

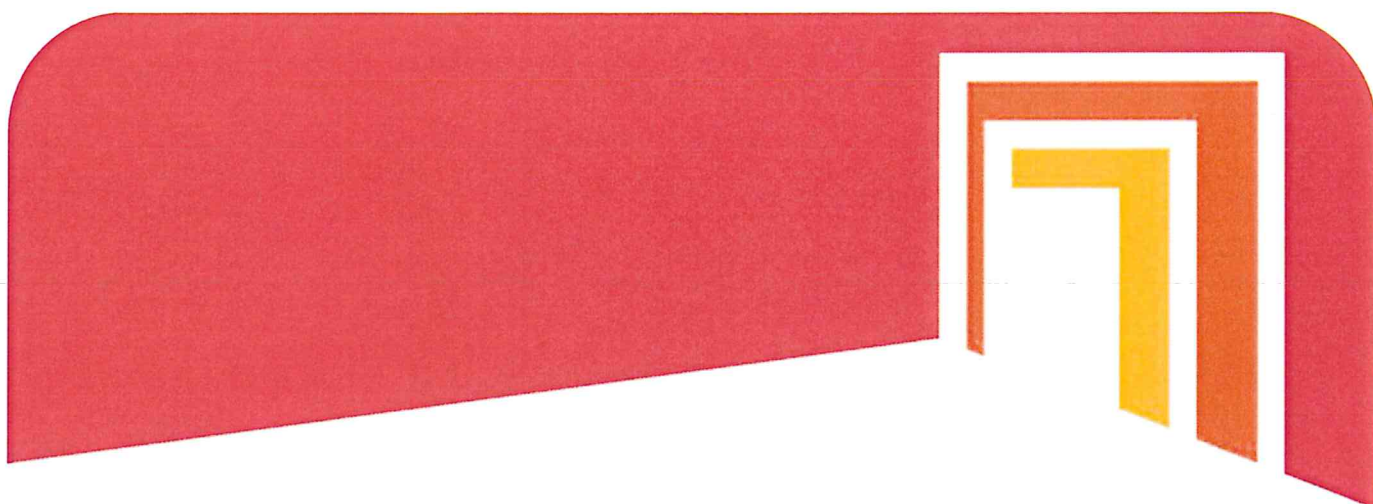
Submission 44 - South Australian Government, Defence SA

The South Australian Government, Defence SA made submission 5 to the inquiry into the Future of Australia's naval shipbuilding industry in the 44th Parliament.

This document is intended as a supplementary submission to the original submission 5.

All submissions received in the 44th Parliament can be accessed via the following link:

http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Naval_shipbuilding/Submissions



**THE SENATE ECONOMIC REFERENCE COMMITTEE
INQUIRY TO THE FUTURE OF AUSTRALIA'S NAVAL
SHIPBUILDING INDUSTRY**
Submission from the South Australian Government
March 2017

Introduction

On 11 October 2016 the Senate referred to the Senate Economics References Committee (the Committee) an inquiry into the future sustainability of Australia's strategically vital naval shipbuilding industry. The Terms of Reference for the inquiry include consideration of the utilisation of local content and supply chains; the integration of offshore design work and supply chains in Australia; opportunities for flow on benefits to local jobs and the economy; and related items. The South Australian Government will address these considerations in its submission.

The sustainability of South Australia's naval shipbuilding industry is a critical element of the state's economic and innovative future. South Australia will be the nation's centre for complex warship and submarine construction following the Australian Government's decision to construct 12 Future Submarines, nine Future Frigates and the initial Offshore Patrol Vessels at Techport.

Due to their size and complexity, these new projects will play a key role in progressing South Australia's transition to a high-tech advanced manufacturing future. The projects secured will create thousands of jobs for decades to come across Australia, driving innovation and economic growth.

The South Australian Government recognises the national importance of this program.

Background

ASC have approximately 2600 employees across three sites, primarily involved in shipbuilding and submarine sustainment activities, with over 3500 companies nationally providing products and services for submarine maintenance and upgrades and over 900 Australian suppliers as part of the Air Warfare Destroyer (AWD) shipbuilding supply chain. The role of Australian suppliers in the AWD build is almost complete with block construction effectively concluded on Ship 01, *Hobart* which is about to be delivered to the Royal Australian Navy, Ship 2 *Brisbane* launched in 2016 and Ship 3, *Sydney* in the final stages of block outfitting and final consolidation ahead of her launch in 2018.

The Australian Government workforce strategy outlined by Senator the Hon Marise Payne, Minister for Defence (media release, April 2016¹) and the Hon Christopher Pyne MP, Minister for Defence Industry (media release, November 2016²) aims to maintain at least 400 direct employees from the conclusion of the AWD project through the Offshore Patrol Vessel (OPV) program, ramping up to over 2000 direct employees to support the Future Frigate build due to start in 2020.

Referring to the Australian Government's report into the 'Future Submarine Industry Skills Plan', and more broadly the 'Plan for the Naval Shipbuilding Industry', a minimum number of skilled workers are required to be retained following the ramp down of the AWD project to enable a ramp

¹ Media Release, 18 April 2016, "Continuous Naval Shipbuilding", Prime Minister and Minister for Defence. <https://www.minister.defence.gov.au/minister/marise-payne/media-releases/prime-minister-and-minister-defence-continuous-naval>

² Media Release, 30 November 2016, "Local industry the focus for Offshore Patrol Vessel project", The Hon Christopher Pyne MP. <https://www.minister.defence.gov.au/minister/christopher-pyne/media-releases/local-industry-focus-offshore-patrol-vessel-project>

up to 2000+ employees on the Future Frigate program, without suffering a significant productivity or capability deficiency.

In building and maintaining regional superiority for Australian naval forces and in particular the future submarine, the Australian Government has identified the importance of establishing key sovereign capabilities and innovation within local industry. The Australian Government's Defence Industry Policy Statement 2016 recognises that Australian SMEs along with Australian research institutions and academia are critical to a broad innovation agenda and capability edge.

Benefit of naval shipbuilding to the South Australian economy

The Australian Government commitment to a continuous build of major warships and submarines at Techport will provide a strong boost in economic activity through the creation of up to 5200 jobs, as stated by Minister Pyne in his speech at the Committee for Economic Development Luncheon on 7 December 2016³.

The naval shipbuilding program will be a national enterprise which involves all States and Territories, however much of the current public and media commentary is creating the false perception that all of the economic benefits will be delivered to South Australia.

A benchmark previously reported to senate estimates by the Standing Committee on Foreign Affairs, Defence and Trade⁴, is that when considering the total cost of ownership of a naval vessel, i.e. design, build, sustain, upgrade and decommissioning, the initial acquisition costs represent only 30% of the life cycle costs and the balance of 70% expended through-life.

For practical reasons, through-life support work is conducted as close to the fleet base as possible, most likely in Western Australia and New South Wales depending on the final force disposition.

Further, much of the acquisition cost is expended through global supply chains spanning the nation and the world. In particular, a significant proportion of complex equipment is manufactured overseas, because there is no equivalent product manufactured in Australia and there is insufficient volume for economic production in country.

Whilst the Australian Industry Content (AIC) plans are not yet developed for the new naval projects, we can draw on a 2015 Report into the economic impacts of submarine construction commissioned by the Department of Defence⁵. The Collins Class Submarine project expended 67% of its cost in Australia and 42% in South Australia specifically. However, it should be noted that Collins undergoes its deeper maintenance activities in South Australia which is not the case for surface ships and may not be the case for our future submarines.

³ Speech by Minister Pyne MP, at the Committee for Economic Development Australia Luncheon - Adelaide (CEDA) 7 December 2016 - <https://www.minister.defence.gov.au/minister/christopher-pyne/speeches/committee-economic-development-australia-luncheon>

⁴ Report (2006), Parliamentary inquiry into naval shipbuilding in Australia, Standing Committee on Foreign Affairs, Defence and Trade
http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/Completed_inquiries/2004-07/shipping/report/c10

⁵ Report (2015) "Building Submarines in Australia – Aspects of Economic Impact May 2015" Department of Defence
http://www.defence.gov.au/FOI/Docs/Disclosures/145_1516_Documents2.pdf

A similar AIC analysis of the AWD program has not been completed at this time, however, an Australian National Audit Office (ANAO) 2013-14 Report into the progress of the AWD program reported an Australian industry share of direct project costs at 52.3%.⁶ Drawing on these published data points, with through-life support performed outside of the state, we can hypothesise that only 10-15% of the total cost of ownership of a naval vessel would be expended in South Australia.

In addition, it is also important to consider the implication of the duration over which this future work will take place. Whilst continuous naval shipbuilding is strongly supported by South Australia due to the opportunity to develop a world-class, sustainable and efficient industrial base in South Australia and across the national supply chain, a consequence is that the economic impact will be spread over a much longer period of time than the previous major shipbuilding programs undertaken in Australia.

The criticality of SEA 1180 Offshore Patrol Vessels to naval shipbuilding and implications for the Australian supply chain

The Australian Government made the decision to construct the first OPV in South Australia in order to preserve a core competence from which to rebuild the workforce required for future warships and submarines on completion of the AWD in 2019. The Defence Material Organisation 2013 Report into Future Submarine Industry Skills Plan⁷ outlines that "...experience levels need to be maintained at a level that can support the ramp up" and the consequence of not maintaining these skills prior to the AWD program being an "... erosion of skills between projects resulting in some very significant cost overruns on subsequent naval projects".

Inevitably this ambitious schedule creates a tension between 'cutting steel' on the first OPV in mid-2018 and the utilisation of Australian supply chains built up in support of the AWD. Further, from various briefings held with all three OPV contenders, the South Australian Government understands that the shipyard workforce needed to construct their designs is closer to half of the 400 workers stated by Minister Pyne.

In order to protect the construction schedule, the Capability and Sustainment Group (CASG) has made the rational decision to allow only a few design changes that are essential for the first OPVs constructed. All three contenders can readily support this strategy as they currently build vessels in foreign countries through the local consolidation of a 'pack' of pre-fabricated parts from their European shipyards.

The owners of South Australian small and medium enterprises (SME) are now concerned as it becomes apparent that this strategy is being extended so that an Australian supply chain will be excluded from the first OPVs constructed and only be built up once the program is relocated to Western Australia. This may explain the emerging gap between the quoted workforce and the numbers that are now emerging.

⁶ Report (2013/2014), "Audit report into progress on the Air Warfare Destroyer program", Australian National Audit Office (ANAO) for Department of Defence, Defence Material Organisation (DMO) <https://www.anao.gov.au/work/performance-audit/air-warfare-destroyer-program>

⁷ Report (2013) – Future Submarine Industry Skills Plan, A plan for the naval shipbuilding industry. Department of Defence, Defence Material Organisation (DMO) http://www.defence.gov.au/dmo/Multimedia/Future_submarines_industry_skilling_plan.pdf

The consequences of excluding an Australian supply chain at the outset of the build process are more than job losses within SMEs. A stable supply chain is necessary to realise the productivity gains of a continuous build. If retention of core competencies is restricted to the shipyard, Australian SMEs will be rebuilding capability and workforce on the Future Frigate program, a much more complex and challenging build. The AWD program has demonstrated the negative impact on cost and schedule of building capacity and capability while undertaking a complex 'First of Class' project.

Australian SMEs currently have the capacity to commence the OPV program immediately. With available materials, steel could be cut, pipes could start fabrication and steel structures could begin to take shape. Facilities are available today, on both the Common User Facility in Techport and at the ASC South shipbuilding site now that the second AWD has been launched.

Recommendations

1. The South Australian Government recommends the detailed economic modelling of the naval shipbuilding program, taking into account through-life support as well as the construction in order to better inform the public of the benefits to the nation as a whole. The modelling should consider 'technology spill over' benefits and the extent to which that is expected to contribute to the sustainability of local industry.
2. That the Committee seek clarification from the Australian Government on the strategy for retaining competence in the Australian supply chain and its implications for future naval programs.
3. That the Committee seek clarification from the Australian Government as to the size and nature of the workforce that will be retained by commencing the OPV program in South Australia and the evolving workforce split between the shipyard, Australian and European supply chains.
4. That the Committee seek clarification from the Australian Government on the extent of sovereign capabilities needed for the naval shipbuilding program, the plans to generate those sovereign capabilities, undertake research and development and the flow of that work into Australian industry and Academia.

Conclusion

The naval shipbuilding program is a national enterprise that will involve all states and territories. Contrary to public perception, the substantial economic benefits of these programs are not limited to South Australia, with Western Australia and New South Wales positioned to benefit from through-life support centred at their fleet bases.

The involvement of Australian SMEs in the first OPVs is critical, as core competencies from the AWD project do not just lie within the shipyard. A stable supply chain is necessary to realise the productivity gains of a continuous build program.

For industry to invest in assets and to begin building a capable workforce, the Australian Government need to provide certainty to the entire supply chain, to the shipyards, and to the SME's that support shipbuilding. This can only be achieved by committing to Australian industry from the outset.