

## Barriers and impediments to the growth of Australia's defence exports

### Introduction

- 5.1 During the inquiry, a range of factors and themes were identified as barriers to Australian defence exports.
- International market competition and distortions caused by protectionist measures
  - Industry challenges
  - Sponsorship and advocacy
  - Selling to the ADF
- 5.2 Earlier in the report, the significant role of intellectual property as an enabler of defence exports was outlined (see chapter two).

### International market competition

- 5.3 While success can be achieved, the international market remains a competitive space. As discussed in the previous chapter, other countries have taken measures to insulate their defence industries from open competition, creating market distortions that Australian exporters must attempt to navigate. These market effects, combined with the relative costs and complexity of doing business in Australia, create challenging conditions for prospective defence exporters.

- 5.4 The unevenness of the market was noted in the Victorian Government's submission:

Competition in international defence trade does not always occur on a level playing field. Many countries confer regulatory and taxation advantages to domestic companies to improve their cost-competitiveness... and to drive economic benefits for local industry by leveraging major military procurement programs.<sup>1</sup>

- 5.5 Australian naval shipbuilding company Austal submitted:

Austal is an advocate of the free market and competition across the global market; however in the defence sector a free market approach is becoming less and less common.<sup>2</sup>

- 5.6 Austal's submission added:

It is now common for Austal to compete with manufacturers in Vietnam and China. This was one of the key motivations for Austal to establish a shipbuilding facility in the Philippines.<sup>3</sup>

- 5.7 Some witnesses noted the complexity of gaining access to the US market. Mr William Taylor (Senior Strategy and Business Development Manager, QinetiQ Australia) said:

The US market, for example, is subject to an array of legislation, regulations and procedures that limit access for imported products. ... Market access in the US is a complex area that in some instances requires case-by-case consideration of the US national interest by US officials. It is not often well understood by Australian companies, especially small to medium enterprises.<sup>4</sup>

- 5.8 He continued:

This volume of regulation and its complexity may be one reason why some Australian exporters have moved to establish manufacturing facilities in the US – that is, working from inside the system is easier than trying to export into it.<sup>5</sup>

- 5.9 Mr Gilbert Watters (Senior Principal Consultant – Government, QinetiQ Australia) said:

In the case of the US, there is a very commercial model. If the US wants to buy an aircraft, they contract Lockheed Martin, Boeing or Raytheon to develop it; and then the US government owns the

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1 Victorian Government, *Submission 36*, p.5.

2 Austal, *Submission 31*, p.9.

3 Austal, *Submission 31*, p.8.

4 Taylor and Watters, *Committee Hansard*, 13 February 2015, p.10.

5 Taylor and Watters, *Committee Hansard*, 13 February 2015, p.10.

technology but the people who know about how it works reside in those companies. That puts them in a very advantageous position in terms of selling those big assets around the world.<sup>6</sup>

5.10 He added:

So I think you have got to look at the circumstances and the model by which Australia does business. ... You have got to work through the policies and get those policy settings in place, and I think you will then see an improved export performance.<sup>7</sup>

5.11 Dr Andrew Davies (ASPI) said that Australian companies sometimes face 'unreasonable' barriers when attempting to export overseas.<sup>8</sup> He said:

An example is Austal's efforts to sell the littoral combat ships to the US navy. While ultimately successful, it required finding an American partner and setting up a shipyard in the United States because of local protectionist measures. Given the run that American companies get in the Australian defence market, that hardly seems fair. When our major ally and a significant trading partner presents those sorts of obstacles, it is little wonder that Australian firms feel hard done by.<sup>9</sup>

5.12 However, he noted:

Ultimately, we are never going to convince the US Congress that it is in their interests to take a completely free approach to Australian companies buying in to US programs.<sup>10</sup>

5.13 Defence's submission agreed that offsets and local industry protection measures in overseas markets are challenging for Australian SMEs:

Overseas trade barriers are a particular challenge for small to medium enterprises (SME) seeking to export to countries that have these policies. SMEs usually lack the resources and scale of operations to manage these requirements in the manner undertaken by large international defence prime contractors.<sup>11</sup>

5.14 In addition to international competition, challenges facing the defence industry within Australia affect our ability to succeed as an exporter of defence products and services.

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6 Taylor and Watters, *Committee Hansard*, 13 February 2015, p.15.

7 Taylor and Watters, *Committee Hansard*, 13 February 2015, p.15.

8 Davies, *Committee Hansard*, 13 February 2015, p.20.

9 Davies, *Committee Hansard*, 13 February 2015, p.20.

10 Davies, *Committee Hansard*, 13 February 2015, p.23.

11 Department of Defence, *Submission 41*, attachment A.

## Defence industry challenges

- 5.15 A number of challenges pertaining to the Defence industry in Australia were noted during the inquiry. Notwithstanding these challenges, the Committee notes that there have been a number of successful Australian defence exports, such as Thales' Bushmasters (troop carriers) and CEA's radar technology.
- 5.16 Defence characterised the challenges of the Australian defence exports industry as follows:
- An enduring need to embrace new technologies to provide the ADF with a military-strategic advantage;
  - Often volatile Defence demand, as Australia purchases, upgrades and modifies most weapons systems and platforms relatively infrequently;
  - High 'fixed' costs for developing and producing improved capital equipment, which ideally need to be spread over a broad customer base;
  - A heavy reliance on specialised labour skills to develop, build, adapt and sustain equipment which is among the most technically complex of any held within Australia;
  - Unusually high levels of both seller concentration and foreign ownership; and
  - The need to function in a broader environment where substantial economic and regulatory barriers exist to a free flow of defence knowledge, expertise, goods and services across international boundaries.<sup>12</sup>
- 5.17 Defence's submission added:
- General impediments faced by Australian exporters include distance to overseas markets, high exchange rates, currency fluctuations and access to export finance.<sup>13</sup>
- 5.18 The Department of Industry identified the following growth challenges:
- Leadership, management and entrepreneurial skills; access to, and retention of, skilled labour; workplace performance; access to finance; access to market-relevant ideas and intellectual property; ability to acquire and deploy new technologies and new ways of operating; high business input costs; competitive business environment; and regulatory impediments, including certification and qualification issues.<sup>14</sup>
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12 Department of Defence, *Submission 41*, p.2.

13 Department of Defence, *Submission 41*, attachment A.

14 Department of Industry, *Submission 22*, p.3.

5.19 Lockheed Martin Australia's submission also identified similar issues:

- High labour rates (especially in the services industry) which make some elements of the Australian Industry inherently expensive;
- Access to competitively priced materials, which puts Australian industry at a competitive disadvantage, as they often cannot compete on volume purchase arrangements;
- The bureaucratic and regulatory environment for defence exports is considered onerous; and
- A perceived and real distance to and from Australia creates a potential risk to product schedules.<sup>15</sup>

5.20 The submission added:

Additionally, companies new to the advanced manufacturing arena face large investment and training costs to bring machinery and staff up to the high levels required to conduct this work.<sup>16</sup>

5.21 The Committee notes the comments regarding Australian labour rates; however, in the case of submarines, available information suggests that labour costs do not present an issue. In September 2015, Chairman of German submarine builder ThyssenKrupp Marine Systems was reported as saying that building submarines in Australia is 'not less efficient' than building them in Germany and that the existing workforce would be utilised.<sup>17</sup> Prof Goran Roos has advised the Committee that building submarines in Australia may be more cost effective:

It would cost no more to build in Australia than it would cost to build in Japan, Sweden, Germany or France given:

- That they are all high cost countries with very low differences in labour cost (the labour cost component of a submarine makes up about one third of the total build cost whilst material makes up two thirds);
- That one third of the material cost is made up of specialised input sourced from a sole supplier, or from a group of very few alternative suppliers and hence there would be no real cost difference depending on build location; [and]
- That two thirds of the material cost is made up of domestic input where there might be some benefits of scale depending on the size of the submarine project, but since most submarine projects are low volume and the Australian would be in this

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15 Lockheed Martin Australia Pty Ltd, *Submission 39*, p.2.

16 Lockheed Martin Australia Pty Ltd, *Submission 39*, p.2.

17 AAP Newswire, 'Local Submarine Build as Cheap as Germany: TKMS', 9 September 2015; see also 'TKMS Says up to 50,000 Skilled Workers Will be Ready to Build Subs in Australia', at <<http://www.news.com.au/national/tkms-says-up-to-50000-skilled-workers-will-be-ready-to-build-subs-in-australia/story-fncynjr2-1227520019577>> (viewed 16 October 2015)

group a high volume this is likely to generate a lower cost in Australia.

If anything it can be seen that it might actually end up cheaper building in Australia.<sup>18</sup>

5.22 Austrade's submission referred to the challenges of meeting quality control standards:

For example, international defence primes and original equipment manufacturers (OEMs) impose strict procurement requirements on their supply chain. Qualifications and certifications such as AS 9100 rev C, NADCAP [National Aerospace and Defense Contractors Association Program] and ISO [International Standards Organisation] 9000 represent significant expense and require dedicated internal resource to fulfil and maintain.<sup>19</sup>

5.23 Austrade added that consequently, innovation programs are 'paramount' to Australian companies winning defence and aerospace contracts.<sup>20</sup>

5.24 H I Fraser Pty Ltd submitted:

Essentially Australian domestic businesses are competing on the global market within Australia. To survive in the current Australian marketplace you have to behave like an exporter as there are no benefits to being Australian.<sup>21</sup>

5.25 The Australian Manufacturing Workers' Union (AMWU) submission noted the impact of the exchange rates:

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.<sup>22</sup>

5.26 The AMWU added:

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. It is important to note that

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18 Roos, *Exhibit 9*, p.2.

19 Austrade, *Submission 30*, p.2.

20 Austrade, *Submission 30*, p.2.

21 H I Fraser Pty Ltd, *Submission 2*, p.2.

22 AMWU, *Submission 24*, p. 3. Exchange rates have changed since this information was provided. As at August 2015, the Australian dollar was trading at around 72 cents to \$US1.

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.<sup>23</sup>

- 5.27 Both the Export Council of Australia and Australian Business Defence Industry observed that the relatively small size and scale of the Australian defence industry makes it difficult for local defence suppliers to achieve economies of scale.<sup>24</sup>
- 5.28 QinetiQ Australia suggested that the range of challenges make Government support for defence exports more relevant:
- Given the regulatory environment, trade barriers, international taxation regimes and fierce competition in the global market we consider that the Australian Government has a critical role to play in the success of Australian defence industry exports.<sup>25</sup>
- 5.29 To assist industry secure export opportunities, the Committee was informed that Government needs to be involved in the promotion and endorsement of the Australian defence industry.

## Sponsorship and advocacy

- 5.30 International promotion of Australia's defence industry through sponsorship and advocacy were considered during the inquiry:
- Advocacy via defence attachés;
  - Defence presence at trade shows, fairs and similar events; and
  - Endorsements from Ministers travelling overseas.
- 5.31 The Industry Statement (accompanying the 2015 White Paper) may be a basis upon which the benefits of buying from Australia could be identified. Industry, Defence and relevant Ministers could use the Statement as a point of reference to highlight areas of industry advantage.
- 5.32 Defence's submission noted that a key form of promotion is 'facilitating Australian industry participation in international defence trade shows.'<sup>26</sup> Australian companies are supported under the Team Defence Australia

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23 AMWU, *Submission 24*, p. 3.

24 Export Council of Australia, *Submission 27*, p.2; ABDI, *Submission 9*, p.2.

25 QinetiQ, *Submission 12*, p.1.

26 Department of Defence, *Submission 41*, p.7.

(TDA) banner, which Defence advised is intended to 'signify the relationship between Defence and the Australian defence industry.'<sup>27</sup>

5.33 Defence also advised:

Overall, TDA-supported activities provide companies with low-cost export promotion opportunities, which would otherwise be cost prohibitive for the majority of companies if participating independently. Selection of companies for TDA events is through a competitive application and assessment process. TDA also targets known companies for participation in events based on the matching of a company's capability to known opportunities in the region.<sup>28</sup>

5.34 The Department of Defence's Capability Acquisition and Sustainment Group has offices in Washington and London. The functions of these offices include industry engagement.<sup>29</sup>

## Defence attachés

5.35 At Australian diplomatic posts overseas, resident defence attachés may be appointed, who are used as a linkage between the Australian Government and the host country's military.<sup>30</sup> Some witnesses suggested that the role of defence attaché could be expanded to include export facilitation.

5.36 The Committee was informed that other countries provide support for the defence industry through political and diplomatic channels. For example, Austal submitted that European governments use political leaders to support the defence industry:

Many of our competitors particularly the British, French, Italian, Dutch and German organisations receive direct support and representation from all levels of government from their Royal family to Prime Ministers in support of defence sales. This level of support sends a powerful message to prospective customers regarding the level of government faith in the product and support of that product.<sup>31</sup>

27 Department of Defence, *Response to Questions on Notice* (Question No. 22).

28 Department of Defence, *Response to Questions on Notice* (Question No. 22).

29 Department of Defence, 'CASG International Offices' at <<http://www.defence.gov.au/dmo/DoingBusiness/Internationalengagementandexportsupport/CASGinternationaloffices/>> (viewed 26 August 2015).

30 Birrer et al, *Committee Hansard*, 24 March 2015, p.11; Department of Foreign Affairs, Defence and Trade, *Response to Questions on Notice*, p.2.

31 Austal, *Submission 31*, p.14.



5.37 Mr David Shiner (Vice President, International Sales, Austal) provided the following overall assessment of Australia's defence export promotion:

If we compare Australia with the likes of the UK and the other European countries, we would appear to be very behind in the way that the services actually support export activity.<sup>32</sup>

5.38 The Export Council of Australia submitted that competitors 'send high-level government officials, even the President or Prime Minister' to meetings to support companies.<sup>33</sup>

5.39 Mr Chris Burns (CEO Defence Teaming Centre) stated that while working as Australian Defence Attaché in the Philippines, his 'fellow attachés from other countries actively informed, lobbied for and supported their nation's defence industries'.<sup>34</sup> Mr Gerard Ogden (Head of Marketing and Sales, SAAB Australia Pty) stated that many other countries' defence attachés fulfil a role supporting defence industry opportunities.<sup>35</sup> The possible utilisation of Australian defence attaches is discussed separately in chapter three.

5.40 Mr Chris Burns (CEO, Defence Teaming Centre) explained:

Our defence attachés have unique insights into what might generally be available for Australian defence industry to compete for. My frustration was often exacerbated by the fact that my fellow attaches from other countries actively informed, lobbied for and supported their nation's defence industries. Our defence industry would greatly appreciate greater support from our defence diplomats on the ground in pursuing export opportunities.<sup>36</sup>

5.41 Mr Robert Forbes (Commercial Director, CEA Technologies Pty Ltd) said that using attachés could be beneficial:

We find that there is a mixed interest in defence industry sales within the Defence attachés, but they are potentially a very valuable resource and on quite a few occasions have been valuable resources. They can do the things that Austrade does in the more generalist environment, except they have better contacts because they are always dealing with your potential customer.<sup>37</sup>

5.42 ASPI's submission stated:

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32 Shiner, *Committee Hansard*, 13 February 2015, p.30.

33 Export Council of Australia, *Submission 27*, p.3.

34 Burns and Taylor, *Committee Hansard*, 9 October 2014, p.14.

35 Ogden, *Committee Hansard*, 10 October 2014, pp.4-5.

36 Burns and Taylor, *Committee Hansard*, 9 October 2014, p.14.

37 Davis and Forbes, *Committee Hansard*, 28 October 2014, p.8.

Defence attachés and other Defence officials overseas should have the requirement to support export facilitation written into the statement of work objectives.<sup>38</sup>

5.43 Aspen Medical suggested that senior government and Defence officials could advocate by providing references, recommendations or referrals during visits overseas or when foreign delegations visit Australia.<sup>39</sup>

5.44 Defence advised that the role of defence attachés does not currently include assisting foreign governments fulfil their capability shortfalls<sup>40</sup> and have a 'limited' role as lobbyists.<sup>41</sup> Nevertheless, Mr Scott Dewar (First Assistant Secretary, International Policy Division, Department of Defence) said:

I would also say in that sense that defence attachés also, when we have delegations visiting or Team Defence Australia, obviously play a role in supporting those things – those delegations. In terms of being able to facilitate meetings and so on – definitely. Identifying capability and other opportunities is something that depends a lot on the market and the particular circumstances.<sup>42</sup>

5.45 Defence advised the Committee that information provided to attachés in the past (prior to commencing their post) has included a presentation from the Australian Military Sales Office; Defence indicated that it intends to revive this practice in 2015.<sup>43</sup> Further:

In relation to Team Defence Australia activities alone, it is noted that since 2007 TDA has assisted 288 defence industry companies to secure export contracts for defence capabilities and technologies to the value of approximately \$785 million.<sup>44</sup>

## Trade shows

5.46 Witnesses said that the presence of uniformed ADF personnel alongside Australian products at exhibitions and trade fairs has been advantageous and encouraged this practice to continue in an expanded form.

5.47 Mr Dean Rosenfield (Managing Director, Saab Australia) said:

...we had the combat system operators from *HMAS Perth* sitting behind our consoles with our principal warfare officer there

38 ASPI, *Submission 20*, p.4.

39 Aspen Medical, *Submission 37*, pp.3-4.

40 Birrer et al, *Committee Hansard*, 24 March 2015, p.11.

41 Department of Defence, *Response to Questions on Notice* (Question No. 18).

42 Birrer et al, *Committee Hansard*, 24 March 2015, p.11.

43 Department of Defence, *Response to Questions on Notice* (Question No. 2).

44 Department of Defence, *Response to Questions on Notice* (Question No. 17).

talking to our potential customers. The incredible sway that that brings to industry, and Australian industry in particular, is that we now have an endorsement from the user, and the user talking to other users.<sup>45</sup>

5.48 Mr Gerard Ogden (Head of Marketing Sales, Saab Australia) added:

We would not advocate that Navy put people on our stand against other competition, but if you are in contract and you have delivered and the government sees it then the reference ability of Australia as a customer is a great asset for us when we are marketing around the world.<sup>46</sup>

5.49 Thales Australia submitted:

The value of users from the Australian Defence Force who can demonstrate and brief interested buyers on the range of equipment and technologies employed by our individual services can never be underestimated. ... At present there are still significant approvals and other impediments to releasing equipment and personnel to attend commercial sales activities, which could be relaxed or fast tracked if supported by government mandate.<sup>47</sup>

5.50 Saab Australia submitted:

Saab believes the government should establish policy and a mechanism which permits Defence personnel to actively engage in support of Australian defence industry.<sup>48</sup>

5.51 Mr Michael Halloran (Managing Director, Supacat Pty Ltd) said:

I think it should be a whole-of-government operation. We have been quite successful using Austrade. We have been quite successful just making contact with Defence attachés and picking their brains for local knowledge. That is very useful to us. But I do not think you can ask Defence as a department to take on the role of selling. I mentioned in my submission that different countries have different cultures in defence. Ours is very professional – Defence is focused on defence. That is fine. I am not making a judgement on that. But I think to ask them to then go and sell would not have a good outcome.<sup>49</sup>

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45 Giulinn, Ogden and Rosenfield, *Committee Hansard*, 10 October 2014, p.4.

46 Giulinn, Ogden and Rosenfield, *Committee Hansard*, 10 October 2014, p.8.

47 Thales Australia, *Submission 19*, pp.8-9.

48 Saab Australia, *Submission 10*, p.7.

49 Halloran, *Committee Hansard*, 31 October 2014, p.9.

5.52 Mr Rohan Stocker (CEO, Marand Precision Engineering Pty Ltd) said:

We do not expect the government to do the sales and the business development for us, but we do appreciate it when there is help and support in that area. There are opportunities and doors that can be opened by the government that we cannot necessarily open ourselves.<sup>50</sup>

5.53 Mr Andrew Hudson (Director and Chair - Trade Policy Committee, Export Council of Australia) said:

I think one of the concerns parties have is that the engagement is inconsistent – that, when there is a trade show or similar, there is still a sense that each of the individual exporters is on their own, so to speak; and, even for those who get a level of ‘Team Australia’ support, it is not as comprehensive or as organised as it might be.<sup>51</sup>

5.54 The Defence Teaming Centre’s submission suggested appointing a ‘Defence Industry Advocate’ with industry experience and who would be ‘afforded a non-executive role in the Defence leadership group.’<sup>52</sup>

## Ministerial advocacy

5.55 Use of government ministers was also suggested as a way to promote Australian defence exporters. BAE Systems submitted:

Most other nations use ministers and eminent personalities to promote their Defence exports. ... Australian Government ministers are effective in promoting trade through personal involvement in free trade agreements and the like but rarely actively intervene to promote Defence exports.<sup>53</sup>

5.56 Mr Merv Davis (CEO, CEA Technologies Pty Ltd) said that in his experience, when made available, ministerial and departmental support had made a valuable contribution:

CEA is very innovative and has benefited from an effective relationship with the Department of Defence now for many, many years. We operate within what is referred to as the high-frequency and phased array radar priority industry capability, and as such we deliver critically important capability – capability that is world leading in terms of its capability and cost. Notwithstanding CEA’s

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50 Stocker, *Committee Hansard*, 31 October 2014, p.29.

51 Hudson, *Committee Hansard*, 31 October 2014, p.35.

52 Defence Teaming Centre, *Submission 6*, p.3.

53 BAE Systems, *Submission 3*, p.4.

significant investment, ministerial and departmental support has been critical to our development and our success.<sup>54</sup>

5.57 Mr Davis added:

DMO and Navy support throughout that program and in subsequent activities, including ship visits to allied countries, facilitating allied naval personnel visits during capability demonstrations, providing personnel support to demonstrations in the US and elsewhere, and supporting capability in technical interchanges with allies, has enabled our capabilities to be showcased.<sup>55</sup>

5.58 In contrast, the Export Council of Australia's submission noted the 'lack of high-level Government support' for defence exports and suggested 'a greater commitment by ministerial and diplomatic representatives'.<sup>56</sup>

5.59 ASPI's submission stated:

This lacklustre performance starts at the political level, where ministers tend to avoid any systematic involvement in export promotion work. Why that should be the case is a puzzle, because Australia has a good story to tell about its defence industry.<sup>57</sup>

5.60 ASPI recommended that the Minister Assisting the Minister for Defence should have 'particular responsibility for defence export promotion.'<sup>58</sup>

5.61 During the inquiry, the Committee was advised that sponsorship and advocacy efforts are greatly enhanced when product performance can be demonstrated through past sales to the Australian Defence Force.

## Importance of selling to the ADF

5.62 A number of submissions and witnesses argued that for prospective defence exporters, establishing business reputation and credibility often begins with having a successful record of interaction with the Australian Defence Force. The Committee was informed that for international customers, this factor is regarded as an assurance of product performance.

5.63 Dr Rowan Gilmore (CEO, EM Solutions Pty Ltd) stated:

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54 Davis and Forbes, *Committee Hansard*, 28 October 2014, p.1.

55 Davis and Forbes, *Committee Hansard*, 28 October 2014, p.1.

56 Export Council of Australia, *Submission 27*, p.3.

57 ASPI, *Submission 20*, p.3.

58 ASPI, *Submission 20*, p.3.

If there is a silver bullet, it is surely that if the local Department of Defence shows enthusiasm for that product or service, demonstrably through its own procurement, then the path to exports is immeasurably simpler.<sup>59</sup>

5.64 Mrs Sue Smith (Executive Officer, Australian Industry and Defence Network Inc) said:

Without the credibility of supplying the ADF, it is extremely difficult to convince offshore purchasers that they should be using your product, even if it is state of the art, innovative and leading edge.<sup>60</sup>

5.65 Mr Chris Burns (CEO, Defence Teaming Centre) said:

The first question a foreign company asks an Australian defence industry company when it is considering importing their products is: does your Defence Force use your products? If the answer is no, a very, very short conversation follows. In order to be considered to export, a nation's defence industry must have global credibility. It is difficult to generate that credibility when the government does not support that industry.<sup>61</sup>

5.66 Mr David Shiner (Vice President International Sales, Austal) said:

For us one of the major benefits, or a point that is of interest to all our offshore clients, is the fact that our current domestic defence customers are using that particular product.<sup>62</sup>

5.67 He said that a recommendation from an existing end-user, such as the Australian Navy, is a 'highly sought recommendation.'<sup>63</sup>

5.68 Mr Mike Lovell (Director, Operations and Integration, Northrop Grumman Australia) said that the 'pre-condition to exporting something is that it has to be in service with the ADF.'<sup>64</sup> He said:

The ADF, while it is small, is seen as a smart buyer. It does not buy dud technology and does remarkably good things with that technology. So we think that a key thing, if you want us to be able to export, is to buy Australian defence innovations.<sup>65</sup>

5.69 Northrop Grumman's submission stated:

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59 Gilmore, *Committee Hansard*, 17 October 2014, p.35.

60 Smith, *Committee Hansard*, 31 October 2014, p.39.

61 Burns and Taylor, *Committee Hansard*, 9 October 2014, p.13.

62 Shiner, *Committee Hansard*, 13 February 2015, p.28.

63 Shiner, *Committee Hansard*, 13 February 2015, p.28.

64 Lovell, *Committee Hansard*, 13 February 2015, p.40.

65 Lovell, *Committee Hansard*, 13 February 2015, pp.41-42.

Australia is unlikely to improve its defence industry export position without the development and sustainment of a strong a growing local industrial base (both from Primes and SMEs) achieved largely through participation in domestic defence acquisition and sustainment programs.<sup>66</sup>

- 5.70 Mr Brendhan Egan (Director General, Business Services and Reform, Department of Defence) was asked why Defence may or may not endorse an Australian product. He said:

In some cases it is because the particular application does not fit what we are looking for. There are examples I have seen where there is something that is perfectly good, but we may have a different capability need to that particular product. It does not mean that we do not think it is good.<sup>67</sup>

- 5.71 The Committee subsequently sought Defence's views on the specific proposition that exporting is difficult unless a company has previously sold products to the ADF. Defence advised:

Anecdotal evidence from industry suggests that it can sometimes be more difficult for Australian defence manufacturers to sell into export markets without first selling to the ADF. Procurement decisions are made foremost on the basis of supporting the capability needs of Defence and delivering value for money, whilst at the same time seeking to maximise opportunities for Australian industry.<sup>68</sup>

- 5.72 The Committee has considered a range of viewpoints of Government support for the defence industry in relation to comparable countries and numerous the barriers growing defence exports. The Committee's views and recommendations below are applicable to chapters three, four and five.

## Committee comment

- 5.73 Gaining access to defence export markets is particularly challenging given levels of competition and the efforts of some foreign governments to protect and subsidise their local industries. Nonetheless, in this context, Australian Government support or endorsement could overcome the challenges of the global market and lead to successful export relationships.

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66 Northrop Grumman, *Submission 28*, p.6.

67 Birrer et al, *Committee Hansard*, 24 March 2015, p.10.

68 Department of Defence, *Response to Questions on Notice* (Question No. 19).

- 5.74 Australia's policy framework for defence exports should be categorised into core and secondary areas of export focus, depending on the relationship with fundamental inputs to capability:
- Core export focus would apply to elements of industry output recognised as a fundamental input to capability, where defence exports can help sustain or spread production costs. In this case, Government should provide direct assistance. Research and development support (for instance, from models based on the Defence Material and Technology Centre and Defence Science and Technology Group) should align with this objective.
  - Secondary export focus would apply to those elements of industry output not recognised as a fundamental input to capability. Defence should assist where this is practicable, along with other agencies such as EFIC and Austrade.
- 5.75 The Committee welcomes the benefits derived from the Global Supply Chain program described in Chapter 3. Nevertheless, involvement in projects that generate work by building to print should be distinguished from projects that generate intellectual property within Australia. For reasons previously explained in this report, development of intellectual property is the foundation upon which exports may eventually follow. Support for individual exports – market advice, contractual guarantees and finance – may then be applied. The ability of SMEs to do business with Defence needs to be enhanced, particularly given the intention to recognise industry as a fundamental input to capability in the 2015 Defence White Paper.
- 5.76 Assessing the support available to defence exports in other countries revealed some points of interest and distinction, when compared with Australian practices.
- 5.77 Australia is not alone in having its industry policy based on competitiveness and innovation, although some countries appear to give greater weight to sovereign interests. The UK has recognised their defence industry as a strategic asset and its policies indicate a preparedness to retain sovereign control over key capabilities. Canada implements its policy positions through rigorous independent oversight of procurement and to a greater extent than occurs in Australia. The US has traditionally applied protectionist measures, although this position may gradually be relaxed.
- 5.78 Additionally, other countries appear to have ensured there is separation and independence between government entities responsible for defence export regulation and defence export promotion. In Australia, regulatory and promotion functions are largely carried out by the Department of



Defence. The Committee is satisfied that defence exports promotion and defence exports regulation can remain within Defence, provided the two functions remain separate.

- 5.79 The Committee was impressed with the UK and Canadian approaches and believes that Australia could emulate relevant aspects:
- Canada's Export Strategy for Defence Procurement; and
  - The UK's approach to complex weapons procurement;
  - The UK's promotion activities and their use of military personnel at trade shows and events.
- 5.80 In general, Australian Government support for defence exporters was described as having fallen behind our competitors. Witnesses and submissions viewed other countries as being more active, particularly by harnessing their government ministers, senior defence officials and defence attachés as interlocutors for exports promotion. One option to achieve these standards would be to enhance the role of the Australian Military Sales Office to include implementing a future defence exports strategy.
- 5.81 Greater support is needed for the promotion of Australian defence exports in three ways:
- The presence of suitable ADF personnel at trade shows alongside the defence industry with Australian products. These personnel should be appropriately briefed before the event and understand the relevance of their role;
  - Use of defence attachés at diplomatic posts to initiate discussions with foreign governments and, where appropriate, promote Australian products. Defence attachés' training and preparation should include mandatory familiarisation, and understanding of, the Australian defence industry; and
  - Ministerial advocacy on behalf of defence exporters and ministerial assistance with government-to-government sales agreements.
- 5.82 The Committee does not envisage having ADF personnel or defence attachés assigned to roles that are solely related sales or exports promotion. Nevertheless, Defence attachés should give advice to industry on export opportunities and initiate discussions with governments regarding potential sales from Australia. In addition, defence attachés should provide information and feedback on performance to Australian industry via the Australian Military Sales Office.
- 5.83 Lastly, the Committee agrees that the credibility and sustainability of the domestic defence industry is impaired and long-term ADF capability placed at potential risk when Defence decides not to use domestic

suppliers for FIC-related acquisition. Recognition of the defence industry as a fundamental input to capability, however, ought to place more emphasis on ensuring industry impacts are considered when Defence makes decisions on acquisition and sustainment options.

## Recommendations

### Recommendation 12

The Committee recommends that defence export assistance efforts be prioritised based on a distinction between areas of core and secondary export focus:

- Core export focus would apply to elements of industry output recognised as a fundamental input to capability (FIC), where defence exports can help sustain or spread production costs. This support should extend to funding for research and development that supports exports that will have an impact on the associated FIC; and
- Secondary export focus would apply to those elements of industry output not recognised as a FIC. In such cases, Defence and other related agencies should provide assistance where practicable.

### Recommendation 13

The Committee recommends that the Australian Government develop a defence exports strategy and the Department of Defence expand the role of the Australian Military Sales Office to include implementing the objectives of this strategy, based upon the defence industry as a fundamental input to capability.

**Recommendation 14**

The Committee recommends that the Department of Defence task appropriate Australian Defence Force personnel to assist at trade shows or exhibitions, alongside defence industry participants, to inform and advise foreign customers of the Australian Defence Force's experience using the displayed products.

**Recommendation 15**

The Committee recommends that the Department of Defence revise the roles of defence attachés to include:

- Gathering information relevant to defence export opportunities on behalf of the Australian defence industry;
- Relaying this information to industry, along with other advice on export opportunities and constructive feedback on Australian defence industry performance, via the Australian Military Sales Office;
- Initiating discussions with foreign governments regarding potential military sales from Australia; and
- Where appropriate, the promotion of Australian products.

Further, pre-deployment training for defence attachés should include mandatory familiarisation with, and understanding of, the Australian defence industry.

**Recommendation 16**

The Committee recommends that relevant Government Ministers fulfil a prominent advocacy role on behalf of the Australian defence industry, in particular the Minister for Defence Materiel and Science.

