



After Covid-19

Volume 3
Voices from federal parliament



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STRATEGY

Procurement: priorities, partnership and programming—no future in past practice

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Ask not what opportunities our country should provide to Australian industry—ask what our country needs from Australian industry to be a free, resilient, first-world nation.

Covid-19 has brought supply-chain integrity into stark focus and led to wide-ranging discussions about resilience. The pandemic has exposed vulnerabilities in ‘business as usual’ commercial practices, which often rely on products or components that are imported ‘just in time’ to meet the need of a consumer. For many retail consumer items, delays in supply are an inconvenience but not of great consequence for the individual or the nation. For some items, however, a disruption in supply can undermine Australia’s ability to function as a first world nation.

The pandemic has also highlighted that national self-interest has dictated the behaviour of governments under pressure, rather than the global norms and agreements that have underpinned cooperation between governments over recent decades. Those behaviours led to decisions by supplier nations to ban the export of critical products (because of national self-interest) as well as predatory and competitive purchasing practices by some consumer nations. Coupled with supply shortfalls due to manufacturing workforce quarantine restrictions, the global impact to supplies of critical products and components to both governments and the private sector has been significant.

These actions and outcomes lead to three key questions:

1. Which critical supply chains can no longer be entrusted to free-market, just-in-time replenishment?
2. How do we support those critical supply chains to generate a sustainable and scalable domestic capability?
3. What do we need to change in our approach to procurement to achieve that?

Beyond sectors closely associated with the Covid-19 pandemic, such as health (for example, PPE), the same questions are valid for sectors in which government has large, long-term acquisition programs, such as defence and space. This expands consideration of supply-chain disruptions to include the consequences of regional—or even global—conflict.

Answering those three questions is a particular challenge for government, which over several decades has operated on the assumption that the market will provide what it needs when needed and that global competition will deliver the best value for the taxpayer dollar. Unlike the private sector, which has very clear performance indicators, such as profit and loss—which will drive rapid analysis of supply-chain failures and the implementation of the changes required to improve resilience—government lacks similarly effective triggers for analysis and is less agile in responding when a need does become apparent.

A critical Australian National Audit Office report or poor media coverage may be politically uncomfortable, but it’s hardly ever an urgent driver of fundamental and timely change. In contrast, the 2020 Defence Strategic Update should be a trigger for the defence sector. It highlighted the deterioration in Australia’s regional security and recognised that Australia now has a reduced period of notice to be ready to deter and effectively respond to military threats.

This preparedness requirement means that our military capability must be:

- available (serviceable) when it's needed (including the ability to sustain ongoing operations)
- effective against the evolving threats faced by the ADF.

The 2015 First Principles Review stressed that achieving that our level of preparedness depends on an effective engagement by government with industry, defining for the first time that some parts of industry are a 'fundamental input to [military] capability' (DoD 2015).

The 2016 Defence Industry Policy Statement (DIPS) further stressed that the priority for engagement should be ensuring that Australia has those industrial capabilities and the workforce needed to help guarantee the ADF's independence of action:

There are some capabilities that are 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. As such, it is critical that the industry base associated with these capabilities is maintained and supported by Defence as sovereign industrial capabilities. (DoD 2016:23)

For our military systems to be available and effective regardless of the actions of other nations, we need as a matter of urgency to answer those three key questions regarding resilience. Yet, four years after the approval of DIPS, Defence still hasn't fully answered Question 1 (what are our critical priorities, which DIPS called sovereign industry capabilities). Without detail about those priorities, support to industry has largely been on the basis of one-off grants to a wide range of companies, as opposed to effectively sustaining and growing the subset that operate in areas deemed critical (Question 2). It has also made reform of the Commonwealth Procurement Rules and agency policies problematic due to the absence of a recognised 'value' that the government is seeking through its procurement programs (Question 3).

The same is true of the space sector. As the information domain is increasingly contested (using electronic and, potentially, kinetic means), the national interest is likely to benefit from a sovereign capability to launch a low-cost, short-term intelligence, surveillance and reconnaissance (ISR) payload into low-Earth orbit in response to an unexpected threat. Even if Australia's emerging space industry can create the ISR payload, unless we can be assured that an international provider will supply a suitable satellite bus and launch capability at short notice, we don't really have a resilient sovereign capability. In the absence of recognised priority capabilities, Defence, the national intelligence community and agencies such as Geoscience Australia don't have a reason to coordinate their procurement of space products and services so as to help develop Australia's sovereign resilience to use space for our national interests.

Having discussed the problem space, I now consider what a whole-of-government response would look like.

Strategic requirements for national resilience

Whether considering PPE for health, satellites for the Office of National Intelligence, crop-protection products for agriculture, JETA-1 fuel for the aviation sector or submarine capabilities for Defence, Australia needs to develop an assessment framework to identify those specific industrial capabilities and supply chains that are critical to making decisions in the best interests of the nation, independently of the actions of others.

Without such a framework, government has no consistent basis for assessing when it's prudent (or essential) to generate or sustain an Australian industry capability, which in some circumstances may require initially accepting a higher cost or risk profile.

The 2018 government inquiry into liquid fuel security is an example of an attempt to analyse supply-chain vulnerability. The 2016 DIPS mandates another approach relating to the defence industry.¹ Both are well intentioned but poorly implemented.

To borrow from the systems engineering world, we need competent people to conduct an analysis of all the ways things are likely to fail in a system²—including the supply chain that underpins the ability to manufacture, maintain or upgrade—and then assess which failures will critically affect the outcomes we care about.

Only then can we make informed, risk-based decisions about how to increase our resilience to crises. This isn't a task solely for departmental officials. It requires direction by technically competent practitioners (that is, people who have relevant qualifications and task-specific experience), such as systems engineers from the separate industry sectors.

Partnerships

While the relationship between Defence and industry has improved considerably since the 2012 Senate report into defence procurement (SSCFADT 2012), the broader federal government procurement system still lacks a framework that encourages partnership (as opposed to competition) as a driver of value for money. Partnership is important in several key areas:

- **Industry.** Once critical industry sectors (and occasionally even individual companies) have been identified as a priority for support, the government needs to move beyond the well-worn approach of one-off grants to encourage innovation or enable a capability demonstration. Only procurement contracts provide the confidence and cash flow for companies to invest in people, processes, infrastructure and R&D to improve and sustain the competence and capacity the nation needs. Good contractual models used by the UK Ministry of Defence in shipbuilding and complex weapons procurement ensure value for money and efficiency as well as long-term effectiveness. In other areas, such as liquid fuels, concepts such as the universal service obligation performance agreement in telecommunications could be extended to manufacturers and distributors, in addition to measures such as supporting innovation in processing alternative feedstock to help ensure adequate resilience across the supply of petrol, diesel and aviation fuels.
- **Other Australian entities.** Some critical capabilities may have a primary association with one particular department, which might not represent total demand. For example, it might not be viable to sustain the Australian manufacturing capability—established during Covid—based solely on demand from the federal Health Department to replenish the national medical stockpile. There are other entities, such as the Department of Foreign Affairs and Trade, the Defence organisation, state governments, many private health providers and industry sectors, however, who also need PPE and in some instances benefit from the stockpile. The aggregation of that demand could enable offtake agreements of a scale that makes domestic production sustainable and competitive.

Using the satellite example: an analysis of the critical capabilities required could lead to a priority to establish and sustain an Australian satellite manufacture and launch capability. That would require

multiple departments to then view procurement as a program—to jointly support the phased generation of domestic capability over an agreed time frame—as opposed to simply focusing on the cheapest and quickest way to complete their own siloed projects.

- **Like-minded nations.** Despite the nationalistic behaviour of foreign governments during the pandemic, it's inevitable that Australia will continue to rely on international providers for some critical products and components. This has three key implications for Australia:
 - Nationalistic responses are now a demonstrated risk that must be factored in when evaluating the probability of supply-chain-failure modes, particularly if some nations may even use supply chains as a coercive measure in times of tension or conflict.
 - Carefully structured agreements with like-minded nations are needed to ensure that the mutual benefit of achieving shared interests outweighs the short-term advantage a foreign government might seek in response to domestic political pressure or other global priorities (such as when the partner is involved in multiple theatres of conflict).
 - We must proactively identify and invest in areas of natural strength for Australia that contribute to trusted supply chains with like-minded nations for economic benefit but also to assist in achieving shared goals (such as the critical-minerals agreement with the US).

Procurement policy and programming

The Commonwealth Procurement Rules (CPRs) and subordinate departmental policies and accountable authority instructions must be amended to recognise that to 'generate or sustain an identified critical capability' is a priority when evaluating value for money.

Currently, paragraphs 4.4–4.7 of the CPRs outline criteria such as being fit for purpose, quality and whole-of-life costs and underline those considerations with an overriding focus on competition (Department of Finance 2019). Finance officials point to paragraph 4.7 (broader economic benefit) to claim that there's a basis for consideration of other factors, but this has proved to be inadequate.

For example, the Defence Policy for Industry Participation (DPIP 2019), cites the CPRs and provides examples of broader economic benefit in paragraph 2.9 that go to issues such as providing employment, but makes no mention of generating or sustaining critical (sovereign) industry capabilities. The absence of a 'head of power' in the CPRs has resulted in paragraph 1.11 of the policy stating that 'Defence will not preference Australian industry. The focus is on maximising opportunities to compete for work' (DoD 2019).

The CPRs must be amended to include a new subparagraph after 4.5b dealing with assessing value for money to the effect that:

- c. the extent to which the proposal contributes to the generation or sustainment of an approved critical (sovereign) industry capability.

Authorities should also consider how programming or phasing of a procurement activity can assist with the generation or sustainment of a critical capability. The increased return on investment and decreased risk and life-cycle cost that underpin Australia's continuous shipbuilding program should be expanded to other sectors with strategically important supply chains or capabilities.

Conclusion

Past Australian Government procurement practice—based on assumptions about the efficiency and reliability of a competitive market operating within a global order governed by accepted norms of behaviour—has proven inadequate as a basis for the future resilience of Australia’s critical systems.

Despite the dictates of the CPRs, the current federal approach to procurement can’t be relied on to deliver value for money in critical areas when under stress.

If we ask the three key questions above, and effectively implement outcomes from the subsequent analysis, Australia will be more resilient and capable of independent action to respond to threats or crises. Partnering with industry to generate and sustain the key industry sectors our nation needs generates domestic supply chains that will lead to more innovative and competitive companies capable of competing for and winning work in non-critical sectors, both locally and through export.

References

- DoD (Department of Defence) 2015. *First Principles Review: creating one Defence*, Australian Government, 1 April, [online](#).
- DoD (Department of Defence) 2016. 2016 Defence Industry Policy Statement, Australian Government, 25 February, [online](#).
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- Department of Finance 2019. Commonwealth Procurement Rules, Australian Government, 20 April, [online](#).
- SSCFADT (Senate Standing Committee on Foreign Affairs, Defence and Trade) 2012. *Additional Comments by Senator David Fawcett*, Parliament of Australia, 30 August, [online](#).

Notes

- 1 The framework is intended to apply strategy, capability and resource lenses to what the ADF needs to be able to do to defend the nation and assess areas of critical dependence on the Australian defence industry to achieve it.
- 2 A failure mode effects criticality analysis is a structured approach to analysing the component elements and interfaces within a system, the possible modes of failure and their impacts on the system’s intended performance.



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For this volume of ASPI's After Covid-19 series, we asked Australia's federal parliamentarians to consider the world after the crisis and discuss policy and solutions that could drive Australian prosperity through one of the most difficult periods in living memory. The 49 contributions in this volume are the authentic voices of our elected representatives.

For policymakers, this volume offers a window into thinking from all sides of the House of Representatives and Senate, providing insights to inform their work in creating further policy in service of the Australian public. For the broader public, this is an opportunity to see policy fleshed out by politicians on their own terms and engage with policy thinking that isn't often seen on the front pages of major news outlets.