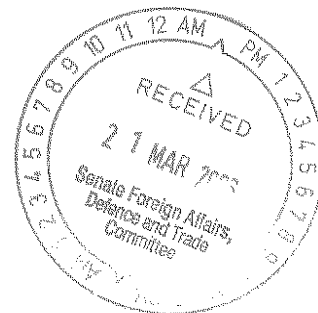




THE NAVY LEAGUE OF AUSTRALIA

A.C.N. 008 451 063

PATRON IN CHIEF - HIS EXCELLENCY THE GOVERNOR GENERAL



9th March 2006

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

Dear Dr. Dermody

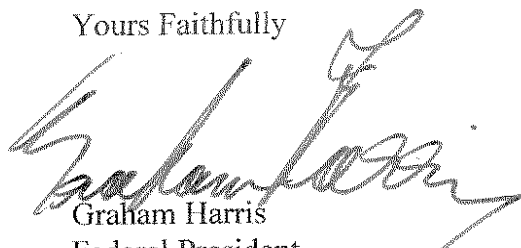
Thank you for your letter inviting the League and it's members to make a submission on naval shipbuilding to the Committee.

I enclose a submission on behalf of the League. The Terms of Reference invite comment on naval shipbuilding with a particular emphasis on economics. We imagine that other submissions, including from the shipbuilders, can better deal with the economics. We have sought to direct our comments so as to highlight the benefit of local production and the issues of continuity and competition.

In our submission there is reference to articles in the United States Naval Institute journal *Proceedings*. I assume the Committee has access to this publication. If this is not the case please let me know and I will send you copies.

If there is anything further we can do please let me know.

Yours Faithfully


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Navy League of Australia Submission to the Senate Foreign Affairs, Defence and Trade References Committee

This League submission will seek to identify and comment on issues relevant to naval shipbuilding in Australia. Its purpose is to discuss and to highlight the benefit of local production and the issues of continuity and competition.

Insofar as the Inquiry wishes to examine particular matters such as the capacity of the industrial base, the comparative economic productivity of the shipbuilding industry and the comparative economic costs of repair and maintenance the League is content to defer to others. We presume the principal builders, Tenix, ASC, Austal etc will be putting in submissions covering these matters.

The benefit of local production.

While warships can be obtained from overseas there are many advantages in construction in Australia including;

- * Employment (in the building of the ANZACs, as well as the workforce in the building yard, over 1000 Australian firms received contracts)
- * Acquisition of skills and development of industry
- * Through-life maintenance, repair and modernization/upgrade of ships. While it is possible to carry out these tasks in Australia for ships that have been built overseas, it is much easier if the ships have been built in Australia, since the knowledge and experience is here
- * Current account balance
- * Tax paid by workforce and by industry
- * The existence in Australia of an efficient shipbuilding industry can be of considerable assistance to allied navies. (in WW2 our shipyards repaired and maintained many allied warships)

The Committee is no doubt aware of the study done on the ANZAC frigate programme. The study sets out the benefits to the national economy as well as the gains in technological progress, employment and social outcomes.

It is the view of the League that the above considerations indicate the long term advantages to be had in maintaining a naval shipbuilding industry and if necessary paying a reasonable premium for local construction.

Australia has had a number of yards that have built ships for the Navy. At the

present time there are four builders that could be considered able to meet the RAN's needs:

*Tenix Defence - at present completing an order for ten ANZAC class frigates for the RAN and RNZN at Williamstown in Victoria.

*Australian Submarine Corporation - which has built and is now maintaining six COLLINS class submarines at Osborne in South Australia. The air warfare destroyer contract has recently been awarded to this builder. With the assistance of the South Australian government the necessary infrastructure is now to be established at Osborne to permit the building of the destroyers.

*Austal in Western Australia and Incat in Tasmania - these builders have built and are building high-speed aluminium multi-hull vessels for the commercial market and for the United States Navy. Austal is at present building 14 ARMIDALE class patrol boats for the RAN

The League believes that Australian industry has the capability to construct the RANs destroyers, frigates, patrol boats, submarines, mine warfare vessels and hydrographic ships.

So far as the construction of large naval vessels are concerned the situation appears less clear. Australia has in the past built quite large merchant ships. However the yards in which those ships were built no longer operate. It may be that local builders believe that they can develop, on a commercially realistic basis, the facilities to construct ships of 25,000 to 28,000 tons. The League is not able to assess the likelihood of this option. No doubt submissions by the builders will deal with this issue.

In the event that a yard cannot be found able to construct ships of such size in Australia then there should be no difficulty in obtaining competitive bids on the world market.

The procedure the League would recommend in such circumstances would be to have the hulls built overseas with the fit out including radars, combat systems, communications, etc carried out in Australia

The Committee is no doubt familiar with the history of mv Delos, a commercially built tanker which was purchased new from an overseas yard by the RAN and is now being fitted out to become HMAS SIRIUS.

Two or three of the builders listed above, plus ADI in Sydney, would be capable of carrying out the fit out of large naval vessels.

The Terms of Reference include the issue of maintaining, repairing and refitting large naval vessels.

Australian industry has the capability to maintain, repair and refit the existing RAN

fleet. The League does not see why Australian industry, including ADI with its large dry dock, ought not be able to do likewise for the new large naval vessels. The industry's capacity to do so would be enhanced by having the large naval vessels built or at least completed in Australia.

Continuity

To ensure the viability of the local shipbuilding industry it is necessary that there be a steady flow of orders. Continuity is essential. It is uneconomic to maintain the shipbuilding infrastructure if there are long gaps in the building programme. Without work the skilled workforce is soon lost. The Committee may be interested in the discussion of these issues in the United States Naval Institute journal *Proceedings* of February 2006 and in particular pages 21-23 and 90-91 (the latter pages deal with the UK situation)

The above observations do not apply in the same way to smaller and simpler warships such as patrol boats. Such vessels can and have been built in yards that have civilian work to sustain them.

In recent years there has been some continuity in naval shipbuilding. Since the late 1980s we have built in Australia two ADELAIDE class and ten ANZAC class frigates and six COLLINS submarines.

With the three air warfare destroyers and two amphibious ships now to be built there is the opportunity to ensure a continuous flow of work. It seems that these two programmes will take us through till about 2017. By then the next generation of submarines and frigates will be near to building.

While it can be said that the above programmes involve different types of vessels built in different yards the reality is that much work is shared around or sub-contracted. In the case of the ANZACs Williamstown was the lead yard, but a lot of significant work was done elsewhere in Australia and New Zealand. With the submarines much work was done at places other than Osborne, South Australia. It seems likely that a similar process will take place with the air warfare destroyer.

It is the view of the League that it is not inconsistent with a competitive tender to require that a proportion of the work be carried out by other than the "winning" yard. This should assist in ensuring that the valuable body of knowledge and experience gained in recent years is retained in Australia. Given that a good deal of outsourcing and sub-contracting already takes place such a requirement need not represent an inhibition to competitive tendering.

Competition

The desirability of competition is probably self evident. The real issue is how to obtain real competition when there are few orders and few builders. The problem is made more acute if, as the League believes, it is desirable to have naval shipbuilding in Australia. Obviously it is easier to generate competitive bids if bidding is open to yards world wide.

The issues raised by naval shipbuilding are, of course, not unique to Australia. Even in the United States, with a much larger economy and a far bigger Navy these issues are being actively debated. In the American discussions one issue highlighted was the need to maintain at least some level of competition between builders.

An article in the May 2005 edition of the United States Naval Institute journal *Proceedings* (see pages 54-58) concerning shipbuilding in that country has some relevance for Australia.

The author of the article, Captain David Lewis USN, comments that over the last decade the American industry has consolidated from six independent companies down to two large corporations. He states that their products are increasingly being supplied in a low-risk monopoly or cartel market. "Submarine, aircraft carrier and amphibious ships are monopolies today" In a subsequent comment on Captain Lewis' article Rear Admiral Stuart F Plant USN wrote that Northrop Grumman Newport News and General Dynamics Electric Boat are the only two companies capable of building capital ships and that they co-operate rather than compete for contracts.

Captain Lewis argues that in the United States ship price changes now outpace inflation. "The controlling factor in shipbuilding pricing is the presence or absence of effective competition, not combat capability."

As examples he cites the budgeted cost of a competitively awarded Aegis cruiser in 1985 as US\$884 million and a similarly competitively awarded Aegis destroyer in 2001 at US\$918 million. Despite many combat capability improvements in the latter vessel the increase in price over 16 years was only 4%, well below the rate of inflation. In comparison, the budgeted cost of a competitively awarded nuclear-powered attack submarine in 1987 was US\$638 million in 1987 but a cartel built nuclear powered submarine in 2005 had a budgeted cost of US\$2.5 billion, an increase of 300% in 18 years. There had been significant combat capability improvements incorporated into the later submarine, but just as there had been with the later Aegis destroyer.

Captain Lewis describes five ways that shipbuilding can be said to operate today.

*Full competition. Many suppliers, many customers; price and quality, innovation and cost control maximised. This describes much of the world commercial shipbuilding industry today.

*Limited competition. Two or three suppliers for one customer with the latter driving innovation and cost control.

*Monopoly/Cartel. One company or one or two companies in combination dominating the industry and able to set prices and control production

*Regulated. Government may establish a regulated monopoly; in return for a guaranteed customer base lower profits and a higher degree of customer involvement are accepted.

*Publicly owned. An Australian example of a publicly owned yard was Williamstown before privatisation.

It is not suggested that the situation in Australia is a monopoly or cartel. Competition for contracts is real. The above definition of limited competition (one customer, two or three suppliers) seems to describe the Australian situation. The ANZAC frigate and the ARMIDALE patrol boat programmes suggest that in Australia we can have effective limited competition.

The League can see no reason why the tender for the two large amphibious ships should not also be competitive. We certainly urge that every effort be made to ensure that this is achieved.