

Parliament of Australia Inquiry into Government Support for Australian Defence Industry Exports

Assessment of the Export Support Given to Defence Industry by Governments of Comparable Nations

An example of UK Government support

July 2014

1 EXECUTIVE SUMMARY

- 1.1 This paper has been prepared by MBDA in response to the Parliament of Australia “Inquiry into Government Support for Australian Defence Industry Exports” and provides an example of the support the UK government provides to industry, with respect to defence exports.
- 1.2 Over recent years, the United Kingdom (UK) Government has placed increasing importance on the support given to the defence industry in order to enhance the exportability of defence equipment and technology. The economic benefits of legitimate defence exports are an essential enabler for sustainment of certain industrial capabilities that may be required in order to maintain the UK’s operational advantage and freedom of action, at a time where there is increasing pressure on the national defence budget.
- 1.3 Whilst the current UK defence white paper specifies that procurement of military capability will, where possible, be through open competition, the recognition of the need to maintain strategically critical areas of sovereign capability in the interest of national security, has led to a non-competitive approach to the development of complex weapons in the UK. The principle of the Team Complex Weapons commercial arrangement is premised upon a partnering approach between the UK Ministry of Defence (MoD) and MBDA UK, which enables £1.2 billion of savings over a ten year period compared to a traditional fully competitive approach.
- 1.4 The joint approach to Team Complex Weapons extends to enhance exportability of UK developed weapons in order to deliver further benefits and savings. A Joint Export Management Team, comprising representatives from the UK MoD, UK Trade and Industry (UKTI) Defence and Security Organisation (DSO) and MBDA UK, actively pursues export opportunities. The joint team co-ordinates export campaigns, undertakes joint market analysis, and prioritises and aligns UK programme activities early in development in order to maximise export opportunities.
- 1.5 Through this Joint Export Management Team, a model to quantify the economic benefits of export to the UK government and industry has been developed, approved by the UK MoD Cost Assurance and Analysis Service (CAAS) and is used to support MOD project business cases. The Export Benefits Model predicts the benefits that are apportioned to the UK MoD using an open book approach and sharing of the improved unit price and reduced overheads as a result of increased business volume due to export, as well as the wider economic benefits to Her Majesty’s Treasury (HMT).

- 1.6 The UK government is taking such partnering approaches with Industry further, through the government and industry Defence Growth Partnership, which entails wider British defence industry from Small and Medium Enterprises (SMEs) and academia to prime contractors. The MBDA UK Managing Director has a central role in the Defence Growth Partnership as co-chair, on behalf of industry, with the UK Minister of State for Business and Enterprise. The objective of the Defence Growth Partnership, like Team Complex Weapons, is to transform the UK defence industry for the long term sustainment of key capabilities, as well as ensuring competitiveness and exportability for an affordable military capability. The Defence Growth Partnership was launched in 2013, with the implementation plan to be published in July 2014.
- 1.7 The Royal United Services Institute for Defence & Security Studies (RUSI) highlighted in a Whitehall Paper on “The Defence Industrial Triptych : Government as Customer, Sponsor and Regulator”¹, that governments ‘sponsor’² their defence industry in a number of different ways, which is not necessarily only financial support. The UK government through these partnering relationships is able to support the UK defence industry, by providing a more transparent and open way of working and interdependent relationship with Industry, recognising the different objectives of both parties. In industry, the objective is profitability and sustainment, whereas for the UK government, their objective is to provide operational advantage and freedom of action of its military capability, whilst ensuring value for money and affordability.
- 1.8 The RUSI Whitehall paper also highlights that industry and governments cannot gain the economic benefits from exports if it does not have the skills and capabilities to develop high technology products. The paper states that *“If the UK government is to purchase its defence equipment off the shelf from the world market, the UK will not necessarily research and develop its own capabilities or equipment packages in future. Under this scenario it is difficult to fathom just what defence and security equipment the country will be able to export in the mid-to-long term.”* Hence it is important for governments to retain specific in-country defence industry capabilities and provide preferential support to national defence programmes, which in turn enables export and the wider economic benefits, which can be invested back in-country.
- 1.9 In terms of relevance to Australia, there are already examples of preferential support to in-country defence industries. An example would be CEA technologies and the phased array radar technology. However, adopting similar partnering relationships to the UK would provide greater incentives for both the Australian government and local industry. Through greater consideration of export and the economic benefits that could be returned on the initial investment, it may be more beneficial to consider investment in the local defence industry, rather than predominantly Off The Shelf (OTS) procurement.

¹ Royal United Services Institute, Henrik Heidenkamp, John Louth and Trevor Taylor, “The Defence Industrial Triptych : Government as Customer, Sponsor and Regulator”, 2013

² ‘Sponsor’ in this context refers to government’s commitment, or otherwise, to support and promote defence industries through the generation of tailored policies, processes and activities.

2 INTRODUCTION

- 2.1 MBDA is a world leading Missiles and Missile Systems company with an annual turnover of the equivalent of about A\$4 billion and an order book in excess of A\$13 billion. The company has three major aeronautical and defence shareholders – Airbus Group (37.5%), BAE Systems (37.5%) and Finmeccanica (25%) and 10,000 employees across UK, France, Italy, Germany, Spain and the United States.
- 2.2 MBDA Australia is a registered trading name of MBDA UK Limited. An office was established in Canberra in 2013 to enable a greater understanding of the defence environment within Australia so that MBDA can appropriately respond to the needs for the Australian Defence Force.
- 2.3 MBDA Australia has prepared this paper in support of the terms of reference for the “Inquiry into Government Support for Australian Defence Industry Exports”. This paper specifically addresses the “assessment of the export support given to defence industry by governments of comparable nations”.
- 2.4 This paper provides an example of the support the UK government has given to the defence industry, with respect to defence exports. It is based on the experience of joint collaboration between MBDA UK and the UK government as part of the Team Complex Weapons partnering agreement. In particular, it describes the activities undertaken by the Joint Export Management Team to enhance the exportability and market attractiveness of UK complex weapons.
- 2.5 MBDA UK would be pleased to engage in further dialogue with the Australian Government and Department of Defence to expand on the UK experience of this joint approach to export.

3 UK GOVERNMENT OVERALL EXPORT POLICY

- 3.1 In 2011/12, the UK coalition government stated a challenging ambition to double exports across all industrial sectors to £1 trillion by 2020 and to increase the number of companies exporting by a further 100,000.³
- 3.2 The UKTI DSO is a government department responsible for encouraging international co-operation as part of Industry led defence export campaigns, including providing government to government and government to industry support. Whilst the UK government target reflects export performance across the whole of the British economy, the UKTI DSO also has a specific target to *“Maintain the UK’s position as the second largest defence exporter with at least 20% of the defence export market”*⁴.
- 3.3 The UK government has placed priority on improving defence exports due to the benefits that it brings to the nation. The then UK Minister for International Security Strategy, Gerald Howarth stated *“Defence exports also bring prosperity to the nation in terms of profits, employment and intellectual property”*⁵.
- 3.4 The UK defence white paper *“National Security Through Technology”*⁶ highlights the critical role, both in terms of the wider benefits and the financial benefits, that export plays in the UK’s defence and security policy objectives. Defence exports help to:
- a) *“Develop, build and enhance bilateral relationships and defence cooperation with key allies and helps other like-minded nations to build up their own defence and security capabilities, contribute to regional security, helping to tackle threats to UK national security closer to their source.”*
 - b) Balance the economies of scale by reducing the cost of programmes to the UK by spreading the non-recurring costs of research and development over increased production runs and reduced unit costs, as well as providing long term viability for suppliers, smoothing the impact of fluctuating or limited domestic demand.
 - c) Make a significant contribution to advancing our technological and manufacturing capabilities, through greater opportunities for innovation and long term viability of suppliers, and specifically those industrial capabilities essential to UK national security.
- 3.5 This paper specifically addresses the financial benefits to the UK as a result of the UK government and MBDA partnering relationship in Complex Weapons.

³ National Audit Office, *“Supporting UK Exporters Overseas”*, 16th October 2013

⁴ UKTI DSO, *“UKTI At A Glance 2013/14”*, April 2013

⁵ Royal United Services Institute, Gerald Howarth Minister for International Security Strategy, *“Ministry of Defence Support to Defence Exports”*, November 2011

⁶ UK Ministry of Defence, *“National Security Through Technology: Technology, Equipment and Support for UK Defence and Security”*, February 2012

4 GOVERNMENT SUPPORT TO UK COMPLEX WEAPONS

- 4.1 Within the UK defence white paper, the UK MoD has identified aspects of Complex Weapons as an example of a capability where it is necessary to protect the UK's operational advantage and freedom of action. This means that the UK MoD aim to fulfil the majority of its future requirements for Complex Weapons from UK suppliers, rather than through open competition subject to ongoing, stringent affordability and demonstrated value for money tests.
- 4.2 As a result in 2010, the UK MoD signed together with MBDA UK, the Team Complex Weapons Interim Portfolio Management Agreement (PMA). The objective of the PMA is for UK MoD to leverage greater military capability within a much reduced cost base through a partnering arrangement with Industry.
- 4.3 The shared vision of the Team Complex Weapons PMA is achieved through an interdependent relationship between Industry and the MoD customer, recognising the need to achieve the differing organisational goals:
- a) The UK MoD requires current and future military capability with operational advantage, freedom and action and value for money, which is achieved by the sustainment of appropriate industrial sovereign capability; and
 - b) MBDA UK requires a sustainable and profitable business through being MoD's primary partner of choice for the supply and support of world leading complex weapons which delivers shareholder value.
- 4.4 This collaborative approach to transforming and sustaining the supply and support of the UK Complex Weapons portfolio, ultimately delivers net benefit compared to the previous procurement approach. In 2010, the UK MoD engaged independent assessors who verified a £1.2 billion cost capability net benefit within 10 years compared to existing competitive procurement. With further independent assessments and following the positive experience over the previous three years, the UK MoD re-affirmed its commitment to this approach through the signature of the Full PMA with MBDA in 2013.
- 4.5 These savings are achieved through activities such as commonality and modularity of sub-systems and technologies, optimising the design to minimise through life costs, as well as enabling greater flexibility to trade requirements and cost across the portfolio.
- 4.6 Delivering these benefits requires not only behavioural changes across both MoD and MBDA, but also a proactive approach to working together. This is achieved through greater transparency based on open book accounting, improved agility and flexibility by both parties and greater efficiencies and responsiveness within Industry.

- 4.7 Furthermore, the PMA seeks to exceed the £1.2 billion savings through a shared approach to business transformation activities across the Portfolio. As part of this the UK MoD and MBDA UK works together to increase the export of UK developed weapons.

5 EXPORT OF UK COMPLEX WEAPONS

5.1 The UK defence white paper underpins the government's approach of supporting UK industry to increase the share of global defence exports through:

- a) Consideration of export-related issues early in the MoD's acquisition cycle;
- b) Robust analysis of customer requirements in potential export markets;
- c) Collaboration with industry to specify broader parameters for equipment requirements, which allow for export potential;
- d) Adjustment of UK requirements to maximise the mutual benefits (qualitative and quantitative) that can be gained by working more closely with allies and overseas customers;
- e) Use of methodologies such as modularity, open systems, and technology insertion to meet the UK's specific needs; and
- f) Strengthen the consideration of exportability issues within the MoD's business case approvals process.

5.2 In keeping with these guidelines and in line with the principles of the PMA, the UK MoD, UKTI DSO and MBDA UK actively work together to enhance the exportability of UK developed complex weapons. The objectives of this Joint Export Management Team are to define cross-cutting policies/strategies, prioritise activities in support of export, act as a single point of focus, co-ordinate activities with respect to overseas markets, and plan and deliver joint/coordinated export campaigns.

5.3 The Joint Export Management Team comprises representatives from UK MoD Defence Exports & Commercial Strategy (DECS), UK MoD Defence Equipment and Support (DE&S), UK MoD Capability, UKTI DSO and MBDA UK. The Joint Export Management Team work together on a series of work strands ranging from market analysis, strategic tasks for high level campaigns and programme alignment and tactical tasks to support the day to day coordination and prioritisation of export activities.

5.4 The Joint Export Management Team report into a 1 star Joint Export Management Board on a bi-monthly basis. The purpose of the Joint Export Management Board is to set the priorities for the joint team, endorse recommendations and to escalate issues to the 2 star Export Steering Board.

5.5 The 2 star Export Steering Board is held every 6 months to provide strategic direction to the Joint Export Management Team and Board, and comprises senior leaders from UK MoD, DE&S, UKTI DSO and MBDA UK.

6 BENEFITS OF A JOINT APPROACH TO THE EXPORT OF UK COMPLEX WEAPONS

6.1 The UK MoD and MBDA UK have committed through the PMA to transform their approach to export to improve the prospects of exporting to a greater number of nations and also due to the recognition that this will provide greater benefit to HMT, MoD and MBDA when compared to the traditional approach, including:

- a) For HMT – An element of the initial investment can be recouped through the wider economic benefits such as corporation tax, local employment and associated personal tax contributions and spending;
- b) For MoD – Synergies between UK and export requirements enable savings, which can be re-invested back into the Portfolio and in turn improve military capability and long term sustainment of the wider UK industrial base to ultimately support the goal of being able to protect the country's operational advantage and freedom of action; and
- c) For MBDA UK – Through re-investment of MoD savings into the Portfolio, the long term viability and sustainment of the skills and capabilities within the company can be maintained.

6.2 These savings may accrue as a result of an increase in the production quantity enabling a reduced unit price, reduced overheads as a result of increased business volume, and potentially the spread of non-recurring development costs if the timescales of domestic and export requirements can be aligned.

6.3 The majority of financial benefits flow primarily to HMT (e.g. via income tax and corporation tax etc) through both a conventional and partnering approach. The difference with the standard approach to export compared to the partnering approach is that savings due to the greater economies of scale associated with increased business volume due to export would flow solely to industry. Through this joint approach, both industry and MoD are incentivised to enhance exportability.

6.4 The UK MoD and MBDA UK have jointly developed an Exports Benefit Model to enable a quantitative analysis of the value of these benefits. Figure 1 provides a representation of this model, which has been generalised for the purposes of this inquiry and to remove any commercial sensitivity.

6.5 The input data into the model comes from the following:

- a) A 10 year assessment of the investment that will be made to in-country defence industry for future Complex Weapons capability requirements; and
- b) A joint market analysis of the potential export orders for the future Complex Weapons capability requirements, developed in conjunction with the government export organisation (e.g. DSO).

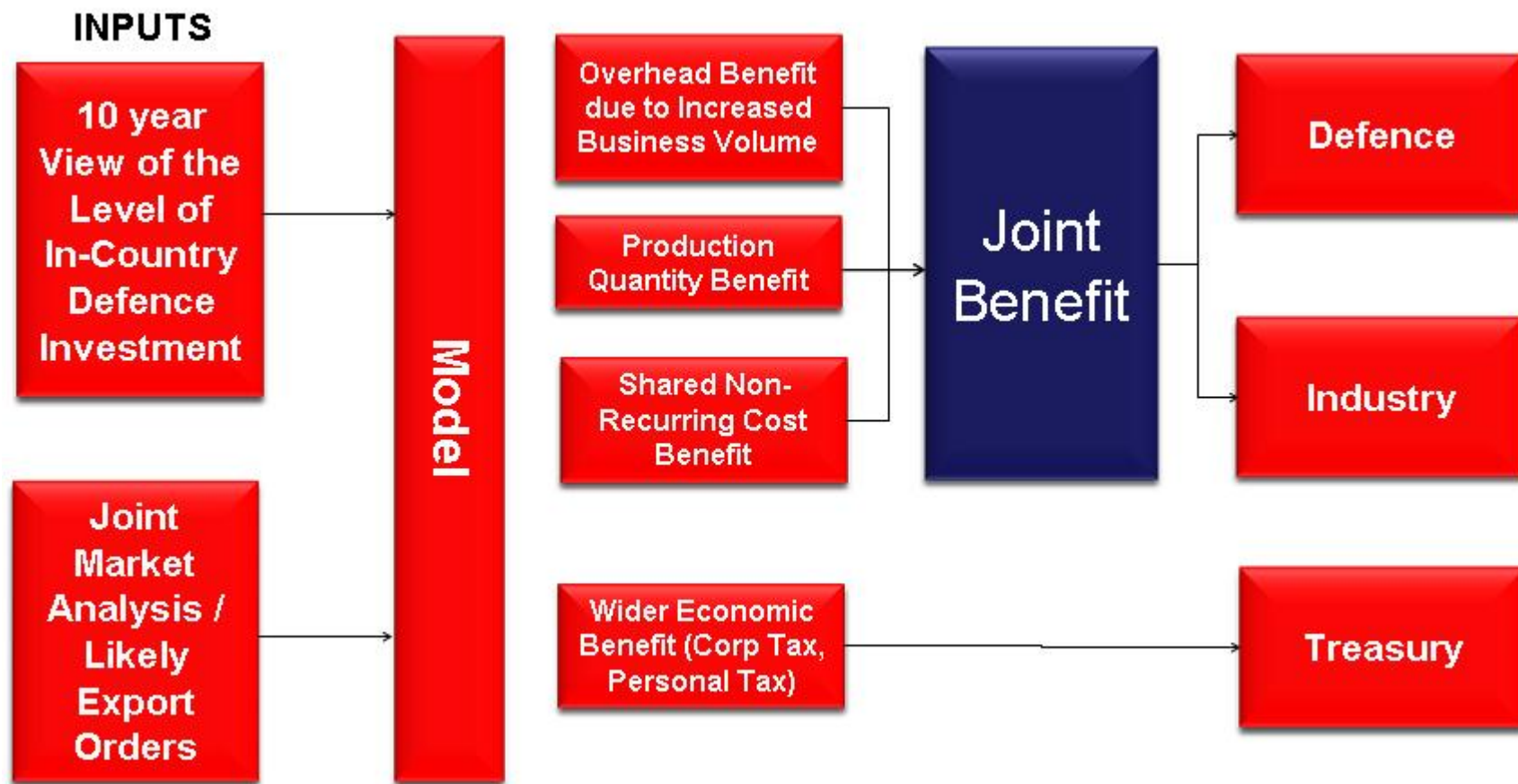


Figure 1: Simplified Export Benefits Model

- 6.6 The Export Benefits Model determines, based on these inputs, the likely amount of investment that could be recouped by Treasury and the benefits to defence, which could then be re-invested into future military capability.
- 6.7 The assessment of the level of benefit is an essential part of the UK MoD investment decision making process. All business cases to be submitted to the Investment Approvals Committee must now consider whether the programme is maximising the export potential of equipment, infrastructure or services being acquired for the UK Armed Forces.
- 6.8 The UK MoD Approvals Guidance Process⁷ specifies that the UK MoD must consider, as part of the investment proposals, the qualitative and quantitative benefits to be gained by exports, underpinned by robust market analysis of customer requirements. Where changes could be made to the programme to maximise opportunities for exportability, without detriment to defence in terms of increased cost or reduced military capability, the business case needs to quantify these benefits to inform investment decisions.
- 6.9 As such, the mechanism and use of this model has been approved by the UK MoD CAAS, the centre of excellence for pricing and costing support to the acquisition community. CAAS is responsible within the MoD for the continuous improvement of the acquisition process, risk reduction, and ensuring best value for money for defence.
- 6.10 Typically, through the innovative Team Complex Weapons business model and in particular the direct benefits to the UK MoD, defence is likely to save in the order of 3-5% of the total investment through reduced unit price and overheads as a result of export. These savings maybe re-invested into the Portfolio to enable greater future military capability.
- 6.11 Whilst the wider economic benefits of investment into the British Economy are not taken into consideration (due to the difficulty in accurately quantifying these benefits in real terms), research concludes that investment in the UK supply chain is an important source of tax revenue for the government. The UK Royal United Services Institute (RUSI) analysis, *The Destinations of the Defence Pound*⁸, identified that *“By using British businesses and conducting the work on-shore, close to 36 per cent of the Government spend of each £1 million was returned to the Exchequer via tax and national insurance contributions.”* This outcome is similar to the conclusions drawn by Oxford Economics in 2009⁹.
- 6.12 This independent research into the wider economic benefits supports the Complex Weapons Export Benefits Model, which predicts that an estimated 15-20% of the investment could be recouped.
- 6.13 There has been interest in this type of model for other industries and sectors, and as such the UK MoD and MBDA UK have provided briefings on the model and its application to economists in the wider government community for non defence related applications.

⁷ Sec(EC)/1/7 Approvals Guidance version 10.9 May 2013

⁸ Royal United Services Institute, Trevor Taylor and John Louth, “The Destinations of the Defence Pound”, January 2012

⁹ Oxford Economics, “The Economic Case for Investing in the UK Defence Industry”, August 2009

7 BROADER GOVERNMENT DRIVE FOR DEFENCE EXPORTS

- 7.1 Following on from the success of the Team Complex Weapons partnering arrangement in terms of providing an innovative business model for an affordable solution to the long term sustainment of the complex weapons sector, MBDA UK takes a central role as joint lead, on behalf of wider defence industry, with the government in the Defence Growth Partnership.
- 7.2 The Defence Growth Partnership initiative¹⁰, launched in 2013, states that *“by working in partnership (government and industry), our objective is to have a truly competitive, sustainable, and globally successful UK Defence Sector that provides affordable leading edge capability and through life support for our Armed Forces and international customers, and in addition brings wider economic benefits to the UK”*.
- 7.3 This initiative also encompasses the wider British defence industry, from Prime Contractors to SMEs and Academia, working with the Department of Business Innovation and Skills, UK MoD and UKTI, as well as trade associations such as Advancing UK Aerospace, Defence, Security and Space Industries Group (ADS).
- 7.4 The emphasis of the Defence Growth Partnership is on achieving best value for money, through modernisation and reshaping the way the UK Defence Sector works to secure future prosperity. It is about developing new opportunities based on strengths within the UK to deliver growth. It therefore relies on industry to evolve and improve its competitiveness through greater efficiency and the development of new business models and innovative, affordable solutions.
- 7.5 One particular strand of the initiative is to grow international business, with the recognition that defence exports make a significant contribution to the UK economy at a time where there is continuing pressure on the UK defence budget. This strand supports SME led export opportunities as well as major prime contractor opportunities.
- 7.6 The activities within the export strand of work are underpinned by the need to support in-country defence industry, to ensure appropriate retention and enhancement of skills and knowledge to develop high technology products which are exportable.
- 7.7 The Royal United Services Institute for Defence & Security Studies (RUSI) published in 2013 a Whitehall Paper on *“The Defence Industrial Triptych : Government as Customer, Sponsor and Regulator”*¹¹, which states that:
- “If the UK government is to purchase its defence equipment off the shelf from the world market, the UK will not necessarily research and develop its own capabilities or equipment packages in future. Under this scenario it is difficult to fathom just what defence and security equipment the country will be able to export in the mid-to-long term.”*
- 7.8 This is further supported by the Royal Aeronautical Society, which states that *“unless the UK defence industrial foundation is maintained, then the potential for the defence exports will be critically weakened.”*¹²

¹⁰ Defence Growth Partnership, *“Securing Prosperity: A Strategic Vision for the UK Defence Sector”*

¹¹ Royal United Services Institute, Henrik Heidenkamp, John Louth and Trevor Taylor, *“The Defence Industrial Triptych : Government as Customer, Sponsor and Regulator”*, 2013

¹² Royal Aeronautical Society, *“The Future of UK Defence Aerospace”*, November 2012

- 7.9 Through retention of the in-country skills and knowledge, and with the wider economic benefits of exporting defence technology, the UK government is able to capitalise with greater military capability whilst maintaining their ability to act autonomously.
- 7.10 The detailed implementation plan for the Defence Growth Partnership is due to be released in July 2014.

8 NOT A QUESTION OF SUBSIDISING UK DEFENCE INDUSTRY

- 8.1 The RUSI Whitehall Paper on “The Defence Industrial Triptych : Government as Customer, Sponsor and Regulator” deals with how the respective governments of the United States (US), UK and Germany deal with defence and in particular their relationships with defence industry. Section 3 of this Whitehall Paper, addresses “Government as Sponsor”, whereby it seeks to evaluate the support given by these respective governments to helping on-shore defence industry survive and prosper.
- 8.2 The report recognises the different levels of sponsorship between the three governments, from the US predominantly providing financial sponsorship to the local defence industry in the form of Research and Development (R&D), through to the German perspective of providing industrial sponsorship in terms of policies aimed at providing the right environment for defence, and with the UK somewhere in-between.
- 8.3 The RUSI report identifies that the UK MoD policy on the level of investment within R&D (approximately 1.2% of the defence budget) is only effective due to the emphasis on industry to invest their own money. To that end, the Team Complex Weapons PMA facilitates a collaborative approach to research, which more effectively aligns public and private funding to the UK MoD future capability and technology roadmaps, ensuring exploitation of this investment into future projects. An example of this is the Weapons Science and Technology Centre (WSTC), which is an enterprise led by QinetiQ on behalf of the Defence Science and Technology Laboratories (DSTL), comprising over 50 partners from the UK MoD, Academia and Industry. The principal aim of the WSTC is to plan and deliver technologies into the UK Team Complex Weapons portfolio. Underpinning and cross-cutting technology needs are identified within the long term capability plans and exploitation paths identified into future Complex Weapons programmes.
- 8.4 In addition, it identifies partnering between government and industry as a type of sponsorship, for which the UK is identified as the example since it does not have the funds of the US to financially invest heavily into the defence industry. Taking this further, the Team Complex Weapons partnering arrangement between the UK MoD and MBDA UK required a robust due diligence process to be put in place to ensure that constraining competition in favour of a portfolio approach continues to deliver the UK tax payer with significant savings over a traditional fully competitive approach. Indeed, as mentioned earlier, the independent MoD assessment confirmed a saving to the UK MoD of £1.2bn over 10 years through this partnering approach. The arrangement is subject to ongoing and regular UK MoD scrutiny, to ensure that a largely non-competitive approach to the procurement of guided weapons in the UK represents best value for money, with commercial safeguards in place to enable the UK MoD to revert to a traditional fully competitive procurement policy in the future, should the circumstances change.
- 8.5 Specifically in relation to exports, all three governments provide substantial support to industry for exports. For the UK, this is through active backing of defence exports rather than financial incentives, particularly for SMEs who typically cannot easily monitor markets across the world.
- 8.6 The report identifies that the benefit of government sponsorship, in whatever form is relevant to the state, is of particular importance to SMEs, as it is these smaller niche businesses that bring the greatest level of innovation to the defence industry.

9 POTENTIAL APPLICATION TO THE AUSTRALIAN DEFENCE ENVIRONMENT

- 9.1 With record increases in defence exports in 2012 of 62%¹³, it suggests that the emphasis being placed on exports by the UK government is starting to pay dividends. Through the Defence Growth Partnership and specifically for MBDA UK through the Team Complex Weapons Partnering arrangement, the UK government is actively working with industry to enhance opportunities for defence exports.
- 9.2 The principle of both the Defence Growth Partnership and Team Complex Weapons is through a collaborative partnership between industry and government. These partnerships enable the government to provide sponsorship to industry, not specifically in the form of financial assistance or incentives. The focus is on innovative new ways of working to specifically improve UK export opportunities, whilst providing cost effective on-shore capability through competitiveness and efficiency.
- 9.3 In both cases, industry and government share a common goal relating to affordability and sustainability, which is driven through different perspectives to achieve that goal. For instance, industries are driven by the need to be sustainable and profitable, whereas government are driven by the need to have the best military capability that can be afforded within the defence budget.
- 9.4 Australia's defence policy is focussed on open competition and 'Off The Shelf' (OTS) procurement, and as such is closely aligned to the UK's defence white paper. The key difference is that the UK have identified the need to protect certain capabilities that are essential to maintain the nations operational advantage and freedom of action, although this is caveated by the importance of doing so, only if it is cost effective. This has been achieved in the UK, through a drive to create more innovative and effective business models, rather than UK MoD subsidising the defence industry.
- 9.5 As highlighted within the RUSI report, like the UK, the US and Germany have also identified industrial sectors that they consider vital to their national defence efforts and as such are reluctant to rely on foreign suppliers in these sectors. Similarly, within Australia there is recognition of the importance of critical skills and capabilities to be maintained in-country through the Australian Industry Capability programme. For Australia to sustain those capabilities that are identified as critical to national security without significant financial investment, consideration of alternative business models is essential.
- 9.6 Whilst Australia for example, does not have the broad capability to design and manufacture a complete guided weapon system (identified as a Strategic Industry Capability) through in-country suppliers, this could be achieved through working closely with international partners who are able to share intellectual property with local SME's who have capabilities in specific niche areas. This would enable these local SME's in Australia to maintain a level of on-shore capability by participating in development projects and enabling defence to independently evaluate, modify, operate and sustain equipment through life.
- 9.7 Proactive and joined up relationships between the Australian government and local industry could stimulate more innovative business models for the longer term preservation of a defence sector within Australia, providing skills, knowledge, capability and the generation of intellectual property which is ultimately needed for the growth of exports. As the RUSI paper highlights it is difficult to understand what

¹³ UK Government, "Defence exports largest increase in 5 years", 20th June 2013

technology and products can be exported, if the procurement approach is principally OTS.

- 9.8 As such, if the Australian government is to seriously address support to defence industry exports, one of the first steps is to assess the options for a 'non-OTS' procurement policy in specific technologies and capabilities. These technologies and capabilities would need to be targeted at those areas where it is not only essential to maintain a level of in-country capability, but also where export market analysis demonstrates greatest opportunity for exploitation of Australian developed products. Whilst traditional manufacturing offsets can sustain a level of in-country capability, the economic benefit to Australia for the export of these systems would be low, as there is little or no intellectual property owned by Australia. The real benefit of export will come from participation in core development work in high end critical technology and system functions enabling innovation and driving capability enhancement.
- 9.9 There are existing examples where the Australian government have already committed to an in-Country development contract, instead of OTS procurement: submarines, ship building and phased array radars to name a few. The difference between the current approach to non-OTS procurement and a Team Complex Weapons type partnering relationship is the inter-dependence between defence and industry to become more competitive and efficient. It is through this symbiotic relationship with industry, that the Australian government could maximise their already high investment into local industry, through recouping of savings and benefits as a result of subsequent export orders. A similar joint governance structure and method of calculating and evaluating the export benefits would support the decision making process.
- 9.10 Whilst the joint Team Complex Weapons export governance structure primarily deals with export at a platform/weapon system level, this is only enabled by consideration of export and flow down of strategic direction to sub-system level and associated technologies. As such the principles of a partnering relationship and associated support to export can equally be applied to sub-systems and technology.
- 9.11 Taking this further and relating it to the guided weapons sector in Australia, there is a precedence of partnering between the UK and Australia on the Advanced Short Range Air to Air Missile (ASRAAM). Since 1998, when ASRAAM was first selected by the Royal Australian Air Force (RAAF), the Australian defence organisations and in particular the Defence Science and Technology Organisation, have developed capabilities not present in the UK for the mutual benefit of both countries. These capabilities in the field of missile simulation and hardware in the loop, have enabled the Australian Defence Force to understand the performance of the missile against Australian regional threats, improve and enhance the performance, as well as support the development of Australian tactics.
- 9.12 A similar approach with the key local SME's could be adopted, with Australian industry included within the global supply chain for the development and manufacture of future weapon systems. If Australia were to partner with a country like the UK, who are proactively working with industry and Government organisations to enhance export opportunities, this could provide a mechanism for inserting Australian developed technology and sub-systems into a variant of the weapon system to meet not only Australia's needs but to also support the export market, and gain greater economic export benefits for Australia.

10 CONCLUSION

- 10.1 The key elements of the UK experience of how government can support defence industry exports are:
- a) Partnering relationships between government and industry stimulate alternative innovative business models and different ways of working to be more efficient and competitive;
 - b) Export allows the sustainment of key high end capabilities required in strategically critical areas of national security with reduced dependency on government;
 - c) Support to defence exports can offer financial benefits to the government, directly through savings due to greater business volume and indirectly through wider economic benefits.
- 10.2 The above elements can only be realised through research and development, which stimulates the local defence industry capabilities or equipment packages and associated intellectual property that is essential for export. A procurement policy that is premised predominantly on OTS equipment, manufacturing offsets or low end technology development, is unlikely to gain any significant, long term economic benefit from defence export.
- 10.3 Whilst Australia may not have, or want to have, a defence industry that is capable of developing a complete guided weapon system it could, for example, through a partnering relationship with the UK, foster greater opportunities for local Australian SMEs to exploit their niche capabilities to a greater extent through inclusion within the global supply chain. The unique relationship of the two countries enables greater opportunity to share intellectual property, which in turn develops local skills and capabilities to develop the Australian owned intellectual property essential for export.