

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMICS REFERENCES COMMITTEE

#### *Inquiry into Australia's sovereign naval shipbuilding capability*

Hearing of Friday, 14 August 2020

#### Question on Notice 1 (pages 15 and 16 Proof Hansard)

**Senator PRATT:** Thank you. Are there any legal impediments to prevent Australia from mandating minimum Australian industry content levels in our naval shipbuilding program?

**Mr Jagers:** I'd probably have to take the specific question on notice.

...

**Senator PRATT:** So, can I ask: if the government was to mandate a 90 per cent minimum of Australian industry content—and that's not to go to what's already in the contract—would they be able to do that? Are such thresholds legally enforceable?

**Mr Jagers:** I would have to take specific questions like that on notice, because there is a complicated framework of international treaties and obligations that we have. I wouldn't want to make an off-the-cuff response to that.

**Senator PRATT:** Okay. Could you either confirm for us that there are no legal impediments or outline what those legal impediments are and be quite specific as to the department's views about which free trade agreements they are and where exactly—in which clauses—those constraints actually exist?

#### Response

Australia is party to the WTO Agreement on Government Procurement (GPA) and a range of free trade agreements with government procurement obligations. These arrangements are implemented domestically by legislation and/or Commonwealth policy. Relevant international obligations have been incorporated into the Commonwealth Procurement Rules. Therefore, an official undertaking a procurement is not required to refer directly to international agreements.

A number of Australia's free trade agreements contain non-discrimination and national treatment obligations which require parties to treat each other's suppliers on conditions no less favourably than the party applies to its own domestic suppliers. Further, Australia's free trade agreements prohibit the mandating of domestic content when procuring goods and services covered by a free trade agreement.

There are exemptions within the WTO GPA and Australia's free trade agreements to these obligations. The essential security exemptions within the WTO GPA and Australia's free trade agreements mean that a party is not precluded from applying measures necessary for international peace or security, or the protection of its own essential security. Further, the procurement of a number of goods are not covered by the government procurement obligations of Australia's free trade agreements. These goods are listed in Australia's annexes to its free trade agreements.

Unless an exemption applies, or a procurement is not covered by Australia's free trade agreements, the government would not be able to mandate a 90 per cent minimum of Australian industry content.

The obligations that may constrain an Australian industry content mandate are located in the following clauses of Australia's free trade agreements:

<b>Free Trade Agreement (FTA)</b>	<b>Date of entry into force</b>	<b>Clause</b>
Australia-New Zealand Closer Economic Relations Trade Agreement	1 January 1983	Objectives of the Agreement
Singapore-Australia Free Trade Agreement	28 July 2003	<i>National Treatment and Non-Discrimination</i> Chapter 6: Article 4: Paragraphs 1-3  <i>Offsets</i> Chapter 6: Article 4: Paragraph 6
Australia-United States Free Trade Agreement	1 January 2005	<i>National Treatment and Non-Discrimination</i> Chapter 15: Article 15.2: Paragraphs 1-2  <i>Offsets</i> Chapter 15: Article 15.2: Paragraph 5
Thailand-Australia Free Trade Agreement	1 January 2005	<i>National Treatment and Non-Discrimination</i> Chapter 15: Article 1503: Paragraphs 1-2  <i>Offsets</i> N.a
Australia-Chile Free Trade Agreement	6 March 2009	<i>National Treatment and Non-Discrimination</i> Chapter 15: Article 15.4: Paragraphs 1-4  <i>Offsets</i> Chapter 15: Article 15.6
Korea–Australia Free Trade Agreement	12 December 2014	<i>National Treatment and Non-Discrimination</i> Chapter 12: Article 12.3: Paragraphs 1-2  <i>Offsets</i> Chapter 12: Article 12.3: Paragraph 4

<b>Free Trade Agreement (FTA)</b>	<b>Date of entry into force</b>	<b>Clause</b>
Japan-Australia Free Trade Agreement	15 January 2015	<i>National Treatment and Non-Discrimination</i> Chapter 17: Article 17.3: Paragraphs 1-5  <i>Offsets</i> Chapter 17: Article 17.6
Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)	30 December 2018	<i>National Treatment and Non-Discrimination</i> Chapter 15: Article 15.4: Paragraphs 1-3  <i>Offsets</i> Chapter 15: Article 15.4: Paragraph 6
World Trade Organisation Government Procurement Agreement (WTO GPA)	5 May 2019	<i>National Treatment and Non-Discrimination</i> Article IV: Paragraphs 1-2  <i>Offsets</i> Article IV: Paragraph: 6
Australia-Hong Kong Free Trade Agreement	17 January 2020	<i>National Treatment and Non-Discrimination</i> Chapter 13: Article 13.4: Paragraphs 1-2  <i>Offsets</i> Chapter 13: Article 13.4: Paragraph 5
Peru-Australia Free Trade Agreement	11 February 2020	<i>National Treatment and Non-Discrimination</i> Chapter 14: Article 14.4: Paragraphs 1-3  <i>Offsets</i> Chapter 14: Article 14.4: Paragraphs 6

## Department of Finance

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#### **Question on Notice 2** (pages 17 and 18 Proof Hansard)

**Senator PRATT:** So you could meet all those rules and still have a blowout of 30 per cent in two years. You could meet all those rules and still have no understanding of how much Australian industry participation there will be in this acquisition. You're saying they're relevant, but I would like more detail as to how they're relevant in the case of these particular questions.

**Mr Jagers:** At the time of a decision of the procuring entity—in this case, Defence—they would have used the Commonwealth procurement rules to help guide and determine how they will go about that process to achieve value for money. In relation to costs—you've presented that a couple of times as cost blowouts—I think the Department of Defence have answered it as a series of questions on the costs of each of their projects. I think they quite recently answered some questions to the JCPAA parliamentary inquiry following the ANAO's report on the Defence major projects report. They certainly didn't characterise the costs in the same that you have and as earlier witnesses were talking to. There are a range of numbers and costs that have been talked about on the basis of whether they were from the original white paper in 2016 or talking about the costs in 2016 in terms of current dollar costs and then what those numbers look like over a long-term program, taking into account impacts of inflation, exchange rates and various other bits and pieces where you get a different number. That's a matter for Defence to talk to in terms of its program. I note that they've done that to a number of committees.

**Senator PRATT:** In the context of the Auditor-General reports, have you reflected on your rules and what kind of guidance those rules provide to Defence in the context of the problems they highlighted?

**Mr Jagers:** I would have to take on notice whether the particular report that was released led to specific considerations. I imagine that it would have informed the guidance material that I've just been talking about regarding benefits to the Australian economy, but I would have to take that on notice.

**Senator PRATT:** Okay. If you could be as specific as you can about how Finance has responded to those reports and where it's made changes, including in those guidance materials, that would be great.

## **Response**

The Department of Finance (Finance) reviews Auditor-General reports and considers any relevant conclusions and recommendations and updates its guidance if necessary.

The 2017-18 Major Projects Report published by the Auditor-General did not make any conclusions or recommendations in relation to the Commonwealth Procurement Rules.

In August 2020 Finance updated its *Consideration of broader domestic economic benefit in procurement* guidance to provide further guidance and examples of how the economic benefit of a procurement should be considered in the context of assessing value for money, as per section 4 of the Commonwealth Procurement Rules. It now also provides an additional focus on the development and sustainment of industry capabilities.

Finance collaborated with the Department of Defence and the Department of Foreign Affairs and Trade on the updates.

# Department of Finance

## Response to Question on Notice

### SENATE ECONOMIC REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

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#### **Question on Notice 3 (Page 19 of the Hansard Proof)**

**Senator PATRICK:** So you don't have any ongoing function to advise the Minister for Finance of risks associated with programs that are of the magnitude of \$80 billion, \$90 billion or \$45 billion?

**Mr Jagers:** Cabinet will be considering the risks and progress of projects, and Finance will provide its view to the Minister for Finance in the context of that cabinet consideration. Certainly to be able to provide that view Finance is involved in a number of forums with the Department of Defence, including secretary-level interactions with key agencies and also interactions with deputy secretaries and other levels within the agency. That's to ensure that we're across the detail of what's happening in the projects and program so that we can provide advice to the finance minister in the context of that cabinet consideration.

**Senator PATRICK:** So you think the Australian public have no right to understand or know what Finance independently thinks the risks of these 134 billion dollar programs are?

**Mr Jagers:** I'm just describing the process that we go through. I'm not—

**Senator PATRICK:** Alright. Can I ask you to provide that risk and cost analysis to the committee. The minister can claim public interest immunity if he wants to and I'll take it up with him in the parliament. Can you take that on notice, please.

**Mr Jagers:** I will.

#### **Response**

Finance provides a statement relating to the veracity of the cost estimates and risks solely for inclusion in each Cabinet submission relating to Defence Integrated Investment Program projects to inform Government considerations. This advice cannot be separated from the Cabinet Submission. It is a longstanding practice not to disclose information about the operation and business of the Cabinet, as to do so would potentially reveal its deliberations which are confidential.

# Department of Finance

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### SENATE ECONOMICS REFERENCES COMMITTEE

#### **Inquiry into Australia's sovereign naval shipbuilding capability**

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#### **Question on Notice 4** (page 19 Proof Hansard)

**Senator PATRICK:** In terms of foreign exchange, Finance bears the cost of foreign exchange variations in each of the projects; is that correct?

**Mr Jagers:** Each department would bear the cost.

**Mr de Re:** Tony Dalton's previous testimony on this has advised that the Commonwealth bears that at a whole-of-government level. Whether specifically that's the Department of Finance or the Department of the Treasury we can take on notice, but it's dealt with it a whole-of-government level.

**Senator PATRICK:** It seems to me that someone has to take it on. Defence describe it in their answer as 'no-win no-loss' because the Department of Defence doesn't bear that. So I would like to know who actually holds responsibility for that. If it is Finance, can you please take on notice what percentage of the total constant value for the Future Submarine Program is affected by foreign exchange and the same for the Hunter class program.

**Mr de Re:** We can take on notice.

#### **Response**

Entities are required to comply with the Commonwealth Government risk management framework which came into effect from 1 July 2002, set out in the Australian Government Foreign Exchange Risk Management Guidelines managed by the Department of Finance (Finance).

Entities are responsible for consulting with Finance prior to entering into any expenditure commitment where the total foreign exchange exposure exceeds the equivalent of AUD 100 million, to allow for early recognition of significant foreign exchange exposures from a whole-of-government perspective and enable Finance to consider the impact that large foreign exchange exposures may have on the Budget. Entities are also responsible for providing reports to Finance to enable Finance to meet its own reporting requirements to Government.

The Reserve Bank of Australia manages foreign currency exposure at a whole-of-government level, including through the use of hedging and other investments.

To ensure entities are not unduly affected by foreign exchange currency movements in the procurements or contracts they are entering into through the financial year, departmental appropriations may be adjusted on a No Win/No Loss basis to offset foreign exchange losses or gains.

Defence notifies Finance at each economic update of changes in overall foreign exchange exposure. Any underfunding is supplemented with funding provided in the next set of Appropriation Bills, and any overfunding is returned to Government. Project level information on foreign exchange exposure should be sought from Defence.

## Department of Finance

### Response to Question on Notice

#### SENATE ECONOMICS REFERENCES COMMITTEE

#### Inquiry into Australia's sovereign naval shipbuilding capability

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#### Question on Notice 5 (pages 19 and 20 Proof Hansard)

**Senator PATRICK:** In relation to full-cycle dockings for the Collins class submarines, noting that the Minister for Finance is the shareholder minister, is the finance minister waiting on any answers to questions in respect of either ASC or Defence to assist in any decision-making?

**Mr Jagers:** I'll have to check with the finance minister if he's specifically waiting on something.

**Senator PATRICK:** So you don't look after ASC? What's your area of responsibility?

**Mr Jagers:** Sorry. You asked: is the finance minister waiting on something? I won't always know whether he is waiting on something in particular. I can say that ASC, the Department of Finance and the Department of Defence have completed a piece of work. I think we've discussed that with you before. The matter is under consideration by the government in the context of that transition from the Collins fleet to an attack fleet. One of the issues there is full-cycle docking of the Collins fleet and how and when that occurs. I think that we've completed a piece of analysis on that. But the decision is one that has a number of elements, and it's a matter for government.

**Senator PATRICK:** I understand that and hence the reason I was only delving into Finance's inputs. You're going to receive cost and risk related inputs so you can potentially give independent advice associated with a cabinet submission or to the finance minister. This decision was due, according to Minister Reynolds, in December 2019. It hasn't been made. So I'm just trying to work out whether there's anything that Finance is doing that's holding up the decision.

**Mr Jagers:** I don't—

**Senator PATRICK:** Is there anything outstanding from Finance that would fetter the government in making a decision?

**Mr Jagers:** I'd characterise this as one part of a of a transition process from one fleet to another. I think the government's indicated it needs to be careful. It needs timely and careful consideration in the context of that transition of the fleet. So it's not as simple as just asking: is there anything further on full-cycle docking? As I've indicated, we have completed a piece of work on that, but the timing of the decision needs to be in the context of that broader transition approach.

**Senator PATRICK:** Is there anything that Finance has outstanding in respect of that broader decision that needs to be made by government?

**Mr Jagers:** There's nothing currently before me, but I might have to take on notice whether there are any other elements in Finance that are part of that broader transition piece that I spoke about. I'd probably need to take that bit on notice.

## **Response**

The Government's approach to the transition from the *Collins* Class fleet to the *Attack* Class is currently under consideration. The location of *Collins* Class Full Cycle Docking is a component of this, and is yet to be considered. The provision of advice to the Finance Minister and Government on these significant policy issues remains ongoing and is subject to the requirements of the Finance Minister and Government.