

# Chapter 11

## Economic benefits

11.1 The previous chapter found that there are cost savings to be gained in the through life support phase of a naval vessel if that vessel were built in Australia. This chapter looks beyond these narrow economic savings to consider possible broader economic benefits from constructing naval ships in Australia.

### **Broader benefits accruing from an in-country build**

11.2 In its submission to this inquiry, the Victorian government stressed that 'the comparative costs of construction is only one factor, and perhaps not even a dominant factor, in making an appropriate decision on where to build Australia's new warships'.<sup>1</sup> It highlighted 'the contribution major defence projects make to critical mass for innovation and technology transfer, and the building of skills that translates to an improved productive capacity through the economy'.<sup>2</sup> Indeed, many submitters provided a long list of what they considered significant benefits that accrue from the construction of naval vessels in Australia. They included, but are not limited to:

- increased gross domestic product from capital investment;
- reduced pressure on the balance of payments;
- enhancement of the labour market;
- expanded indigenous research and development (R&D), design, production and management capabilities;
- the acquisition and development of valuable new skills, manufacturing techniques and processes;
- extensive technology transfer across a broad spectrum of activities;
- a strengthening belief in Australia's own capabilities and confidence in its own ability to exploit opportunities;
- enhanced potential for exporting;
- the maintenance of capability to support vessels throughout their operational lives, shorter turn around for repairs with in-service support; and
- greater foreign investment.

11.3 Attributing a value to these many benefits, however, is difficult and further complicates the task of comparing the costs of constructing a ship in-country with the costs of an overseas build. The following section considers the broader advantages

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1 *Submission 31*, p. 5.

2 *Submission 31*, p. 6.

from an in-country build over and above the savings from through-life support. The strategic advantages of an in-country build are discussed in the following chapter.

### **Quantifiable evidence of wider economic benefits**

11.4 The Tasmanian government's submission noted the ripple effect that flows through the economy from increased activity in the naval shipbuilding and repair industry. It cited research from Australian Economic Consultants Pty Ltd showing that:

for every dollar spent on new or retained manufacturing business output, benefits flow not only from increases in manufacturing activity, but also from Australian industries that provide inputs into manufacturing activity and from industries meeting the consumption demands resulting from more jobs, wages and salaries.<sup>3</sup>

The Victorian government's submission similarly underlined the wider economic advantages gained from constructing naval ships in Australia. It stated:

Compared to buying warships from overseas, in-country construction of major defence platforms generates additional activity throughout the local economy. Some of this additional economic activity is captured in standard economic models that are based on multiplier effects, as local expenditure is spread through the economy through wages and profits. Modelling of the ANZAC frigate program suggests that the \$5.6 billion construction program generated between \$3 billion and \$7.5 billion in additional GDP.<sup>4</sup>

### ***The Minehunter and ANZAC studies***

11.5 Indeed, many witnesses referred to the studies of the ANZAC (Tasman Asia Pacific) and Minehunter (Tasman Economics) projects to demonstrate the broader economic benefits that can accrue from building naval vessels in-country.<sup>5</sup> The studies sought to quantify the flow of economic benefits from these projects to the wider economy. They indicated that substantial benefits extend to the broader economy from naval shipbuilding through linkages to other industries, increased employment and improved productivity.<sup>6</sup>

11.6 The extent of the economic benefits identified in these studies depended on the model used. For both projects, the Tasman Asia Pacific and Tasman Economics reports applied a general equilibrium analysis and an input-output multiplier analysis. The general equilibrium model takes into account constraints on the supply of labour,

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3 *Submission 30*, p. 3.

4 *Submission 31*, pp. 5–6.

5 Tasman Economics and Tasman Asia Pacific are the forerunners to ACIL Tasman.

6 Tasman Asia Pacific, February 2000, *Impact of Major Defence Projects: A case study of the ANZAC Ship Project*, pp. 43–49; Tasman Economics, January 2002, *Impact of Major Defence Projects: A case study of the Minehunter Coastal Project*, pp. 53–76.

capital and other inputs that will apply in an economy like Australia. On the other hand, the input-output multiplier analysis does not take account of an economy with no excess capacity or full employment.

11.7 Using the input-output multiplier analysis for the Minehunter project (valued at \$1000 million in 2001 dollars over a period of nine years), Tasman Economics calculated that the project's economic benefits would:

- contribute up to \$1665 million (2001 dollars) to national output;
- contribute up to \$505 million (2001 dollars) to Australia's Gross Domestic Product; and
- generate (or sustain) up to 9250 full-time equivalent jobs) (Tasman Economics 2002).<sup>7</sup>

11.8 Using a general equilibrium analysis, Tasman Economics calculated that the project's economic benefits would:

- contribute up to \$887 million to GDP;
- contribute up to \$492 million to consumption; and
- generate or sustain an average of more than 1800 full-time equivalent jobs each year.<sup>8</sup>

11.9 Using the input-output multiplier analysis for the ANZAC project (valued at \$5600 million in 1998–99 dollars over a period of approximately 15 years), Tasman Asia Pacific calculated that the project's economic benefits could have:

- generated up to \$10 900 million in national output; and
- supported up to 57 000 full-time equivalent jobs.<sup>9</sup>

11.10 Using a general equilibrium analysis, Tasman Asia Pacific calculated that the project could:

- contribute at least \$3000 million to GDP;
- contribute at least \$2200 million to consumption; and
- generate around 7850 full-time equivalent jobs.<sup>10</sup>

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7 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, p. 55.

8 Tasman Economics, January 2002, *Impact of Major Defence Projects: A case study of the Minehunter Coastal Project*, pp. vii and 75.

9 Tasman Asia Pacific, February 2000, *Impact of Major Defence Projects: A case study of the ANZAC Ship Project*, p. 44. The input-output multiplier analysis tends to overstate the flow-on effect of projects on the wider economy because it does not factor in the economic effects between industries and it cannot take into account of the impact of a change in demand when there is no excess capacity. In other words, the input-output multiplier analysis does not take into account the constraints that can apply in an economy.

11.11 The Minehunter and ANZAC projects' modelling concluded that for both projects the Australian economy would have been worse off if Defence had sourced the new capability requirements 'off the shelf' from an overseas supplier rather than building them in Australia. In the case of the ANZAC ships, this finding included the assumption that importing the frigates could have saved 3.5 per cent of the Australian contract price.<sup>11</sup>

11.12 One of the greatest benefits from an in-country build was the flow-on effect of new technologies and business practices from companies involved with the ANZAC and Minehunter projects. In its submission to this inquiry, the Australian Association for Maritime Affairs Incorporated stated:

Although it [ANZAC study] was produced six years ago, the key findings of this study included an estimate that the national GDP would grow by around \$3.0 billion annually, and that the project would generate around 7850 full-time jobs. Importantly the project was able to stimulate improvements across the board by the many companies involved, specifically in the fields of productivity, research and development, business practices, and export opportunities. In addition this project enabled an efficient and through life support capability to be built up in country: in balance of trade terms this project has been a significant achievement.<sup>12</sup>

11.13 A February 2006 ACIL Tasman study, *Naval shipbuilding in Australia: A background briefing*, reiterated the findings of the ANZAC and Minehunter studies. It stressed that through linkages to other industries, and the increased employment and economic activity associated with these linkages, Australia's naval shipbuilding industry makes a substantial indirect contribution to the economy.<sup>13</sup> Significantly, the study referred to input-output multipliers as 'a well-established analytical approach for assessing the extent of the direct and indirect linkages between an activity...and the rest of the economy'. It added:

It should be borne in mind that the general equilibrium modelling in both instances did not consider the benefits to the Australian economy flowing from a combination of local construction and through-life support.<sup>14</sup>

However, as the following section notes, some witnesses have highlighted the limitations of the input-output multiplier analysis and modelling methods generally.

10 Tasman Asia Pacific, February 2000, *Impact of Major Defence Projects: A case study of the ANZAC Ship Project*, p. iv.

11 Tasman Economics, January 2002, *Impact of Major Defence Projects: A case study of the Minehunter Coastal Project*, p. 75; Tasman Asia Pacific, February 2000, *Impact of Major Defence Projects: A case study of the ANZAC Ship Project*, p. 46.

12 *Submission 13*, pp. 1–2.

13 The study was commissioned by the South Australian government as background information for its submission to this inquiry.

14 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, pp. 67–68.

### ***Critiques of the ANZAC and Minehunter studies' modelling***

11.14 While many submitters quoted the above studies as evidence of the broader economic benefits of naval shipbuilding, the Department of Industry, Tourism and Resources (DITR) and the Department of Defence recommended caution in interpreting analysis of multiplier effects. DITR noted that input-output multiplier models are based on an unrealistic model of the economy. Specifically, that 'in a relatively fully employed economy, with scarce skilled labour and price pressure on raw material, input-output multipliers do not provide credible results'.<sup>15</sup> With regard to general equilibrium analysis, DITR observed that the broader economic gains reported are a result of assumed increases in efficiency. Therefore, the reported economic benefits of the projects are realistic only in so far as the assumptions made about productivity gains are realistic.<sup>16</sup> DITR noted that a critique of the methods was not intended to suggest that no broader economic benefits accrue from naval shipbuilding. Rather, 'the size of any such benefits is a matter for judgement that will depend on the particular circumstances of the project, the involved firms and the broader economy'.<sup>17</sup>

11.15 Based on advice from the Treasury, Defence went further to state that much of the focus tends to be on the positive multipliers. It indicated that it is possible for second order effects to be negative; for example, 'where labour and capital are displaced from more productive to less productive sectors, lower national income can be expected to result'. Specifically:

...where labour and capital are displaced from more productive to less productive sectors, lower national income can be expected to result. If there were skill shortages, then in the process of competing for skilled labour, nominal wages would be bid up as these resources were drawn away from other naval projects and/or the oil and gas sector. In these situations, economic activity is simply shifted rather than increased, and not necessarily shifted to its most productive use.<sup>18</sup>

Treasury also advised that where the need for skilled labour is satisfied by temporary migrants 'any multiplier or second tier order effects may be limited by the extent to which they seek to repatriate their wages to their home country'.<sup>19</sup>

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15 DITR, *Submission 38*, p. 17.

16 DITR noted that in the study of the ANZAC project, productivity gains reported in a survey of businesses involved with the project were unrealistic, so a more moderate assumed productivity growth figure of three per cent was used in the model. For the Minehunter study, the productivity growth figure used reflected business survey results, that is, 2.24 per cent improvement in 35 per cent of project sub contractors' 'non-Defence' work.

17 DITR, *Submission 38*, p. 19.

18 Treasury advice quoted by Defence, answers to question on notice, 28 March 2006 (received 29 May 2006), question 17, p. 44.

19 Treasury advice quoted by Defence, answers to question on notice, 28 March 2006 (received 29 May 2006) question 17, p. 44.

11.16 Defence's submission noted that:

Constructing the ships identified in the DCP [Defence Capability Plan] in Australia has the potential to impact adversely on the overall wealth of the nation. Given the competition for scarce, skilled resources these may be better focused on non-Defence projects (such as export orientated investments) aimed at the long term good of the nation and wealth generation rather than being employed in new ship construction.<sup>20</sup>

11.17 Ms Denise Ironfield, author of the Minehunter and ANZAC reports, told the committee that while Treasury's advice was theoretically correct, Defence projects tend to be high-technology, high value added projects with a high return to GDP. As firms will move within and across industries to higher yield areas and labour resources will, where possible, move to higher reward work, it is therefore more likely that Defence projects would displace resources from less productive sectors, rather than more productive sectors.<sup>21</sup>

11.18 Defence noted that even calculating the direct economic benefits of naval ship construction is not straightforward. For ships constructed in Australia, the designs will normally be based on overseas designs and most equipment and systems will be sourced from overseas suppliers. Defence suggested that typically around 45 to 64 per cent of total expenditure for a warship project will be put towards work generated in Australia.<sup>22</sup>

### **Employment growth and broadening the industrial base**

11.19 Submitters strongly supported investment in naval shipbuilding as a basis for employment growth, skills generation and higher economic growth.

- The Western Australian government referred to a 'wider heavy engineering matrix' which can and should contribute to naval shipbuilding projects 'while simultaneously attending to other national engineering tasks'. Its submission noted that if WA constructs 'about one-third' of the AWDs and integrates and consolidates the LHDs, the estimated annual economic benefits to the state from all naval shipbuilding and support projects 'could be as high as \$450 million per annum'.<sup>23</sup>
- The Victorian government emphasised the additional economic benefits from naval shipbuilding that are not captured in ACIL Tasman's modelling. In particular, its submission cited the impetus that defence projects give to mass for innovation and technology transfer, skills development 'that translates to an improved productive capacity through the economy' and additional

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20 *Submission 20*, p. 28.

21 *Committee Hansard*, 3 July 2006, pp. 92–94 and 97.

22 Department of Defence, *Submission 20*, p. 27.

23 *Submission 23*, pp. 28–29.

taxation revenue for the Commonwealth 'that would not occur if warships are purchased directly from overseas'.<sup>24</sup>

- Tenix referred in its submission to the 'ripple effect' that the naval shipbuilding industry provides to the resource sector, infrastructure projects and manufacturing 'by channelling significant investment into training and development of a long-term skilled workforce'.<sup>25</sup> Mr David Miller, Executive General Manager of Tenix Defence Pty Ltd, also emphasised the importance of sustaining existing industry capability in an economically significant national asset.<sup>26</sup>
- The RSL noted that significant employment benefits are to be gained in Australia by letting tenders to Australian shipbuilders to build Australian warships. It identified several industries that benefit from large naval shipbuilding projects including engine manufacturers, steel makers, transportation companies, weapons producers, electronic and electrical firms.<sup>27</sup>
- Mr Mark Proctor, Business Development Manager of Saab Systems Pty Ltd, told the committee that local construction projects are crucial for local SMEs to get 'the confidence and track record to be able to compete for international work'. He argued that local investment in large local defence programs provides a 'nation wide stimulus for training and development of an experienced workforce' in both defence and non-defence industries. This investment puts in place 'a sustained capability' which is an important asset when negotiating transfer of foreign owned intellectual property.<sup>28</sup>

### **Contributing to an innovative and productive industrial base**

11.20 The February 2006 ACIL Tasman report revisited the findings from its ANZAC and Minehunter studies. It argued that naval shipbuilding can bring considerable indirect benefits such as technology transfer, the uptake of performance enhancing practices and higher productivity.<sup>29</sup>

11.21 According to more than 20 per cent of respondents to the survey of businesses participating in the ANZAC and Minehunter projects, their firms obtained a transfer of technology resulting from their involvement with the project. For the majority of these companies, the technology transfer benefited their business performance and

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24 *Submission 31*, p. 6.

25 *Submission 26*, p. 7.

26 *Committee Hansard*, 27 April 2006, pp. 2 and 20.

27 *Submission 6*, p. 5.

28 *Committee Hansard*, 20 April 2006, p. 3.

29 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, p. 60.

growth.<sup>30</sup> Among the surveyed businesses involved in the Minehunter project, around 25 per cent obtained a technology transfer, one-third improved their export prospects, and around 35 per cent increased their overall productivity.<sup>31</sup> In the ANZAC project, one-fifth of surveyed businesses obtained new technology and over 20 per cent improved their ability to export through involvement in the project.<sup>32</sup>

#### 11.22 The RSL's submission argued that:

Advances in technology continue to revolutionise the work place and in no arena is this more apparent than in the development of defence force platforms, weapons and sensors. These advances bring with them economic gains. Australian developments such as the Nulka System for ship protection from missiles along with technology transferred from allied countries assist in this process.<sup>33</sup>

#### 11.23 Mr Gallagher told the committee:

Take Nautronix, for example: I suspect that, had it not gone into the defence business and been part of that program—albeit in a very small way, in the latter stages—considering what is happening in the oil and gas sector today and our relative percentage splits, we might not have a Nautronix. I think that would apply to quite a number of other companies, given the number of organisations that were involved in many ways in that submarine build program and have gone on to be part of a future defence industry program—or it allowed them to upskill and be part of other industrial programs. Given that one cannot rely wholly and solely on defence programs, you look for synergies and other opportunities. I think a lot of companies will have benefited from having had that opportunity in that build program; therefore, the Australian industry base has also benefited as a result.<sup>34</sup>

11.24 Nautronix provided an example of the spur given to technological development and innovation from its participation in defence industry. In the early to mid-1990s, when the Collins class project was experiencing difficulties, it was realised that some of Nautronix's acoustic capability and product and solutions could be applied to Defence purposes. As part of the development activity associated with its work on the Collins class submarines, Nautronix invested in water communications. The company used technology which could 'transfer very accurate SMS type messages between shore and submarine and now from submarine to submarine to ship'. Mr Gallagher explained:

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30 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, p. 61.

31 Tasman Economics, January 2002, *Impact of Major Defence Projects: A case study of the Minehunter Coastal Project*, p. vii.

32 Tasman Asia Pacific, February 2000, *Impact of Major Defence Projects: A case study of the ANZAC Ship Project*, pp. vii and x.

33 *Submission 6*, p. 5.

34 *Committee Hansard*, 3 April 2006, p. 42.



The evolution of that, and through the acquisition of MariPro in the US from SAIC, got us into the fixed ranges business. Part of that technology transfer out of MariPro into Australia allowed us to extend our capability into the portable ranges business, which was also a spin-off from the oil and gas sector.

...

The evolution of these activities got us into underwater computing systems and we are currently under contract with the Navy for the provision of these hand-held diver systems that are a spin-off from the electronic charts. ... Now, I do not suggest that Nautronix in the near or even medium term is going to be a military systems integrator of the significance of, say, a Raytheon or a Boeing et cetera, but it is having that capability that will allow us to strengthen the overall base in Australia and support those major companies or clients in getting the jobs done in a cost-effective and timely fashion.<sup>35</sup>

#### 11.25 Nautronix explained further that:

At the moment, on board the vessels themselves, we have the through water communications system or HAIL, the hydro acoustic information link. Around the USN, through MariPro we have the fixed ranges as part of that, but we have supplied our portable range technologies into the USN and they are currently operational in Hawaii and will be extended across the US operating straits.<sup>36</sup>

#### 11.26 The economic benefits from an in-country build extend more broadly to improved commercial opportunities and productivity outcomes for local companies. The RSL's submission highlighted the comments of Mr Hector Donohue, General Manager, Strategic and Business Development at Tenix Defence Systems:

Local construction of ships has facilitated the 'Australianisation' of vessels, such that much of the ship fitted plant and equipment is sourced in Australia and tailored to meet specific Australian standards. This results in equipment that is optimal for Australian conditions and requirements and equipment that can be supported locally. It is therefore capable of local evolution as technology advances, threats change and capabilities improve and mature. Australian naval shipbuilders have expertise in systems adaptation, design refinement and systems integration. Systems integration, in particular, has encouraged shipbuilders to enter into the strategically important areas of data management, signal processing, command, control and communications.<sup>37</sup>

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35 *Committee Hansard*, 3 April 2006, p. 38.

36 *Committee Hansard*, 3 April 2006, p. 38.

37 *Submission 6*, p. 6. Speech at the Australian National University titled 'Whole of Nation Concepts—Industry Perspectives' by Hector Donohue AM, General Manager, Strategic and Business Development, Tenix Defence Systems, October 2003.

11.27 The 2006 ACIL Tasman study highlighted a strong link between the implementation of 'best practice' programs, such as quality assurance, and improved productivity and business performance. It suggested that 'involvement with a Defence project had been a key factor in businesses' decision to introduce all or a number of the performance enhancing programs and practices'.<sup>38</sup> In the main, the benefits from participating in a shipbuilding project improve productivity. The survey findings from ACIL Tasman's ANZAC and Minehunter studies suggest that:

...the identified productivity increase and other improvements in business performance were in large part driven by the businesses access to technology transfers and the performance enhancing programs and practices which were implemented in order to meet Defence's stringent quality requirements.<sup>39</sup>

11.28 The management and logistical aspects of building, operating, maintaining and repairing warships are a crucial part of their effectiveness. The use of world's best practice in these facets can deliver flow-on effects to the broader Australian economy, as well as maximising the cost effectiveness of the Australian fleet.

11.29 The promotion of best practice is often facilitated through the influence of large foreign multinationals in Australia. Mr Gallagher of Nautronix told the committee that past government investment in the naval shipbuilding sector had been successful in attracting high-profile multinationals to Australia.<sup>40</sup> Mr Mark Proctor of Saab Systems noted that the presence of world-class international companies with a base in Australia gives confidence to Australian companies to compete for international work. He also noted the importance of a strong indigenous electronics industry with which Australia can bargain with when negotiating transfer of foreign owned intellectual property into Australia.<sup>41</sup>

11.30 A number of submitters also referred to export opportunities created by defence programs. For example, Nautonix informed the committee that:

It also allows us the opportunity to get through some of the international hurdles such as the Itar restrictions imposed by the US. We have had a number of successes in that space, particularly as one of the very first Australian companies to go through the foreign comparative test program and get our system on board US platforms.<sup>42</sup>

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38 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, p. 62.

39 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, p. 64.

40 *Committee Hansard*, 3 April 2006, p. 34.

41 *Committee Hansard*, 20 April 2006, p. 3.

42 *Committee Hansard*, 3 April 2006, p. 35.

## Disadvantages of building overseas

11.31 The flipside of the economic benefits from in-country construction of naval vessels is the relative disadvantage associated with building the vessels offshore. ACIL Tasman concluded their recent study with the statement that:

General equilibrium analysis undertaken as part of the two case studies considered the implications to the Australian economy had these made naval acquisition programs been sourced 'off the shelf' from overseas suppliers. In both instances it was found that the Australian economy would have been worse off had the foreign supply option been followed. In the case of the ANZAC ships modelling it was found that Australia would have been worse off even if the 'off the shelf' acquisition would have cost Defence 3.5 per cent less than the alternative locally sourced option.<sup>43</sup>

### *Commercial risks*

11.32 Several submitters also highlighted drawbacks from offshore construction and reliance on offshore suppliers. For example, the Submarine Institute of Australia Inc. noted the higher commercial risk associated with offshore construction where there is no overseas parent navy and for which the RAN is the only operator.<sup>44</sup> It also urged that to avoid a repeat of the problems with the Collins class submarines, Australia must 'seek to obtain the core design and integration work from overseas'.<sup>45</sup> Weir Strachan and Henshaw told the committee of their first-hand experience in dealing with overseas supplying on the Collins class project:

So we found that our dealings with them [the overseas suppliers] became more and more strained, and they were less and less interested in dealing with us. So, although probably in the first instance the companies were quite keen to supply equipment to the projects, once the acquisition was complete, and because often, as we discussed earlier, there were no requirements on them to support the equipment through life, the business model was not attractive for them. There just was not enough business in support for them to look after it. If they were pressed, they would look after the equipment, but it was actually at a price and a schedule that pleased them rather than our customers. That led us to take things into our own hands.<sup>46</sup>

11.33 The Fremantle-based SME, Nautronix Ltd, argued that Australian companies suffer from a 'tyranny of distance' in their interactions with overseas shipbuilders. Mr Mike Deekes, Chief Executive Officer of Nautronix, told the committee:

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43 ACIL Tasman, *Naval shipbuilding in Australia: A background briefing*, 9 February 2006, pp. 66–68.

44 *Submission 3*, p. 15.

45 *Submission 3*, p. 8.

46 *Committee Hansard*, 20 April 2006, pp. 26–27.

If that industry goes offshore then it is going to be very difficult for SMEs particularly to compete in an international space and be part of what is effectively a foreign shipbuilding program without some absolute direction or requirement by, say, the government of the time. Shipbuilders will tend to want to, if they are to provide a cost-effective solution, fit those ships with the systems that are prevalent in their sister classes in their own countries.<sup>47</sup>

11.34 In blunt terms, Mr Deekes told the committee:

You lose the flexibility and accessibility to being part of the program, and that would apply to a whole range of companies. Why would you buy nuts and bolts from some guy in Australia when it is obviously far cheaper to walk around the corner in the US or wherever the ships might be being built?<sup>48</sup>

### *Eroding the Australian industrial base*

11.35 Another major disadvantage in purchasing naval vessels offshore is that it overlooks the investment needed to maintain in-country capability and infrastructure. An offshore build uses taxpayer money to support investment in offshore capabilities. It also allows the foreign yard to use the build of the Australian ship as a promotional tool for its prospective customers, an advantage not enjoyed by Australian industry.

11.36 The RSL noted that purchasing vessels from overseas reduces the capacity of the Australian industrial base.<sup>49</sup> It cited the case of HMAS *Westralia* which was purchased from Britain:

When this vessel had to be deployed to the Persian Gulf during the 1991 Gulf War it could not meet the 'one stop shop' need of the warships it was supporting. This operational shortcoming has been perpetuated by the second stop-gap measure of acquiring the foreign built tanker *Delos* to replace HMAS *Westralia*. Even after conversion in an Australian shipyard it will not have the 'one stop shop' AOR capability when it enters service as HMAS *Sirius*. The support ship will be unable to replenish ammunition and will lack some of the other features normally built in to an AOR.<sup>50</sup>

11.37 Mr Peter Croser, Managing Director of Gibbs & Cox Australia Pty Ltd, highlighted the pitfalls of buying ships off-the-shelf from an overseas seller. He emphasised the importance of acquiring cutting-edge technology to suit Australia's unique strategic requirements:

Because we then would be buying a ship that was from a few years before, and the capability requirement that the Australian Navy are asking for is

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47 *Committee Hansard*, 3 April 2006, p. 39.

48 *Committee Hansard*, 3 April 2006, p. 41.

49 *Submission 6*, p. 3.

50 *Submission 6*, p. 3.

from last year not 10 years ago. They want to be 10 years ahead of the game or else they are in the future going to be 10 years behind the game. Effectively, we are looking to meet a capability that the Australians need for their projected future, not USN's projected future. I think they are different.<sup>51</sup>

11.38 Mr Miller of Tenix emphasised the economic importance of continuing Australia's investment in warship construction. He told the committee that recent experience with Tenix and other Australian shipbuilders has showed that Australia can compete with yards in Europe, both in material costs and labour costs. Mr Miller emphasised that shipbuilding is of 'economic value to Australia' and contributes to the economic strength of the nation. He noted that Australia, as a country with an established shipbuilding industry, does not face the huge economic barriers to entry as would a company seeking to enter the aircraft manufacturing industry.<sup>52</sup>

#### *The effect on Australia's trade deficit*

11.39 Large one-off purchases of defence items substantially increases Australia's balance of payments deficit. The Australian Manufacturing Workers Union noted in its submission that over the past decade, the growth in imports of elaborately transformed manufactures (ETMs) has 'greatly exceeded' ETM export growth. It argued:

The purchase of naval vessels overseas would increase our imports of ETMs by a massive margin. For example, if the Federal Government had decided to source the Air Warfare Destroyers completely from overseas that would have added approximately \$6 billion to our ETM import figure, representing 4.4% of total ETM imports or increasing our trade deficit by 26.3%.<sup>53</sup>

11.40 On the other hand, local procurement of naval vessels not only avoids worsening the ETM trade deficit but can also provide a basis for exports of naval vessels. Not only does local construction reduce ETM imports; it often leads to more ETM exports. Mr Miller told the committee:

It is a part of Australian industry that in our business alone we are fairly confident that we have contributed several billion dollars to the export and balance of payments situation here in Australia. I am certain that John Rothwell and the many other successful people in shipbuilding in Australia would be able to point to exactly that. We got into the industry and there are areas now where we certainly can compete. I do not think we are terribly disadvantaged simply by being in Australia.<sup>54</sup>

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51 *Committee Hansard*, 19 April 2006, p. 49.

52 *Committee Hansard*, 27 April 2006, p. 20.

53 *Submission 21*, pp. 13–14.

54 *Committee Hansard*, 27 April 2006, p. 20.

11.41 Australia is well-placed to continue capitalising on these past export successes. Against a backdrop of sustained economic prosperity and large budget surpluses, it is important that Australia invests in its indigenous naval shipbuilding industry.

### **Defence's assessment of these benefits**

11.42 Defence agreed that all of the benefits put forward by witnesses can accrue to some extent from Australian naval shipbuilding. However, these broader benefits are not generally considered when assessing tenders. Defence explained:

Some of the less tangible benefits, such as technology transfer and access to intellectual property, are achieved through the activities proposed for Australian industry and form part of the evaluation of these activities. Others, such as potential spin-offs to industry at large and wider benefits to the economy, such as increased employment, may be recognised but play little or no part in the numerical evaluation. Such benefits will be noted in advice to Government.<sup>55</sup>

11.43 Defence stated it is not their practice to base a source decision solely on cost. The primary consideration is 'value for money', which balances cost with acquisition capability.<sup>56</sup> These issues are discussed in more detail in chapter 15.

### **Conclusion**

11.44 The committee notes several economic benefits from past investment in an indigenous naval shipbuilding industry. Both the ANZAC and Minehunter projects had clear spin offs for the companies involved and the wider Australian economy in terms of employment growth, higher GDP and consumption, technology transfer, export opportunities and the adoption of best practices. Disagreement over the accuracy of different economic models to measure these benefits is an argument about the size of the projects' economic benefits, not their existence.

11.45 The committee has received considerable qualitative evidence pointing to the importance of in-country investment in warship construction for job creation, technological innovation and higher productivity. There have been corresponding arguments that offshore construction not only fails to recognise these benefits, but also fails to capitalise on the sizeable investment already made in the naval shipbuilding sector. Moreover, failure to continue investing in an indigenous naval shipbuilding industry would threaten the livelihood of the existing industrial base, detract from the economy's overall value and compromise the effectiveness and timeliness of Australia's key strategic requirements.

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55 Department of Defence, answer to question on notice, 28 March 2006 (received 29 May 2006) question 52, p. 48.

56 Department of Defence, answer to question on notice, 28 March 2006 (received 29 May 2006) question 27, pp. 17–18.