

Additional Comments by Senator Nick Xenophon

Ship happens?

1.1 I welcome the Senate Economics References Committee Chair's report, Part I, into the Future of Australia's naval shipbuilding industry and the tender process for the navy's new supply ships.

1.2 This first part of the inquiry was brought about due to the Government's rash and misguided decision to exclude Australia's naval ship building industry from tendering for Project-SEA 1654, a \$1 billion to \$2 billion project to supply the Royal Australian Navy with two replenishment ships.

1.3 Instead, as announced by the Defence Minister on 6 June 2014, the Government decided to proceed with a limited tender including only two non-Australian ship builders, Daewoo Shipbuilding and Marine Engineering (DSME) from South Korea and Navantia of Spain.¹

1.4 The Committee conducted one public hearing, on 21 July 2014 in Canberra, and I acknowledge all those who made themselves available to give evidence, including the Chief Executive Officer of the Defence Materiel Organisation (DMO), Mr Warren King.

1.5 I also acknowledge that notice was short for those invited to attend and some, such as the leadership of ASC in Adelaide, were unable to attend due to a scheduled board meeting in South Australia on 21 July.

1.6 It is imperative that Australian industry be permitted to competitively tender, in whole or in part, for the replenishment ship project.

1.7 That Australian industry has been excluded from the usual competitive tendering process is outrageous and must be reversed.

1.8 This is especially so due to the impending closure of Australia's local car making industry and the flow-on effects in South Australia and Victoria of the expected loss of more than 30,000 manufacturing jobs.

1.9 According to the Australian Industry & Defence Network Inc, naval shipbuilding directly employs some 6,000 people and indirectly nearly 15,000 people. The additional multiplier effect must also be taken into account.

1.10 The Defence Department's normal competitive tendering process must ensure the best, most cost effective and most beneficial outcome for Australia's defence needs, and the national interest. I refer more broadly to the Senate inquiry into

1 Defence Minister David Johnston, media release, 6 June 2014.

government procurement moved by Senator Madigan and myself in relation to flaws in the current Commonwealth procurement process generally.²

1.11 Cost effectiveness must include active consideration and quantification of through-life benefits of engaging local navy ship building industry, including but not limited to:

- (a) The strategic advantage of building and maintaining Australia's essential naval assets in Australia, including and especially during periods of conflict and tension overseas when Australia should not be reliant upon overseas suppliers
- (b) The multi-plyer effects for the economy of spending defence funds in Australia
- (c) Reductions in through-life maintenance and sustainment costs due to investment in infrastructure and skills during the construction phase
- (d) The development of a highly skilled workforce and increased innovation that comes through research and development and knowledge transfer for the wider economy
- (e) The project's contribution to national economic growth and employment. These benefits are recognised by the Canadian Government in its National Shipbuilding Procurement Strategy (NSPS)³
- (f) The tax revenue advantages to Government of engaging local industry, estimated to be up to a third of the cost of the project, as outlined in a 2012 paper published by the Royal United Services Institute of the UK.⁴

1.12 No-one should be under any illusions as to what is at stake here. If the Australian government does not do what is necessary to significantly involve local industry then the country stands to lose up to 7000 naval ship building jobs⁵ and many thousands more in supply industries.

1.13 Indeed, the oft-cited 'Valley of Death', which will see navy shipbuilding jobs lost due to lack of engagement from the Federal Government in coming years, is already upon us. The Committee heard that Forgas laid-off 110 skilled navy

2 Senate Finance and Public Administration References Committee, inquiry into Commonwealth procurement procedures, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Finance_and_Public_Administration/Commonwealth_procurement_procedures

3 Canadian National Shipbuilding Procurement Strategy (NSPS), <http://www.tpsgc-pwgsc.gc.ca/app-acq/sam-mps/snacn-nsps-eng.html>

4 *Over a third of UK sourced defence contracts may be recovered by the Treasury in tax revenue*, https://www.rusi.org/news/ref:N4F194BF09B370/#.U_v0wvnEJSi

5 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 34.

maritime jobs from its Newcastle Tomago yard recently⁶ due to a lack of continuity in naval ship building work.

1.14 The enormity of the 'Valley of Death' will become clear from next year when work for the Air Warfare Destroyer project in Newcastle and Melbourne comes to an end, and will worsen from 2016 when work in Melbourne on the navy's Landing Helicopter Deck (LHD) ships comes to an end.⁷

1.15 Both the Future Frigates and Future Submarine projects were not expected until the 2020s and the Government had not signed-off on any of its public commitments to utilising Australian industry for these projects.

1.16 Recent media coverage, driven apparently by backgrounding from Government sources, indicates that a foreign build of the Future Submarine program was increasingly likely.⁸

1.17 This, despite a clear commitment from the Coalition ahead of the election that it 'wanted to build (the Future Submarines) in Australia'⁹ and that 'we will deliver those submarines from right here at ASC in South Australia.'¹⁰

1.18 Mr King's comments to the Committee that he envisaged Australian industry would build eight Future Frigates were welcome, they did not amount to a commitment, and Australian SMEs were risking going out of business in the meantime.

1.19 As Mr Chris Burns, CEO of the Defence Teaming Centre in South Australia, commented, industry 'cannot go to the bank with a prospect' of a Future Frigate build. 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.¹¹

1.20 Further context for the Government's decision on the replenishment ships is provided by its decision, also revealed in June, to outsource the construction of 12

6 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 35.

7 Mr Glenn Thompson, AMWU, *Committee Hansard*, 21 July 2014, p. 33.

8 *Australia to sign new submarines deal with Japan ...*, <http://www.news.com.au/national/australia-to-sign-new-submarines-deal-with-japan-as-prime-minister-shinzo-abe-visits-tony-abbott-in-canberra/story-fncynjr2-1226980720135>

9 Senator David Johnston, radio interview ABC Canberra 666, 1 May 2013.

10 Senator David Johnston, media release, 8 May 2013.

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

smaller navy vessels to Vietnam via a novel commercial arrangement with an Australian bank, and the construction of two ice breakers in Europe.¹²

1.21 The current Government appears to be walking away from Australian industry involvement in navy shipbuilding.

1.22 This is unacceptable and risks the loss of more than 10,000 skilled and semi-skilled jobs. Leadership must be demonstrated so as to restore adequate and competitive involvement for Australian naval ship building companies.

1.23 The Government's decisions and public comments since June do not support the Government's promise of a Navy Capability Plan in 2015 which will include an 'enterprise level shipbuilding plan that will bring together navy capability requirements, available resources and recommendations around Australian industry requirements.'¹³

1.24 As Mr Burns told the Committee:

The essence of my appearance at this inquiry is to voice the concerns of South Australia's defence industry, an industry that is reluctant to speak publicly against the government for fear of retribution and repercussions; an industry that is not looking for handouts from government or charity in the awarding of contracts; an industry that wants to be recognised and respected for the significant role it plays in the development and delivery of Australian Defence Force military capability and the preservation of the nation's sovereignty; an industry that wants 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.

The last few years under successive governments have truly left the industry confused. It is an industry that truly questions if the Australian government and the department want a defence industry at all. If it does then it needs to support and partner with it, to collaborate and deliver military capability. If it does not, then let us know and we can put on our banana republic T-shirts, learn how to pick fruit, dig ore out of the ground and serve drinks to wealthy tourists—because, ladies and gentlemen, that is all that will be left for our de-industrialised nation to do.¹⁴

12 *South Australian ship builders cut out of contracts as Federal Government buys overseas*, <http://www.adelaidenow.com.au/news/south-australia/south-australian-ship-builders-cut-out-of-contracts-as-federal-government-buys-overseas/story-fni6uo1m-1226945174449>

13 Defence Minister David Johnston, media release, 6 June 2014.

14 Mr Chris Burns, *Committee Hansard*, 21 July 2014, p. 41.

1.25 1.25 The Committee heard various industry witnesses attest to the ability and capacity of Australian industry to deliver a competitive tender for constructing the replenishment ships, either as part of a hybrid project with overseas shipbuilders and the detailed fit-out done in Australia, or an entire Australian build.

1.26 Infrastructure limitations, where they exist, could be overcome with additional investment of less than \$50 million, the committee heard.¹⁵

Recommendation 1

1.27 That the Government reverse its decision to exclude Australian industry from tendering for the navy's replenishment ship project and permit Australian industry to tender, in whole or in part, as is usual for such projects.

1.28 Virtually nothing I heard in the public hearing or read in the submissions gave me any comfort that the current Government will engage properly with Australian industry for its future navy ship building needs.

1.29 This inquiry has a long way to go but the direction of the Government is clear. It appears to be prepared to cut Australian industry loose, and for the economy to be further de-industrialised with the loss of many thousands of jobs.

1.30 What we heard from Mr King was blame-shifting for the problems encountered in the Air Warfare Destroyer project onto Australian industry, a project for which the DMO had lead responsibility; selective criticism of the current Landing Helicopter Dock (LHD) ships being built in Melbourne and a one-person assessment that Australian naval ship building industry was simply not capable of competing for the replenishment ship project due to cost and time demands.

LHD was supposed to be delivered to me months ago is still late—late by seven months. And they had all the time they wanted to build that ship. I have to make judgements over the top of a commercial proposal. Perhaps I could give you some examples. On an LHD there were 30,000 man-hours of work left over that Navantia did not do. It cost 70,000 hours in Australia. I have to put forward a degree of credibility, and for someone to propose that a hybrid build (for the replenishment ships) would add only six months is not credible. I spend most of my time trying to explain to the public why the AWD is late, why the LHD is now seven months late. And it is because we get more ambitious than we are able to deliver. I would like to see an industry that can deliver.¹⁶

There is not much point in my putting out a tender that is not fair. If I were to put out a tender and say, 'You must have this solution to me in two years,' they would not be able to do it.¹⁷

15 Mr Andrew Fletcher, Defence SA, *Committee Hansard*, 21 July 2014, p. 49.

16 Mr Warren King, *Committee Hansard*, 21 July 2014, p. 19.

17 Mr Warren King, *Committee Hansard*, 21 July 2014, p. 16.

1.31 Mr King appears to lightly excuse Navantia's incomplete work on the LHD, using this as a pretext to criticise a local contractor for low productivity in cleaning-up after the Spanish company's incompetence.

1.32 The above comments by Mr King, among others, raise questions as to his ability to provide Australian industry with a fair assessment of past performance and a fair go in obtaining future defence work.

1.33 The Chair repeatedly challenged Mr King's assertion that Australian industry was incapable of delivering the replenishment ship project, in part or in full, pointing out that this assertion would be tested in an open tender process.

1.34 Mr King told the committee that he was, in effect, saving the local industry the time and money involved in tendering in a hopeless cause.

1.35 This is a very disappointing position for the head of the DMO to take. It is unacceptable and must be reversed by the Government.

1.36 Mr King said it was he who advised the Government to exclude Australian industry from the project, for the reasons mentioned above.

1.37 Consideration for First Pass approval to proceed with Mr King's recommendation of a limited tender was given by the National Security Committee on 4 April 2014.¹⁸

1.38 The Defence Minister waited until 6 June to announce the decision. The timing of the announcement came two days after the Defence Minister and Finance Minister flagged the findings of the secret Winter Report into the Air Warfare Destroyer project.

1.39 The Government has refused to release the Winter Report, in whole or in part, while citing it to heavily criticise Australian navy ship building industry.

1.40 Indeed, in its 6 June 2014 announcement to limit the tender for the replenishment ships, the Government cited 'the current low productivity of shipbuilders involved in the AWD project; and value for money considerations' as partly justifying its decision.

1.41 It is disappointing that the Government kept secret from Australian industry for two months its decision to exclude local participation in a project that would provide much-needed additional work for thousands of Australians.

1.42 It is further disappointing that it has used a secret report to partly justify its decision, once it was finally announced.

18 Department of Finance, *Submission 14*, p. 2.

1.43 The Senate has voted twice on my motions to have the Defence Minister produce the Winter Report and on both occasions the Government has refused.

Recommendation 2

1.44 The Government must release the Winter Report, in whole or in part, so that Australian industry and all Australians know the basis upon which it is making decisions on the future of thousands of Australian workers and their families.

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