



# REVITALISING THE AUSTRALIAN DEFENCE INDUSTRY

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POLICY BRIEF - CONNOR CLARKE

# EXECUTIVE SUMMARY

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For states to be able to pursue an effective national security strategy they must first ensure that they are capable of procuring the necessary materials required by the defence forces. The 2018 Australian Defence Export Strategy was designed to build upon the Australian Government's defence industry policy by setting out a comprehensive system to plan, guide and measure defence export outcomes, setting a goal to become a 'top ten...defence exporter' whilst enabling 'greater innovation and productivity... to deliver world-leading Defence capabilities' by 2028.[1]

This is ambitious when considering the Stockholm International Peace Research Institute's findings that in 2018, Australia globally dropped from the 18th to the 25th largest defence exporter whilst rising from the fourth to the second largest defence importer.[2] There are many causes for this drop, yet one primary issue sticks out as the main source of contention; that Australia's industry policy has created a glass ceiling for domestic defence contractors, creating an inhospitable legislative environment that stunts the development of domestic innovation in favour of foreign prime contractors.

Whilst there are certainly benefits in procuring defence materials through foreign prime contractors, the *raison d'être* of the Australian defence industry is not to make a profit, but to be an effective facilitator of national security. An increasingly pertinent cause when considering the rapidly shifting regional security environment characterised by the pace of military modernisation and challenges to the rules based global order. [3]

To begin the process of establishing an effective domestic defence industry, it is recommended that:

- 1 Australia reform the existing Commonwealth Procurement Rules. These rules dictate which contractors can bid on large defence contracts.
- 2 Australia centralise defence acquisition and innovation into a single department.

## BACKGROUND

Australia is the world's 13th largest economy, 19th most powerful military and is the 25th largest defence exporter.[4] Taking this into account, Australia is a successful state. However, a disparity exists between its position as only the 25th largest defence exporter and its position as a G20 nation. Economic success has not translated to defence export success. This can largely be accounted for when considering Australia's history. Having federated in 1901, Australia only produced small arms until World War Two, when it expanded to include anti-aircraft weapons and Australian variants of foreign fighter aircraft. Historically this industry was government-owned until the 1980s, and described by John O'Callaghan, former Director of the Australian Industry Group Defence Council as 'unproductive government-owned ammunition, dockyards and aerospace entities'.[5] However, in the 1980s the import quotas and tariffs which bared foreign contractors from interacting with the Australian market were removed and as a result, by 2008, 80 percent of defence material produced by the top 50 suppliers within Australia were supplied by overseas prime contractors.[6] Australia relies upon and encourages multinational corporations to facilitate defence industry growth, specifically valuing open competition, emphasising the 'the need to obtain value for money for the Australian taxpayer'.[7]

# THE PROBLEM

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The problem is two-fold. The first is that whilst an open market approach to defence acquisition allows for the rapid acquisition of military technologies and short-term savings for Australian taxpayers, it does not facilitate the development of domestic capability. If supply chains are threatened or prime contractors decide to withdraw from the Australian market, it has the capacity to radically destabilise Australia's national security. This issue stems from the Australian Department of Defence (DOD) following the Commonwealth Procurement Rules (CPR's) which explicitly establishes that all potential government suppliers must 'not be discriminated against due to their size, degree of foreign affiliation or ownership, location, or the origin of their goods and services'.<sup>[8]</sup> Creating an environment where there is little impetus for the Australian government to award contract to domestic contractors when it is more economically viable for prime contractors to import proprietary technologies from their overseas parent companies rather than in engage domestic innovation.<sup>[9]</sup>

The second problem is that there is a large degree of departmental overlap within Australia's defence industry and defence acquisition programs; creating a system which lacks a truly cohesive national grand strategy. For example, the 2018 Defence Industrial Capability Plan and the 2016 Defence Industry Policy Statement, only mention CASG once, and a larger degree of prominence is placed upon the Centre for Defence Industry Capability (CDIC) as the 'cornerstone of the Government's strategy for resetting the Defence-industry partnership'.<sup>[10]</sup> However, the 2016 Sovereign Industrial Capability Priorities (SICP) also outlines a separate framework which seeks to 'support the development, maintenance or enhancement of the capability of Australian small to medium enterprises'.<sup>[11]</sup> The SICP primarily seeking to ensure that 'strategically critical capabilities remain within Australia's exclusive control'.<sup>[12]</sup> Yet, the SICP is then highly influenced by the Australian Industry Capability Program, which itself seeks to 'provide opportunities for Australian companies to compete on merit for defence work within Australia and overseas'.<sup>[13]</sup> At the same time native innovation within the defence industry is being led by the Defence Science and Technology Group, the Defence Innovation Hub and grants from the CDIC.<sup>[14]</sup>

# POLICY RECOMMENDATIONS

## 1

Australia must reform the CPRs. These rules, whilst productive in generating capital and saving some revenue in the short term, do not support the overall goal of shifting focus to the improvement of a domestic defence industry. The current rules pose a threat to national security and hold an unbiased prejudice against Australian SME's that lack the necessary capital to compete with prime contractors. Whilst Australia should not totally halt its acquisitions from prime contractors, it can do more to facilitate domestic companies.

It can seek to do this through first making greater use of limited tenders. Looking to preference Australian entities as the first choice for the provision of goods, services or research. Specifically, the limit of high value procurements for non-construction defence acquisitions can be raised from \$80,000 to \$500,000 when purchasing from Australian owned business.[15] This approach is one which is already been implemented within Western Australia to assist in its in its economic recovery to COVID-19. Enacting procurement reform which allows for direct purchase up to \$250,000 (previously \$50,000) or invite quotes up to \$500,000 (previously \$250,000) from local businesses. [16]

# 2

Australia must centralise defence acquisition and innovation into a single department to reduce the level of duplication between different government programs and entities. The current system is inefficient with its attempts to facilitate domestic innovation through three separate entities. There is little capacity for the departments to isolate and fund domestic projects which will be able to provide a long-term strategic advantage to Australia's defence forces. This would allow for a greater capacity to nurture innovation based upon procurement needs, as opposed to financing defence development through a series of overlapping jurisdictions and overly onerous programs. This approach is one which has been implemented in Japan in 2015 when it amalgamated its four agencies responsible for innovation, procurement and acquisition into one with this agency overseeing all aspects of Japan's significantly larger native defence industry from research and development to international procurement.[17]

In conjunction with the first recommendation, it would mean that rather than the Australian Government financing SMEs on an ad hoc basis, they could be nurtured over time through a central agency based on pre-established, centralised sovereign priorities.

# CONCLUSION

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The Australian Defence industry lacks focus being defined by foreign prime contractors, with a host of agencies attempting to encourage domestic development and 'sovereign capability' whilst also trying to cater to principles of free trade and open markets. The *raison d'être* of the defence industry is not to make a profit, but to be an effective facilitator of national security. Hedging national security on the stability of international supply chains and good will of foreign owned corporations on the principle of non-discrimination is risky. To remedy this, Australia has to focus its efforts on developing a legislative environment which allows for and supports the further development of domestic defence contractors. Which can begin to be supported via Australia ending its over-reliance on foreign defence contractors whilst improving the machinery of government responsible for defence procurements and innovation.

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