

Building Defence Capability: A policy for a smarter and more agile Defence industry base

Australian Industry Group
44 Sydney Avenue, Forrest ACT
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SPEAKER:

The Hon. Greg Combet AM MP

Thank you Heather for the kind introduction.

I'd like to acknowledge the Chief of the Defence Force, Air Chief Marshal Angus Houston, the Secretary of the Department of Defence, Dr Ian Watt; members of the ADF, other Defence officials, members of the defence industry, ladies and gentlemen.

Introduction

We are here today to launch the 2010 Defence Industry Policy Statement titled Building Defence Capability: A Policy for a Smarter and More Agile Defence Industry Base.

This policy is a culmination of two and a half years of engagement with the defence industry and analysis of the strategic requirements that shape our Defence policy.

Since coming to office in 2007, the Government has significantly reshaped Australia's Defence policy by:

- * delivering the first Defence White Paper in almost a decade;
- * initiating the most wide-ranging reforms of the Defence Organisation in a generation;
- * providing Defence with an unprecedented twenty-one year long funding commitment; and
- * implementing a further set of improvements to defence materiel procurement and sustainment embodied in the Government's Response to the Mortimer Review.

At the same time, there has been significant consolidation and globalisation of the defence industry. This consolidation has resulted in a domestic defence industry dominated by a small number of very large defence companies, mostly headquartered in Europe and North America. Australian-owned defence firms are generally small to medium sized enterprises (SMEs).

In turn, this presents both challenges and opportunities for Australia's defence industry. It is a challenge for small to medium enterprises (SMEs) that need to accommodate major investment decisions made in Europe and North America. Yet it is also an opportunity for Australian SMEs to make profits through integrating into the global supply chains of international primes and their major subcontractors.

If for no other reason, this policy statement is different from earlier defence industry policies in the emphasis it places on the international nature of this industry and the global trends that have driven the defence industry.

Australia's defence industry policy needs to evolve to take account of this contemporary industry structure, and the new strategic policy directions identified in the Defence White Paper 2009. The policy emphasises that the strategic requirements of the Australian Defence Force must drive industry's investment priorities. It also highlights that the Government will always seek to achieve the best value for money when making decisions to acquire new Australian Defence Force capabilities.

The policy introduces four key elements to guide defence industry policy. I will describe these elements shortly, but in summary they are:

- * setting clear investment priorities;
- * establishing a strong Defence-industry relationship;
- * seeking opportunities for growth; and
- * building skills, innovation and productivity.

To support this policy, the Government has committed more than \$445 million out to 2018-19 for a range of programs that industry can access to improve their competitiveness, their capacity for innovation, their ability to enter export markets and the skills of their workforce.

The main challenge for Australia's defence industry policy is not to articulate new concepts or establish new assistance programs. It is to set clearly communicated goals, to develop the frameworks and processes to implement those goals, to customise these programs to assist industry across the entire capability development life cycle, and to do it with programs that appropriately complement each other to maximise the positive effect on Australia's defence capabilities and defence industry.

For example, to enable SMEs to break into global supply chains, the Defence Industry Innovation Centre can help them to become 'export ready' by benchmarking their performance against best practice and facilitating access to other programs from Federal and state governments. Once they have the resources, capability and capacity to compete internationally, companies can then enter the Global Supply Chain program.

Setting Clear Investment Priorities

The first element of the new defence industry policy is that Government must set clear priorities that encourage investment. The Statement outlines why and how the Government is articulating Australia's strategic priorities to encourage investment by the Australian defence industry.

Defence industry investment priorities must be driven by the Government's endorsed strategic tasks for Defence and the military capability needs that derive from these tasks. The Defence White Paper 2009 and the Strategic Reform Program articulate clear strategic priorities for Defence, which this policy applies in the defence industry context.

The policy provides a much clearer outline of the role of the Priority Industry Capabilities (PICs) in defence industry policy. The 2009 White Paper defines the Priority Industry Capabilities

as those industry capabilities which would confer an essential strategic advantage by being resident within Australia, and which, if not available, would significantly undermine defence self-reliance and ADF operational capability.

In reaching decisions based on value for money in PIC-related procurements, Government may take

into account factors such as Australian industry impacts, the national interest, broader strategic factors, and other whole-of-government considerations.

Due to their potential to become PICs, the Government also monitors a broader range of capabilities, known as the Strategic Industry Capabilities (SICs). The statement provides greater detail on these important capabilities than the much broader 2009 White Paper was able to provide.

The SICs are capabilities which provide Australia with enhanced defence self-reliance, improved ADF operational capability, and/or greater longer term procurement certainty.

The SICs are important, but will require less oversight than PICs as we believe that there should normally be sufficient demand to sustain that capability – for example ship maintenance. Or the industry capability is closely linked to demand in the wider economy and hence is more sustainable. For example the repair of hydraulics for armoured vehicles will draw on skills and capabilities resident in the wider heavy vehicle repair industry.

To gauge the overall condition of the SICs, Defence will continue to consider factors such as the proposed level of utilisation of these industries offered through tender responses, the performance of these industries under contract, Company ScoreCard information, and information obtained through engagement with industry associations and the network of Business Access Offices.

Where they occur, both types of industry capabilities will be identified in projects appearing in the Public Defence Capability Plan. If a PIC element is listed this will require industry to specify a costed locally based option for that part of the tender. However, this requirement will always be subject to value for money considerations.

To ensure that these capabilities reflect the latest technology and strategic guidance, the Priority Industry Capabilities will be reviewed through the annual classified Defence Planning Guidance process. While some additional capabilities may become Priority Industry Capabilities through this process, it is also likely that some capabilities will not be retained in the future.

The Government is committed to ensuring that the Priority Industry Capabilities are available domestically to support the Australian Defence Force. As part of this approach, I am pleased to announce today that the Government has decided to establish a new Priority Industry Capability Innovation Program, with funding of \$44.9 million out to 2018-19.

This is a practical, long term program that will help sustain the research, design and engineering workforces of industry in Priority Industry Capability areas. Under the program, companies will be encouraged to submit innovative proposals relating to one or more Priority Industry Capabilities to Defence for direct funding.

Defence is developing a set of guidelines for the program, with the first annual funding round to occur in late 2010.

I am also pleased to announce that the Government will establish a Defence Industry Innovation Board to advise Government on resource allocation under the program. A senior defence industry executive will chair the Board, which will include members from the primes, small to medium enterprises, Defence, the Department of Innovation, Industry, Science and Research, industry associations and unions.

The Board will also coordinate the innovation programs that Defence operates for industry and improve communication regarding these programs.

In keeping with key aspects of Defence's activities becoming more strategy-driven, Defence's

Strategic Policy Division has taken carriage of producing this and subsequent industry policy statements. This is to ensure that there is close alignment between this policy and the Defence White Paper 2009 and other strategic guidance.

Strategic Policy Division will also work closely with DMO and other agencies in the future to ensure there is alignment between Defence's industry policies and programs and its broader policy and capability needs. This will result in a more strategy-driven approach to a range of industry policy issues. DMO's Industry Division will remain the point of contact for all industry programs.

Stronger Defence and Industry Relationship

The second element of the defence industry policy is a commitment to establish a stronger relationship between Defence and industry.

The implementation of the Defence White Paper 2009, the achievement of Force 2030, and the successful completion of the Strategic Reform Program, will all require a robust relationship built upon more flexible approaches to defence procurement and contracting. This Statement advances a considerably more flexible approach to defence procurement and contracting, where varying kinds and levels of risk are managed through the appropriate procurement and contractual vehicles.

Both Defence and industry have clear expectations of the commercial relationship that exists between them. The relationship must be driven by two factors:

- * clear information and open channels of communication so that goals, priorities and risks are mutually understood and
- * incentives for competitiveness, and by implication productivity improvements, through performance-based contracts that deliver the best results for Defence and industry.

The reforms resulting from the Strategic Reform Program will entail a closer working relationship between Defence and industry. Under these reforms, industry can expect to be involved at an earlier stage in the development of acquisition strategies.

And the reforms to enhance the DCP as a tool for industry will ensure Defence's capability priorities are mutually understood and industry is given the strategic planning information it needs, balanced, of course, against the Commonwealth's need to protect its legitimate security and commercial interests.

Defence needs to do more than just provide more information to industry. It also needs to listen carefully to industry's views, especially at the formative stages of projects.

As part of this approach, Defence is reinvigorating the Capability Development Advisory Forum, which provides advice to Defence on capability development issues. In future, the Forum will meet more regularly, enabling industry to offer their views earlier in the capability development process.

The new Defence Industry Innovation Board is another example of how Defence will work more closely with industry.

Seeking Opportunities for Growth

The third element of the Statement involves the initiatives by which the Government will help Australian defence industry to identify and make the most of business opportunities within Australia and overseas.

This involves reducing and removing the barriers to the growth of local firms by giving Australian companies the opportunity to compete for, and win, work in both Australian and global procurement

programs based on their merits. The Statement provides a policy basis for the large defence industry primes to more fully engage SMEs in their supply chain and assist in increasing their competitiveness.

The policy is emphatic in affirming that the Government will not use offsets or local content quotas to help protect Australian defence industry from overseas competition. Previous experience has shown that this approach is not in the best interests of Government, industry or Defence.

We firmly believe that offset policies do not work. They do not drive policy outcomes that place the industry on a sustainable footing. There are countless examples overseas of offset agreements that are patently not targeted at building indigenous capabilities.

Two such examples spring to mind. I remember reading about one country being offered a vacuum cleaner factory in return for purchasing a certain type of jet fighter.

Another such example occurred when a nation's leader proposed a unique offset of chickens for fighter jets. When asked about the proposed deal, the leader was reported as saying

They both have wings and they can both fly

This followed on the purchase of tanks in return for an unknown quantity of fruit.

This is not to criticise the policies of these nations. I merely put these examples forward to demonstrate where a defence industry policy based on offsets can take us.

This Government firmly believes that unless Australian industry wins work based on the quality and competitiveness of the product, the industry will not be placed on a sustainable footing.

We are confident that the Australian defence industry can compete with the best of the world and the Government is committed to giving them that opportunity. Over the next decade the Government has dedicated \$102.5 million to increase the opportunities for the Australian defence industry to identify and make the most of business opportunities within Australia and overseas.

As part of this approach, the Government launched the Defence Export Unit in 2008 to boost Australian defence industry exports. The Government has committed \$34 million to the Defence Export Unit over the next decade. To date, the Unit has helped Australian companies win contracts in excess of \$550 million.

The Government also established the Global Supply Chain program in 2009. We have funded the program to the tune of \$59.9 million out to 2019. The program helps create opportunities for Australian industry in the global supply chains of overseas prime contractors and their major subcontractors.

However, seeking opportunities for growth also means increasing opportunities based on domestic defence procurement through programs such as the Australian Industry Capability program.

Importantly, this program does not guarantee work for Australian firms – but it does give them a better opportunity to compete fairly on their merits. However, only those local firms that are efficient and competitive – and have the right product – will benefit.

I am pleased to announce today that Defence has created a specific Australian Industry Capability Implementation Unit to improve implementation of the program. Its two most important roles are to engage early in the acquisition strategy to embed AIC requirements in the project and to conduct random audits of System Project Offices to ensure that the Australian Industry Capability plans are

being delivered.

Overall, the long term outlook for defence capability project expenditure is positive. While fluctuations are inevitable due to the varied spending profile of individual defence acquisition projects; very strong growth is projected over the decade.

Sustainment expenditure, which generally accounts for almost half of total defence materiel expenditure, shows more uniform growth – it will increase over time, in line with the long term growth in acquisition expenditure.

So I firmly believe that there will be significant opportunities for the Australian defence industry to grow driven by local expenditure over the next decade.

Building Skills, Innovation and Productivity

The fourth key element of the Statement concerns building the skills, innovative capacity and productivity of the Australian defence industry. This is consistent with the Government's wider agenda of building the productivity of all Australian industry.

We have been told over and over again by the industry that we need to provide support for skills development and that is what we are doing. One of the challenges in maintaining a competitive defence industry sector in Australia is ensuring that the numbers and skills of the workforce match current and future demands.

Defence industry is faced with an ageing demographic, quickly changing technologies and competition for skilled workers from other areas of the economy such as the mining and energy sectors.

The Government has committed \$292.8 million to build the skills, innovation and productivity of the Australian defence industry over the next decade.

To maintain a competitive Australian defence industry, we need to ensure that the numbers and skills of the workforce match current and future demands. The Skilling Australia's Defence Industry and the Industry Skilling Program Enhancement initiatives offer opportunities to industry to create additional skilled positions and improve training.

The Government expects to create 7,500 training opportunities between 2009 and 2015. We also expect 3,500 school students to participate in defence industry pathway programs between 2009 and 2015.

There is also a range of other programs to assist Australian defence industry. For example, the Capability and Technology Demonstrator program, and the associated Extension program, allow industry to demonstrate how advanced technologies can enhance Australian Defence Force capability. These programs also encourage technology development and provide opportunities for industry to become long-term technology suppliers to the Australian Defence Force.

The Defence Industry Innovation Centre is designed to increase the productivity, competitiveness and sustainability of SMEs that support defence. The centre's business advisers deliver practical services that help SMEs improve productivity and build their capability.

Where to from here?

This defence industry policy sets the framework for the interactions between defence and industry. It articulates in much greater detail the industrial capabilities most vital to national security.

What it does not do is articulate any sector specific approach in each of the five sectors of the defence industry.

This is intentional and was driven by the logic of the process we have undertaken.

First, the Government has set the strategic directions of defence through the 2009 Defence White Paper.

Second, we have initiated the Strategic Reform Program which included the Government Response to the Mortimer Review. This explored the various acquisition strategies, including contracting approaches, which defence would adopt.

Third, we have determined and disclosed the Priority and Strategic Industry Capabilities that are most important to Defence.

And finally, we have developed and released the 2010 Defence Industry Policy that sets out the approach this Government will take to the defence industry.

It is only now that Defence can then look at what are the sectoral implications of each of these four activities. This builds on the analysis of each of the sectors that Defence conducts as a routine order of business.

Conclusion

To support this policy, the Government has committed more than \$445 million out to 2018-19 for a range of programs for a range of programs. This includes initiatives worth \$104.8 million announced in the Defence White Paper 2009.

The policy for the first time features a comprehensive, coherent description of the range of programs in place to support the competitiveness of Australia's defence industry. These programs need to be effective not just individually, but together so they support the defence industry over the course of the capability life cycle.

The Government is committed to implementing the policy set out in this document. The ultimate goal of the Government's defence industry policy is to ensure that the Australian Defence Force receives the materiel, systems, support and sustainment that it needs; that Australian taxpayers get the best value for their money; and that local firms obtain real and substantial opportunities to win business both domestically and internationally.

This Defence Industry Policy Statement sets out the Government's vision for how Defence and industry will work together to achieve this outcome.

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