Question: You mentioned in paragraph 2(c) the interface between Defence and Border Force in terms of their role. Can you take this on notice - can you give us a little more detail as to where you think those bottlenecks or overlaps are and how we should be resolving that? Through this legislation or actions that you think Border Force need to take so that our industry is not encumbered with two layers of bureaucracy for essentially the same 11:45 - 11:46 transaction, whether it be people, goods, intellectual property

ASPI's analysis has not comprehensively examined the relationship between Defence Exports Control (DEC) and the Australian Border Force (ABF) in relation to process coordination and deficiencies but we have identified, including through research with Australian companies, a lack of clarity on occasion in advice from the ABF and the Department of Defence, or different advice, about obligations to remain compliant with export control license requirements (industry examples cannot be provided without their permission). This has meant companies have been left to make their own assessment and have sometimes got it wrong (as later assessed by ABF) and faced recriminations when ultimately a finding from one agency or the other found a company not in compliance. Greater coordination and consistency of support to companies seeking advice on requirements between Defence and ABF could usefully focus on closing this apparent gap. Resources could be made available for this purpose – in the form of improving the online self-portal experience and in terms of in-person service and advice from the recently released DIDS grants.

ASPI recommends two areas warrant consideration based on our research:

1. Guidance from DEC's self-help portal can be inadequate and result in unintentional misunderstanding. Businesses relying on the tool have been subsequently harmed when ABF disagreed with its evaluation and issued violation letters associated with the resulting exports. This has resulted in some in business expressing distrust in the tool. This distrust will likely result in widespread hesitation to rely upon it following imposition of stricter export control regulations carrying criminal penalties. If DEC is to continue offering the tool, it should be prepared to invest in improvements and indemnify individuals who rely upon it, with all the potential legal complications this implies. Absent that, the government should expect far greater reliance on in-person service and would need to resource the office accordingly.

2. Businesses rely on DEC for adjudication, while ABF is responsible for enforcement. There is evidence that the interagency process has some deficiencies which inhibit conflict resolution when both agencies are involved in a dispute. ASPI identified cases where both agencies concurred that export control violation letters were unfairly issued but neither

was willing to accept responsibility for correcting the error. Such problems with existing regulations will grow more severe as the rules are tightened. The government should establish governance mechanisms in anticipation of future disputes. These would need to be empowered not only within responsible agencies, but at the governmental level to address interagency regulatory gaps.

Question: Two final questions, one I will put on notice and the other short. On notice, could you provide 11:50 - 11:51 a prospective, viscous job governance level questions, where a line system at export controls, how important is it we also look at what alignment may be necessary in terms of how we fund research, because the American system is very different to ours, and how we constrain or consider procurement because while we may align our export controls, it does not change the congressional committee control over procurement with all of their considerations nor does legislation such as binary crack and et cetera, it doesn't change our procurement rules which make it easier for our officials to buy offshore than it does for them to justify buying to Australian companies. Which means there is a real risk of a flight of procurement activity from Australia to overseas. 11:51 - 11:52 Which is a real risk. Could you take that on notice?

The Australian defence industry is reaching a critical point. More so than either of its AUKUS partners, it relies on a broad base of small businesses. But, too often in the defence sector, a firm's expertise in navigating regulations can be a more relevant source of competitive advantage than supplying the best product. If reforms add to the regulatory burden for Australia's SMEs—and by extension, its entire defence industry—this will come at both cost to business and act as a serious disincentive to participation and engagement with Defence. ASPI is of the view that the government should make it clear in messaging, regulatory reform and procurement practice that SMEs are valued and neither treated as expendable nor having to prove effectiveness overseas before entry into the Australian market.

Regulatory reform, such as creation of a licence-free zone for AUKUS, which increases compliance burdens unnecessarily risks smaller Australian companies losing competitiveness against larger Australian defence contractors, while subjecting those small businesses to more competition from US companies with far more experience operating in defence markets. The probability of winning contracts (not grants) both in Australia with Defence and through US DoD opportunities will fall for Australian companies as competition grows, without significant support.

While an existing problem, regulatory reform must ameliorate not exacerbate the fact that the Australian defence acquisition system relies to a large degree on overseas vendors. This has resulted in an underdeveloped domestic defence industry. Reliance on overseas vendors is also a result of underdeveloped private-sector capacity: a chicken-vs-egg dilemma that makes solving the problem particularly difficult. The situation has three fundamental causes:

1. Australian investment in early-stage defence research and development activities is well below international norms. The Defence Science and Technology budget is approximately 5% of the size of the capability acquisition budget. In contrast, the US defence R&D budget is nearly 80% the size of its procurement budget. Even looking strictly at early-stage research, the US figure is still in the order of 40%. Good economics suggests that risk profiles create suboptimal private investment in early-stage R&D. Industry relies on public-sector funding to fill this gap. Australia's inadequate investment (and unwillingness to accept the high failure rates that go with early-stage R&D) starves its defence sector of the innovation that drives long-term growth.

2. The Australian acquisition system fails to make use of the full range of contracting tools employed by major allies. Excessive emphasis on probity and open competition (while these are valuable objectives in themselves) fails to account for associated tradeoffs. It restricts the use of contract vehicles that are uniquely suited to R&D, such as cost-plus awards and public-private partnerships. These types of arrangements are critical to developing not only technological innovations themselves, but the broader industrial capacity to commercialise them. Close, long-term partnerships with government allow private businesses both to develop competitive technologies and simultaneously build complementary capabilities required to market them (e.g. product strategy, workforce, business development, compliance, scaled manufacturing techniques, mass production).

3. Direct support provided to small businesses seeking to operate in defence markets is well below that of major partners. The US defence department offers major subsidy programs to its small-business ecosystem, as detailed in publications of its Office of Small Business Programs. Australia's defence industry is comprised disproportionately of small businesses who are in direct competition with these heavily subsidised competitors. The disparity puts Australian businesses at a disadvantage. The strength of the AUKUS partnership is in its ambition so measures that are overly conservative and fail to accept any risk are likely to exacerbate Australia's acquisition-system deficiencies and push more business to US competitors. For example, tightening Australian export control regulations to match those of the US without reciprocal addressing of inadequacies that plague the US system will cut off Australian small businesses from critical international markets while

opening opportunities only in places where they are uncompetitive. Market integration without leveling the playing field of public R&D investment and small business subsidies would be similarly detrimental.

On the other hand, a comprehensive effort at integration and cooperation would ameliorate deficiencies in the Australian acquisition system and foster growth of its domestic industry. An export control system that is both aligned with international security standards and avoids the deficiencies of the US' International Traffic in Arms Regulations (ITAR) would be both a competitive advantage to Australian businesses and incentivise US businesses to increase their operations in Australia. Opening US small business subsidy programs to Australian businesses (and vice versa) would help address the funding gap. Providing Australian businesses with the knowledge and support to win US tenders for R&D programs would serve the same end.

QuestionTo turn our minds to some practical changes, I think we can see there 12:04 - 12:05 was a need for change, but I want to ask about what can be done to ensure that the DEC can be appropriately placed to manage this change. I think it really could be an important catalyst for industry if it is invested in and that is both in terms of the size of the staffing, so the number of people who are actually involved in getting these licenses through and assisting companies in the process, and it is also about, again, the ability to educate and communicate with the companies themselves, or the people, actors, individuals, institutions, businesses to whom this legislation will apply to really clarify how it fits with them. We are really concerned about them being left to work this out for themselves. So, look, to the previous line of 12:05 - 12:06 questioning - we do believe that we need to help people understand how this impacts them. That is going to take investment. It is going to take people within defence. It is going to take education. It is going to take communication. It is probably going to take development of a series of courses. The current state of what is described a little bit by industry as self checking themselves through the export licensing process and what they should - what applies to them andincudign seep expertise in the technicla and legal what doesn't - is insufficient. So, this will be people, this will be money, but I think it will be incredibly well spent and it will return to the economy in outcomes if defence and government is willing to do it. Well, maybe on notice then, if you list some specifics for the committee, that would be great. A

The government should invest in a public sector workforce that has both commercial and security backgrounds as well as deep expertise in the technical and legal aspects of the defence industry and the adjacent dual use space. They should also look at grants,

especially under the just released DIDS, to ensure that companies have the resources to meet increasingly stringent security and other requirements that require deep understanding of regulations and requirements (including new cyber security certification requirements necessary to win US contracts and which has the flow on benefit of ensuring company standards are high and meet or exceed Australian requirements).

ASPI's research has uncovered deficiencies in export control self-help tools provided by the DEC. Businesses must use the tools (intended to achieve efficiencies for both Defence and industry) to avoid delays that can make business relationships uneconomical because DEC is not staffed to provide this service. Existing problems would be exacerbated by making rules even stricter and penalties more severe. Reliance upon the DEC workforce will increase, as will the level of private investment required to achieve and maintain compliance. In ASPI's view, a successful transition to the new regulatory framework will require more time and resources than are currently envisioned in the Defence impact assessment. Training programs, while useful at the margin, will not address the underlying problem. Small business owners do not have the time to make export control compliance their full-time job. Their resources are often inadequate to hire the necessary staff. The change will require not only a one-time investment to bring business processes into compliance, but ongoing investment in maintenance of these processes and associated business systems.

The cost of doing business will rise across the board, damaging the business case for large numbers of marginally profitable businesses. ASPI's research suggests that the problem is larger than commonly anticipated. Not only do Australian businesses lack the resources to achieve compliance, but the expertise required to do so does not exist in the Australian economy in adequate quantities. Businesses who are trying to hire those with export-control skillsets cannot find suitable personnel. The effective size of the defence industry—and associated demand for export control expertise—will increase dramatically as purveyors of dual-use technologies who have never exported or sold to Defence are pulled into the system by deemed export regulations.

Required investment will go beyond the time and effort required to secure necessary licenses. Businesses wishing to operate in defence-specific or dual-use markets must make substantial upgrades to their business systems to maintain compliance. This includes the full range of support mechanisms, from human resources and enterprise resource planning to product marking, tracking, shipping and receiving. Businesses will further lose competitiveness against international peers as they reprioritise investment away from core technological innovation.

A range of support programs to address these deficiencies must accompany any regulatory change. Training programs must serve not only the niche requirements of individual business owners, but the future generation of experts who will serve the defence industry as a whole.

The timeline for implementation and imposition of criminal penalties must be substantially extended to allow adequate time not only to train existing business owners, but an entire corps of experts in international trade law. While direct government resourcing will be necessary, it must be carefully tailored to the challenges of the problem outlined above. Providing funding for businesses to hire compliance expertise will not be useful if the Australian economy does not possess adequate quantities of that expertise. The current plan underestimates the problem's size and allows inadequate time and resources for the required period of macroeconomic adjustment.

Targeted government programs will be inadequate to drive the envisioned level of rapid, large-scale adjustment across the entire defence industry. Time will be required for industry to adapt to the new environment. Much of the associated resources will need to come from increased competitiveness and market access, requirements for which were outlined in the previous answer.

Could you come back to us with ASPI's 12:08 - 12:09 perspective on how important it is to have a framework that will allow us to work with South Korea, Japan, Israel, Philippines, European partners, et cetera, that we already have existing procurement

arrangements or strategic arrangements with, but they are not part of AUKUS. Can do. Thank you.

It is vital that Australian companies are not constrained from doing business with regional and other international partners beyond AUKUS, not only to sustain existing procurement relationships but to grow and open new markets for great Australian products.

As such, the national interest lies in Australia's revised export control system being a critical source of competitive advantage which can be achieved if the government and Defence sets international standards for industrial security while avoiding problems that plague the US' ITAR. A significant deficiency in ITAR is its failure to recognise varying security standards across partner nations. It treats exports to the United Kingdom or Japan the same as exports to Egypt or Pakistan. Revisions to Australia's regulations must address this gap. Nations with trusted relationships to Australia and export control systems that meet the international standard must be treated accordingly. In this regard, it is important to note that exemptions in the reforms proposed under the legislation extend to countries on the Foreign Countries List as per Defence information (which is the

authority on this): https://www.defence.gov.au/about/reviews-inquiries/defence-trade-controls-amendment-bill-2023.

Australia's defence industry is composed disproportionately of small- and medium-sized enterprises. Such businesses are characterised by intermittent and unpredictable cash flows. Delays to international sales caused by export control approvals can mean a small business owner does not make payroll or misses a mortgage payment on the family house. Such businesses rely on a global customer base to achieve consistent sales. Therefore, careful consideration must be given to non-AUKUS business relationships to avoid damaging the profitability of Australia's defence industry. Export control exemptions with the US and UK will provide additional sources of revenue for marginally profitable businesses.

However, the businesses most likely to be adversely affected are also those that will have the hardest time winning in competitive US and UK defence acquisition programs. They lack the knowledge and networks to identify opportunities. This will require active engagement and support from the government and Defence. These SMEs often lack the industrial security frameworks to access classified data. They lack the scale and capital to deliver in quantities common to US procurements.

Stricter export control rules for non-AUKUS transactions have the potential to make critical markets uneconomical for large numbers of Australian businesses as they open opportunities only in markets where those businesses are uncompetitive. To avoid this outcome, the government will need to strike the right balance between protecting sensitive technologies and facilitating international trade. This means regulatory requirements and due diligence practices that incentivise a willingness to accept more risk with close, trusted and reliable partners simultaneously with a default against, or controls limiting, defence-related investment, collaboration and research with rivals and untrusted nations – in particular authoritarian regimes such as China, Iran, Russia and North Korea but also others who align with those regimes.