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Principles and practice – Australian defence industry and exports

Inquiry of the Defence Sub-Committee

Joint Standing Committee on Foreign Affairs, Defence and Trade

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Contents

Foreword	viii
Membership of the Committee	x
Membership of the Defence Sub-Committee.....	xiii
Terms of reference	xvi
List of abbreviations	xvii
Executive summary	xxi
List of recommendations	xxv
1 Introduction	1
Conduct of the Inquiry.....	1
Structure of the report	1
Defence policy and capability planning	2
2 Australian defence industry.....	3
Introduction	3
An overview of the Australian defence industry	4
Australian defence imports and exports	7
Domestic defence sales and Defence's requirements of industry	9
The economic and strategic significance of the Australian defence industry.....	12
Spillover and second order effects of the defence industry.....	15
Australian defence industry policy.....	20
Intellectual property and innovation	26
Defence's procurement decisions.....	32

The Australian Industry Capability and Priority Industry Capability programs.....	38
Defence industry as a fundamental input to capability	45
First Principles Review reforms to capability development.....	48
RAND report - continuous build strategy an example of managing FIC	50
Departmental and ministerial responsibilities for the defence industry	52
Forthcoming White Paper and industry policy statement	53
Implications for defence exports	55
Identifying FIC and alternatives to competition.....	56
Committee comment.....	58
Recommendations	62
3 Defence industry engagement and assistance	65
Introduction	65
Defence industry support programs	66
Global Supply Chain program	71
Austrade and market advice	74
Australian Military Sales Office assistance	76
Access to finance.....	78
4 Export support available in other countries.....	83
Introduction	83
Forms of industry support and protection available in other countries	83
Offsets.....	85
Comparable countries	89
Canada	94
United Kingdom	96
United States	100
5 Barriers and impediments to the growth of Australia’s defence exports ...	107
Introduction	107
International market competition.....	107
Defence industry challenges.....	110
Sponsorship and advocacy.....	113
Defence attachés	114

Trade shows	116
Ministerial advocacy.....	118
Importance of selling to the ADF	119
Committee comment.....	121
Recommendations	124
6 Operations of the Defence Export Control Office	127
Introduction	127
Role and operation of the Defence Export Control Office	129
Regulation of defence exports.....	136
Australian export control law	137
Restrictions on re-export of US technology.....	138
Exports restricted due to temporary sanctions regimes	139
Export pre-approval.....	140
Approval of sensitive exports	142
Areas of possible improvement or reform.....	145
Administrative arrangements.....	145
Communication regarding status of applications.....	146
Complex regulations	149
Risk management	155
Implementation of the <i>Defence Trade Controls Act 2012</i>	160
Committee comment.....	163
Recommendations	164
Appendix A: List of Submissions	167
Appendix B: List of Exhibits	169
Appendix C: Answers to questions on notice.....	171
Appendix D: Witnesses who appeared at public hearings	173
Appendix E: Extracts of the United Kingdom's 'Defence Industrial Strategy: Defence White Paper' (December 2005).....	179

Appendix F: Extracts from 2009 contract between the United Kingdom Secretary of State for Defence and BVT Surface Fleet Ltd.....201

LIST OF TABLES

Table 2.1	Top defence contractors and small/medium enterprises in Australia 2014.....	5
Table 2.2	Leading suppliers of major weapons 2009 to 2013	7
Table 2.3	Leading recipients of major weapons 2009 to 2013	9
Table 4.1	Offset policies in other countries.....	86
Table 4.2	Australia, Canada, UK and US economic and defence industry comparison	91
Table 4.3	Australia, Canada, UK and US defence industry policy comparison.....	92
Table 6.1	Defence Export Control Office assessment process.....	132
Table 6.2	Export applications related to Regulation 13E	133
Table 6.3	Export applications related to the Defence Trade Controls Act	133
Table 6.4	Export assessments related to WMD Act and MEU provisions	133
Table 6.5	Percentage of export applications processed within 15 working days	134
Table 6.6	Overview of Australian Government export control legislative responsibilities	146
Table 6.7	Number of export applications received and rejected or denied	149

LIST OF FIGURES

Figure 1	Defence acquisition and exports framework.....	xxiv
Figure 3.1	Overview of departments and agencies involved in defence industry exports.....	70
Figure 3.2	EFIC finance to exporters.....	79



Foreword

The conduct of this inquiry highlighted, yet again, the yawning gap between many elements of Defence industry policy and its implementation as experienced by Australia's defence industry sector. The Committee's comments in Chapter two and the associated appendices outline an approach that will lead to a far more strategic partnership between Defence and industry.


The Committee's starting point was accepting the evidence provided during this inquiry – and validated by recommendations of the First Principles Review – that elements of defence industry are essential to Australian Defence Force capability. Defence therefore has an interest, indeed an obligation to identify elements in industry that are fundamental inputs to capability (FIC) and then to use available means – including domestic procurement programs and support for exports – to enhance and sustain them.

This will need a new approach to identifying and managing risk, and an acceptance that for complex systems, value for money may be found more often in long term partnerships than through ongoing, open competition. Where elements of industry are identified as being FIC, programs that encourage research and development that leads to intellectual property and a path to commercialisation should be funded as a priority. The Defence Material Technology Centre model is one existing example that should be expanded into other technology areas to help achieve this goal.

In summary, support for defence exports – where they assist to sustain or develop industry elements that are identified as FIC – should be viewed as a core Defence responsibility in the same way as the services manage other FIC elements including training, personnel plans, facilities and doctrine development.

I commend this report to the reader and thank the many witnesses who gave time and effort to inform the deliberations of the Committee.

Senator David Fawcett
Chair
Defence Sub-Committee



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Terms of reference

The Joint Standing Committee on Foreign Affairs, Defence and Trade shall inquire into and report on Government support for Australian Defence industry exports, having particular regard to:

1. Identification of barriers and impediments to the growth of Australia's Defence exports;
2. How Government can better engage and assist Australian Defence industry to export its products;
3. The operations of the Defence Export Control Office;
4. Assessment of the export support given to Defence industry by governments of comparable nations; and
5. Any other related matters.



List of abbreviations

ABDI	Australian Business Defence Industry
ACB	Arms Control Branch
ACBPS	Australian Customs & Border Protections Service
ADF	Australian Defence Force
ADJR	<i>Administrative Decisions (Judicial Review) Act 1977 (Cth)</i>
AG	Australia Group
AGDESF	Australian Government Defence Export Support Forum
AIC	Australian Industry Capability
AIDN	Australian Industry and Defence Network
AIG	Australian Industry Group [Defence Council]
AMSO	Australian Military Sales Office
AMWU	Australian Manufacturing Workers Union
ANAO	Australian National Audit Office
ASC	Australian Submarine Corporation
ASPI	Australian Strategic Policy Institute
AUSTRADE	Australian Trade Commission
CASG	Capability Acquisition and Sustainment Group

CDG	Capability Development Group
CPR	Commonwealth Procurement Rules
CSIRO	Commonwealth Scientific and Industrial Research Organisation
CTD	Capability and Technology Demonstrator
DCP	Defence Capability Plan (Note: DCP is also used to refer to the Defence Cooperation Program)
DECO	Defence Export Control Office
DEU	Defence Export Unit
DFAT	Department of Foreign Affairs and Trade
DIIC	Defence industry Innovation Centre
DIPS	Defence Industry Policy Statement
DIRF	Defence Innovation Realisation Fund
DMO	Defence Materiel Organisation
DLTP	Defence Logistic Transformation Program
DMTC	Defence Materials Technology Centre
DPPM	Defence Procurement Policy Manual
DSGL	Defence and Strategic Goods List
DSTG	Defence Science and Technology Group (formerly DSTO)
DSTO	Defence Science and Technology Organisation
DTC	Defence Teaming Centre
DTCA	<i>Defence Trade Controls Act 2012 (Cth)</i>
EFIC	Export Finance and Insurance Corporation
FIC	Fundamental Input to Capability
FMS	Foreign Military Sales

FPR	First Principles Review
GAO	Government Accountability Office (United States)
GDP	Gross Domestic Product
GSC	Global Supply Chain
IP	Intellectual Property
ISPE	Industry Skilling Program Enhancement
ITAR	International Traffic in Arms Regulations (United States)
JSF	Lockheed Martin F-35 Joint Strike Fighter
MEU	Military End User
MTCR	Missile Technology Control Regime
NACC-ISP	New Air Combat Capability – Industry Support Program
NSC	National Security Committee
NSG	Nuclear Suppliers Group
OEM	Original Equipment Manufacturer
PICs	Priority Industry Capabilities
PICDF	Priority Industry Capability Development Fund
R & D	Research and Development
RPDE	Rapid Prototyping Development and Evaluation
SADI	Skilling Australia Defence Industry
SICs	Strategic Industry Capabilities
SIDCDE	Standing Interdepartmental Committee on Defence Exports
SIPRI	Stockholm International Peace Research Institute
SME	Small to Medium Enterprise
TDA	Team Defence Australia

UKTI DSO	United Kingdom Trade and Investment Defence Security Organisation
UNSC	United Nations Security Council
VFM	Value for Money
WA	Wassenaar Arrangement
WMD	Weapons of Mass Destruction
WP	White Paper



Executive summary

The terms of reference for this inquiry required the Committee to consider whether it was in the national interest for the taxpayer, via Defence, to fund additional¹ measures to help Australian defence industry export products and services. Evidence to the Committee made it clear that attempts to do this in the past have not generally been seen as core Defence business, reflecting the culture that “the Defence budget is to equip Defence, not to support industry”.

Evidence to the Committee also showed that, with a few exceptions, there was a strong relationship between export potential and a sustainable domestic capacity to design, manufacture and support defence materiel. The cost-benefit of enhanced support for export could therefore only be made in the context of policies governing the relationship between Defence and the domestic defence industry sector in matters of capability development, acquisition and sustainment.

Defence engagement with domestic industry has largely been defined by a combination of acquisition practices and Defence industry policy which have a chequered history of coordination and implementation in Australia. The practical effect of these two policy areas has tended to please neither those who want to acquire equipment off-the-shelf at the lowest possible price nor those who wish to use the investment in Defence to create Australian jobs.

In the Committee’s view, neither of those outcomes are the appropriate measures to assess value in the strategic relationship between Defence and Defence industry. The Committee formed this view on the basis of evidence – supported

1 Government already helps facilitate exports from many business sectors through programs operated by the Department of Industry.

by the First Principles Review – that some elements of defence industry are in fact fundamentally important to the operational and materiel support of complex equipment used by Defence. Rather than remaining at arm’s length from industry, the Committee supports the notion that Defence has an interest, indeed an obligation, to adjust its capability development and procurement policies to work with industry to identify, and then help sustain, those elements that represent fundamental inputs to capability (FIC).

In the Committee’s view, this fundamentally changes how the assessment of value-for-money should be approached and then leads to three discrete procurement priorities.

The assessment of value-for-money should take into account:

- The extent to which the procurement helps sustain a FIC element of industry;
- The whole-of-life costs and benefits, including second order effects (where appropriate);²
- The value added by contractual models that allow for long term partnerships to drive productivity, innovation and efficiency instead of a default reliance on competition throughout the life of any given capability.

This approach to assessing value-for-money should be applied across three procurement streams that reflect a more strategic approach being:

- A primary focus in acquisition and industry policy that identifies and sustains (through carefully programmed procurement) the sub-set of the domestic defence industry sector that provides key enabling inputs to Australian Defence capability.³ This ties in closely with the First Principles Review recommendation for defence industry to be regarded as a fundamental input to capability (procurement stream A);
- A secondary focus – recognising that overseas suppliers will continue to provide many of the complex platforms/systems used by Defence – to use

2 The Committee accepts evidence that not all Defence acquisition will deliver second order benefit to the Australian economy. There is however evidence that complex procurement activity generates new IP and productive capacity that does generate measurable economic benefit that should be assessed.

3 The United Kingdom Ministry of Defence has recently conducted analysis of whole industry sectors that produce complex systems for the UK to determine (down to identifying specific trades and areas of technology) which elements of defence industry have a bearing on their sovereign ability to acquire, sustain and operate complex military equipment. Australia could draw on this approach as well as similar Australian work (eg: Rizzo, Blueprint 2020, RAND Submarine Design Capabilities and Capacities) to help identify FIC.

Defence procurement processes (including contractual arrangements and strategic partnerships) to develop and retain the technical expertise within Defence and Australian industry that allows Australia to be a smart buyer, capable of making informed decisions about the military capability it purchases and then operates (procurement stream C); and

- A tertiary approach – still using the evolved consideration of value for money – that covers those contracts where no FIC or smart buyer considerations apply (procurement stream B).

This framework more clearly defines those areas where it is demonstrably in the national interest for the taxpayer to be funding additional measures to support defence exports. Where an element of the local industry represents a FIC, Defence should make it a priority to support any export opportunity that will help make that industry sector more commercially sustainable and increase the potential – including to Australia’s defence community – of relevant products, services, capacity, competence or intellectual property.

This framework is shown in figure 1.

The First Principles Review has articulated clearly that Defence capability managers have an obligation to ensure that the subset of industry elements that form fundamental inputs to Defence capability remain available and in fact develop along with best practice. In the Australian context, Service Chiefs as Capability Managers are responsible to ensure FIC are effective and sustainable.

The Service Chiefs and Capability Acquisition and Sustainment Group (CASG) therefore have an obligation to oversee a change in both culture and policy that makes identification, development and maintenance of both FIC and smart buyer competence (which often overlap) a priority. This will require an integrated acquisition and industry policy that enables innovation and promotes the development of sustainable industrial capacity in key sectors. Because intellectual property, design and engineering competence as well as manufacturing capacity all take time to develop, constancy of work is essential if personnel are to become competent and industry to remain viable. Defence should work with industry to achieve this across a portfolio of acquisition activities rather than the basis of individual projects. Defence exports are in effect part of the portfolio of activities that can assist industry to remain viable.

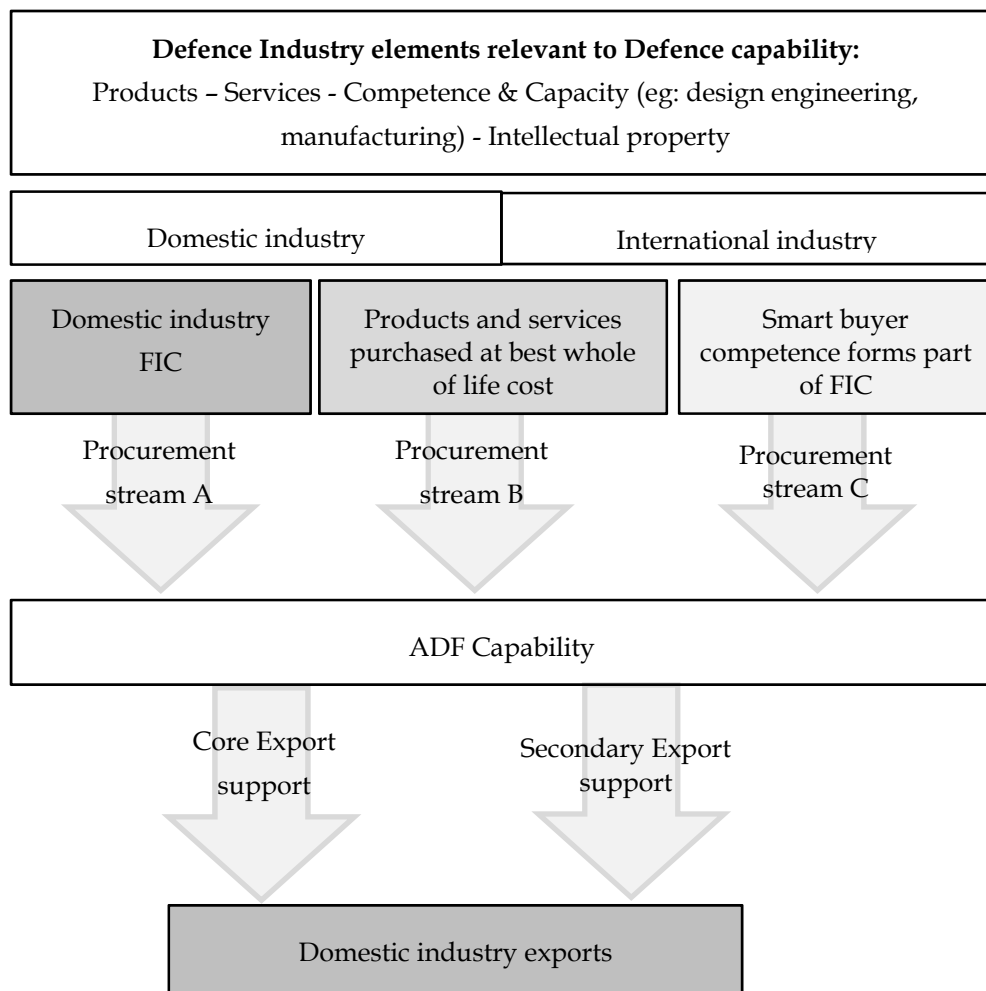
As Defence evolves its policy and culture in respect to industry engagement based on using procurement to sustain FIC, existing programs such as the Priority and Strategic Industry Capabilities (PIC and SIC) should be phased out. For non FIC

acquisition, tender rules requiring global primes to involve Australian industry through the Australian Industry Capability program (AIC) may still be applicable as could participation in the Global Supply Chain program.

Priority export support could include funds to support R&D and the development of Intellectual Property (IP) in FIC related areas. Greater funding for cooperative engagement models such as the Defence Materials Technology Centre (DMTC) should assist commercialisation of products for domestic use or export where they are considered to help sustain FIC. Defence support should also include support at trade shows (including overt advocacy by ADF personnel), utilising defence attachés at foreign diplomatic posts to identify and exploit export opportunities. Ministerial advocacy would also be appropriate for priority exports which help sustain FIC.

For non FIC related exports, existing Government programs (eg: Austrade and EFIC) should be continued, as should low cost, opportunity based support where feasible for exports.

Figure 1 Defence acquisition and exports framework





List of recommendations

2 Australian defence industry

Recommendation 1

The Committee recommends that the Department of Defence incorporate into policy, doctrine, procurement instructions and all associated training the addition of defence industry as the ninth fundamental input to capability.

Recommendation 2

The Committee recommends that the Department of Defence build on previous activities in Australia and abroad to develop a system to identify those elements of industrial competence or capacity that are deemed to be fundamental inputs to ADF capability (FIC). This activity should be led by the Service Chiefs and implemented by Capability, Acquisition and Sustainment Group at a strategic level with an assessment of how each new significant project may change the assessment of FIC or indeed could contribute to the maintenance of FIC from a whole of program perspective.

Recommendation 3

The Committee recommends that when implementing the First Principles Review changes to roles and responsibilities, capability development, procurement and sustainment, Defence take into account the framework for industry engagement based around the fundamental inputs to capability illustrated in Figure 1.

Recommendation 4

The Committee recommends that in areas where an aspect of industry is identified as a fundamental input to capability, Defence's procurement and probity guidelines provide suitable pathways for long term partnerships to be the default approach to driving innovation,

productivity and value for money rather than a primary focus on open competition. Defence should publicly report savings achieved by virtue of this revised approach to procurement.

Recommendation 5

The Committee recommends that where a procurement activity is linked to a fundamental input to capability, the Department of Defence develop guidelines that encourage identification and management of risk rather than avoidance of risk through defaulting to an offshore contract.

Recommendation 6

The Committee recommends that the Department of Defence significantly expand its investment in activities that generate fundamental input to capability-related innovation and intellectual property, and support commercialisation through partnership models such as the Defence Materials Technology Centre.

Recommendation 7

The Committee recommends that where an industry-related fundamental input to capability has been identified, the Department of Defence prioritise Australian based procurement contracts so that relevant industry and Defence staff can develop competence in specific tasks via hands-on experience, or where this is not possible, through making the placement of Australian staff in original equipment manufacturers or foreign military engineering bodies a condition of contract.

Recommendation 8

Subject to acceptance of Recommendations 1-7, the Committee recommends that the Department of Defence discontinue the Priority Industry Capability and Strategic Industry Capability programs, retain the Australian Industry Capability targets for procurement activity that do not involve an identified fundamental input to capability and continue to promote the Global Supply Chain scheme wherever possible.

Recommendation 9

The Committee recommends that the Department of Defence increase the level of support to defence exports where such exports will help sustain or develop a fundamental input to capability.

Recommendation 10

The Committee recommends that the Minister for Defence Materiel and Science have responsibility for how the capability development, procurement and sustainment systems work, the investment in fundamental input to capability-related innovation and export

opportunities including an increased focus on Government to Government sales.

Recommendation 11

The Committee recommends that Defence develop performance measures relevant to the management of the defence industry as a fundamental input to capability and publicly report the outcomes.

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

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.

6 Operations of the Defence Export Control Office

Recommendation 17

The Committee recommends that the Department of Defence enhance the existing risk-based approach to assessing applications to export materiel and technology subject to Australian export control laws.

Recommendation 18

The Committee recommends that the Defence Export Control Office improve the defence export approval process by:

- Providing timely updates to applicants on the status of their application;
- Ensuring information regarding regulatory change is promptly communicated to relevant stakeholders;
- Allowing export licences to be valid for longer periods;
- Introducing a simplified process for renewal where approval expires; and
- Managing this process depending on the risks in each case.

Recommendation 19

The Committee recommends that the Department of Defence publicly report the Defence Export Control Office's budget, expenditure, numbers of applications processed and overall performance on an annual basis.