



DEFENCE COUNCIL OF THE AUSTRALIAN INDUSTRY GROUP

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Australian Industry Group
Defence Council

23 February 2006

Ms Kathleen Dermody
Secretary
Senate Foreign Affairs, Defence and Trade References Committee
Suite SG.57
Parliament House
CANBERRA ACT 2600

Dear Ms Dermody

Subject: Opportunities for Naval Shipbuilding in Australia

Thank you for your letter dated 16 November 2006 inviting the Australian Industry Group to lodge a submission in regard to the inquiry by the Senate Foreign Affairs, Defence and Trade References Committee into opportunities for naval shipbuilding in Australia. On behalf of Ai Group's Defence Council I welcome the invitation and offer the following input to the Committee's inquiry.

The Ai Group Defence Council has had a long-term commitment to promote the credentials of Australia's defence industry, including the world-class expertise of its naval shipbuilding sector.

It is timely that the Committee is giving consideration to this most important subject, especially as the government will, in about 12 months from now, give consideration to where to build one of the largest naval construction projects ever contemplated by Australia, namely two new amphibious ships for the Australian Defence Force (ADF). This project is essential to the long-term well being of Australia's naval construction industry.

On 21 July 2005, Heather Ridout, Chief Executive of Ai Group wrote to the Prime Minister seeking his support for local construction of the two new amphibious ships, based on:

1. Previously demonstrated substantial benefits to the Australian economy generally and to regional development; from naval construction projects;
2. Australian defence industry's proven track record in building complex naval platforms, such as the Anzac frigates;

3. The proven capacity and cost benefit of Australia's industry to support and upgrade major naval capabilities through their 30-year life cycle;
4. World-class skills and performance of our maritime engineers and systems technicians; and
5. The strategic importance of Australia's shipbuilding sector which guarantees the ability of the ADF to meet its extremely demanding tasks in this increasingly uncertain world.

In his response of 21 September 2005, the Prime Minister advised that "While the government's preference is for the amphibious ships to be built in Australia, the government is also committed to adhering to a responsible process for defence acquisitions that ensures that projects are delivered on time and on budget, in accordance with the recommendations of the Defence Procurement Review 2003 (the Kinnaird Review)." He went on to indicate that "... government consideration of this matter will be informed by well coordinated advice that takes into account key issues including capability requirements, affordability, value for money, industry and workforce impacts, skills formation and retention, scheduling issues and the overall national interest".

Ai Group welcomes the Prime Minister's confirmation that the government favours an Australian build for the amphibious ships and acknowledges that a number of issues will be considered by the government when it eventually gives consideration to the preferred construction arrangement. A careful analysis of Australian industry's credentials against each of those issues would lead to a decision in favour of local construction.

Australia's naval construction industry has already proven its capacity to deliver major defence capabilities on time and on budget. Both ADI and Tenix have been involved in recent, highly successful naval construction projects, namely Minehunters and ANZAC frigates.

The ANZAC frigate project, based at Williamstown, Victoria, provides a first-class template of success. The project for 10 frigates, costing \$5.6 billion (in 1999 dollars) over 10 years, was, until the new Air Warfare Destroyer project, the largest single defence contract ever entered into by Defence. All of the frigates have been delivered on time and on budget.

A major study for Ai Group by Tasman Asia Pacific, which included sponsorship from the Victorian Department of State and Regional Development and Industry and Procurement Infrastructure Division of the Department of Defence, which reported in February 2000, addressed the impact of the ANZAC frigate project on participating firms and the Australian economy.

The report concluded that, by constructing the ANZAC frigates locally rather than purchasing similar vessels from overseas, Australia:

- increased annual GDP by as much as \$500 million and, over the 15 year construction phase, gains to the Australian economy were estimated to amount to \$7.5 billion;
- increased annual consumption by over \$300 million per annum; and
- saw the creation of nearly 8,000 full time equivalent jobs.

Through-life support costs for maintaining the new frigates over a period of around 25 years were estimated by Defence to be in the order of \$45 billion, with the majority of support being provided within Australia.

More than 1,200 Australian companies were involved in the ANZAC frigate project.

The Minehunter project provides a similar story to the ANZAC frigate project. According to another report commissioned by Ai Group with Tasman Economics (January 2002), Defence's decision to source its new Minehunter Coastal capability from Australian industry rather than from overseas suppliers was seen as a win for:

- the economy and regional Australia;
- Australian industry; and
- Defence

In 1994, Defence awarded ADI Limited a contract to build 6 Italian-designed minehunter vessels at a contract value of \$917 million, or over \$1 billion in 2001 dollars.

ADI delivered the first minehunter, HMAS Huon, on time and on budget in March 1999

Over the 9 years of construction of the minehunter vessels, the project was estimated to have:

- contributed nearly \$900 million to Gross Domestic Product;
- contributed up to nearly \$500 million for Consumption;
- directly and indirectly generated (or sustained) an average of more than 1,800 full-time equivalent jobs each year; and
- created more than 3,000 jobs alone in the Newcastle region.

Ai Group welcomed the decision by the Federal Government to commit to Australian construction of the new Air Warfare Destroyers (AWDs). This project will provide substantial benefits to Australian industry, both in South Australia and

elsewhere, and has the potential to create thousands of jobs during the construction phase and in support of the destroyers through their 30-year life.

In reaching its decision to construct the AWDs here, the Federal Government presumably took into account any premium associated with local construction. Ai Group is concerned that, in some parts of Government, there is a view that the premium for construction of the two new amphibious ships here will be such that these ships should be built overseas. Like the preferred AWD design, the amphibious ships design will be modified to meet Australian requirements and, therefore, the cost of the construction here will be larger than for overseas construction. Australian industry should not, therefore, be penalised for tendering accordingly. Further, any perceived cost acquisition benefit by procuring off-shore would be outweighed by a whole-of-life cost advantage in choosing to build locally.

Ai Group has been working closely with the Federal Government, including with the Defence Materiel Organisation on its "*Skilling Australia*" initiative, and industry to overcome skills shortages impacting on the naval shipbuilding sector and is confident that Australian industry is capable of meeting the skills challenges required to build both the AWDs and amphibious ships here.

It is the case that Australia's naval shipbuilding industry fully appreciates the substantial construction challenges posed by both major projects - amphibious ships and AWDs. Ai Group welcomed the Federal Government's confidence that ASC would be capable of handling the highly complex AWD construction and combat system integration. ASC is putting together a highly experienced team of tier two contractors to undertake that task. Equally, both ADI and Tenix, which have declared their intention to bid for construction of the amphibious ships, are proven performers, who have fully met government requirements to build complex naval platforms on budget and on time. Heading offshore to undertake this project makes no sense to Ai Group and would be contrary to long-term government policy of encouraging a competitive, vibrant and strategically critical naval construction capability in Australia.

I look forward to providing additional information to assist the Committee in its current inquiry, should members require it.

Yours sincerely

John O'Callaghan
Executive Officer
Australian Industry Group Defence Council