you look at those requirements and the costs that go with them and say, 'What's the point?' That is not good; it is just the way it is. I am sure there are a lot of companies that would quote on those things but just step away and say, 'No, I do not want to go there.'

Mr Rodgers—The other factor that I came across—and it is worth reporting—is that local companies were very keen to assist ADI, as part of a community effort, so they went out of their way and worked around the clock for some deadlines to meet a particular requirement of ADI's customer or to see a particular outcome. People worked very hard and then found that perhaps they were not really the preferred supplier at the end of the day. They had some doubts whether, even after putting in that effort, they would actually receive the benefit of their work. As I found on the *Anzac* ship project, a lot of work goes into trying to please the customer, and then it becomes very complicated after that if some changes flow on from certain design decisions. It means that all that good effort, which is probably voluntary and adds to the costs of the supplier, does not necessarily get rewarded. Again, a creeping cynicism comes into the relationships.

ACTING CHAIR—Most of the companies that you would be associated with are, as we said, SMEs. ADI will look after themselves—this is a personal point of view—because they are big enough to do that. The people that you are really trying to represent today, if I understand it correctly, are those SMEs.

Mr Rodgers—Yes.

ACTING CHAIR—You are saying that the contracting processes seem to have a degree of complexity that makes it difficult for them to map out and plot a future for themselves. Is that a reasonable assessment?

Mr Rodgers—That is correct. There is no doubt that it is complex. It is definitely complex. It is difficult for someone who is trained in quite complex contracts to untangle a lot of these requirements.

ACTING CHAIR—So you spend most of your time, through the ISO, trying to assist these small businesses to be reasonable participants in the process?

Mr Rodgers—That is right. Some of them have a very smooth process, and they go through it very quickly. As mentioned by other speakers here, the fast tractor project has really been a very smooth process. People have hopped in and helped and been rewarded. The Bushmaster project is at the other end of the spectrum in terms of complexity and delay and not being a very satisfactory kind of arrangement.

ACTING CHAIR—Do the SMEs complain to you about not having direct contact with the major customer, being Defence, and the fact that they have to work with ADI? That is not necessarily a criticism of ADI; it may be a criticism of the process. Does that come up?

Mr Rodgers—Most of the SMEs I deal with consider ADI as their client, and they will do all they can to please their client.

ACTING CHAIR—I accept that.

Mr Rodgers—There may be complications brought about by a visiting defence group who want a change, and that has all sorts of implications. It may be that they change one element which then changes something which they thought they had signed off on.

ACTING CHAIR—The point that I am trying to get at, which has been expressed to the committee, is that some SMEs feel that if there were a capacity and an ability to have direct contact with the customer, being Defence, instead of dealing through a third party—or, in some cases, a fourth party, because it depends how far down the pecking order they are in the subcontracting arrangements—they may be able to give greater clarity and better solutions to the problems that are confronting a particular defence project.

Mr Rodgers—If we go away from the Bushmaster project, I have other clients who deal directly with the Defence Materiel Organisation elements, and they find that is a much clearer process—they have a demand from a defence organisation through the purchasing area to a supplier. They find that is a much easier process compared to the complications of being a second or third tier in a major project like the Bushmaster.

ACTING CHAIR—Given that Defence, for certainty of operation of some of these major contracts that they are leasing or letting, will need a prime contractor, do you have a model or some sort of concept as to how they can still be retained as the prime and have those who are at the second, third and fourth tier in the contract process able to have a direct relationship with the customer?

Mr Rodgers—I am not always sure who the customer is. It might be operational staff, design staff or materiel staff. You would have to be pretty clear about what your objective was in seeking information. You would have to say, ‘Is this the group I need to talk to, or would this be a waste of time?’—if you understand what I am trying to say. I do not have any model, apart from the fact that it is always better to talk to the people who are trying to define the specification. Mind you, in a big project, the specifications should have been signed off. I think one of the problems with Bushmaster has been that some of the specifications have been unclear.

ACTING CHAIR—Under the rearrangement with the DMO, has having System Project Officers, SPOs, assisted the process?

Mr Rodgers—That has not affected my work here in Bendigo.

ACTING CHAIR—So they are nonexistent—you did not know about them?

Mr Rodgers—No.

ACTING CHAIR—We can pursue that later. We might go to Dr MacBean and see if he has some matters to raise and then we will open it up for general questions.

Dr MacBean—I have to admit that I saw the terms of reference for the first time this morning, so the remarks that I would like to make probably fall outside your terms of reference, which very much go, as I read them, to the department’s needs. I want to take a fairly general perspective and then make some comments on what Steve Gibbons referred to in terms of the economic significance of the facility here in Bendigo.

The perspective I want to introduce into the debate—as the name of my centre might indicate, the Centre for Sustainable Regional Communities—is not just about small towns; it is about

regional communities the size of Bendigo as well. But the small town analogy is a useful one. A bank makes a decision to close a branch in a smaller community. School numbers fall to a certain level and the school is closed. You know the story; you must have encountered that frequently. And it is this sort of separated decision making that occurs that has such a huge impact. So, if we are serious about regional development as a nation and if we are going to avoid—as I heard on Ian MacNamara's program one morning—becoming like coral polyps just living in concrete boxes around the coast, we will have to ask all government departments in their decision making to look at the impact of their decisions on broader community obligations.

Bendigo was involved with ADI—and I am talking about ADI, the manufacturing operation—and other defence provisions in terms of the survey regiment and, in times past, the defence apparel. Bendigo has been a significant player in the provision of those sorts of services over a long time. Picking up that argument that I was trying to introduce, what Bendigo offers as a regional centre is capacities that have been built up, capacities that we need—and I will put some figures on that in a moment—the mix of the economy that we need, and the opportunity of non metro Australia. I do not know enough about the initiatives that ADI has taken but I can give you another analogy. Bendigo in its sewage treatment was the first centre in Australia to introduce a full-scale biological nutrient removal treatment, and that is because we are inland on the north side of the divide. We discharge into creeks and, not just in this year but in most years, the flow of them declines to next to nothing. Faced with that sort of need, we took that initiative. We have obviously a skills base here. The other thing that Bendigo offers, not just to ADI but to a range of manufacturers, is a level of labour stability.

My Centre for Sustainable Regional Communities works along the triple bottom line approach, and I will talk specifically about the economic activities that we are doing. By virtue of the university not having boundaries and being seen to be a neutral player in the regional economy, we have also been instrumental in assisting, not necessarily leading alone but developing partnerships that are strengthening this region. So we think we are making a useful contribution to regional development and certainly in terms of the state government initiative to look at a whole of government community building approach which goes back to that first point I made—the obligation that I think all departments have to the wider need of the communities that they are serving, not just the decisions that they might be directed to make.

So that is the sermon, if you like, on the general issues. On the economic modelling, if I had been better informed, I probably would have sent my colleague along who has developed a regional economic modelling tool for strategic planning, analysis and insight. It is an input-output analysis that enables us to drill down to a regional, municipal level and look at the impact of any given major investment or, for that matter, a major loss, if that were the case.

We have done some good modelling work with the city of Greater Bendigo, Goldfields Esperance in Western Australia and the Central Murray Area Consultative Committee. The Central Murray ACC study is one that has been funded by the federal, New South Wales and Victorian governments, so it is really a pilot where we are looking at a region encompassing 10 municipalities but we are also providing those individual municipalities with the modelling capability. It is user friendly. We license the software on and train officers of the regional development body, the municipality, so that, on an ongoing basis for the period of the licence, they can do their own economic modelling, rather than hauling in a consultant every time they need to develop a project. It has cut the costs to them dramatically.

I mentioned the city of Greater Bendigo and us. We have done that, and we have some pretty good figures based on the model, which employs top-down. When we have had the opportunity to work with a municipality we do verification through survey modelling, and we have a very good picture of the Bendigo economy. We did a bit of modelling on the significance of ADI—this is in terms of perceived threats to ADI in terms of potential job losses and what the flow-on of that might be. Whether it be a job loss scenario or, as Steve Gibbons mentioned, a potential investment in the order of \$50 million, just perchance I have some figures. Of 32,500 employment units for the City of Greater Bendigo—and I would like to keep all these figures ‘in the order of’, rather than being held too accurately to them; if that is required, I would like to come back—just over 4,000 of those are in manufacturing; that is, 12½ per cent. But, with ADI, it depends on the scenario that you project. It can be one per cent of the overall employment or a much greater percentage, more in the order of 20 per cent, of the manufacturing component. So it is very significant to our economy. With the development of mining in our community, Bendigo City is currently running a study looking at the downstream opportunities of the mining development in Bendigo. Bendigo Mining are projecting a conservative estimate of 12½ million ounces of gold. There are by-products of mining—the economic opportunities—and already there are spin-offs of that mining initiative in terms of manufacturing. We can build on those opportunities by having a strong capacity through ADI.

I apologise that I have not come better prepared, but those general contextual things are important to Bendigo. I think they are fundamental to the longer term regional development arguments that state and federal governments are still grappling with. We have to somehow break down the silo thinking—I do not like the term but it is used widely—that exists within government departments.

ACTING CHAIR—On the models that you would develop for local industry, do you look at the relationship between local industry, particularly the small to medium enterprises, and big departments such as Defence and how that relationship should work?

Dr MacBean—That has got to be followed up by the economic development officer in the municipality. But for Bendigo, because we have probably been working with the city on that for longer, we have got a grid of all 107 industry sectors which looks at the level of interactivity between them and it just comes out as a colour coded thing. I am not an economist—

ACTING CHAIR—Neither am I. That stands us in good stead sometimes.

Dr MacBean—The colour coding shows where there is a lot of regional interactivity between the sectors and, where it does not show up, there are the opportunities. It may be for import replacement—Ged’s area—and the potential.

ACTING CHAIR—That is where ISR are important—import replacement.

Dr MacBean—Yes. Specifically, in response to your question, between ADI and the smaller suppliers that Ged was speaking about, they would be subjects that Ged and the economic development officers of the municipality would have to follow up.

Mr Rodgers—I think that outside organisations do not appear on that analysis. It is really an internal input-output analysis of our economy in Bendigo but there are impacts from contracts that flow into this area, and Ian can map the influences of those.

Senator JOHNSTON—I have a question for Andrew Paul. Are you or any other members of the group here today aware of the gross direct and indirect value of the Bushranger project to Bendigo in dollars?

Mr Paul—No, I am not, other than to say that I understand you will be talking to ADI later in the day. They would be able to tell you the number of staff directly. We would probably just look at some simple extrapolation of the number of staff directly employed. Certainly over the three- or four-year period of what I would call the hiatus between the awarding of the contract and the still yet to occur commencement of production, we have seen a significance reduction in the level of employees at ADI. Somewhere in the vicinity of 100, I think, employees have been let go during that period of time. Even at an average of \$30,000 to \$40,000, that in itself probably has to equate to \$3 million or \$4 million directly. How much of that is attributable to the slowness of that process I cannot be certain, but I would suspect that there is some correlation.

Senator JOHNSTON—Are you aware of the value to ADI of the overall tender?

Mr Paul—I understand something in the vicinity of \$200 million to \$300 million is something like the total value of the project.

Senator JOHNSTON—Are there any other industries that equate to that sort of size in dollar value in Bendigo?

Mr Paul—From a manufacturing perspective, companies of the size of Empire Rubber, I would suspect, who employ somewhere in the vicinity of 500 employees, would be certainly a larger manufacturing enterprise. Traditionally, going back 20 or 30 years, ADI would have been substantially our largest manufacturing employer by a factor of multiples of any other manufacturing industry. I think Empire Rubber are now our largest. If you go beyond that, you would probably be looking at some of the food industries like Hazeldene Poultry. But ADI are still very much probably in our top half a dozen manufacturing employees, even at current employment levels.

Senator JOHNSTON—On behalf of your community, have you studied what Defence goes through in order to bring a project like this to the point of tender and beyond that? When you talk about the delays, I am interested to know in what context you perceive that there has been delay.

Mr Paul—A simple answer to your question is no, we have not gone into the detail. We have only gleaned this, I suppose, from being a support to our local community, to the local work force and to the local company in trying to get the work under way. I can probably only relate delay to my own organisation. When we go to tender and we award a tender, work generally commences fairly soon after the awarding of that tender. We go to tender on the basis that we have a distinct outcome or product in mind and that we have a specification on how to deliver that product in place. It seems, from my perspective, from working in an organisation like mine,

incongruous to think that you could have a tender awarded—and I understand it was awarded, although that might be my technical understanding of it—and then, four years down the track, work, in the true sense, has not actually commenced on the delivery of that project. I find that unusual, to say the least.

Senator JOHNSTON—You and a lot of taxpayers.

Mr Paul—Yes.

Mr Ellis—Skills are required to make the Bushmaster et cetera. During that long, drawn-out process of waiting for somebody to make it happen, small companies can go broke. The people they employ get put off and finish up taking benefits or finding jobs elsewhere in industry, hopefully. But, suddenly, once the contracts get operational—if they ever do—it is discovered that there has been a loss of skills, and people have to start all over again. The cost of that comes to the manufacturer and the engineering businesses, not to the government. That makes people quite jaundiced about getting involved. Notwithstanding that, in times of peace, I guess price is all important. In times of war, you want to be able to make it yourself. Heaven forbid that we should go there again, but we need to retain the skills for all of those types of things. I do not need to tell you gentlemen that.

ACTING CHAIR—So how does one get the balance—which seems to be the point you are getting to?

Mr Ellis—My opening comments were about costs and so forth, and I think Australian industry is quite capable of being competitive. It is certainly capable of producing a very high-quality product. We need to be given the chance, but I guess all Australians need to realise that sometimes they may have to pay the piper to some degree to have that option.

Senator MARSHALL—Dr MacBean, I suspect that that one per cent of employment that ADI represents is at a fairly high-skill level. Do you have any information about the percentage of skilled tasks that it represents in industry?

Dr MacBean—No, and they are our estimations from a distance. If this is information that the committee and the city needs, we would certainly like to work with the city and ADI themselves so that we can be assured that the figures we are feeding into the model are accurate. As part of that process, you could then break down the skill levels.

Senator MARSHALL—It goes to the proposition you were putting that we should be taking into consideration the effect on the community—on skill levels and those sorts of things—as well as just the economic decision-making process when we are tendering for these sorts of projects. I suspect Bendigo, in particular, would have suffered significantly from the skill base it has been able to draw on. Ten years ago, lots of training would have been conducted in the railway workshops and we would have seen ADI with employment levels of two, three or even five times higher than they are now. Again, do not hold me to these figures, but, probably going back six years, ADI would have been training 120 or 150 apprentices. They would now train 20—maybe. I guess that also then draws the question: if we are going to take into consideration the effect on the community of awarding these contracts, what consideration should be given to

the mutual obligation to also provide skills, jobs and training to the general community? Would you care to comment generally on those matters?

Dr MacBean—I have no problem with the idea of mutual obligation. I think it is an element of the labour force stability that we have in provincial cities. In other economic areas, the city is marketed very effectively to attract enterprise to Bendigo. I agree with all you say, but I would like a little bit more of a feel for that breakdown of skills across the ADI work force. Certainly my personal perception is that it has probably fallen to a level that is quite critical. If it falls any further it may not be recoverable—but that is a personal perspective.

Senator MARSHALL—The information I would be interested in is whether that one per cent of the total work force actually represents—just speculating—35 per cent of the skill base in heavy engineering, for instance. It may even be higher; it may dominate the region in terms of those skills. Therefore, if we lose that altogether, we may completely lose the threshold for being able to attract those skills to the region and maintain those skills in the region. So it may not just be the losing of ADI; it may have a cascading effect whereby the whole ability of the region to maintain the skills to produce anything in heavy engineering may be lost completely. I think that sort of information is crucial if we are going to seriously take into consideration adding the community into the process of awarding contracts.

Dr MacBean—If we had the opportunity to provide further input to your hearing process, I would be very pleased to work with the city and Barry's manufacturing group to fine that up a bit.

Mr Rodgers—I am charged with promoting regional capability, and it saddens me to see the decline in ADI skills. It is an ageing work force and they have world-class facilities and a world-class engineering capability which have been inextricably shrinking. That makes it much harder to promote the company outside this region as capable of organisation as the years go by. Speaking as a member of the Bendigo engineering group, we all have to focus on the issue of the image of engineering and the promotion of engineering to young people. Without the flagship that ADI represents, that is going to be more difficult. That is a tremendous attraction if it could be promoted properly and encouraged through the school network and so on. It is a wonderful asset to the region to be able to put that up as an example of where engineering could take you as a young person.

ACTING CHAIR—Something that we have not previously had evidence on, which has been mentioned today—and at the end of proceedings I am going to give the representatives of DMO an opportunity to make a statement on this—is the matter with respect to the main gun mounts on the patrol boats. That matter has not been raised before in evidence to the committee. I have seen some newspaper articles where the amount mentioned was, I think, \$50 million. I do not know if that is the correct amount. Has your group discussed the loss of that contract from this region and the impact?

Mr Ellis—No.

Dr MacBean—In a sense, we are not a group. We have not met—

ACTING CHAIR—You are not a collective?

Dr MacBean—No.

Mr Paul—From the city's perspective I think the answer is no, in the sense that we were unaware of that contract.

Mr Gibbons—As I said before, ADI have geared their business for vehicles but are also in the business of some pretty sophisticated manufacturing. The main gun mounts were a classic example. When you go out there today you will see there is a major contract that they are still fulfilling for General Electric in the United States, which makes the engine modules for the United States Navy.

If ADI are starting to lose the ability to tender for these sorts of contracts, we will see a situation where they will be geared totally for vehicles—and the Bushmaster and its derivatives are a totally different engineering concept. Unfortunately, you do not need the sorts of skills that you need for the other components, for example. Bushmaster, by definition, is a welded hull with a whole series of components bolted onto it. I think that makes it an attractive proposition for the Army, given that the spare parts, for example, are going to be readily available because they are sourced from already existing manufacturers. But the expertise that ADI has built up in heavy engineering in the manufacture of the General Electric engine modules for the United States Navy and the gun work will be lost if they are not able to continue to bid for contracts. If that is lost and if Bushmaster for whatever reason does not come to fruition, the plant will close completely. Because they have taken a business decision to gear for vehicles with all of the trauma of that, given the nature of the contract, we have a strong chance of losing the other expertise. The patrol boat gun mount is a classic example of that.

ACTING CHAIR—Let us assume in that contract that—and I do not think anyone is bringing into question the processes that were followed—all things being equal, the ADI tender in the process was just inferior to the other. How does one then address that issue?

Mr Gibbons—I think you will find—and I go back to the Bushmaster contract—the problem that these companies have in dealing with the defence department or DMO is that the goalposts are constantly moving. We saw it with Bushmaster. Bushmaster was shortlisted with another South African designed vehicle manufactured by, I think, a Queensland company. Both vehicles were trialed extensively for a period of between 12 and 14 months. Bushmaster won hands down, but after that the specifications changed, so the tender changed. That was the sort of problem that they faced. I suspect that the same—

Senator JOHNSTON—But, hang on, it is a tender process. When you tender for something, you cannot say the goalposts have moved when you are out there openly tendering for a particular specification where you give commercial undertakings on proper cost-profit analysis. I know there have been problems with that project, but the process I think is a clear one.

Mr Gibbons—I meant to say that the specifications changed. The other problem faced, and it may well be the same for the gun mounts, is that there was a lot of—what would you call it?—argy-bargy: the defence department and the Army, for example, were not unanimous in the support of it, and there was a lot of argy-bargy within the Army about Bushmaster and whether it was suitable or not. There were various press releases and a lot of the defence writers were stirring up a fair amount of controversy. So they are the problems that defence manufacturers in

Australia face. I think both problems are very similar in terms of the goalposts changing in the specifications.

Senator JOHNSTON—Can I just pause there, because it seems to me that an underlying theme in what you are saying is that regional sustainability should be a consideration in the process of Defence materiel acquisition and contracting. Is that a reasonable ingredient in the process and, if it is, what can we ask of the regions that want to have that leverage in their competitive capacity through their prime contractor, such as ADI in Bendigo? What is the trade-off that the community is going to bring to the table in order to say, ‘We need this contract because of local jobs, enterprise, expansion et cetera’? Is Defence realistically a government expenditure department that is suitable for such trade-offs? I would have thought that, when we are talking about a vehicle, for example, that has a dozen lives at stake, driving over landmines and what have you, we want the best and the cheapest that delivers the capability in the most efficient way. So I come back to the point: does regional sustainability come into the process at all?

Mr Gibbons—That is a pretty philosophical question. Remember, this vehicle was shortlisted amongst others down to two, and most of the experts say that it does fulfil all of those expectations very well. So we are capable of tendering for and supplying the best equipment in the world. That should stand on its own merits without assuming that the defence department suddenly becomes a department of regional development—that is the point you are making.

Senator JOHNSTON—So Bendigo can compete with Perth, Melbourne, Kalgoorlie, Brisbane or wherever?

Mr Gibbons—Yes, most assuredly, and do very well. If you had a good look at the details of the main gun contract—and maybe ADI will explain it to you this afternoon when you go out there—you will be able to see what sort of an experience it has been. We have no doubt that we are able to produce equal to anywhere else in the world. We have proven that. The high-speed mobility engineering vehicle—or tractor on steroids, as I prefer to call it—is a very unique vehicle in the world. That is why the American army have purchased it. As I said before, the American army is probably one of the hardest markets for any defence manufacturer to crack, yet ADI have been able to do it.

Senator JOHNSTON—So on that basis, regional sustainability should not be part of the equation.

Mr Gibbons—It does not need to be because we can stand alone; we can do it. We can build the equipment up to any standard in the world.

Mr Rodgers—In terms of sustainability, you also have to build in opportunity—and I guess this is an ISO message—whereby, with a properly thought through industry participation plan and allocating resources and energy to that, a la *Anzac* ship project, you do get a better result. What tends to happen with a complex project is that you go the safe route. There are some engineering value decisions you could be making, and I have quite a few on the Bushmaster. We probably would have got a better outcome by digging deeper into the local sustainable industry

base. So there is that other aspect to it. It is the way you implement it that will cause, in the longer term, a sustainable result, in a sense.

Senator JOHNSTON—How do we go about implementing that? How do we go about digging deeper into the local expertise and niche—small to medium enterprise skill and ability—that I have got no doubt regional communities such as this have? How do we go about doing that when you have got one single prime contractor in town and when the whole of the operation falls under the apex of the head contract?

Mr Rodgers—That is a fair point. If the project leader or the company awarded the contract does not have firm guidance from the customer in terms of his requirement, like they did on the *Anzac* ship project, then you would tend to have a half-baked allocation of funds to that effort.

Senator JOHNSTON—So it is a contractual relationship from the outset?

Mr Rodgers—If it is clearly spelt out in the contract, then I think you have a chance to drill down into local capability because people put energy into it—they assign people to it. Once you do that, then someone is committed to doing a better job and suddenly you start to get some communication happening. That happens over and over again in my work. Once we get alongside a project team, things start to happen. If you are kept at arm's distance, because they do not feel any stress to fulfil that requirement and they can get around with a token effort, a motherhood approach, that is what you will get. And you do not have the flow down into the sustainability aspect of the local SME group.

Senator JOHNSTON—I think what you are saying is that the sustainability is a natural byproduct of a successful regional capacity that wins contracts on its own merit.

Mr Rodgers—No, I think you have to work at it. Like any business activity, you have to focus people's minds on the task and work away at the task. You certainly cannot afford to be complacent. You have to be as competitive as the other players.

Senator JOHNSTON—I accept all that. I would just come back to the realistic commercial reality of having the DMO sitting down and looking at contracts and awarding tenders based upon which regional community needs it most—if you follow what I am saying there.

Mr Paul—I think there is an element of a long-term view in this, too; that is, if we do not sustain to a degree the capability in regional areas and throughout the country, then perhaps 20 or 30 years down the track we will not be in a position where we have to look at regional sustainability as an issue. When I say 'regional', it might be regional Melbourne even, as against regional Bendigo—if we have not at least maintained the capacity to deliver these types of services and these types of products within our own economy.

Senator JOHNSTON—I agree with you entirely, but the question is this: who is the chicken and who is the egg? Does the local community call upon its technical education facilities and institutions to focus on the area of defence to accommodate its biggest single industry or does it wait to see whether the biggest single industry wins the contract and then react to that? That is a very interesting question because each of them has a completely different outlook for the town in the long to medium term.

Dr MacBean—We will work in tandem on this. There is interaction with our colleague institution, the Institute of Technology, which is geared more to working with ADI. There is a lot of contact there and they do work alongside. It is a huge issue of scale for us. Many years ago I was in charge of our engineering programs at the university. I was also chair of our regional development board. We had a forum on contracting to ADI. Kevin Mannie was with ADI at the time and he was also a member of our economic development board, and one local manufacturer, who had got accreditation, shared their experience. There may have been similar initiatives since which I am not aware of. It is a scale thing. It is about the potential of some of our smaller manufacturers to gear up. Ged spoke about putting in submissions and then being told, 'You're unsuccessful on this occasion.' They do not have the capacity to keep trying. As a citizen reading in the paper that the gun mounts contract looks as if it is moving from a preferred tenderer here, ADI in Bendigo, to another country, I am happy to be the odd man out on regional development if we are fostering capacity in other economies.

ACTING CHAIR—I have one last question. Can anyone comment on the extent to which R&D and the building up of intellectual property is an important aspect of local manufacturing?

Mr Ellis—As private companies, we are continually spending large amounts of money on research and development in the pursuit of our business. It has absolutely nothing to do with government tenders or anything else. In our case, we sell product overseas. A million companies like ours are striving to produce product that is high quality, low price, and can be sold around the world. We do not need the government to tell us to do it or not to do it; we have to do it. That is where we are at. So it is happening. We benefit from research and development grants et cetera that are available, but I do not know of any company that is surviving that is not looking towards R&D, training and all the other things that we need to do to have our highest quality work force and produce the best quality product. We would not survive. Keech Castings has been going for nearly 80 years. To survive the next 80 years, the changes that happened in the first 80 years are probably going to be tenfold and we will need to cope with those changes.

Mr Rodgers—AusIndustry recently appointed three regional managers to encourage a closer relationship with regional companies. There is one of those in Bendigo, and I believe that is making a difference to the way people see their R&D programs and the opportunities that they can pursue through them. Again, it needs the community. Neil Hamilton is the man. He works very closely with this group. In a sense that this is a community of interest, and it is just an added factor in the equation.

ACTING CHAIR—As there are no further comments, I thank you for appearing before the committee. I will now give officers of the Department of Defence from the Defence Materiel Organisation an opportunity to put on the *Hansard* record any comments they may wish to make with respect to the issue raised about the main gun mounts.

[10.15 a.m.]

CLARKE, Ms Dianne Mary, Director General, Materiel Renewal, Defence Materiel Organisation

CHAIR—Welcome. Over to you.

Ms Clarke—I wish to provide some clarification on the issue of the selection of the Rafael system for the replacement patrol boat. Stage 1 of the replacement patrol boat tender indicated a preference for an ADI manufactured UK designed MSI weapon. The ADI weapon was originally preferred because of potential benefits of commonality with the weapon on the RAN *Huon* class minehunter and the cannon fitted to the Army's ASLAV.

As part of the replacement patrol boat request for tender, which was released in September 2001, Defence indicated that tenderers could offer alternative weapons to the preferred ADI system, provided they were of equivalent or superior performance and offered better value for money. The majority of the replacement patrol boat tenderers offered the Rafael designed typhoon mount as an alternative weapons system. The Rafael weapon uses the same US manufactured 25 millimetre Bushmaster cannon as ADI offered. Rafael have entered into an agreement for the second and subsequent mounts to be assembled in Australia with GM Defence Australia in South Australia. It is expected that some subassemblies will be manufactured in Australia, which means a significant Australian industry involvement in the Rafael contract, which was assessed as offering better value for money. The selection of Rafael was totally in accordance with Commonwealth purchasing principles.

ACTING CHAIR—I do not think that was in doubt; it is just handy to have that on the record. Just to be clear, did ADI have a chance to come back and revisit the original tender?

Ms Clarke—All tenderers were given the same opportunity—

ACTING CHAIR—Did this go through the two-pass system, in effect?

Ms Clarke—I cannot clarify that for you.

ACTING CHAIR—All right. It just seems to me that there is a bit of a two-pass model used.

Ms Clarke—This was a tender with a preference.

ACTING CHAIR—We are not going to hang, draw and quarter you for this.

Ms Clarke—There was a tender with a model preferred because of commonality with other weapons systems, and we said that was what we would prefer unless there was something that offered better value for money.

ACTING CHAIR—So at some stage through the process you people went back to the prospective tenderers and said—

Ms Clarke—No. My understanding is that this was in the original tender—that this was a preferred model but you could offer an alternate model method. That is what was offered by Rafael. It was an alternate that offered better value for money.

ACTING CHAIR—And that includes whole-of-life support?

Ms Clarke—My understanding is that the whole-of-life support contract is not included in this contract, but it was probably a consideration.

Senator JOHNSTON—How many tenderers were there?

Ms Clarke—I do not have the number of tenderers.

Senator JOHNSTON—But there was a shortlist of what—two or three?

Ms Clarke—I cannot tell you that; I am sorry.

ACTING CHAIR—We might get you to give us a better briefing of this when the committee next sits. Obviously, some interest has been expressed in it today, so if you can give us a one-pager which outlines the processes, that would be helpful indeed. Thank you, Ms Clarke.

Committee adjourned at 10.19 a.m.