Defence Industry Policy 2016—Well-Intentioned but Conflicted

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The Defence Industry Policy Statement (DIPS) 2016 announced on 25 February 2016 contains a number of policy positions with the potential to positively impact on Australia's defence industry. These improvements include the recognition of Industry as a Fundamental Input to Capability, an increased emphasis on the contribution of local industry, simplified pathways for defence-related innovation, and the introduction of sovereign industry capabilities. Whilst DIPS 2016 is well intentioned, the ability to achieve the sought-after results will be inhibited by an overall lack of focus, and by omissions and conflicts between the DIPS and the broader strategy in the 2016 Defence White Paper.

The 2016 versions of the Defence White Paper (DWP2016), Defence Integrated Investment Program (DIIP) and Defence Industry Policy Statement (DIPS) were finally released by the Prime Minister and Defence Minister on 25 February 2016. The industry policy is a significant improvement on the 2010 version and provides a number of initiatives for defence with the potential to change the way in which Defence behaves, and in which Industry invests and develops.

The most important of these foreshadowed changes are the recognition of Industry as a Fundamental Input to Capability (FIC), the increased emphasis on the local defence industry, the simplified pathways for innovation and the introduction of locally-developed capability, and the replacement of Priority Industry Capabilities (PICs) and Strategic Industry Capabilities (SICs) with Sovereign Industrial Capabilities. Each of these developments individually has the potential to make a significant change but the synergistic effects should be greater.

The problem, however, is that whilst the implementation of these initiatives is well intentioned there are important parts of the industry puzzle that are missing and the achievement of the sought-after results will be inhibited by an overall lack of focus, and omissions and conflicts between the DIPS, the broader strategy as enunciated in DWP2016, and trends and behaviours that have developed in the Defence environment over the past decades. This article examines the intent and the inherent tension in the announced defence industry policy, but will frame this discussion by first examining the why and what for Australia’s defence industry.

1 Department of Defence, 2016 Defence White Paper (Canberra: Commonwealth of Australia, 2016).
**Australian Defence Industry—The Need**

From the government’s perspective, the need for a defence industry flows from the broader consideration of the need for military capability and for an Australian Defence Force (ADF). The answer to this question is simply to mitigate strategic risks where a military response is deemed by government to be appropriate.

The structure for the ADF is in theory a direct response to the nature of the perceived strategic risks and in government consideration of the responses that might be required. This is the essence of the White Paper process and DWP2016 clearly states this as “the Government’s strategic defence policy is to manage strategic challenges by developing Defence’s capabilities and agility to take a more active role in shaping regional affairs and to respond to developments which threaten our interests” (para 3.2).

DWP2016 also recognises that “Australians rightly expect that our military force be capable of the self-reliant defence of our territory from attack or coercion” (para 3.13). Although the concept of self-reliance is less prominent when compared to previous White Papers,² the ability to mount a military response continues to require military forces that are adequately readied and adequately sustained. This in turn is the essence of preparedness. Robert Wylie has highlighted the relationship between preparedness and the ability of the government to make sovereign choices about the utilisation of the force-in-being.³ Alan Hinge has expanded the concept of preparedness to include operational preparedness and structural preparedness where the former includes readiness and sustainability and the latter is the suitability of the forces available to government to undertake the required tasks.⁴

While the aim of each individual company is to maximise business activity, at the strategic level the role of a defence industry can be considered as providing support in the readying and sustainment of the military force, and covering technologies and activities that the defence establishment cannot itself provide. In Australia, since the commencement of privatisation of government-owned defence-related facilities in the 1980s and the subsequent out-servicing of defence support functions, the ability of the Defence establishment to provide the necessary technologies and services from internal resources has diminished and the ADF has come to increasingly rely upon industry.

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Given the role of the military as outlined above, the principal strategic focus for local defence industry activity should, from the government's perspective as a monopsonistic defence buyer, be to aid in the mitigation of strategic risk through focused support for preparedness. This point, of relating government support for industry to national strategy, is made in a 2011 review of the US defence sector by the Center for Strategic and Budgetary Assessments that stated:

The United States' defense industrial base strategy should ensure the preservation of those few sectors that are currently critical to American national security, adding over time any emerging sectors that become critical, and ruthlessly underfunding or jettisoning any sectors that cease to be critical.5

In addition to this key requirement, defence industry can add value to the wider economy through employment, product development, service delivery, export, innovation, and other related activities but it is the contribution to the mitigation of strategic risk that provides defence industry with its raison d'être and distinguishes it from other industrial activities.

As “the Government’s approach to Australian defence industry and innovation policy aims to maximise the defence capability necessary to achieve the Government’s defence strategy, supported by an internationally competitive and innovative Australian industrial base” (para 4.99) it is illustrative to consider the current state and trends upon which this new policy will be based.

**Australian Defence Industry—The Status**

A number of Defence-related activities and policy positions in the past two decades have resulted in a national defence establishment that (1) is dominated by, and reliant on, foreign interests; (2) is risk averse; (3) does not actively promote the take-up of locally-developed innovation; and (4) has low expectations in terms of the local industry’s capability to make a meaningful contribution to the defence effort.

Australia, as a middle-ranking power with a small domestic and military market cannot realistically expect to develop and sustain significant defence technologies solely from indigenous sources, but the privatisation of government-owned facilities as outlined above, and the subsequent sale of Australian-owned companies such as ADI and Tenix, has resulted in a local defence industry dominated by a small number of multinational companies. More recent sales of second-tier Australian defence companies such as Qantas Defence Services, Rosebank Engineering and C4I have exacerbated this situation.

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With the obvious exception of the United States, most countries have a defence industry comprised of a mix of indigenous and foreign firms. The UK defence industrial policy embraces this combination and defines the UK defence industry in terms of “where the technology is created, where the skills and intellectual property reside, where the jobs are created and sustained, and where the investment is made”. Such a definition highlights the challenges facing Australia and the development of the local defence industry as Australia stands apart from the majority of advanced Western top-tier economies as it has no globally-active, locally-owned defence industry brand, and in many cases the technology and the intellectual property reside offshore.

In parallel to the changes outlined above, since the delivery of the Kinnaird Report recommendation in 2003 that at least one off-the-shelf option be included in the advice to government at First Pass, Defence has become increasingly risk averse. This position was amplified in 2008 when the Mortimer Report advocated that “any decisions to move beyond the requirements of an off-the-shelf solution must be based on a rigorous cost-benefit analysis of the additional capability sought against the cost and risk of doing so.”

Whilst the drivers for both the Kinnaird and Mortimer recommendations were a need to get more control of project cost and schedule risks, the result has been a local defence industry that has become increasingly marginalised in terms of high technology, high intellectual-content activities; with the obvious exception of the CEA Technologies and the development of the CEAFAR Phased Array Radar.

The Australian part of Australia’s defence industry is now viewed as being little more than an avenue for the provision of sustainment, as reinforced by the Secretary of the Department of Defence in a speech to the Menzies Research Centre on 24 February 2016 when he stated that Australia does not “aspire to sovereign capability across the totality of the ADF” and that “sovereign capability is sustainment and maintenance of capabilities”. This position is in marked contrast to that advocated in Canada where it is recognised that:

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7 Department of the Prime Minister and Cabinet, *Defence Procurement Review 2003* (Kinnaird Review), p. 15.


9 Dennis Richardson, speech to Menzies Research Centre, Parliament House, Canberra, 24 February 2016.
It would be in the national interest to have a strong domestic defence industrial base, one that goes well beyond the basic capability of maintenance and repair to the actual sovereign production of key goods and services. In particular, this would be the case in areas where Canada has specific requirements that may not be met adequately by foreign contractors in terms of timely or secure supply.  

Whilst the push towards off-the-shelf capability solutions may have been to manage the cost and schedule of major projects, the result has been an increase in the use of Foreign Military Sales (FMS), a reduction in the number of companies with whom Defence is willing to contract, a reduction in the value of defence contracts being awarded into Australia, and an ongoing concomitant diminution in the value of acquisition and sustainment contracts being signed with Australian-owned companies.

Analysis of Defence Materiel Organisation (DMO) contracts undertaken by Australian Business Defence Industry (ABDI) and cited by Dunk11 show that the value of FMS contracts increased consistently from 11.8 per cent in 2007/08 to just under 30 per cent in 2014/15. The number of FMS contracts per year similarly increased over the same period from 160 to approximately 400. During the eight years under analysis the percentage of DMO contracts awarded into Australia declined from almost 80 per cent of total value to less than 60 per cent. In addition, the Joint Standing Committee on Foreign Affairs, Defence and Trade (JSCFADT) report into government support for defence exports12 referenced the ABDI analysis and noted that in 2014/15 the combined value of acquisition and sustainment contracts placed by the DMO with Australian-owned companies other than ASC comprised less than 5 per cent of the total award.

It is against this backdrop of defence industry activity in Australia that DIPS 2016 is framed.

**Australian Defence Industry—The Intent**

As noted in the introduction to this article, DIPS 2016 contains four important defence industry initiatives. The most revolutionary and potentially far-reaching is the formal acknowledgement of Industry as a FIC. DIPS 2016 states that the “recognition of industry as a Fundamental Input to Capability will ensure Defence fully considers the industrial capabilities and the

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capacity of Australian businesses ... to deliver Defence capability, including operational capabilities and the full spectrum of support functions."\textsuperscript{13} The Statement goes to say that the intent of including industry as a FIC is "to drive more formal consideration of industry impacts through the early stages of the capability life cycle."\textsuperscript{14}

Such recognition is warranted, certainly long overdue, it will force Defence planners and decision-makers to consider the potential contribution of the local industry, and "will better match the development of new capabilities with industry's ability to deliver them".\textsuperscript{15} However, the treatment of industry as a FIC lacks focus. Importantly, DIPS 2016 contains a two-way consideration of industry, namely not only how Australian industry might contribute to defence capability development and sustainment but how defence-related decisions might impact on the "resilience and health of supply chains".\textsuperscript{16} It is at this point that the lack of focus noted above becomes apparent.

If the logic at the commencement of this article is accepted, namely that the primary role of military capability is to mitigate strategic risks as required by government, and the primary function of a defence industry is to provide products and services that the Defence establishment cannot provide from internal resources, then it could be expected that 'mitigation of strategic risk' could be an underlying theme in the defence industry policy. Not so; in fact 'mitigation of strategic risk' does not appear at all in DIPS 2016.

If 'mitigation of strategic risk' were included as a primary theme to guide the development of the defence industry it would be possible to overcome the somewhat disjointed nature of DIPS 2016, enable Defence planners to concentrate on industry sectors determined to be most closely aligned with strategic risk and to tailor Defence-Industry engagement mechanisms accordingly. Such engagement might be closer, earlier and more transparent of Defence plans for companies operating in high strategic risk industry sectors than for those where the strategic risk may be deemed to be low. This would have benefits for all parties.

The absence of 'mitigation of strategic risk' from DIPS 2016 is particularly disappointing as the recent JSCFADT report into defence exports stated that "some elements of defence industry are in fact fundamentally important to the operational and materiel support of complex equipment used by Defence" and that what is required is "a new approach to identifying and managing risk".\textsuperscript{17} What is not helpful is the use of the descriptor

\textsuperscript{14} Ibid.
\textsuperscript{15} Ibid.
\textsuperscript{16} Ibid.
\textsuperscript{17} Principles and Practice—Australian Defence Industry and Exports, pp. xxii, viii.
‘Fundamental Input to Capability’ in both the JSCFADT report and DIPS 2016 where the former uses the term to describe industry capabilities associated with high strategic risk whereas the latter uses the term in a broader context to include all industry.

An approach that included ‘mitigation of strategic risk’ as a thematic principle would also provide a vehicle for the implementation of Defence as a ‘smart buyer’ and for improved mechanisms through which to determine value for money and “the considerations of sovereign requirements for Australian industry involvement which would guarantee the ADF’s independence of action”. 18

DIPS 2016 has also replaced the Priority Industry Capabilities (PICs) and Strategic IndustryCapabilities (SICs) introduced in the 2009 Defence White Paper with sovereign industrial capabilities to be managed under a Sovereign Industrial Capability Assessment Framework (SICAF). Properly defined and utilised sovereign industrial capabilities could address concerns regarding strategic risk as these are stated as being “so important to Australian Defence missions that they must be developed or supported by Australian industry because overseas sources do not provide the required security or assurances we need”. 19

The recognition of sovereignty requirements for defence industry activity in this way, and the link to Defence missions, is welcomed but the definition is weaker than that which had been applied to PICs, namely being “those industry capabilities which would confer an essential strategic capability advantage by being resident within Australia, and which, if not available, would significantly undermine defence self-reliance and ADF operational capability”. 20 This dilution of the definition, and the lack of direct recognition for the ‘mitigation of strategic risk’ in the SICAF criteria, reinforces the overall lack of focus and connectivity for the elements within DIPS 2016. The weakened definition also reinforces the notion that the importance of self-reliance as an underlying principle of Australia’s defence has also diminished.

Sadly DIPS 2016 does not indicate which capabilities may be determined to be sovereign and leaves such determination to the second quarter of 2017. The comment within the policy statement that “Defence envisages the number of sovereign industrial capabilities will be small, properly targeted and managed”, 21 together with the reference to the already-in-existence CEAFAR and Nulka, suggests an interest in maintaining what might already exist rather than using the SICAF as a means to review sovereign

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19 Ibid., p. 23.
20 Department of Defence, Defending Australia in the Asia Pacific Century: Force 2030 (Canberra: Commonwealth of Australia, 2009), para 16.21.
capabilities against changing strategic risk, and thereby providing a vehicle for the consideration of new technologies.

The revised approach to innovation in the defence environment is welcomed, particularly the statement that “Defence will change its culture and business processes to systematically remove barriers to innovation”. The centre-piece of the innovation policy, the Defence Innovation Hub, is frustratingly vague, however, saying only that “new contracting and intellectual property regimes will be established to maximise incentives” and “Defence will develop new approaches to risk … to allow innovation to flourish across the Defence enterprise”. This is a similar sentiment to that expressed in the 2010 version of the Defence Industry Policy Statement that “The Government will ensure that Australian defence firms have every opportunity to enhance their capacity for innovation, skilling and productivity”. It is also not significantly removed from the statement by the then Minister for Defence Industry, Science and Personnel, Bronwyn Bishop, who stated at the release of the Defence and Industry—Strategic Policy Statement on 2 June 1998:

This is a policy soundly based on commercial realities as it is on strategic imperatives. Defence and industry will create a culture of one team—Team Australia. The Government’s new vision for defence industry is simple—we want a technologically advanced Australian Defence Force supported through a close partnership with efficient, innovative and sustainable firms.

The claim that the “establishment of the Hub within Defence represents a transformational change in the way Defence approaches innovation, bringing together Defence, our academic and industry partners in a more collaborative and effective way” is difficult to substantiate at this time given the lack of detailed information on the actual operation of the Hub, but will certainly be a big step forward if realised. Given that the political intent has been common for an extended period, the issue of Defence culture is likely to be the defining factor for success; a point recognised in DIPS 2016 by the statement that “critical to the success of the Hub will be the development of the supporting policies and culture to remove the current barriers in Defence to innovation”. Significant and ongoing effort is therefore required to address cultural change within Defence.

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22 Ibid., p. 30.
23 Ibid., p. 35.
26 Department of Defence, 2016 Defence Industry Policy Statement, p. 36.
27 Ibid., p. 35.
The final point to be examined under the intent of DIPS 2016 is that of defence exports. The 2016 version of defence industry policy has continued the recognition from previous White Papers and Industry Policy Statements that exports are an important component in developing an efficient and globally-competitive defence industry sector, and that government support is needed in order for this to occur. Moreover, the importance of Science, Technology, Engineering and Mathematics (STEM) to the longer-term future of the defence industry is given serious attention.

Unfortunately there is no statement to link innovative national developments and subsequent exports with introduction into service in the parent military. The principal aim of the export aspects of DIPS 2016 is to have Australian innovations and companies become part of global supply chains. Whilst the global supply chains of the international primes can bring benefit to individual companies there is a simplistic assumption that the strategic aims of these international primes and those of Australian defence somehow align. Defence needs to be more cognisant of the benefits that will accrue from direct take-up of local innovation, particularly in the important area of capability renewal, rather than acquiring the same via a circuitous route. The same change to Defence culture that has been recognised as key to innovation success is required if export results are to markedly improve.

As in other parts of DIPS 2016 a broad approach to exports, STEM and Australian Industry Capability (AIC) Plans is adopted, rather than a more focused alternative that would address those industry sectors that are more closely associated with the mitigation of strategic risk. An example of this lack of focus is seen in the statement that a skills gap analysis by sector will be conducted “to help ensure Australia has the skills needed to meet the requirements of existing and future capabilities”.\(^\text{28}\) Whilst such an analysis will be useful, a more effective utilisation of time and resources and more targeted outcomes to redress deficiencies could be achieved by an initial focus on those sectors that contribute most to the overall mitigation of strategic risk.

**Australian Defence Industry—The Conflict**

Apart from the lack of focus within DIPS 2016 as described above, the potential to achieve the envisaged future for Australian defence industry is hampered by conflicts and omissions between the DIPS 2016 intent and the overall strategy as outlined in DWP 2016.

The first such omission is the absence of a definition of sustainment. This omission is not new as no previous Defence document has provided such a definition. In Australian defence parlance there is a simplistic division between acquisition and sustainment, and that the two can be treated as

\(^{28}\) Ibid., p. 47.
separate entities. In reality, however, acquisition and sustainment form part of a spectrum of industrial activities that also includes capability renewal and the repair of battle damage. In turn each of these activities is comprised to varying degrees of design, manufacture, integration and test for both software and hardware. The Canadian experience recognises a more nuanced consideration of in-service service (ISS) support as:

The specific ISS functions include repair and maintenance; modifications to address changing requirements over the lengthy lifetime of most major equipment, as well as extension of that lifetime; and training incident to the ISS mission. The key capabilities within the broad domain of ISS are those that are technologically sophisticated (usually requiring access to the relevant Intellectual Property of the equipment supplier) and those that are needed to maintain critical assets and functions …

This description raises the second omission in both DWP2016 and DIPS 2016, namely there is no recognition of any requirement for access to detailed system design knowledge from international equipment suppliers. Without such access to intellectual property Australia will have little or no ability to undertake indigenous renewal of in-service systems to address technological or operational challenges that we may face; either alone, or in a more strategically-pressing manner than that faced by the equipment supplying nation. That is, without such information our sovereign choices and independence of action are likely to be constrained.

Preparedness is the third omission, or more precisely the lack of recognition of the link between industrial capability and capacity, and the ability of the ADF to undertake the tasks required by government. Wylie has commented on the increasing role of industry in Defence preparedness that was implicit in the 2009 Defence White Paper, but DWP 2016 limits the coverage of preparedness to a short section near the end of the document that states that “preparedness is about having forces that can be deployed and sustained on operations in a timely and effective way” (para 5.90) and that higher levels of preparedness will be required. The current White Paper tacitly suggests, therefore, that the higher preparedness can be achieved from within Defence resources.

The industry contribution to preparedness in critical areas should be a consideration within the sovereign industrial capabilities. Without appearing to labour the point, inclusion of ‘mitigation of strategic risk’ as an underlying theme within the overall defence industry policy would provide a mechanism for this to occur.

Alliance interoperability, and the need to enhance the high level of interoperability with US forces, is mentioned regularly through DWP 2016

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29 *Canada First*, p. 32.
and it is this that provides the conflict between the achievability of the industrial intent and the strategic reality. DWP 2016 unequivocally states that “access to the most advanced technology and equipment from the United States and maintaining interoperability with the United States is central to maintaining the ADF’s potency” (para 5.21). Such statements have been regularly made in Defence White Papers with the 2000 version stating that “the kind of ADF that we need is not achievable without the technology access provided by the US alliance”. DWP 2016 is more forthcoming regarding the extent of this on the capability development process and states that around 60 per cent of Australian acquisition spending is on US equipment.

Whilst Australia has achieved access to high-technology US equipment it has not achieved the same access to the intellectual property upon which the capability is based. In some cases Australia has entered into associated alliances, partnerships and Memoranda of Understanding for these capabilities but anecdotal information is that detailed design information is not transferred. One example is the submarine-related Advanced Processing Build (APB) Program for acoustics, imaging, tactical control, electronic warfare, and advanced sonar arrays for which Australia is a joint partner but Australian industry has had minimal direct influence or involvement.

The lack of such access directly impacts on the achievability of the plan for defence industry as outlined in DIPS 2016. In particular the ability to renew in-service equipment to address regional operational and technological movements will be inhibited as Australia seeks to convince the intellectual property holders of the value of any proposed upgrade, with a consequent impact upon Australia’s sovereignty and independence of action. Other impacts will be felt on the government’s aims regarding the introduction into service of local innovation and on the overall export success of Australian companies.

Conclusion

The Defence Industry Policy Statement 2016 contains many aspects with the potential to impact positively on the Australian defence industry. The recognition of Industry as a Fundamental Input to Capability, (potentially) the recognition of sovereign industry capabilities, the increased focus on local innovation and the emphasis on the importance of exports are all welcomed. The document is however limited in its ability to deliver the desired outcomes through a lack of focus, and the absence of the mitigation of strategic risk as

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a key industrial theme through which Australia’s defence industry can be guided to be the one that Australia needs.

The absence of such a theme means that DIPS 2016 is not really a defence industry policy, but merely an industry policy in a defence wrapper.

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