

Scramble will not content everyone

MARK THOMSON

After a long period when off-the-shelf defence purchases figured prominently in Australia, we've seen the return of targets for local content. Not since the 1990s has an Australian government been so eager to purchase its defence equipment locally.

Curiously, the government's single-minded focus on local defence industry was all but absent from the defence industry policy statement it released alongside its 2016 defence white paper.

Instead, the centrepiece of last year's policy statement was the elevation of defence industry to the status of a "fundamental input to capability". That won't mean much to those not versed in the arcane language of defence. But the idea is that defence industry will be considered an essential component of military capability—a laudable but ultimately rhetorical shift.

Of somewhat more significance, the government also increased assistance to defence industry from \$87 million to \$160m a year. Key initiatives included a new Centre for Defence Industry Capability and an expanded innovation fund. That might seem a lot of money, but it's only a bit over 1 per cent of the roughly \$14 billion currently spent each year on acquiring (\$7.5b) and sustaining (\$6.5bn) defence equip-

ment—a drop in the ocean.

In most other respects, the 2016 defence industry policy statement was an unexceptional document; continuity with pre-existing arrangements was the order of the day. But almost before the ink was dry on its new policy, the government changed track and embraced a wholehearted "buy Australian" policy. To quote the Prime Minister, "every dollar we spend on defence procurement as far as possible should be spent in Australia". The goal, we are told, is to drive economic growth and create jobs.

Although the priority for local defence production was clearly an afterthought to the formal policy released only a couple of months earlier, the government seems determined to follow through. Lest there be any doubt, a dedicated Defence Industry Minister—no less than the redoubtable Christopher Pyne—was appointed to oversee its implementation.

The new approach has stoked the fire of rent-seeking around defence procurement, in the first instance. State governments, trade unions and individual defence firms are all lobbying hard for larger slices of the \$195bn of new work up for grabs over the next decade.

By rewarding South Australian special-pleading with a package of lucrative shipbuilding projects, the government has created a rod for its

own back. For example, claims of "bastardry" arose when it was leaked that bidders for the \$35bn Future Frigate project were not bound to partner with existing Australian shipbuilders (notwithstanding that it made no difference to the amount of work likely to occur

in-country). It was enough that expectations of entitlement had not been met. The scramble for the defence dollar extends beyond the top-tier firms competing for prime contracts. Potential subcontractors are lobbying for high local-content targets to ensure they are given preference. The risks are that the taxpayers will be left to carry the cost of local suppliers with marginal economies of scale and the Australian Defence Force will have to wait longer for capability.

Unfortunately, there's precious little evidence that local sourcing will deliver the bounty of jobs and growth promised. A 2015 government-commissioned economic impact analysis compared offshore and onshore submarine production. It found that local production would divert workers from other industries more than it created net additional jobs.

Specifically, it found that for every additional job created, three other workers would be diverted from alternative employment else-

where in the economy. That should not come as a surprise; skilled labour is a finite resource.

If we choose to build naval platforms in Australia, other economic activities will have to cease, so the net gains are far less than the headline figures quoted in government announcements. It's no wonder that the report was only released under freedom of information.

Whatever the supposed benefits, they will come at a cost. For example, the government freely admits that there will be premium paid for building submarines in Australia. Given its steadfast refusal to release the figure, we can only conclude that the impost on the taxpayers will be embarrassingly large. After all, if there was a business case beyond narrow political expediency, the government would be all too happy to share the details.

At least with the old car industry, we had visibility of the cost of maintaining local employment.

Our experience with protected industries prior to the opening of the Australian economy in the 1980s was dismal. Cocooning an industry sector from overseas competition removes the incentive for firms to innovate and contain costs. There's no reason to think that the government's current flirtation with protectionism will fare any better. In the specific case of naval shipbuilding, the government is creating a series of entrenched monopoly suppliers, and it will surely be worse.