

Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

2016 - 2017

Division/Agency: Productivity Commission

Question No: 383

Topic: Shipbuilding and the submarine assembly industry

Reference: Hansard pages 27-28 (20 October 2016)

Senator: Xenophon, Nick

Question:

Senator XENOPHON: [...] Would you reconsider the Productivity Commission's reviews on that given that expert shipbuilders and Defence have made other assertions in relation to efficiencies? And do you consider that, in the context of building locally, there are benefits in terms of tax receipts, employment, and spillover and multiplier effects?

[‘That’ refers to box 3.1 — Illustrative effective rate of assistance for locally built submarines and local steel supply — from the Productivity Commission’s Trade & Assistance Review 2014-15]

Answer:

In box 3.1 of its *Trade and Assistance Review 2014-15*, the Commission outlined the method for calculating effective rates of assistance (ERA) so that others could test the impacts of their own cost assumptions about foreign and local build costs. The PC’s illustrative example used a local cost premium of 30 per cent and assumed that 50 per cent of the project was spent in Australia (covering wages and local materials). These estimates were consistent with press reports at the time of the decision but, as the Commission has previously advised the Committee, it would be highly desirable if better information was released on the cost and benefit of such a large project, on which such large industry as well as defence policy expectations have been placed.

This scenario generated an effective rate of assistance of 250 per cent, which is higher than the estimated peaks (approaching 200 per cent) reached for certain motor vehicles and textiles, clothing and footwear in the late 1970s and early 1980s when high tariffs and import quotas operated.

Regarding the 2015 report commissioned by the Defence Department from the RAND Corporation, *Australia’s naval shipbuilding enterprise*, that report concluded that defence shipbuilding in Australia carries a 30-40 per cent price premium, which could be approximately halved over time with a steady production program that leads to a productive workforce.

If a cost premium of half, i.e. 15 per cent, is input into the ERA calculations, the result is 109 per cent. If, at the same time, local expenditure is assumed to be 65 per cent of the total project the estimated ERA falls further (in the range 40 to 67 per cent, depending on the apportionment of expenditure between labour, materials and capital). For comparison, the estimated ERA for motor vehicle production in Australia in 1995 (after quotas were removed) was 43 per cent. That is, the submarine project is still a very high recipient of assistance in any recent historical comparison.

The multiplier and spillover benefits from big ticket projects are often misrepresented.

The most critical aspect in multiplier analysis is that where there is a specialised labour force or other resources required for a complex project, these are unlikely to be unemployed, and therefore have to be drawn from other industries (or from offshore). Consequently, a local submarine build will generally have *both* positive and negative multiplier effects.

Expenditure on local labour and materials increases activity in industries that provide inputs to the project, increasing their employment and output. This is the *gross* multiplier.

Concurrently, the expenditure on the submarine crowds out other public expenditure, or is financed by higher taxation or borrowing. Either way, these impacts create a *negative* multiplier. The same applies for tax receipts from the project. These increase for businesses and employees involved in the submarine project, but fall for industries whose activities fall.

The magnitude of any technology or workforce spillover effects of building the submarines locally have been examined in two reports commissioned by Defence: The RAND report; and *Building submarines in Australia – aspects of economic impact* (May 2015, released under FOI on 19 August 2016). Both these analyses cast doubts about the realisation of spillover benefits.