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Senator David Fawcett
Chairman

Joint Standing Committee on Foreign Affairs, Defence and Trade.

10 June 2014

Dear Sir,

H.I. Fraser Submission to - Inquiry Into Government Support for Australian Defence Industry Exports

H.I. Fraser exports gas and fluid components and systems for Oil and Gas to Korea, Japan, US, Pakistan and South Africa.

H.I. Fraser has not had success exporting our Defence products and services to Defence international markets.

The question is why?

Australia Setting

Australia is in the grip of a “lowest possible cost acquisition” mindset where cost is the primary driver. Supporting a strategic industry is difficult argument to make in the current cost constrained environment. It is just too hard to argue against a sound accounting argument with a qualitative guess on what the monetary value is of the possibility of needing defence industry in the future. It is clear to see that the Department of Finance and Deregulation (DOFD) and the Department of Treasury have the upper hand in the current decision making process.

The current low cost behaviour is underpinned by the belief that Australia will always be able to get the equipment and spares it needs during periods of conflict from the USA and other allies. Consider how the procurement behaviours in Australia would change if we did not have the USA as an insurance policy, if Australia had to be self reliant.

International Defence Markets

Nations other than Australia view Defence products and services as a strategic capability and they keep the work in-country. This is a sovereign issue and is often borne out of the brutal experience of civil and world wars where they have had no-one else to rely upon.

Nations I have visited in Europe and the Americas clearly understand that when you design things, industry becomes involved in the engineering and problem solving process. Ship building nations such as the USA and Spain recognise that when you design a ship you can create “protected species” of local equipment suppliers. These protected species are then sole sourced every time a platform is exported. Consider:

1. The sole sourced Spanish suppliers of platform equipment for the AWD and LHD.
2. US suppliers that were specified into the AWD and LHD because the basic design rules come from Bath Iron Works in the USA.

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3. The US suppliers that supply to the C17, FA18E/F, C130J and C27 that Australia has procured.

Essentially, Defence exports are a reward for all of the risk and cost invested in the design process.

To make things more difficult for other nations to supply their equipment into a platform, countries use the following to price Australian businesses out of projects:

1. Intellectual property transfer,
2. Local content rules,
3. Subsidies,
4. Offsets,
5. ITAR, and
6. Regulations on profit that remains in the country.

International defence markets are not perfect and countries are naive if they think that the invisible hand of capitalism will make the markets perfect and fair.

If you think that the Defence Export marketplace is a market where everyone plays nice in a perfect economic rationalist market, you are sadly mistaken. The recent heated exchanges between TKMS(ASPI) and SAAB at the SEA1000 ASPI show how hard countries fight for export sales.

How Australia Is Viewed From Overseas

Australia is rich pickings for international defence companies because there is no desire to accept the cost and risk associated with design and manufacturing things here and hence no local design and manufacturing capability means that there is no organic competition.

Successive Australian governments have made the decision not to show any preference or offset for Australian industry. Even the Australian Industry Content policy is flawed because it is not audited after the tender phase nor during the course of the project and there are no consequences to not meeting the AIC quoted during the tender phase. This means that international businesses can export to Australia with no requirement to engage with local industry.

Essentially Australian domestic businesses are competing on the global market within Australia. To survive in the current Australian marketplace you have to behave like an exporter as there are no benefits to being Australian.

Consequences To Defence Exports

Because we only have limited appetite for designing anything in Australia the best we can hope for is "build to print" of components. When Australian Industry competes on "build to print" there is limited competitive advantage and we are competing on price where we are disadvantaged by our high costs.

Exceptions

There are some exceptional Australian businesses that export in the Defence market and to do this they are truly world's best practice. Examples include Daronmont and Marand. These companies design and manufacture their own products or they are embedded in the clients

design and manufacturing process overseas where design and manufacturing decisions are made.

Another good Australian example of Defence exports are Bushmasters and Nulka. Each time a Bushmaster or Nulka is sold there are drag along Defence exports for all of the smaller subcomponent manufacturers.

The point here is that the playing field is not fair as exceptional Australian businesses are often competing overseas and losing to inferior protected companies because other nations governments understand the consequences of not having a robust defence industry. Other nations do not openly encourage or welcome the same scrutiny that Australia seems to afford its Defence spending.

Back to H.I.Fraser

H.I.Fraser exports gas and fluid systems for Oil and gas to Korea, Japan, US, Pakistan and South Africa.

H.I.Fraser has not been able to open up export markets in Defence products and services. An example is the design and manufacture of submarine fittings and couplings. H.I.Fraser manufactures COLLINS submarine specialist fittings and couplings. We export specialist industrial fittings and couplings from the same H.I.Fraser business unit to the South Korea industrial marketplace. We cannot break into the protected submarine fittings and couplings market because Korea recognises the importance of having industry capability and protects it.

The simplest way H.I.Fraser would get export sales of Defence couplings is if Australia exported a submarine. This is the strategy employed extensively by the USA for aircraft and ships.

H.I.Fraser is not big enough to design our own platform and other nations protect the areas of Defence we supply to in the domestic market. Hence to date we have not been able to export defence equipment.

Conclusions

1. Defence exports are a reward for good behaviours and tough decisions of investing in design and manufacture in-country.
2. The default Defence Export position is "build to print" as the cost and risk upfront is borne by someone else. This leaves industry competing in a commodity market often in another country where their domestic industry is protected.

Recommendations

1. Review the fundamental assumption that Australia will always be able to get equipment and spares from the USA and our allies. Procurement decisions would certainly change if Australia was not able to get equipment and spares from the USA and had to be self reliant.
2. Show leadership and buy Australian. Why should any other nation buy Australian when the Australian government often does not choose Australian equipment?
3. Understand that buying Australian may be more expensive upfront, but there is value in building things in Australia that we can then export.

4. Review the legislative framework to make it easier to procure Australia designed and manufactured equipment. This may mean curbing the enthusiasm of DOFD and DOT to get the cheapest acquisition price and the lowest risk during the tender assessment process.
5. Consider leveraging the relationship with the USA to demand more Australian content and IP transfer when purchasing equipment in the USA. This could be a path to building local capability

Yours Sincerely

Chris Williams
Director