



**Australian Government**  
**Department of Defence**

# **DEPARTMENT OF DEFENCE SUBMISSION**

## **JOINT STANDING COMMITTEE ON FOREIGN AFFAIRS, DEFENCE AND TRADE**

### **DEFENCE SUB-COMMITTEE**

#### **INQUIRY INTO GOVERNMENT SUPPORT FOR AUSTRALIAN DEFENCE EXPORTS**

**August 2014**

## Introduction

1. The submission describes key elements of the Defence's current approach to both promoting and controlling Australian exports of defence capital equipment including advanced weapons platforms, systems, components and technologies. More specifically, the document covers the:

- contribution exports make to Australian defence industry and the role of exports in industry policy;
- programs Defence has initiated to promote exports by Australian-based defence companies and why those programs exist;
- interaction of export promotion programs with other programs Defence has in place to support the development of Australian defence industry, including programs for workforce skilling and innovation; and
- policies and procedures Defence currently applies to control the export of capital equipment items by Australian-based companies.

2. It should be noted that the programs discussed in this submission will be reviewed in the context of the development of the 2015 Defence White Paper and an accompanying Defence Industry Policy Statement.

3. This submission also focuses on Australia's response to the barriers to trade created by other countries rather than a detailed discussion of those barriers. Defence's approach to promoting and controlling exports is, first and foremost, a tailored response to the requirements of the Australian Defence Force (ADF) rather than a broader, principled reaction to the policies other countries might adopt.

4. Finally, the submission deals with the issue of exports in the context of Defence's overall approach to industry and industry policy, recognising that exports are only one element of a much larger defence industry policy construct.

5. Exports help to shape the structure of industry but in turn are influenced by both the intrinsic economic features of defence industry in a small national economy like Australia and the wide range of policy instruments Defence uses to influence the domestic defence market. Consequently, the export matters of interest to the Joint Standing Committee on Foreign Affairs, Defence and Trade need to be viewed from a broad perspective.

## Australian Defence Industry

### Key Points

- Domestic demand significantly influences the size and focus of Australia's defence industry
- Currently, export activity accounts for only a small element of the outputs of key Australian-based defence suppliers.

6. Australia's defence industry builds and supports a myriad of capital equipment - including advanced weapons platforms and systems - on which the ADF depends. This equipment is a critical contributor to Australia's defence preparedness, and the domestic defence industry is essential to ensuring the majority of this equipment is able to be deployed.

7. Expenditure on capital equipment typically accounts for roughly one-third of Defence's total annual budget. Of the total expenditure on capital equipment, the proportion of this expenditure in Australia has remained relatively steady over time at between 50-55 per cent, with a larger portion of the in-country spend directed to equipment sustainment and the remainder to equipment acquisition or build projects. These broad budgetary parameters influence the overall size of domestic defence industry given that Australia's defence industry is centred on the ADF as a customer. Defence analysis suggests that exports by Australian-based companies with strong and direct links to supporting the ADF account for only a small element of their overall output.

8. Defence demand on Australian industry in relation to capital equipment programs accounts for direct employment of around 27,000 people, and substantially more than that number through economic flow-on or multiplier effects. Defence requirements dominate national shipbuilding and repair activity and contribute substantially to the overall size of the Australian market for aircraft maintenance. It makes a smaller contribution to overall Australian markets for electronics, vehicles and other products.

## Key Industry Features and Exports

### Key Points

- Australian defence industry faces unique and specific challenges and trading conditions.
- Exports can play a significant role in broadening the customer base and long-term financial viability.
- Defence export markets are limited, noting that regulation and national interests can restrict opportunities for prospective exporters.

9. For the purposes of assessing export-related industry issues, the industry is characterised by:

- an enduring need to embrace new technologies to provide the ADF with a military-strategic advantage;
- often volatile Defence demand, as Australia purchases, upgrades and modifies most weapons systems and platforms relatively infrequently;
- high 'fixed' costs for developing and producing improved capital equipment, which ideally need to be spread over a broad customer base;
- a heavy reliance on specialised labour skills to develop, build, adapt and sustain equipment which is among the most technically complex of any held within Australia;
- unusually high levels of both seller concentration and foreign ownership; and
- the need to function in a broader environment where substantial economic and regulatory barriers exist to a free flow of defence knowledge, expertise, goods and services across international boundaries.

10. These characteristics suggest that:

- export work in addition to ADF contracts can provide long-term surety for defence-oriented firms;
- an export customer base might be needed to help defray costs, if Australian-based firms are to embark on sophisticated and larger scale forms of new product development;
- industry may need to rely on the international links that Australia's largest foreign-owned companies have with their international parents to exploit export opportunities for indigenously developed defence products; and
- industry may in some circumstances require that Australia enter into Government-to-Government negotiations in an effort to overcome international barriers to trade.

## Exports and Defence Industry Policy

### Key Points

- Defence industry policy directs and guides engagement with industry during the procurement process for acquisition and sustainment of capital equipment.
- Export assistance is only one element of a number of current industry programs.

11. Defence industry policy is developed to support and manage the ways in which Defence connects with industry during capital equipment procurement processes. Activities undertaken during this process include: approach to market, tendering, contract negotiation, production oversight, introduction into service, maintenance and modification, and disposal. As such, Defence industry policy impacts equally on Defence and industry.

12. Defence industry policy consists of four pillars:

- evaluating the payment of price premiums for preferring domestic over foreign sources of capital equipment;
- shaping the structure of defence markets and consequently the levels of competition within them;
- establishing suitable contracting policies and procedures through which defence materiel should be purchased, including approaches to regulating the profits and costs of monopoly suppliers; and
- assistance to Australian-based defence manufacturers, to help these firms overcome economic distortions or imperfections in the way some defence markets function.

13. Assistance for exports relates predominantly to the last of these policy pillars. Such assistance is provided in recognition that access to opportunities in the global defence market can help to build viable Australian defence companies that are less vulnerable to domestic market volatility. It can emerge anywhere in the Defence capital equipment procurement process:

- before the process commences, to better position a firm to bid for Defence contracts;

- during the process, to assist the firm deliver against its extant contractual commitments; or
- after the process has been completed, to support and extend the capability gains firms have already made through capital equipment project participation.

## Primary Program Focus

### Key Points

- Defence provides industry assistance to address market failures, particularly where high barriers exist beyond normal commercial conditions.
- Export programs are one mechanism to address inconsistent demand, barriers to trade and offset high development costs through increasing the potential customer base.

### Overall Programs

14. Assistance which Defence provides to Australian industry, including assistance relating to exports, has as its clear objective the longer-term creation and maintenance of a domestic industrial base able to deliver capital equipment to the ADF on time, on schedule and to the appropriate level of quality and value-for-money.

15. The policy strategy adopted by Defence is based on the fact that relatively small amounts of assistance, ideally applied at an early stage in the Defence Capability Life Cycle and suited to the specific needs of Australian-based firms, can bolster defence industry's capabilities to the point where they can help to avoid the success of Defence's capital equipment projects being placed at risk, and mitigate the need for more costly project solutions at a later date.

16. The underlying rationale for assistance rests with the deviation of defence markets from an economic ideal. Across the range of skilling, innovation and export market development programs Defence administers, it reflects:

- industry often having incomplete access to Defence's plans and priorities from which to plan and target business investment;
- the inherent difficulties faced by smaller companies in particular in ameliorating the risks associated with innovation, attracting related private sector finance and 'breaking-in' to the defence procurement systems of other countries;
- the reluctance some companies have to invest in skilling staff who have the right to change employer at any time;
- obstacles to companies securing intellectual property rights over their innovations;
- difficulty in the Commonwealth codifying and transferring from one company to another the intellectual property it owns pertaining to complex defence systems and platforms;
- a tendency for some companies to monopolise elements of defence markets and create substantial barriers to entry by others; and

- a history of foreign countries erecting trade barriers to favour their own domestic defence suppliers.

17. While none of these sources of ‘market failure’ are easily quantified, their prevalence across the industry is often cited and widely acknowledged. Examples of the various international impediments specific to defence markets are summarised in Attachment A.

### ***Export Programs***

18. Export assistance aims to achieve one or more of the following objectives:

- bolstering industry demand between domestic Defence capital equipment programs;
- overcoming barriers to trade created by other countries, especially for Australian-based small to medium-sized enterprises; and
- helping to bridge the final gap in taking indigenous innovation from idea to reality by helping firms to offset high product development costs through an export customer base.

19. If successful, assistance offers the prospect of facilitating transfers of experience and expertise to Australia. This is achieved by offering the opportunity for Australian-based firms to team with overseas manufacturers, thereby exposing those firms to new technologies and business practices.

20. Above all else, export assistance is provided by Defence to develop niche market opportunities, where this is consistent with Defence’s national security obligations and established principles for cost-benefit analysis. To this degree, Australia’s policy approach to promoting the export of defence materiel reflects its individual needs and aspirations and might justifiably differ from the approaches taken by other countries. Attachment B briefly describes aspects of the approaches taken in the United States, United Kingdom, Canada and Sweden.

## **Exports in a Broader Industry Development Context**

### **Key Points**

- Defence has provided export assistance where the cost-benefit justification exists and the approach does not conflict with Australia’s military-strategic objectives.
- To date, export assistance is typically focused on niche products where Australian firms can demonstrate a comparative advantage.

21. Although export assistance has the ADF’s needs and requirements as its primary and overriding focus, Defence does pursue a broader export agenda where the costs are reasonable and the approach does not conflict with military-strategic objectives.

22. This is based on leveraging the close business relationships Defence enjoys with major multi-national contractors to create opportunities for Australian component manufacturers to participate in global supply chains. Global Supply Chain (GSC) program participation is a means of cultivating a more diversified and technologically advanced Australian manufacturing sector.

23. The following paragraphs describe important considerations for prospective exporters and the different types of associated assistance programs involved. Common to each step is a desire to produce defence-oriented firms with a more global focus and reasonably high degrees of economic self-sufficiency.

24. Building Ideas and Customers - to overcome the inherent constraints of Defence's relatively small and sporadic domestic demand and to be viable contenders for Defence equipment projects, Australian-based companies tend to require a diversified customer base and the capacity to develop specialised or 'niche' defence capabilities. It is also notable that some Australian-based companies have achieved export success with technologies and/or equipment solutions that are not part of the ADF's inventory. Frequently, of course, innovation provides the basis from which a diverse business structure can be achieved and therefore assumes a prominent position early in the industry development process.

25. Exploiting Sources for Improvement - a niche can emerge from innovation initiated and progressed solely within a company. Equally, it often arises from work first conducted or commissioned by public sector agencies - like the Defence Science and Technology Organisation (DSTO) or universities - and progressed from research to engineering solutions by industry players, either individually or collaboratively. Nonetheless, history suggests any leap from good idea to useful product can be daunting. Where positive outcomes have been achieved, the availability of Government funding for innovation, a more cooperative approach to tackling technology problems and an adequate engineering skills base - geared to an industry production environment and the commercialisation of scientific discoveries - have proven decisive.

26. Focusing on Comparative Advantage - a niche is often established using a narrower range of products than might be associated with broader domestic defence requirements for equipment maintenance, modification, upgrade and integration. These activities attract a degree of 'natural' protection due to the very high costs of transporting weapons systems and platforms overseas for support. In defence manufacturing the comparative advantage of Australian-based firms involved in export markets tends to reside mainly with equipment components - rather than entire suites of products - and their ancillary support services. Australia also has emerging comparative advantage in some areas of services exports, including maintenance of ageing military platforms.

27. Expanding Market Reach - finally, opening and exploiting new markets hinges largely on a multi-disciplinary approach to exporting, led by industry but with Government as a close and active partner. This involves coordinating industry participation in overseas trade exhibitions, displays and other marketing efforts, encouraging Australian-based multi-national defence contractors to promote Australian industry capabilities to foreign parents through their global supply chains, and working with Australia's international allies to offer the best of indigenous innovation in return for facilitation of the Australian firms' entry into their respective domestic markets.

## Defence Export Assistance Programs

### Key Points

- Defence export assistance involves a range of activities to create a recognisable brand, increase awareness of Australian products and enhance networking and communication with overseas companies.
- Such assistance also extends to direct involvement in export sales and government to government transactions on behalf of Australian defence industry.

28. The various initiatives or ‘programs’ Defence currently administers to promote the export of capital equipment fall into several categories. The first, and perhaps most obvious of these, is promoting Australian-made equipment in overseas markets through facilitating Australian industry participation in international defence trade shows.

29. Under the banner of Team Defence Australia (TDA), Defence:

- alerts Australian companies to trade display opportunities;
- coordinates the ‘branding’ of Australian products at these events;
- provides experienced and senior ADF personnel to facilitate interaction with counterparts and potential foreign buyers at these events, and advocate for the attributes of the Australian defence products on offer; and,
- manages related liaison activities where Australian companies are given the opportunity to meet with the representatives of foreign Governments to discuss their products and gain additional insight into other country’s defence capital equipment procurement practices and procedures.

30. All applications by companies seeking to participate in TDA activities overseas are provided to the Defence Export Control Office (DECO) for review to ensure the promotion of those companies' goods and services are not subject to export restrictions and do not contravene international conventions and agreements to which Australia is a signatory.

31. The second Defence initiative which facilitates defence exports is the Australian Military Sales Office (AMSO). The Office has been established to facilitate the overseas sales of Australian-made capital equipment through government-to-government channels and to provide assistance in commercial-to-government export sales where direct government-to-government facilitation is required.

32. Overseas buyers of defence capital equipment often prefer to source their materiel through Government sources, to minimise procurement risk and to leverage off defence capital equipment projects Australia might already be managing. Government-to-Government links can provide foreign buyers with a degree of assurance that what they are purchasing is fit for purpose. It can also provide the opportunity for foreign buyers to, in effect, join an Australian procurement project towards its end when both the technical risks and unit prices associated with equipment tend to be lower. Australia uses much the same approach when purchasing equipment from the United States of America (US), under US Foreign Military Sales (FMS) arrangements.



33. The third type of export program administered by Defence is the GSC program. This program provides funding to a small number of leading international defence capital equipment prime contractors with a presence in Australia, with the aim of encouraging them to explore the potential for competitive Australian firms to participate more broadly in contractor supply chains around the world.

34. The GSC program funds business development units within each prime contractor, which market test Australian industry's capacity to provide components suitable for inclusion in the finished forms of equipment the contractor might sell not only to the ADF but to other international customers. A GSC prime contractor (or prime) examines its production requirements and identifies suitable opportunities across all product lines before seeking qualified Australian companies to receive bid opportunities based on a best fit. GSC primes also work closely with Australian firms to assist them in undertaking business and process improvements to improve competitiveness for identified bids.

35. A fourth initiative is the Joint Strike Fighter Industry (JSF) Program. This program has some similarities to the GSC program but is focussed specifically on the JSF platform and it is linked to Australia's participation in the multi-national development for the Joint Strike Fighter.

36. The JSF Division Industry Team works with the JSF primes, Original Equipment Manufacturers and Australian suppliers to foster business relationships and manages the various barriers to improve their competitiveness in this multinational global program.

37. Finally, Defence supports a number of additional initiatives which help to facilitate international exchanges of information on defence capital equipment and promote a closer dialogue with Australia's trading partners on equipment-related trade issues. These include regular bilateral discussions between Australia and a range of countries on defence materiel development. They also include the provision of advice to industry and other areas of the Australian Government on the complex rules governing international trade in armaments including US International Traffic In Arms Regulations (ITAR).

### ***General Industry Support Programs and Links To Exports***

38. Defence export programs form part of a broader suite of industry programs administered by Defence. It should be noted that these programs will also be reviewed in the context of the development of the 2015 Defence White Paper and an accompanying Defence Industry Policy Statement.

39. These programs are as follows: Skilling Australia's Defence Industry (SADI), Industry Skilling Program Enhancement (ISPE)<sup>1</sup>, Australian Industry Capability (AIC), New Air Combat Capability Industry Support Program (NACC-ISP), Capability and Technology Demonstrator (CTD), Defence Future Capability Technology Centre (DFCTC), Defence Innovation Realisation Fund (DIRF), the Defence Industry Innovation Centre (DIIC), Rapid Prototyping Development and Evaluation (RPDE) and Priority Industry Capability Development Fund (PICDF) programs.

40. This suite of programs incorporates a number of themes and a complex array of linkages, inter-dependencies and feedback loops. However, at their core is the following basic set of relationships which place export market development initiatives in context.

41. The AIC program provides the opportunity for Australian-based firms to participate in a range of Defence capital equipment projects especially those for equipment acquisition, by identifying where these firms can act as competitive or preferred Defence suppliers. A series of programs for industry labour skilling (currently led by SADI), innovation (currently led by CTDs and DIRF) and export market development (currently led by GSC) then make grants or other direct forms of assistance available to eligible firms. The PICDF programs overlays these activities by focusing on more prominent or urgent PIC related-issues. However, other programs for skilling, innovation and exporting also have PIC elements.

42. The aim in this case is to secure, and then build, on the foundation of defence-oriented firms which the AIC program has helped to create. By identifying areas of industry where these capabilities are of highest strategic value to the ADF, the PIC program provides initial guidance on how grants-based and associated assistance measures should be targeted - keeping in mind that the Government's defence industry policy extends well beyond the PIC arena.

43. The AIC program requires that for all larger Defence capital equipment acquisition and sustainment projects a plan be prepared or other arrangements made, which identify the industry capabilities Australia can competitively provide or must deliver for strategic reasons and mandate their sourcing from domestically-based suppliers. The program aims to create a systematic mechanism for ensuring that Australian industry has adequate opportunity to bid for work and that suitable domestic supply options are properly considered by Defence unless a clear and persuasive case can be made by the Department to the contrary. The program is not a grants program but is important to understand due to its links with so many grants initiatives. For export-oriented companies in Australia, the AIC program helps to ensure an adequate base workload.

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<sup>1</sup> The ISPE program has a number of sub-components including the Defence Industry Innovation Centre (DIIC), Defence Industry School Pathways (DISP), Creating and Enabling Work Pathways (CEWP), Defence Technical Scholarships (DTS), Engineering Scholarships (ES), DMO Institute Expansion (DIE), ReEngineering Australia (REA). Information in relation to how all of these programs work and data on other companies who might assist firms exploit the assistance they receive is made available through the D+I information portal. These programs are set out in more detail in the Defence and Industry Policy Statement 2010 (*Building Defence Capability: A Policy for a Smarter and More Agile Defence Industry Base*).

44. Similarly, the PIC program is not grants based but has a critical role to play. The PIC program encompasses a number of tasks: defining clearly which areas of industry hold capabilities which the ADF values most; ensuring these capabilities are factored into the early stages of the Defence capital equipment procurement cycle where acquisition strategies affecting industry are often decided; monitoring the 'health' of relevant industry capabilities on a regular basis; providing guidance on how best to address a health problem (where the demands the ADF places on industry exceed what Australian-based companies can readily supply); and, where a problem does exist, helping to marshal various areas of Defence to provide a solution. In an export context, PICs are capabilities which are given priority attention in Defence export programs.

45. The SADI program provides grants to companies to up-skill workers. The assistance delivered covers tuition costs rather than the wages and salaries of non-supervisory employees and is provided only to companies with links to current, or planned, Defence capital equipment projects. A wide variety of training courses are covered by the program including those for trades training, advanced academic research and general business planning. SADI is potentially important in an export context because successful exporting ultimately depends on a highly skilled industrial workforce.

46. The Capability and Technology Demonstrator (CTD) program was established to give Australian industry and research organisations the opportunity to demonstrate capability enhancing and innovative technologies to the ADF. Its focus is on technologies which might in the future add to the ADF's advantage, and which could be acquired through future Defence projects. One of the aims of the associated Defence Innovation Realisation Fund (DIRF) program is to move selected technologies from successfully completed CTDs closer to the point of being ready for acquisition. Both programs have potentially important links to building the export capabilities of Australian-based defence manufacturers, given that export success rests increasingly on the ability to offer innovative goods or services to highly discerning foreign buyers.

47. The Defence Future Capability Technology Centre (DFCTC) program is designed as a joint venture between defence industry, universities and Commonwealth and State Governments to pursue new defence materials and manufacturing technologies. From the program, a Defence Materials Technology Centre (DMTC) has been created in the form of a private company. Built around a Cooperative Research Centre (CRC) model, the DMTC aims to link public sector researchers, industry and Defence end-users to generate materials-related products - like ceramic body armour, combat helmets and techniques for advanced forms of metal and composites fabrication - suitable for ready transition into service by the ADF. For exports, collaborative research through programs like DMTC offers the advantage of having overseas marketing efforts backed not just by companies but by a range of additional stakeholders.

48. The Defence Industry Innovation Centre (DIIC) program assists business managers and others to enhance their export-readiness and hone their commercial skills through engaging suitably qualified consultants to develop business plans and other strategic approaches to business development. The program is funded by Defence but managed by the Department of Industry. One of the major objectives of the program is to make Australian-based defence manufacturers more attractive to international investors in the innovation space. In an export context, the DIIC program helps companies to build the business fundamentals on which export success depends.

49. The Rapid Prototyping Development and Evaluation (RPDE) program was established in 2005 to bring Defence and Industry together in a collaborative environment aimed at rapidly addressing Defence's complex capability questions. RPDE connects Defence with Australian industry members and academic associates to deliver advice through RPDE Quicklook reports, or develop prototyped solutions through RPDE Tasks. Use of RPDE Quicklooks helps to ensure the robustness of most Defence pre-First Pass project proposals. RPDE activities offer industry exposure to Defence capability requirements very early in the Capability Development Life Cycle, thereby encouraging the development of innovative proposals to solve future Defence capability problems. These can be developed through to maturity via entry into one or more Defence innovation programs. Development of innovative ideas into leading-edge ADF capabilities can provide Australian companies with valuable export opportunities.

50. Finally, the Priority Industry Capability Development Fund (PICDF) seeks to give Defence access to a ready source of funding to deal with PICs with serious health concerns and to support the development of priority capabilities in ways which may not be covered by other assistance programs. The health of PICs can sometimes deteriorate quickly and demand a timely response from Defence. For purely administrative reasons, a separate Fund is needed for this to occur. Equally, other assistance programs may not have agreed conditions for industry participation which are flexible enough for PIC problems to be addressed. The Fund provides the flexibility required and a gateway for Defence to assist Australian-based firms whose capabilities are critical to the operations of the ADF and would benefit from export market development.

51. It should be noted that the DIRF and PICDF programs are funded through the Defence Capability Plan. This requires, for any DIRF and PICDF funding proposals, a demonstrable link to a capability outcome for the Australian Defence Force.

## Australia's Export Controls

### Key Points

- The Defence Export Control Office (DECO) is responsible for regulating the export of defence and dual-use goods as part of Australia's system of export controls.
- Australia's export control system is part of an international effort to stem the proliferation of conventional, chemical, biological, and nuclear weapons and the systems that deliver them.
- DECO provides tailored assistance to help defence industry exporters to understand and comply with Australia's export control system.

52. The Defence Export Control Office (DECO) is responsible to the Minister for Defence for regulating the export of defence and dual-use goods as part of Australia's system of export controls. DECO helps defence industry exporters to understand and comply with Australia's export control system through a comprehensive suite of training and guidance materials, provided face-to-face and online. DECO also provides more tailored assistance where exporters have specific questions or issues and regularly meets with export managers to determine the best licensing solution to meet their particular business requirements.

53. Recognising the time-sensitive nature of export opportunities, DECO works to assess export applications as quickly as possible, and offers ‘in-principle’ assessments so that exporters can determine for marketing purposes whether the future export of a particular product to a particular destination would be likely to receive export approval.

54. Australia's export control system is part of an international effort to stem the proliferation of conventional, chemical, biological, and nuclear weapons and the systems that deliver them. As a member of international counter-proliferation regimes, Australia has agreed to join other member states in regulating the export of goods and technologies listed by these regimes:

- *Wassenaar Arrangement* - conventional arms and dual-use goods and technologies;
- *Nuclear Suppliers Group* - goods and technologies that could have utility for nuclear weapons programs;
- *Missile Technology Control Regime* - missile equipment, rocket systems, unmanned air vehicles and related technology for systems capable of carrying a payload or delivering weapons of mass destruction; and
- *Australia Group* - dual-use chemicals and biological agents.

55. Through implementing the export standards agreed by these regimes, Australia maintains its reputation as a country with a strong commitment to non-proliferation. In turn, this gives other states confidence that their sensitive technologies can safely be exported to Australia, and will not be at risk of proliferation to unauthorised end-users from Australia. This is particularly important from the perspective of ensuring that Australia continues to have access to sensitive US defence technologies.

56. DECO's assessment process is illustrated at Attachment C. DECO assesses all exports against five policy criteria that have been in place under successive Governments since 1988 (international obligations, human rights, regional security, national security, and foreign policy – further details on these criteria is also provided at Attachment C). For complex cases requiring interagency consultation, DECO coordinates the assessment of export applications with relevant subject matter experts from across Defence and other government agencies, including leading scientists at the Defence Science and Technology Organisation. Defence can also seek specialist information from global export control partners where necessary. This is done through a Standing Interdepartmental Committee on Defence Exports (SIDCDE). This assessment process for complex cases obtains input from a range of policy areas:

- The Department of Foreign Affairs and Trade provides advice on foreign policy and human rights implications, as well as any possible implications for the sanctions regime, which they administer;
- Intelligence and Security organisations provide intelligence assessments about the risk of diversion for a particular export to a weapons of mass destruction or military end-user, and advice on the utility of the specific goods to that end user or program;
- Navy, Army, Air Force and the Capability Development Group advise whether the export will have implications for Australia's capability; and

- Other relevant Government agencies are consulted on an as-needed basis depending on the specific export; e.g. Department of Industry's science policy area for research-related cases.

57. The Australian Customs and Border Protection Service (ACBPS) protects the safety, security and commercial interests of Australians through effective border protection. The ACBPS supports the Defence Export Control Office by monitoring compliance with and enforcing relevant export control laws. ACBPS gathers and shares intelligence with other government agencies to target high risk exports and imports, entities and supply chains; intercepts goods of proliferation concern; and investigates and sanctions breaches of the law. Where a breach of an export control law is detected, there are a range of powers available to ACBPS officers, including education, warnings, the imposition of administrative sanctions or prosecution, depending on the facts of the case.

58. There are reform opportunities in how Australia implements its regime obligations:

### ***Risk-based Approaches***

59. Australia could adopt risk-based approaches that are already in place in larger like-minded states such as the United States, United Kingdom and Europe, to provide a leaner and more effective export control system, while delivering on security and economic imperatives

60. Since November 2013, Defence has been working with a Strengthened Export Controls Steering Group to find ways to reduce regulatory burden associated with export controls through risk-based approaches. While this work is focussed on the implementation of controls on intangible exports under the *Defence Trade Controls Act 2012*, its outcomes are informing DECO's approach to all the legislation it administers. These approaches include:

- streamlined, broader licences for lower-risk items going to lower-risk destinations;
- extending maximum licence duration from the current two years to five years, or the life of a project;
- enabling greater self-assessment by exporters as to the control-status of their items; and
- exempting Australian Government agencies, military, police, and contractors supporting Australian Government business from needing to obtain export licences.

61. The intent of these approaches is to focus DECO's limited resources on working with exporters that are exporting higher-risk items and to higher-risk destinations, to resolve their applications as quickly as possible.

62. DECO must implement these changes in such a way that delivers genuine benefits for exporters, and continues to meet Australia's counter-proliferation obligations. To achieve this, DECO is working with exporters from industry and academia to test these approaches, and is liaising with its counterparts in the US, UK and EU to learn from their experiences in implementing their risk-based approaches.

### ***IT solutions***

63. The introduction of an online permit processing system has already reduced processing times for export applications, and there is scope for further improvements through IT solutions.

64. In May 2013, DECO introduced an online permit processing system to replace the previous paper-based system. This has significantly reduced processing time, and DECO is now completing over 90percent of applications within the mandated timeframes of 15 working days for standard applications and 35 working days for complex submissions requiring interagency consultation, compared with around 75percent under the previous paper-based system.

65. DECO's current focus is on developing an online self-assessment tool so that exporters can more easily determine whether their items are controlled for export. DECO's control list is derived from the international counter-proliferation regime lists, which are long and complex. Exporters can always request an assessment from DECO, but stakeholders also want the ability to make their own assessment where possible. This is a priority action requested by the stakeholder-led Strengthened Export Controls Steering Group. The tool will be tested with industry and academic stakeholders.

### ***(c) Stakeholder engagement***

66. DECO has a longstanding program of visiting capital cities every year to conduct workshops to educate and assist exporters to work with export controls, and participates in Defence Industry trade shows and conferences. DECO also has a freecall telephone number and email address for exporters, and has recently modernised its website to make it more user-friendly in response to stakeholder feedback.

67. DECO is working closely with relevant peak bodies to expand engagement on export controls within defence and dual-use industries. For example, DECO and DMO have supported the Australian Industry Group's efforts over the past year to establish a community of interest in export controls, and to develop a Best Practice Guide for Defence Industry Exports.

68. Working with stakeholders on their concerns about new controls being introduced through the Strengthened Export Controls Steering Group established under the *Defence Trade Controls Act 2012* has created avenues for stronger and more strategic stakeholder engagement. Although the Strengthened Export Controls Steering Group will disband after its role of overseeing DECO's implementation of new export controls ends in May 2015, DECO will implement permanent stakeholder consultation mechanisms to ensure that the stronger links into industry and academic sectors are not lost.

69. In its day-to-day operations, DECO is developing a stakeholder-centric model of engagement, which places the onus of responsibility on DECO to better meet stakeholder needs based on the following principles:

- specify the technology that is "peculiarly responsible" for the item being controlled by the *Defence and Strategic Goods List*;

- facilitate open dialogue with the exporter and other Government agencies to develop a better understanding of technology, controls and/or constraints and discuss solutions; and
- develop conditions that will support the exportability of the controlled good, or development of an exportable variant.

70. DECO is placing particular emphasis on travelling to meet with companies that are particularly affected by aspects of the export controls, to work through the specific issues relevant to their circumstances, and to see what can be done to address these issues.



## **International Barriers to Trade**

General impediments faced by Australian exporters include distance to overseas markets, high exchange rates, currency fluctuations and access to export finance. In addition, defence exporters face a number of unique factors including:

### a. Local procurement preferences and Other Schemes

Australia does not maintain purchasing preference or similar scheme which favours Australian over foreign content on Defence capital equipment purchasing projects. In the Defence Industry Policy Statement 2010, it is clearly articulated that protectionist measures are costly and counterproductive. Therefore, these measures are not part of the Government's defence industry policy.

The establishment of Australia's involvement in the JSF procurement program was an example that of the principle of international competitiveness being applied over mandatory offsets in Australian defence procurement. Successive Governments have affirmed this move away from offsets, and this continues to be Defence's policy.

A number of overseas countries employ offsets and other forms of local procurement requirements such as work-share arrangements in the defence sector to some degree. Such policies are more prevalent in developing economies but also exist in advanced economies. These requirements generally include legally mandated percentages of a defence contract value be either directly sub-contracted to local industry, or "offset" in some other manner to benefit the local country (for example, in some cases this could include a community project unrelated to the specific defence procurement).

Some countries also mandate local supply of certain defence equipment and services. A US example is the Berry Amendment (10 US Code § 2533a) which restricts using Government appropriation by the Department of Defense to the purchase of a range of specific end-items, components, or materials that are wholly of US origin. Limited exceptions apply including domestic non-availability or for acquisitions outside the US in support of combat operations. In general, because the Berry Amendment is not covered in any current Australian – US bilateral agreements Australian industry has a limited ability to provide articles or items

covered under this rule to the US Department of Defense. These include, but are not limited to, food; clothing; tents, tarpaulins, or covers; cotton and other natural fiber products; woven silk or woven silk blends; spun silk yarn for cartridge cloth; or wool. There are also restrictions in US Government procurements in other sectors, such as shipbuilding.

Overseas trade barriers are a particular challenge for small to medium enterprises (SME) seeking to export to countries that have these policies. SMEs usually lack the resources and scale of operations to manage these requirements in the manner undertaken by large international defence prime contractors.

#### b. Length and complexity of procurement processes

Lengthy and complex procurement processes in Defence, often the subject of attention domestically, are a common feature of defence procurements internationally. While, the nature of defence projects dictates a certain degree of complexity in procurement, this is a recognised cost and time burden for defence exporters. Prime companies in the GSC program address this issue by assisting firms in their respective supply chains through the provision of dedicated staff resources to provide internal corporate introductions and managing complexity of tender.

#### c. Reliance on agents and intermediaries in international Defence procurement

A number of countries (particularly emerging economies with strongly growing defence expenditure) struggle to maintain sophisticated procurement systems that are necessary to successfully manage the complex and large procurement processes typical of defence acquisitions. Partly in response to this situation industries of agents and intermediaries have emerged in many places, and these entities often play an integral role in the procurement process. Working with agents and other intermediaries adds cost and risk to exporters, and often reduces the transparency of the procurement process to the exporter. While agents and intermediaries are a normal part of the procurement system in many countries and usually operate professionally and ethically, exporters need to be particularly aware of the risk of being caught up in corrupt practices as in some cases these entities can be a vehicle for such practices.

The GSC Program and AMSO can assist with overcoming the challenges of working with agents and intermediaries in overseas defence procurements. Under the GSC Program the

exporter works under the umbrella of a global defence prime contractor and does not need to deal directly with the end-customer or intermediaries. Government-to-government sales undertaken through AMSO remove agents and intermediaries and the cost to suppliers of their fees from the procurement process. The direct connections with military decision makers that are enabled through the senior military reserve officers working with Team Defence Australia (TDA) may increase transparency and afford involvement of appropriate foreign government representatives.

#### d. Industry scale and reputation issues

Australian defence industry tends to be very good at producing innovative (and, in some cases, world leading) solutions to capability problems, but struggles to turn these solutions into sustainable long-term business propositions.

While Australian defence industry produces highly capable and internationally successful materiel solutions including but not limited to CEAFAIR, Nulka, aluminium shipbuilding and Thales Bushmaster vehicles, it remains comparatively modest in scale internationally. Investment in practices and processes to improve productivity such as LEAN Six SIGMA is inconsistent and, where it does exist, is often devoted to a single production line and not comprehensively adopted across an entire business.

Compounding the challenge of scale is a related issue - the lack of a strong Australian reputation as a defence supplier. This issue can make foreign buyers reluctant to deal directly with Australian defence industry, citing concerns about long-term support, supply distances, and the relatively small size of Australian suppliers. AMSO addresses this specific issue through making available to foreign governments the option of purchasing through the Australian Government. In these instances, the Australian Government is effectively putting its reputation directly behind Australian suppliers, although legal and financial risks remain with the supplier to manage.

The JSF Industry and Global Supply Chain Programs, together with the DIIC business assistance program mentioned above, have done much to improve the knowledge and reputation of SMEs in the international defence domain. These programs have also been the catalyst for companies to achieve higher levels of accreditations and quality standards (such as ISO 9000, AS9100 and NADCAP), which are pre-requisites to many defence manufacturing and associated processing opportunities.

The emergence of leading capabilities in a number of areas is improving the international recognition of Australian defence industry. Australia is gaining international traction in the defence sector as a consequence of these emerging capabilities, combined with the increasing awareness of TDA through its presence at exhibitions and trade shows and through TDA-branded trade missions over a number of years. However, it would be reasonable to describe Australia currently as being successful in a number of niche areas rather than as a nation known for being a significant defence materiel exporter (such as Israel, France, Sweden, the UK or USA).

## **The Export Promotion Approaches of Other Countries**

### **US Trade Promotion**

In the US direct support for defence exports is primarily facilitated through the US Commercial Service, the trade promotion arm of the US Department of Commerce's International Trade Administration.

Similar to its Australian counterpart, the Australian Trade Commission (Austrade), the US Commercial Service has over 1,400 staff, 108 domestic offices, and 115 overseas offices in more than 70 countries.

Within the US Commercial Service defence industry is handled by the Aerospace and Defense Technology Team comprising of overseas and domestic trade specialists.

The US Commercial Service has four core capabilities it provides to US industry to further support their exports:

- Business Counselling and Advocacy;
- Market Research – providing country and industry overviews, country commercial guides and trade data and analysis;
- Trade Events - supporting international trade shows, business matching, and trade missions; and
- International Partners – identifying agents, distributors, licensees or strategic overseas partners.

For most of its trade show activities the US Commercial Service partners with the trade exhibition provider, Kallman Worldwide, to organise the US International Pavilions at defence events. Upcoming defence trade shows include Farnborough Airshow (United Kingdom), MSPO (Poland), Africa Airspace & Defence (South Africa) and Land Forces (Australia).

In some instances the US Commercial Service will partner with targeted associations to organise pavilions at particular events such as the Association of the US Army (AUSA) for Eurosatory 2014 (France) or the Navy League of the US for IMDEX 2015 (Singapore).

Where relevant, the US Commercial Service will partner with other federal departments like the Defense Security Cooperation Agency (DSCA) to provide advocacy for industry in targeted opportunities.

Trade promotion is not exclusive to the US federal government as many individual state and municipal governments provide export assistance to local defense industry. For example, the US state of Virginia has been proactive in supporting its local defense industry through direct assistance, such as developing market entry strategies and organising targeted trade missions.

It has been reported in US media that “US defense company proposals are now a consideration in virtually all diplomatic dealings with foreign officials. For example, top government officials traveling to particular countries are now regularly prepared to advocate for US firms who are seeking to sell arms there.”<sup>2</sup>

### **US Barriers to Market Entry**

The International Traffic in Arms Regulations (ITAR) is a set of US Government rules that requires exporters to obtain government permission before exporting controlled items – munitions and commercial items with military applications – to countries, end-users or end-uses of concern. The current system operates under 1970s-era statutory authorities, and was designed to address the challenges of the Cold War world.<sup>3</sup>

In 2009 the Obama Administration launched a review of export controls and determined what needed reform in the then current system. At the end of the review, in August 2010, the President announced, “we need fundamental reform in all four areas of our current system – in what we control, how we control it, how we enforce those controls, and how we manage our controls.”<sup>4</sup>

The Obama Administration determined that the US Munitions List (USML) and, to the extent necessary, the Commerce Control List (CCL) need to be fully structured as “positive lists” describing controlled items using objective criteria (e.g., technical parameters such as horsepower or microns) rather than broad, open-ended, subjective, generic, or design intent-based criteria.

The Administration launched the Export Control Reform (ECR) Initiative, which while not related to the President’s National Export Initiative, is designed to enhance US national security and strengthen the US’ ability to counter threats such as the proliferation of weapons of mass destruction.

The Administration is implementing the reform in three phases. Phases I and II reconcile various definitions, regulations, and policies for export controls, all the while building toward Phase III, which will create a single control list, single licensing agency, unified information technology system, and enforcement coordination center.

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<sup>2</sup> “*Raytheon benefits from surge in US arms exports*” Boston Globe, Accessed 12 June 2014; <http://www.bostonglobe.com/news/nation/2013/12/22/obama-fuels-surge-arms-exports-raytheon-major-beneficiary/bgCreTbinhTZEQLUM5yDVI/story.html>

<sup>3</sup> “*Export Control Reform Initiative Fact Sheet #1; The Basics*” Export.gov; Accessed 12 June 2014 [http://export.gov/static/ECRpercent20Factsheetpercent201percent20percent20Thepercent20Basicspercent20vpercent205\\_Latest\\_eg\\_main\\_047472.pdf](http://export.gov/static/ECRpercent20Factsheetpercent201percent20percent20Thepercent20Basicspercent20vpercent205_Latest_eg_main_047472.pdf)

<sup>4</sup> “*President Obama Announces First Steps Toward Implementation of New U.S. Export Control System*” White House Media Release, Accessed 12 June 2014 <http://www.whitehouse.gov/the-press-office/2010/12/09/president-obama-announces-first-steps-toward-implementation-new-us-expor>

### **US Foreign Military Sales (FMS)**

The US FMS program is administered by the Defense Security Cooperation Agency (DSCA) on behalf of the US State Department, and is used as an instrument of Foreign Policy. It includes grants, leases and loans of defence equipment, the provision of training and Foreign Military Financing. In addition to the acquisition of defence goods and services, FMS purchasers can obtain support items and services required to introduce and sustain equipment. Under the FMS program, the US Government selects the source of the goods or services requested and awards and manages supplier contracts in accordance with US Federal Acquisition Regulations. More than 200 countries and international organisations are currently eligible to access goods and services through FMS.

The FMS program operates on a 'no profit, no loss' basis, generally seeking full cost recovery from customers. A surcharge of 3.5 percent is levied to cover the cost of administration<sup>5</sup>. The US Government also recovers the costs incurred by the agencies involved in the execution and completion of FMS cases. The sale of defence goods and services is conducted in accordance with a range of legislation such as the Arms Export Control Act and the associated International Traffic in Arms Regulations.

### **UK Trade and Investment (UKTI)**

The current UK approach to supporting defence exports arises from the 2012 '*National Security Through Technology*' White Paper. The paper provides a high level guide and established the Defence Suppliers Forum as a medium for Government to communicate with industry. The UK Prime Minister is clear that 'the promotion of British Commerce and international trade [is] at the heart of our [UK] foreign and economic policy'. The White Paper provides the UK Government with the strategic framework to support defence exports.

UK Trade and Investment (UKTI) is the lead Government department, non-ministerial and funded by the Treasury, supporting both investment and export. Within UKTI is the Defence and Security Organisation (UKTI DSO).

UKTI DSO helps the UK defence and security industries to export by building strong relationships with industry and overseas governments. UKTI DSO provides specialist export advice and practical assistance, working closely with industry and government departments including the Ministry of Defence (MOD), the Home Office and the Export Licensing Organisation.

UKTI DSO has around 105 staff in London, another 38 (including MoD Military Officers) in the export support teams and around 20 diplomatic posts overseas with the title 'First Secretary, Defence and Security'. Additional resource is drawn from access to other overseas UKTI staff.

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<sup>5</sup> 3.5 per cent is rate levied to Australia, percentage varies for different countries depending on specific bilateral arrangements

UKTI DSO is responsible for:

- helping UK defence and security industries export their products;
- maintaining relationships with overseas governments to promote British defence and security products;
- working with MOD and industry to ensure defence and security products have export potential; and
- providing UK defence and security companies with specialist support to sell their goods.

Services UKTI DSO offer are as follows (unless indicated subject to charging regime):

- support for UK companies at UK and overseas defence and security exhibitions including, UKTI DSO sponsored space at exhibitions, support for delegations, use of rooms for customer meetings, invitations to UK government organised briefings and receptions, help from British service personnel to demonstrate equipment on stands;
- Defence and Security Industry Days (DSID), for example UK companies can display their products on board a Royal Navy warship; and
- Small and Medium Enterprises (SME) Meet the Buyer opportunities, for example the Small Business Unit organises free of charge Meet the Buyer opportunities at Farnborough International Air Show and DSEi.

UKTI publishes over 1,000 business opportunities per month across all sectors, including defence and security, and over 100 markets. Companies can sign up to the free alert service.

UKTI DSO's military and security advisers are available to provide help at all stages of the business development and export cycle.

Recent developments in the UK include Government (through the development of the Ministry of Defence Director General Exports and Commercial Strategy position) and industry joining together in support of the 'Defence Growth Partnership' (DGP) to improve competitiveness, invest in skills, support SMEs and encourage inwards investment. The DGP is a Government and industry partnership, set up by Prime Minister David Cameron in 2012, in which the government, the UK's top defence companies, the sector trade association and SMEs work together to support growth. Eight teams have been established under the leadership of very senior industry executives including Peter Rogers (CEO Babcock), Victor Chavez (CEO Thales UK) and Nigel Whitehead (Group MD BAE Systems). The target is for a Government and industry joint action plan to be set July 2014.



### **Canadian Commercial Corporation (CCC)**

The CCC is a Federal Crown Corporation reporting to Parliament through the Minister for International Trade. The majority of the defence export contracts signed by the CCC are with the US Department of Defense (DoD) through the Defense Production Sharing Agreement (DPSA). The CCC is also involved in defence related exports to countries outside of the US. Typically the CCC signs a Prime contract with the foreign government as the Prime Contractor and then subcontracts with a Canadian supplier through a domestic contract to deliver the requested goods and/or services. Contract administration and supplier performance monitoring are undertaken by the CCC. The CCC can assist foreign governments in identifying Canadian suppliers in either a Prime or Procurement agent capacity. Depending on the role and the specific needs of the transaction, CCC may assist in the contracting and procurement process. CCC is not limited to the sale of Goods found in Canada's defence inventory. The CCC employs approximately 135 permanent staff.

The CCC receives an appropriation from the Government of Canada to administer the obligations set forth in the DPSA for US DoD. All other activities of the Corporation are funded through fees charged by CCC on a transactional basis.

### **Swedish Defence Export Authority (FXM)**

FXM operates under the Swedish Ministry of Defence. The primary tasks of the FXM are to promote exports by Swedish defence industry and to represent the Swedish Government in bilateral contracts. This includes promoting exports from large, as well as small and medium sized enterprises and also the export of civilian applications of military technologies. The promotion is conducted under the state export control. The FXM also performs sales of surplus stock on behalf of the Swedish Armed Forces.

By establishing the FXM, the Swedish Government has given the responsibility for coordinating export matters to one Government agency. All other defence organisations are still involved in export related activities within their areas of competence and as tasked by the FXM in its coordinating role.

## **Australia's Export Control Policy Criteria**

Australia's export control policies reflect the Government's commitment to ensure the export of defence and dual-use goods is consistent with Australia's national interests and international obligations and commitments.

The Government's policy is to encourage the export of defence and dual-use goods where it is consistent with Australia's broader national interests. Our export control system is the means by which this consistency is ensured. Australia's export control policies and procedures are reviewed regularly to take account of changes in strategic circumstances and priorities.

### **Policy Criteria**

Applications to export defence and dual-use goods are considered on a case-by-case basis. Our assessment of applications will take into account whether the export:

#### *International Obligations*

- is destined for countries to which the United Nations Security Council has imposed sanctions restricting the sale, supply or transfer of defence or dual-use goods;
- is destined for countries where the export might be used in a manner contrary to Australia's international obligations or commitments;

#### *Human Rights*

- poses a clearly identifiable risk that the goods would be used to commit or facilitate serious human rights abuses;

#### *Regional Security*

- might contribute to instability in the region, or aggravate a threat to international and regional peace and security, or aggravate the situation in a region which becomes a cause of serious concern;
- might be used in internal or external conflict, or that could further militarise the situation in the destination country;

#### *National Security*

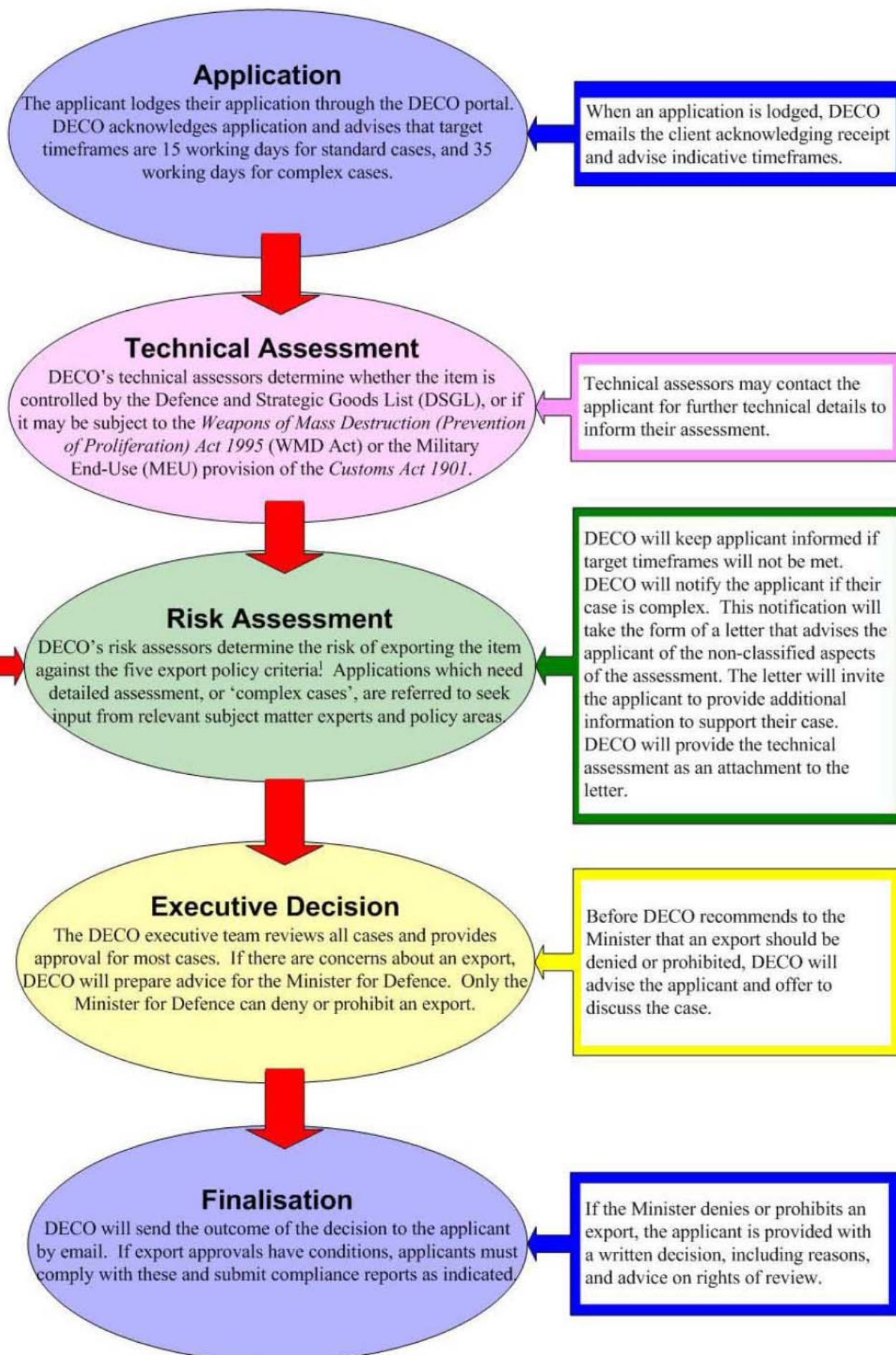
- might compromise Australia's wider security interests, its obligations to its allies and friends and its broader international responsibilities;
- is destined for countries with policies or interests which are inimical to the strategic interests of Australia or its friends and allies;
- might adversely affect Australia's military capability, or substantially compromise its operational capabilities or enhance the power projection capabilities of our potential adversaries;

#### *Foreign Policy*

- is destined for countries developing (or suspected of developing) weapons of mass destruction or the means for their delivery, or supporting terrorism, or whose behaviour or foreign policies risk major disruption to global or regional stability;
- might cause adverse reactions by third countries important to Australia, which may affect Australia's interests, in particular, our regional relations; and
- might be used for mercenary, terrorist or other criminal activities.

## Defence Export Control Office Assessment Process

## Procedural fairness measures



<sup>1</sup> <http://www.defence.gov.au/deco/Policy.asp>

