



**DEFENCE SUB-COMMITTEE OF THE
JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND
TRADE
BAE Systems Australia Submission on
Government Support for Australian Defence Industry Exports**

Terms of Reference

1. The inquiry's terms of reference include examining Government support for Australian defence industry exports, having particular regard to:
 - a. Identification of barriers and impediments to the growth of Australia's defence exports;
 - b. How Government can better engage and assist Australian defence industry to export its products;
 - c. The operation of the Defence Export Control Office;
 - d. Assessment of the export support given to defence industry by governments of comparable nations; and
 - e. Any other related matters.

Preamble

2. The nature of defence exports
 - a. Australia industry does not have the capacity (resources) to design, develop and field a complex weapons system.
 - b. Technical capability exists in many, perhaps most systems that make up a complex weapons system (*e.g.* some types of platform, sensors, communications, software development and electronic warfare to name only a few).
 - c. Australian defence industry sector has the capability for system-of-system integration required for a complex weapons system (*i.e.* integration of platform, sensors, command support, communications, weapons, *etc.*).
 - d. These disparate systems could be acquired from individual OEM provided intellectual property and technical data can be obtained.
 - e. The main inhibiting factor is the prohibitive cost of the risk associated with assuming the prime systems integrator role for a complex weapons system (*i.e.* system-of-systems integration).
 - f. The start-up costs and the lack of economy of scale in production are also inhibiting factors.

3. Difficulties in winning Defence exports
 - a. Nations capable of operating an advanced complex weapons system will generally have the industrial capability and capacity to produce all or part of these systems and will be reluctant to import them.
 - b. Sustainment in service through the life of type requires most of the attributes required for design, development and production of a complex weapons system leading to a strong preference for indigenous capability and reluctance to import them.
 - c. Difficulty will be encountered marketing a complex weapons system that is not already ordered or in service with the ADF.
 - d. This points inexorably to two approaches:
 - (i) Design, develop, produce and export individual systems that could be stand-alone (*i.e.* that cannot be categorised as a complex weapons system, *e.g.* a tactical communications system).
 - (ii) Produce systems for export as part of the supply chain to a complex weapons system produced by an overseas' prime.
4. Special problems with Defence exports to the US
 - a. International Traffic in Arms Regulations (ITAR) can prevent exported Australian systems incorporated in US weapons systems being exported to third party nations.
 - b. Fear of losing intellectual property (IP) to larger US companies that are willing and able to finance the transition to operationally ready products.
 - c. Buy America legislation militates against US primes incorporating foreign systems into larger complex weapons systems unless they are:
 - (i) Demonstrably superior to anything offered by US companies;
 - (ii) A broader ANZUS alliance consideration overrides the requirements of the legislation; or,
 - (iii) The prerequisite to acquisition of major weapons systems such as the F-35 is acceptance of an Australian export (*e.g.* Norwegian purchase of F-35 and the Joint Strike Missile).
5. Strategic considerations
 - a. Defence exports should not be considered as a stand-alone element of Government policy, rather they are part of a strategic industry policy and most of the same arguments/aspects/factors apply to all industry sectors.
 - b. Exports are part of a spectrum of industry policy that:
 - (i) Begins with encouragement and support of innovation;

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- (ii) Continues with commercialisation of products; and,
 - (iii) In the case of Defence products, finishes with the take-up by the ADF.
- c. A vibrant Defence export business generates royalties that are of economic benefit generally and can be re-invested in Defence programs.

Identification of barriers and impediments to the growth of Australia's defence exports

6. The main barriers and impediments are:
- a. Difficulty selling products not already in service with the ADF (in US terms a *program of record*).
 - b. Small production runs for those products that are in service with the ADF leading to higher prices in the global market.
 - c. Protectionist trade policy and/or subsidisation of defence industry by many advanced nations including the US and most European countries.
 - d. The transition of innovative ideas from low Technology Readiness Levels (TRL) to operationally ready products (the subject of an enquiry by the Senate Economics Committee).

How Government can better engage and assist Australian defence industry to export its products

7. The Government can materially assist Australian defence exports through:
- a. Supportive policies;
 - b. High level political involvement;
 - c. Using Defence staff in our overseas' posts to facilitate exports;
 - d. Leveraging major Defence capital equipment acquisitions; and,
 - e. Exploiting alliance arrangements.
8. Policy measures that would support defence exports include:
- a. The explicit inclusion of export policy in a strategic industry policy.
 - b. Preference for Australian products in ADF equipment acquisition to provide a program of record for export trade.
 - c. Encouragement and financial incentives to assist the transition of innovative technology to fully developed product.
 - d. Active promotion of the Defence Free Trade Agreement with the US and its extension to a tri-lateral arrangement with the UK.

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9. Political Involvement
 - a. Most other nations use Ministers and eminent personalities to promote their Defence exports (*e.g.* Prince Andrew on behalf of the British Government; President Francois Hollande for France, *etc.*).
 - b. 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.
10. Overseas' staff can be used to:
 - a. actively promote Australian Defence exports;
 - b. sponsor industry visits and facilitate access to the Pentagon and similar Ministries or Departments of State;
 - c. provide advance warning of operational requirements that could be satisfied by Australian products (this requires uniformed personnel to gain access to capability development personnel);
 - d. identify major complex weapons systems that could include Australian technology or product (*e.g.* Next Generation Jammer)
11. Leveraging major acquisitions:
 - a. Australia is a preferred partner of the US and to a lesser extent the UK for regional and global security, and combined force capability reasons.
 - b. Many Australian military capabilities are based on weapons systems sourced from the US.
 - c. The advantages to the US are that:
 - (i) Australia is seen as a well-informed and shrewd purchaser of military systems and this encourages other less-developed nations to follow our lead in acquiring US systems.
 - (ii) Australian participation in major programs such as the F-35 garners domestic political support in the Congress.
 - (iii) Australian operational capability complements that of the US for combined force operations.
 - d. This desire of the US for Australian participation should be exploited by insisting on a prerequisite *quid pro quo* of selected Australian Defence exports.
12. Exploiting the US Alliance
 - a. As an alliance partner of the US, Australia gains access to advanced technology, intelligence and other sensitive matters related to national security.

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- b. In return, Australia provides political support on a global basis, joint facilities on Australian territory and contributes to combined, coalition and friendly nation operations.
- c. These arrangements could be used to facilitate Defence exports to the US.

The operation of the Defence Export Control Office (DECO)

- 13. The positive features of the DECO are:
 - a. The Team Australia approach that demonstrates commitment to export products.
 - b. The apparent desire to create an Australian FMS system in which Government becomes an active participant in export sales.
- 14. Some shortfalls of the DECO are as follows:
 - a. Although the two-star military officer support provided by each Service is useful because of their operational credibility and easier access to foreign militaries, it falls short of the hard-hitting senior political support used by other nations.
 - b. The new on-line system appears to have improved the processing of marketing licences, however a 12 month licence is far too short for the pursuit of Defence Exports. A more appropriate time period would be 36 months, with a simple “tick the box if you wish to renew”, on the assumption that nothing strategically has changed.

Assessment of the export support given to defence industry by governments of comparable nations

- 15. The UK government provides exceptionally strong support to British Defence exports through:
 - a. A specialised agency dedicated to this task (now located within the Ministry for Trade and Industry).
 - b. Deployment of advanced British capability to target countries (*e.g.* HMS Daring type 45 deployment).
 - c. Proactive use of Defence Attaches to identify Australian and other nations’ operational requirements.
 - d. Relatively easy access to IP and advanced technology transfer.
- 16. The French Government is also very active in the promotion of its military materiel in a similar way to that of the UK.
- 17. The US Government uses similar methods to the UK and France but with some different wrinkles and has formalised the Foreign Military Sales (FMS) process:
 - a. Defence materiel staff in its Embassies are uniformed officers.

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- b. Each US Embassy has a head of Foreign Military Sales (all called different names, *e.g.* Korea JUSMAGK, Japan MDAO) but their only role in life is to prosecute government-to-government defence sales.
- c. Moreover US Pacific Command (PACOM) shares its strategy for each country with US industry giving an indication of the capabilities it believes the regional countries should possess and that they are suggesting the countries acquire. They then advocate with US industry those capabilities to the countries, *i.e.* effectively marketing US-made capabilities.
- d. The FMS procurement system is well defined. Other nations understand the process and also understand they are getting a guarantee from the US government for that sale *i.e.* price and schedule.
- e. Very senior Service officers, often Service Chiefs of Staff, frequently accompany OEM companies on marketing missions to other countries.

18. The Korean experience is particularly worthy of study. Korea in 2006 exported US\$250 million; in 2013 this grew to US\$2.6 billion. Why? Because of strong government incentives on the back of Korean companies that gained technology and positions with foreign entities through offset programs. A great example is the T50 trainer jointly developed by Lockheed Martin and Korean Aerospace Industries, borne out of an offset obligation from a LM sale to Korea. Now the T50 has just beaten *Hawk* in competition in Iraq and is positioned as a key competitor for the US TX program. This point is obviously a very hard pill to swallow as we know the Australian government position on offset arrangements.

19. The Korean government has always encouraged involvement by its major conglomerates in the defence sector by ensuring Korean defence companies enjoy large margins through GST/VAT exemptions and no corporation tax on final products for up to five years. This is in effect a state subsidy which goes some way to improving the competitiveness of Korean companies in the export market.

20. In the past the Korean defence industry sector was setup with national champions for each sector *e.g.* KAI – Air Sector. Therefore for such companies with the domestic market acting as a solid foundation with no competition diluting government funding, technological advances were able to be made in-conjunction with foreign industrial participation. Similarly Korea has understood that the current global defence sector is a buyer's market where huge demands are made for the transfer of technology. Korea's legislation or lack of legislation in this area has allowed significant transfers to take place, no more so than in Turkey where it assisted in the development of Turkey's main battle tank and in the near term potentially with its self-propelled artillery capability. In both cases technology transfer has not been seen as an obstacle to success but instead a competitive edge.

21. Nowadays the national champion model no longer exists as the Korean government wishes to see not only improved competition in the domestic market but consolidation so that its defence exports are better placed to succeed in the global marketplace. With this in mind DAPA released the following policy:

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22. Korean Basic Plan for Fostering the Defence Industry (2013-2017)
- a. DAPA states in its recently published paper that there needs to be consolidation in the defence industry.
 - b. The government recognises that this is not something that can be forced and that they can only encourage consolidation *via* financial incentives (including loans, tax cuts, preservation of production costs and other financial assistance).
 - c. DAPA realise that companies stove piped in single product lines focused on the domestic market lack the breadth and scale to compete internationally.
 - d. DAPA wants to see larger Korean defence companies and cites BAE Systems and its attempted merger with EADS.
 - e. DAPA plans to pick ten companies that possess technology with a real competitive edge and as such is exportable. Of these, two to three will be selected each year and sponsored for the next three years. They will receive R&D, marketing, financial and other support from the Government.
23. The South Korean government will continue to leverage its huge industrial base built on consumer goods, automotive, construction and shipping to support the overall package that can be brought to bear to support defence deals *e.g.* in Iraq Korean firms have been heavily involved in the reconstruction. South Korean foreign policy and its willingness to not interfere or comment on other state's potential use of their defence equipment is also an advantage – this is often an impediment in more liberal democracies. In addition generous financial terms and the leveraging of historical bi-lateral relationships dating back to the Korean War give added impetus to Korea's export ambitions.

Any other related matters

24. No other related matters.

Peter Nicholson
Head of Government Relations
Authorised by David Allott, Chief Executive
On behalf of BAE Systems Australia
Level 2, 14 Childers Street
Canberra ACT 2601

11 June 2014