

Chapter 8

Australian industry involvement

8.1 Defence recently released its *Defence Issues Paper 2014* in which it recognised its reliance on Defence industry 'to supply and maintain the equipment required for military operations', which, it reasoned, 'necessitates a robust in-country industrial base'.¹ The paper also noted the present day pressures on the industry and the need for government to make decisions about supporting this industry and setting priorities within budgetary constraints. With regard to the maritime sector, it stated clearly that the government wanted to see shipbuilding continue in Australia, but not at any cost. In this chapter, the committee looks at the government's decision to undertake a limited tender for the supply ships and its implications for Australia's local shipbuilding industry.

Australia's Defence industry policy

8.2 In 2010, Defence released a new defence industry policy for a 'smarter and more agile Defence industry base'. It recognised the vital contribution that the industry makes to Australia's defence and security. The policy statement had four key elements whereby the government:

- sets clear priorities that encourage investment;
- commits to establish a stronger relationship between Defence and industry;
- seeks to increase opportunities for Australia's defence industry to identify and make the most of business opportunities within Australia and overseas; and
- places a high priority on removing barriers to the growth of local firms by giving Australian companies the opportunity to compete for, and win, work in Australia and global procurement programs based on their merits.²

8.3 The policy also made clear that Defence had expectations of defence industry which, it stated, 'must become more resilient and self-reliant if it is to prosper and grow in the future'.³ The 2013 White Paper similarly recognised the importance of Australia having a skilled, efficient and competitive industry to support Defence and that the industry needed backing in order to develop the skills required. It stated:

While building new skills within the maritime sector is important, it is equally important to maintain the skill level of the existing maritime

1 Department of Defence, *Defence Issues Paper 2014*, a discussion paper to inform the 2015 Defence White Paper, p. 23.

2 Department of Defence, *Building Defence Capability: A Policy for a Smarter and More Agile Defence Industry Base*, 2010, pp. 7–8.

3 Department of Defence, *Building Defence Capability: A Policy for a Smarter and More Agile Defence Industry Base*, 2010, p. 9.

workforce. The Government is committed to a program of naval shipbuilding that will ensure that the skills developed during construction of the Air Warfare Destroyers and Landing Helicopter Dock ships will be available to be applied to the Future Submarine Program and Defence's broader long-term needs. To do otherwise would result in a later delivery of the future submarines at a higher cost than is necessary, thereby resulting in a loss of capability for the ADF.⁴

8.4 In 2013, before being elected to government, the Coalition gave its commitment to supporting local defence industry:

Consistent with getting best value for the taxpayer, and effective and sustainable capability for the ADF, a Coalition government intends that the ADF be equipped by Australian-made goods wherever possible.⁵

8.5 The Coalition's intention was not to implement any local content requirements but to make clear that Australian businesses 'should be given every opportunity to compete for Defence contracts'.⁶ In its policy statement on Defence, the Coalition indicated that it would work with the Australian defence industry 'to avoid production troughs by co-operating closely with companies, big and small, to provide consistency, continuity and a long-term focus to the purchase and sustainment of defence capabilities'.⁷

Industry's interpretation of the decision to tender for the supply ships

8.6 Some in the defence industry, however, interpreted the decision to conduct a limited tender for the supply ships as a slight to local shipyards. Mr Andrew Fletcher informed the committee that the South Australian state government was not consulted prior to the announcement to tender for the replenishment vessels.⁸

8.7 Similarly, Mr Hamilton-Smith informed the committee that the decision was unexpected. He explained that the South Australian government was aware of the argument that the supply ships, by their nature, were less complex than submarines and air warfare destroyers and that an overseas build could be put forward. According to Mr Hamilton-Smith, the South Australian government believed that industry based in the state could take carriage of the project, but just 'needed to have notice and get

4 Department of Defence, *Defence White Paper 2013*, paragraph 12.54, http://www.defence.gov.au/whitepaper2013/docs/WP_2013_web.pdf (accessed 8 August 2014).

5 *The Coalition's Policy for Stronger Defence*, September 2013, p. 7, <http://www.liberal.org.au/our-policies> (accessed 8 August 2014).

6 *The Coalition's Policy for Stronger Defence*, September 2013, p. 7, <http://www.liberal.org.au/our-policies>.

7 *The Coalition's Policy for Stronger Defence*, September 2013, p. 7, <http://www.liberal.org.au/our-policies>.

8 *Committee Hansard*, 21 July 2014, p. 50.

on with the job'. They were 'surprised and disappointed by this decision, suggesting that 'Australian and South Australian workers and businesses are poorer off for it'.⁹

8.8 Mr Burns, ABDI, spoke of an industry that wanted to be recognised and respected for its significant role in the development and delivery of ADF 'military capability and the preservation of the nation's sovereignty'. He referred to an industry that was looking for:

...the opportunity to compete under the construct of holistic whole-of-life benefit to the nation and on a level playing field, where the lowest price is not the determinant of value for money; an industry that would rather collaborate and partner with government and Defence than be subjected to orchestrated campaigns to discredit it in order to justify going offshore to acquire low-risk hardware at the cheapest price.¹⁰

8.9 In his view, successive governments over the last few years have 'left the industry confused'. He suggested that it was an industry that truly questions whether the Australian government or the department wants 'a defence industry at all'. If Defence wants a viable industry then, according to Mr Burns, it 'needs to support and partner with it, to collaborate and deliver military capability'.¹¹ He told the committee that industry was 'extremely disappointed about being excluded'.¹²

8.10 Mr Dunk, Australian Business Defence Industry, also registered industry's concern with the decision. He indicated that the ABDI concurred with the government's stated position that 'defence is not a job creation program'. He also agreed that there could be no doubting that 'the government and the Australian people expect that the tenders will provide value for money'.¹³ In his view, local industry must be 'considered in defence decisions as having value and not just treated as a disposable commodity'. He noted:

Industry capability is easy to dispose of or put into terminal decline but extremely difficult to redevelop should it be required. A more mature way of thinking about the industrial capabilities needed in country and developing, sustaining and supporting them is therefore required. The development of a transparent framework through which these very factors can be considered and the treatment of industry as a fundamental input to capability is required.¹⁴

8.11 To Mr Dunk's mind, the situation with the Navy replenishment ships was basically a manifestation of the failure of government to appreciate the value and

9 *Committee Hansard*, 21 July 2014, p. 50.

10 *Committee Hansard*, 21 July 2014, pp. 40–41.

11 *Committee Hansard*, 21 July 2014, p. 41.

12 *Committee Hansard*, 21 July 2014, p. 41.

13 *Committee Hansard*, 21 July 2014, p. 41.

14 *Committee Hansard*, 21 July 2014, p. 40.

contribution of Australia's defence industry. He suggested that the decision taken on the supply ship was a continuation of the 'repeated inaction on the part of successive governments and the department to a problem that has been well known for an extended time'.¹⁵

8.12 In chapter 6, the committee referred to the need to develop the necessary skills base and know-how to support naval vessels throughout their operational life. This requirement was seen as necessary for security reasons. In the following section, the committee's focus is on retaining these skills.

Valley of death

8.13 There have been a number of people who refer to the potential demise of Australia's naval shipbuilding. For example, the AMWU stated in a recent paper that the naval shipbuilding workforce was facing a 'valley of death'. It noted that current project work ends in three shipyards in 2015: BAE in Melbourne, Forgacs in Newcastle and Austal in Perth'.¹⁶

8.14 The Australian Industry & Defence Network Inc referred to concerns raised by industry representatives about the considerable loss of skills, talent and industrial capability. It noted further in 'some extreme instances the period of low demand may force the closure of infrastructure and facilities supporting the industry'.¹⁷ In this regard, Mr Burns argued that if the supply vessels and the frigates, are not built in Australia the industry will dissipate:

The problem is that in the future you will want to build submarines. You will not be able to take the workforce that maintains the Collins over to build future submarines because the Collins submarines are going to be going for many, many years to come. That workforce will be stressed as it is just keeping the Collins going. You have to build another workforce to build future submarines. If you have lost your shipbuilding capabilities, particularly the management of shipbuilding, you are going to be presented with the situation yet again where you have to build a workforce from scratch that will cost hundreds and hundreds of billions of dollars.¹⁸

8.15 The Government of Victoria acknowledged that while restricting the tender to Spanish and South Korean shipbuilders sent 'a positive signal to these countries on our ongoing engagement with them, the potential negative impact on Australia's local shipbuilding capacities is deep and long-term'. In its view, the Commonwealth

15 *Committee Hansard*, 21 July 2014, p. 41.

16 AMWU, *Australian Naval Shipbuilding: Design, Build & Maintain our ships here*, November 2013, p. 4 and Figure 1, p. 15, http://www.amwu.org.au/content/upload/files/Ships_Campaign_13/AA_AUST_NAVAL_SHIP_BUILDING.pdf (accessed 16 July 2014).

17 *Submission 7*, p. 4.

18 *Committee Hansard*, 21 July 2014, p. 46.

Government has 'an ongoing responsibility to address the potential "valley of death" for Australian shipbuilding that such a decision contributes to'.¹⁹ It highlighted the fact that the Victorian shipbuilding industry had demonstrated its skills and capabilities in design, engineering, fabrication and maintenance of naval vessels over many years, which in turn had brought 'substantial benefits to Defence and the national and state economies'. The Victorian Government noted the need for a commitment to a continuous investment program and continuity of projects in order for Victoria's shipbuilding industry to remain viable. It stated:

For several years the naval shipbuilding industry has been warning the Commonwealth Government (both the current and the previous government) of the pending 'valley of death' in which there is a substantial gap between completion of current naval shipbuilding projects and commencement of major new projects. One impact of this scenario, should it come to fruition, will be substantial job losses. In Victoria the impact on our major naval shipbuilder, BAE Systems, would be the loss of up to 1,000 jobs at the company's Williamstown facility.²⁰

8.16 The *Future Submarine Industry Skills Plan* referred to international examples of where the erosion of skills between projects resulted in 'some very significant cost overruns on subsequent naval projects'. It then cited the recent Australian experience with the AWD and LHD programs and the detriment to the AWD project from having a 'cold start'.²¹ It found:

The problems seen with the current shipbuilding projects in the last few years are the most direct result of having to rebuild Australian shipbuilding given its decline after the ANZAC and Collins projects...shipbuilding projects that start up after any such decline cost more: facilities have to be built or upgraded, and workers have to be recruited and trained. This also leads to schedule delays, cost over-runs, low productivity and issues with production that would have been avoided by an experienced workforce.²²

8.17 The Plan suggested that the best way to maintain experience levels was to employ people in a continuing shipbuilding project. It noted especially the importance of retaining a good number of genuinely experienced shipbuilders at the core of a project.²³

19 *Submission 13*, p. 2.

20 *Submission 13*, p. 2.

21 Department of Defence, *Future Submarine Industry Skills Plan*, March 2013, pp. 31 and 98.

22 Department of Defence, *Future Submarine Industry Skills Plan*, March 2013, p. 123.

23 Department of Defence, *Future Submarine Industry Skills Plan*, March 2013, p. 31.

Maintaining the skills

8.18 Mr Burns highlighted that management was the critical element and maintaining these skills through shipbuilding was a 'very, very important component that Australia would lose if not building ships'.²⁴ He stated:

...it is more about the management skills above the blue collar skills. If you are building ships of any kind, to any level, you are practising those skills and you are keeping that workforce constantly improving and being more and more productive. At the moment, we are looking at a gap in that workforce and so those skills and management capabilities are going to be lost. That is the principle behind continuity of shipbuilding. It is not focused on specific projects.²⁵

8.19 Mr Hamilton-Smith argued that Commonwealth governments, as the single customer, need to realise that if they provide continuity of shipbuilding, then industry would respond. He stated:

But if we build the factory, hire the workforce, do a run of ships, close the factory down, sack the workforce and then come back 10 years later to do it over again it simply will not work. It is wrong to blame industry for what is essentially an organisational problem where government and industry need to work more closely together to build a capability that is sustainable.²⁶

8.20 Mr Thompson, AMWU, recognised that since its inception, the industry has been subjected to peaks and troughs. He explained that people who work on design through to production take time to develop their expertise—'you cannot turn the tap on and off in finding the skills to be able to acquit this work'.²⁷ He took the committee back to before the AWDs when a 'greenfield industry' rose from the ashes.²⁸ In his words, 'you have to work to build capacity':

The South Australian government built a shipyard for these three ships. We had no workforce when this project was won. We have built a capacity, and I think it says in the submarines Defence Capability Plan that it has cost government and industry in excess of \$100 million to reskill the workforce. I am aware that BAE in Melbourne has built a new welding centre for the purposes of training apprentices and upskilling existing welders in the industry. A really important point in Mr King's submission to this inquiry was that, up until ship No. 6, the ANZAC frigate project was in the same position. What we are saying here is that the government should have allowed the local builders to tender for the supply ships to address the interims and the fall-offs, particularly in Newcastle in Victoria, to address

24 *Committee Hansard*, 21 July 2014, p. 44.

25 *Committee Hansard*, 21 July 2014, p. 45.

26 *Committee Hansard*, 21 July 2014, p. 48.

27 *Committee Hansard*, 21 July 2014, p. 35.

28 *Committee Hansard*, 21 July 2014, p. 36.

and maintain their workforce to be in a position to deal with all the other naval requirements that are needed.²⁹

8.21 According to Mr Thompson, Australia cannot afford to lose those skills and repeated the warning that navy shipbuilding was 'facing serious gaps in work', and that 'if we do not have continuity of work, we do not have capacity'.³⁰ He informed the committee there were around 7,000 jobs in the industry and as a result of the AWD project the workforce had built up to 3,800 on that particular project.³¹ He noted that work on the destroyer comes to an end in Newcastle and in Melbourne in 2015 and finishes in 2016 with the capacity of a number of shipbuilding yards already in decline. In his opinion there was capacity in the BAE Victorian facility and in block construction at Forgacs at Tomago.³² He explained:

We have just recently had 110 skilled jobs come out of the Newcastle Tomago yard. Work on the destroyer will end in Adelaide in around 2019-2020 but will taper off dramatically in the years before. Work on the amphibious ship comes to an end in Melbourne in 2016 and production work on the future submarines will not seriously start until the mid-2020s. But we do not have any details yet about that scheduling. Also we have not seen the new scheduling in relation to the ANZAC frigate replacement. We obviously welcome comments from Mr King in relation to the need for a rolling build on that project. If this were to be brought forward, it would not seriously start production until the 2020s.

All of that leaves a gap for several years, especially for the production workers who operate in this industry. The gap in Melbourne and Newcastle is from 2016 to 2022 and possibly longer. In Adelaide it will be from 2018 to 2022.³³

8.22 In his view, this void could prove 'fatal' and, while acknowledging that the project to replace the supply ships was very late, the replenishment vessels could be built in Australia.³⁴ He argued that if Australia does not build its naval vessels then it does not build the capacity and the country 'will not be able to retain the capacity to build all our other naval requirements'.³⁵ He again highlighted the potential loss of jobs and skills:

29 *Committee Hansard*, 21 July 2014, p. 36.

30 *Committee Hansard*, 21 July 2014, pp. 33 and 35.

31 *Committee Hansard*, 21 July 2014, p. 34.

32 *Committee Hansard*, 21 July 2014, p. 35.

33 *Committee Hansard*, 21 July 2014, p. 33.

34 *Committee Hansard*, 21 July 2014, p. 33.

35 *Committee Hansard*, 21 July 2014, p. 36.

We have got 3,800 jobs at risk as a result of a 'valley of death', an issue around some long-term thinking so that we do not have the peaks and troughs.³⁶

8.23 Mr Thompson referred to the decision to have an open tender process in Australia for the patrol boats, which the AMWU welcomed. He argued, however, that the skills and capacity that would be maintained by those patrol boats would diminish the industry's capacity, because 'they do not have the technology and skills that are required to keep a highly skilled workforce'.³⁷ He believed that an open tender for the supply ships would test the union's contention:

Our whole argument here is that our members and the companies that they work for—and the tender is not drawn yet—have not had the opportunity to tender for this work.³⁸

8.24 Mr Hamilton-Smith suggested that the decision about the supply ships 'sends the wrong message'. He indicated that the South Australian government appreciated the pressure the Commonwealth was under, but that the current productivity issues were 'a symptom of previous short-sighted decision-making from successive governments going back decades'. He argued:

We must avoid the same cycle recurring. Advanced manufacturing depends on naval shipbuilding and defence as a technology leader.³⁹

8.25 Mr King acknowledged that since Federation, shipbuilding in Australia had been a stop-start proposition: that there had never been a proper strategic approach to military shipbuilding.⁴⁰ He referred back to a period when Australia had not built a ship more than around 2½ thousand to 3,000 tonne destroyer escort for at least ten years. He explained:

We were buying ships FMS [foreign military sales] from America, from anywhere, and we were doing the odd ship in Australia very unsuccessfully in government owned yards. We then privatised the yard in Williamstown and it, through having a continuous build program, could demonstrate that even with our labour rates and everything else, we could have world-competitive shipbuilding industry. If we go all over the shop, higgledy-piggledy picking it because it has got the word 'ship' in it, it is likely to be deleterious compared to focusing on what is a real strategic opportunity.⁴¹

36 Committee Hansard, 21 July 2014, p. 38.

37 *Committee Hansard*, 21 July 2014, p. 38.

38 *Committee Hansard*, 21 July 2014, p. 38.

39 *Committee Hansard*, 21 July 2014, p. 47.

40 *Committee Hansard*, 21 July 2014, p. 16.

41 *Committee Hansard*, 21 July 2014, p. 29.

8.26 He explained that more recently and without thinking ahead, Australia got into a situation where Defence needed to get LHDs and replace AWDs at the same time. He then explained:

So the peak workforce that we created by having those concurrencies in Australia was probably...larger, as far as I am aware, than we have ever seen in shipbuilding since the Second World War. So we created this peak for that period.⁴²

8.27 In his opinion, there was always going to be a reduction in workforce—not a valley of death. He argued the need for a strategic approach to Australia's shipbuilding industry and believed there was now the opportunity to have such an approach, although Defence and industry would have to lift their performance.⁴³ He explained that currently there were three prospects:

- rebaselining the AWD and re-establishing it so that we have a deliverable three ships;
- a feasibility study hopefully convincing the government—industry and Defence—that we can produce viable surface combatant shipbuilding; and
- the Pacific patrol boat build for Australia.⁴⁴

Notably, the supply ships did not figure in these proposals.

8.28 While some argued strongly in favour of a hybrid build in Australia for the supply ships to bridge the potential trough in activity, Mr King rejected the notion that such a proposal would provide the continuity that industry was seeking. In his assessment, continuity was not at issue because you are welding a metre of weld—continuity applies by building the same ship many times.⁴⁵ He contended:

...building remotely and a totally different ship does not give you continuity. Where you get continuity is building the same type of module over and over again.⁴⁶

8.29 Mr King noted the difference between building an AOR and an air warfare destroyer or a frigate, suggesting that although the latter are smaller ships, they are 'very, very complex and they bring into play all the skills that you need in a complex industry'. He explained:

They bring into play engineering, communications, combat systems, radars. So what you find is, on an air warfare destroyer, for example, more than half of the value can be in electronics, engineering, project management and

42 *Committee Hansard*, 21 July 2014, p. 32.

43 *Committee Hansard*, 21 July 2014, p. 16.

44 *Committee Hansard*, 21 July 2014, p. 32.

45 *Committee Hansard*, 21 July 2014, p. 23.

46 *Committee Hansard*, 21 July 2014, p. 23.

all those really skilled things. So, if you really want a balanced, skilled industry, frigates, surface combatants, is where you bring in all the skills and the continuity.⁴⁷

8.30 In Mr King's mind, although the AORs are very large ships and relatively complex in terms of what they carry, they are not complex in terms of weapons systems, missile systems and things like that'.⁴⁸ In this context, Defence explained that AORs were 'to be based on existing designs with minimal modifications to meet the Navy's requirements, environmental obligations and statutory requirements'.⁴⁹ It stated:

The primary interoperability considerations are the compatibility of the replenishment equipment (ie the ability of the new ship to replenish existing and future warships) and the ability of the new ships to integrate with RAN and Allied ships on exercises and operations. DMO noted that the 'replenishment equipment is governed by NATO standards, which Australia uses, that will stipulate requirements for the new Auxiliary Oiler Replenishment ships'.⁵⁰

8.31 It should be noted that Mr Burns looked at the acquisition of the supply ships from a different perspective. He noted that the replenishment ships undertake complex operations as they carry a lot of fuel which they deliver at sea to up to three ships, requiring a number of systems to do it in all-weather states. Furthermore:

A replenishment ship operates two helicopters—it is a mini airport by day and by night. It has to operate in a hostile environment, so it needs all the command and control capacity to protect itself and have communications including not just unencrypted but encrypted communications. There is a lot of opportunity for what we are good at in the industry, to put those sorts of systems on board a hull.⁵¹

8.32 In addition, the Victorian Government pointed out the particular requirements of the new replenishment ships, which will require:

- adaption to Australia's specific operational, strategic, and geographical environments; and
- some unique Australia systems (such as combat and communication systems) that will need to be integrated with the new replenishment ship platform and be compatible with the rest of the Royal Australian Navy Fleet.⁵²

47 *Committee Hansard*, 21 July 2014, p. 20.

48 *Committee Hansard*, 21 July 2014, p. 12.

49 Department of Defence, answer to question on notice Nos. 24 and 26.

50 Department of Defence, answer to question on notice Nos. 24 and 26.

51 *Committee Hansard*, 21 July 2014, p. 44.

52 *Submission 13*, p. 3.

8.33 In both these areas, the Victorian Government noted BAE's significant experience due to their role as the prime contractor for the construction of the LHDs; their lead role in overseeing the Class Frigate Anti-Ship Missile Defence Upgrade program; and in systems integration activities. Also, according to the Victorian Government, BAE's intimate knowledge of other in-service Australian platforms gives the company a distinct advantage in achieving necessary platform commonality'. The Victorian Government suggested that, even if the ships were constructed in Spain or South Korea, it would 'be vital to their future support and upgrade to have companies like BAE involved in the project from the beginning, installing and testing sensitive systems here in Australia'.⁵³

Avoiding the valley of death and the future frigates

8.34 At the time the government announced the limited tender for the supply ships, the Minister also referred to the future frigate program, which, he described as 'a very vital program strategically for the Navy and for Australia'. He stated that the government had committed \$78.2 million to undertake the design and engineering research 'necessary to bring forward the program'. According to the Minister, part of the work on the future frigate program would be to examine 'whether the government could commit to the construction of some early blocks to ensure that there is no break in production overall'. He referred to this project as 'a potential follow-on program with probably at least eight ships based on the F105 Navantia hull that is currently being constructed in South Australia'.⁵⁴ The Minister informed defence and industry representatives in July 2014 that he wanted a continuous build but needed their help to fix the AWD and also design a Future Frigate program that follows on from the AWD with minimal industry disruption.⁵⁵ Clearly, the acquisition of the supply ships was not seen as integral to maintaining continuity.

8.35 With regard to the proposed future frigates, Mr King argued strongly in support of an Australian build. He suggested that if Australia did it well and structure well, 'we would actually be building them in this country at the same price that we could buy them anywhere else'. In his view, it would be a legitimate business, with a real strategic value that needs no additional budget investment to do it: no subsidies or similar assistance. According to Mr King, for the first time since Federation, Australia had 'an opportunity for a truly strategic shipbuilding capability'. He referred to the past 50 years of off and on constructions—Australia built the ANZACS but stopped; built *Success* but stopped; built two FFGs.⁵⁶ He stated further that should the

53 *Submission 13*, p. 4.

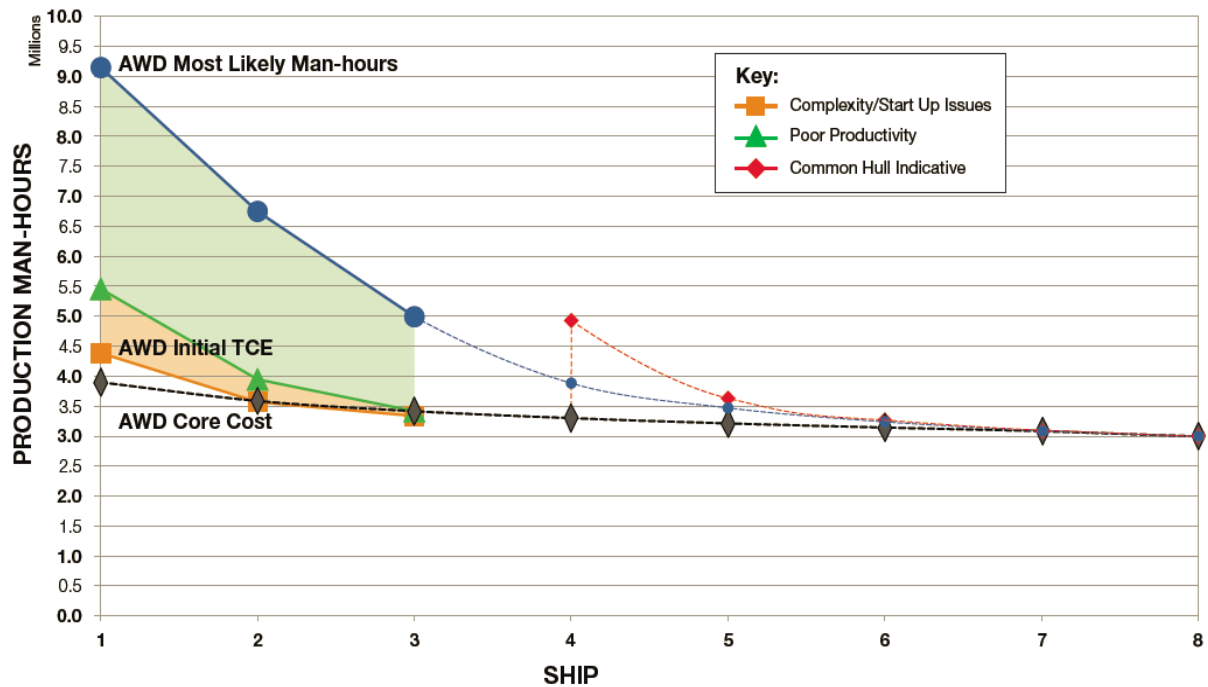
54 'Minister for Defence—Transcript—Naval shipbuilding announcement, CEA Technologies, Canberra', 6 June 2014, p. 2, <http://www.minister.defence.gov.au/2014/06/06/minister-for-defence-transcript-naval-shipbuilding-announcement/> (accessed 4 August 2014).

55 'Minister for Defence—Defence and Industry Conference 2014', Adelaide Convention Centre, 29 July 2014, <http://www.minister.defence.gov.au/2014/07/29/minister-for-defence-defence-and-industry-conference-2014/> (accessed 4 August 2014).

56 *Committee Hansard*, 21 July 2014, p. 23.

government decide to build the future frigates based on the air warfare destroyer hull, incorporating an Australian-made radar, then potentially the program could start at the point of learning efficiency achieved by the AWDs.⁵⁷

Figure 8.1: Indicative Ship Construction Productivity Impact—Common Hull



Indicative Ship Construction Productivity Impact - Common Hull

To retain the option of building these warships in Australia, the Government has approved a limited feasibility study into using the AWD hull for the Future Frigates. This work will focus on continued production of the current AWD hull, suitably adapted and using capabilities from Australian companies CEA Technologies Australia and SAAB Combat Systems.⁵⁸

⁵⁷ *Committee Hansard*, 21 July 2014, p. 23.

⁵⁸ Department of Defence, answer to question on notice No. 30.

8.36 Mr King explained this transition from the AWD to the future frigate. He noted that the AWD did not deliver when expected, so the last AWD construction is estimated to be sitting in the area of 2019–20. He explained that therefore, it was possible, depending on present and future governments, that the future frigate, if authorised and based on the air warfare destroyer hull, could pick up and be 'the basis of a proper strategic shipbuilding industry'.⁵⁹ In his view, if the future frigate is based on the same hull as the AWD, 'we should be able to get to world's best practice around about ship 3, and with Australian radars and Australian technology in it'. He informed the committee that he had never seen a better opportunity to have 'a real strategic capability that is cost efficient, that no-one has to apologise for' and that is of value to the taxpayer.⁶⁰

8.37 In highlighting the importance of continuity in shipbuilding, he again stressed his view that the government's initial decision to look at the feasibility of reusing the air warfare destroyer's hull with Australian radars and other equipment represented the 'best opportunity to deal with continuity'. He stated:

If decisions are made as it is proposed they will be, we could very much be in that place where we keep the continuity of work and keep those skills.⁶¹

8.38 From Mr King's perspective, it was important to remember that the government's decision to bring forward the frigate program was part of a package of decisions, which also included the AOR, and involved how best to allocate work to Australia to ensure continuity and to achieve 'real strategic capability'.⁶² Mr King contrasted the prospects of the frigates with that of embarking on a supply ship that has three times the displacement, with facilities Australia does not have, with a design that no-one in Australia owns plus a 40 per cent premium.⁶³

8.39 Mr Thompson welcomed DMO's indications that it was looking at the feasibility of utilising the AWD platform for the replacement frigates. He added, however, that the union would want government to reiterate its position on this. Even so, according to Mr Thompson, the AMWU had concerns about being able to maintain the workforce built up over the life of the AWD project—some 3,800 skilled workers—until such time as a frigate project comes online.⁶⁴ Mr Dunk also noted that conceptually the frigate proposal was 'a good idea':

59 *Committee Hansard*, 21 July 2014, p. 28.

60 *Committee Hansard*, 21 July 2014, p. 30.

61 *Committee Hansard*, 21 July 2014, p. 31.

62 *Committee Hansard*, 21 July 2014, p. 32.

63 *Committee Hansard*, 21 July 2014, p. 24.

64 *Committee Hansard*, 21 July 2014, p. 35.

It is something we needed to have done years ago—actually commit to a long-term, ongoing rolling build of naval vessels of a similar type so that we can get good at it and do it at a globally competitive price.⁶⁵

8.40 Mr Dunk observed, however, that at this stage, there was 'only a commitment to study the early stages of the frigate design'.⁶⁶ Mr Burns likewise thought that the future frigate proposal was a 'great solution' at this time and strongly supported it.⁶⁷ But he made the point that shipbuilders 'cannot go to the bank with a prospect', noting also that industry had only heard about 'the prospect of a future frigate build'.⁶⁸ He indicated that work was already being lost and in the meantime:

There was no indication of when that future frigate program might commence and when we might see the cutting of steel. The problem for industry is that it has been very hard to go to the bank for the last six years, and time is running out for a lot of the SMEs out there.⁶⁹

8.41 Underlining the need for clarity and certainty from Defence, Mr Burns reinforced the argument that industry can only make investments based on a sound strategic Defence capability and acquisition plan. He told the committee that, from an industry viewpoint, the DCP had not been reliable for a number of years. Indeed, in his view, since 2009 industry had not been able to rely on the DCP because it has 'not been delivered, budgeted or funded'. He stated that industry still does not have a funded Defence capability plan at this time.⁷⁰ Put bluntly, if 'you do not know and you cannot rely on the plan, you cannot go to the bank and make your plans'.⁷¹ He repeated his concern:

Industry cannot invest based on the Defence capability plan because it is not reliable and it is not funded and so a company cannot go to its bank and say, 'I need money to sustain myself in order to secure that project'.⁷²

8.42 Along similar lines, Mr Dunk referred to the Defence White Paper and the Defence industry policy statement, which, in his view, had never made a demonstrable link:

...between the strategic requirement to build ships and the strategic requirement to maintain them and the crossover in skills necessary to ensure that we can achieve the maintenance through shipbuilding. It may

65 *Committee Hansard*, 21 July 2014, p. 42.

66 *Committee Hansard*, 21 July 2014, p. 46.

67 *Committee Hansard*, 21 July 2014, p. 42.

68 *Committee Hansard*, 21 July 2014, p. 42.

69 *Committee Hansard*, 21 July 2014, p. 42.

70 Mr Christopher Burns, *Committee Hansard*, 21 July 2014, p. 45.

71 *Committee Hansard*, 21 July 2014, p. 43.

72 *Committee Hansard*, 21 July 2014, p. 46.

well be that shipbuilding in itself is a strategic requirement, but it is not listed as one as far as the government policy is concerned.⁷³

8.43 As noted earlier, Mr King put great store on the future frigates providing continuity but that industry was sceptical having only heard the word 'prospect'.⁷⁴

8.44 The comments about the lack of clarity and certainty in, and consistency between, the Defence White Paper, the DCP and Defence's industry policy statement have been of long-standing concern to industry. Many people, including Mr King, recognised the need for a strategic approach to Australia's shipbuilding industry. Indeed, governments of both persuasions have recognised Australia's shipbuilding industry as a strategic asset. In this regard, a number of witnesses questioned the appropriateness of locating industry in the DMO. For example, Mr Burns noted that Defence Industry encompasses 'the whole defence and has to deal with infrastructure and with information group'. He explained that:

At the moment the industry division resides within the Defence Materiel Organisation. That is the conduit between industry and Defence. It would be our preference that the industry division be elevated out of the DMO and up to a more strategic level so that it can look across the whole of Defence and give industry one conduit into Defence.⁷⁵

8.45 Mr Dunk also noted that Defence has an industry division; which should be demonstrating the link between the ability to build and the ability to maintain but which 'has not really been demonstrably presented'.⁷⁶ When asked about the government-wide industry policy decision to try to reshape the Australian naval shipping industry towards being a specialised industry, Mr Burns responded that:

Again, such a plan would have to be based on a national strategic plan for acquiring naval ships. The government has to decide what ships it is going to buy, where and when and through what process, and then the shipbuilding industry can adjust to that.⁷⁷

8.46 In its broader inquiry, the committee intends to examine thoroughly Defence's industry policy, including where it should reside in Defence. Having and implementing a national strategic plan for acquiring naval ships and Defence industry's place in this plan will also be explored.

73 *Committee Hansard*, 21 July 2014, p. 44.

74 *Committee Hansard*, 21 July 2014, p. 46.

75 *Committee Hansard*, 21 July 2014, p. 44.

76 *Committee Hansard*, 21 July 2014, p. 46.

77 *Committee Hansard*, 21 July 2014, p. 46.

Australian participation in the construction of the supply ships

8.47 Although, the Australian Business Defence Industry did not believe that it was either feasible or possible to build the entire ship in Australia, it was of the view that there were options for building some of the ship in Australia—the fit-out of a hull built elsewhere or the construction and shipping of the superstructure for offshore integration if the decision had been taken earlier.⁷⁸ Indeed, Mr Hamilton-Smith, informed the committee that anything was better than nothing—the more the better. He indicated defence companies, SAGE Automation as one example, had told him that even with only 20 per cent of the LHD work being performed in Australia, they were fully engaged supporting that project in Melbourne from Adelaide.⁷⁹

8.48 While the Victorian Government accepted that the Federal Government had taken the decision to source the replenishment ships overseas, it strongly called for opportunities to be maximised for local participation in the project. It recommended that the government include a requirement for local industry participation in the Request for Tender that is provided to the Spanish and South Korean companies on these two ships.⁸⁰

Hybrid build

8.49 The committee has referred to the suggestions of having a hybrid build. Mr King explained that some of the unsolicited proposals, of which there were more than two, had come from companies that submitted multiple propositions, some teamed and some not. Drawing on that information, Mr King concluded that the cost to have Australian content in the structural elements of the ship was 'totally disproportionate to the amount of benefit or work we would get out of it'.⁸¹ He reiterated his concern that, to do some structural work in Australia to achieve the 40 per cent level Australian involvement, a lot of that could be just pure profit which contributes little to engaging the Australian workforce. Mr King then referred to the 40 per cent premium for the proposed hybrid build, indicating that the result would be paying nearly 50 per cent more for a ship to get 40 per cent Australian content.⁸² Referring to the unsolicited offer, he stated:

I think 'hybrid' implies more build than just maximising Australian content. I do not want to dance around the facts here, but the hybrid build on the LHD was quite specific. It was two major items of physical construction on the island and these electronics and so on. I am not certain that it would lead to physical construction work for Australian content.⁸³

78 Mr Graeme Dunk, *Committee Hansard*, 21 July 2014, p. 41.

79 *Committee Hansard*, 21 July 2014, p. 53.

80 *Submission 13*, p. 3.

81 *Committee Hansard*, 21 July 2014, p. 29.

82 *Committee Hansard*, 21 July 2014, p. 30.

83 *Committee Hansard*, 21 July 2014, p. 19.

8.50 Furthermore, experience told him that:

...whatever is put in as unsolicited proposals worsen when they become a tender, whether it [is] schedule, price, content. For example, in other areas we have had the issue of companies saying they are going to have certain content and we have to be very vigilant to make sure that when we sign the contract we get that content. We have to be very vigilant, because sometimes that starts to get challenged. So the prospect out of the unsolicited proposals was longer to contract, longer to build and far more expensive to acquire.⁸⁴

8.51 Even so, according to Mr King, Australian industry would be offered opportunities via the prime to be involved in the project. He explained that, while the intention was to limit the tender to a Spanish and a South Korean company, one of which would be chosen as the prime, it would not exclude Australian participation.⁸⁵ He stated clearly that the tender would have 'a specific requirement for an Australian industry capability plan'.⁸⁶ Mr King informed the committee, however, that he did not expect that the opportunities for Australian industry participation would be as significant as with the LHDs—that he did not expect it to be 40 per cent.⁸⁷

On the LHD, with those two island modules, command-and-control and communications were essentially the Australian elements. What we anticipate in the AOR case will be the command-and-control and the communication elements. But we will ask them to maximise the Australian industry content. Of course, beyond construction there will be the support of the vessels through life.⁸⁸

8.52 While uncertain of what would be involved in terms of the total value of the project being carried out in Australia, Mr King surmised that, possibly, it could be as low as 10 per cent.⁸⁹ As noted above, he anticipated that Australian involvement would involve contributing to electronics and command-and-control systems. He stated:

So the bits that we have encouraged or will encourage tenderers to offer are bids that are inserted in the structure: command and control, which is combat management systems; and communication systems—things like that. They are not part of the structural elements of the ship.⁹⁰

84 *Committee Hansard*, 21 July 2014, p. 30.

85 *Committee Hansard*, 21 July 2014, p. 18.

86 *Committee Hansard*, 21 July 2014, p. 27.

87 *Committee Hansard*, 21 July 2014, p. 19.

88 *Committee Hansard*, 21 July 2014, p. 19.

89 *Committee Hansard*, 21 July 2014, p. 20.

90 *Committee Hansard*, 21 July 2014, p. 29.

8.53 According to Mr King, the DMO did not have the details yet, 'of whether it was better to be fitted out there'.⁹¹ Based on history, he imagined that 'the ship would be brought to Australia for final fitting out and the cable laying would be done in the overseas yard'.

8.54 Defence provide additional information on the prospects for Australian content in the project to replace the supply ships. It informed the committee that there would be an opportunity for 'modest Australian industry involvement during the acquisition phase'. It identified the potential for Australian industry to become involved as sub-contractors for activities such as:

- design and installation of the Command, Control, Computers, Communications and Intelligence;
- combat system (preference is an Australian developed SAAB 9LV);
- specialist Integrated Logistic Support Services; and
- develop and provide Royal Australian Navy specific support products.

8.55 Furthermore, Defence stated that the sustainment of the AOR, through the award of an In-Service Support Contract, would provide significant long-term opportunity for Australian industry over the life of the ships.⁹²

Conclusion

8.56 Defence has a defence industry policy that recognises the vital contribution this industry makes to Australia's security. Among other things, the policy seeks to increase opportunities for Australia's defence industry to identify and make the most of business opportunities and to compete for acquisition projects. Even though, the Australian prime contractors face significant challenges in meeting Defence's requirements for acquiring the new supply ships, the procurement process so far shows no evidence that Defence consulted with industry or encouraged open discussion about possible Australian engagement with the project. Indeed, it appears as though local shipyards were shut out of all consideration. The committee is of the view that, despite Defence's strong conviction that the domestic shipbuilding industry could not match the cost, productivity or schedule of the selected overseas tenderers, at the very least it should have consulted with local shipyards and allowed them to present their case.

8.57 The committee also looked at problems facing the industry such as the potential loss of jobs and skills as work generated by naval shipbuilding tapers off. Without doubt, evidence overwhelmingly identified the need for, and supported government having, a national strategic plan for Australia's naval shipbuilding industry so that it is not subject to peaks and troughs in demand.

91 *Committee Hansard*, 21 July 2014, p. 20.

92 Department of Defence, answer to question on notice No. 7.