

Defence equipment: Buying and budgeting

ED Hello and welcome to the Commons Library Podcast where our experts give you an informed and impartial take on issues being discussed in Westminster and where you live. I'm Eleanor Davis and last week I met with Louisa Brooke-Holland, a researcher in the International Affairs and Defence section of the House of Commons Library and we discussed defence procurement, which is how the Ministry of Defence spends its budget on equipment for the Armed Forces.

We touched upon reactions to the MoD's budget, how previous governments have tackled procurement issues around shipbuilding and possible effects of Brexit. So Louisa, welcome to the podcast.

LB-H Thank you.

ED The MoD is budgeting £186 billion on equipment over the next ten years but the National Audit Office has said its plan is unaffordable. MPs have also been questioning how the MoD buys its equipment and the number of contracts it awards without competition.

Now defence procurement, we mean buying equipment that the Armed Forces need to do their jobs, but it also includes planning ahead for any conflicts the UK could be involved in, but what does this mean in practice?

LB-H There are four points I want to make here. Firstly, the UK considers itself a world-leading military power. It has the sixth largest defence budget in the world according to the Military Balance 2019; it has the second largest defence budget in NATO behind the US and it is one of a handful of NATO allies to spend 2% of its GDP on defence and other countries similar to us like France and Germany don't do this.

Secondly, the UK wants to be able to deploy anywhere in the world. We have seen that in recent years in Afghanistan, in Iraq, in Libya, currently in the air campaign in Iraq and Syria. The Armed Forces are also deployed in the Baltics with NATO, on UN peacekeeping missions in Africa and war ships are being deployed to the Far East.

Thirdly, it's not just really all about what the Armed Forces are needing now, but really looking ahead to what they might need in 20 or 30 years. So, for example, one thought is that by 2035 the majority of the world's population is expected to live in cities, with many located on or near the coast. So what does that mean for the type of equipment the Armed Forces may need if they are going to be fighting in that sort of environment?

And an aircraft carrier is a really good example of a country planning 30 or 40 years ahead because a carrier provides the UK with the ability to deploy air power from anywhere in the world without the need for friendly air bases on land. And so that gives the UK options and again it just shows how we are sort of thinking what might we need in the 2030s, 40s, middle of the century.

Lastly, the Government is really looking to have high-end equipment to deter our most capable adversaries. So it is wanting cutting edge technology to a high specification. But put all four of these together and this costs a lot of money.

ED How much money is involved? What sort of budget does the MoD have?

LB-H So in 2017/18 the MoD budget was £36.6 billion. Now out of that it spent 42% of its budget on equipment and support, about £15 billion, and compared to about 34%, a third of the budget on personnel costs.

ED The National Audit Office has described the MoD's equipment budget as unaffordable; why is this?

LB-H So each year the MoD brings out a new equipment plan looking at the period for the next ten years. So the current plan is looking at the period 2018 to 2028 and for that period the MoD has allocated £186 billion spending on equipment and support. That includes supporting current equipment in service and also support costs for new equipment.

At the same time the National Audit Office examines these plans and produces its own verdict on them and for this year it says the current plan is unaffordable. It says that the forecast costs of the plan exceed the allocated budget by £7 billion over the ten-year time frame and this amount could rise to over £14 billion if all the risks materialise.

ED So what type of risks are we talking about?

LB-H Well briefly these include foreign exchange rate changes. The current plan includes an estimated \$30 billion worth to be spent over ten years. And that is not because the UK buys a lot of equipment from the US, but what it does buy it tends to be very expensive, so the Lightning, 35 combat jets, maritime patrol aircraft, and currency fluctuations over the lifetime of a programme can increase costs.

And the MoD said in its current equipment plan that the programme costs for Protector, which is the new unmanned aircraft drone, which is going to replace Reaper, those costs have increased by £56 million because of foreign exchange movements.

The NAO also points out that the current equipment plan is funded by anticipated efficiency savings, which it says may or may not be realised; so if they are not realised that money is therefore not available for the equipment plan.

And also increased costs to individual programmes can mount up and can have a knock-on effect for the rest of the defence budget.

ED But this isn't a new issue; why have previous governments struggled with costs and the defence budget?

LB-H Yes, you are absolutely right. I mean this is something that successive governments have struggled with going back decades. Different governments have tried different approaches to procurement and done different reviews. Under the last Labour Government, Bernard Grey produced a major review of defence procurement and he described an overheated equipment programme with too many types of equipment being ordered for too large a range of tasks at too high a specification.

And the reason is that major equipment takes a long time to develop. It can take decades. I mean the aircraft carriers I mentioned, that decision dates back to 1998, and HMS Queen Elizabeth won't go on her first operational deployment until 2021.

And also things change. The war in Afghanistan, for example, consumed an awful lot of costs, so programmes may be delayed to save money. But that ends up costing more and it adds on additional costs and unexpected costs to lengthen the life of in service equipment.

And on top of this there are wider pressures on the defence budget as a whole, which means there isn't as much manoeuvrability within the equipment side. And all these create pressures on the equipment budget as a whole.

ED Defence procurement is fundamentally different to other types of procurement isn't it, with very advanced equipment needed for the Armed Forces, so presumably the MoD can't buy everything it needs just off the shelf?

LB-H Yes, that's right. I mean some defence equipment you can just buy off the shelf but a lot of it is very high tech, unique really to what the Armed Forces are needing for what the UK purposes are. The MoD's preferred approach is really through open competition and off the shelf where appropriate and that would apply to many different components.

But the UK, like other EU countries, can exclude some contracts from the usual procurement rules that require competition and this is referred to as using Article 346 of the Treaty on the Functioning of the EU. And this allows member states to exclude certain contracts from competition for security reasons.

So it may be to maintain a sovereign capability or protect what the Government calls its operational advantage and freedom of action. For instance, making sure the UK has a technological advantage over competitors or that it can act when it chooses to, or that it can re-supply and re-stock things like weapons and missiles when it needs to without being limited by another government or another country.

Or there may be only one supplier because some defence equipment can be extremely high tech and there may only be one domestic supplier to provide it. Submarines are a really good example of this - that they are built solely in the UK in the northwest, with one trusted prime supplier.

So in 2017/2018 a third of the MoD spend was on non-competitive contracts; and these are known as single-source contracts.

ED But the single-source contracts, the Defence Committee has said it's always concerned by reports that significant procurement decisions are being considered without competitive tender.

LB-H That's right, the committee has questioned in the last year or so, the committee has questioned the MoD's procurement plans for new AWACs, which is the surveillance planes. You may be familiar with the Century, which has the ray dome on top, so it will be the new replacement for them. And also armoured vehicles, both of which are going to be without an open competition on the market.

And the difficulty with single-source regulations is that the rules for them dated back to the 1960s; so in 2014 the Government overhauled the regulatory framework for single-source procurements to try and make the process more transparent, to bring in clearer rules for contract pricing, both to help the government make sure its getting value for money, because if it's with a single-source supplier it has limited abilities to really check that it is getting value for money for the taxpayer. And also to give industry a fair price and clear guidance on what the contract pricing is going to be.

ED Now isn't the Government already amending these regulations?

LB-H Yes. So the Defence Reform Act 2014 requires the legislation to be reviewed within three years. The Single Source Regulatory Body submitted its review in 2017 and the Government has amended secondary legislation on two occasions last year and the MoD says that further changes to legislation are planned in this year. So we will be keeping a close eye on these and this is going to be the subject of a future briefing paper.

ED Now the Government said last year, in summer 2018, it will be developing the next generation of combat aircraft with other countries. How does the UK work with other countries?

LB-H Yes, so this is about the RAF's new combat aircraft. Looking ahead to what the RAF is going to need in the 2030s. I mean we've just got the Lightning coming into service now but already the Government is having to talk to other countries about what it's looking at in the future.

And this is predominantly about cost; these sorts of equipment cost huge amounts and it makes sense to work with other nations to develop them, to work with allies to defray those costs. And combat aircraft are a great example of this. The Tornado aircraft, which has just retired, that was developed with Germany and Italy. The Typhoon, in service now, that was developed with Germany, Italy and Spain. The Lightning, which is just coming in, that's a US-led programme. And so the MoD is already talking to other nations to think about what's, in Team Tempest, what it's going to look at in the 2030s.

ED And we've seen quite a few debates in Parliament about shipbuilding for the Royal Navy, why is this a tricky issue in particular?

LB-H So shipbuilding is really interesting and it really illustrates the different methods of procurement and how the Government has changed its approach over the last few years. And there is a lot of interest in shipbuilding as well because the Navy's refreshing its fleet; so new destroyers are already in service but there's new aircraft carriers coming in, new attack submarines, new frigates, new offshore patrol vessels and new support vessels, either all under way or to be built in the near future.

In recent years BAe Systems has built, predominantly built the Navy ships; built the destroyer, built the submarines and currently offshore patrol vessels.

But in 2017 the Government introduced a new shipbuilding strategy, really to support domestic shipbuilding industry, and to encourage competition within UK yards and MPs are very keen on this. So this is now a new approach for warship building that, rather than contract on a single-source basis as the Government has done for the Type 26 frigate with BAe Systems, warships will now be built by a competition between UK yards, starting with the new Type 31E frigates.

But this doesn't apply to non-warships. So the MoD is also looking at new support ships for the Royal Fleet Auxiliary; the fleet solid support ships. The contract for this will be competed internationally.

ED What is it that MPs have been saying about this?

LB-H So some MPs argue that the contracts for the support ships should be restricted to UK shipyards as the Type 31E frigate contract is. They argue that the Government should be supporting the domestic shipbuilding industry and they argue that the government can apply Article 346 and exempt the support ship contract from international competition.

The MoD disagrees and it sets out its argument in the shipbuilding strategy. It argues that the exemption doesn't apply because they are not warships and therefore for procurement rules they have to compete this contract internationally.

So as it stands, out of the five contenders for the support ship contract one is a British consortium and the others are from Italy, Spain, Japan and South Korea and the decision is expected in 2020.

ED We can't discuss defence procurement without mentioning Trident; how big a part of the budget is it?

LB-H It's a big part. So the annual running costs of the UK strategic nuclear deterrent are given as about 5 – 6% of the defence budget. The cost of the full replacement submarines is estimated to be £31 billion with a £10 billion contingency set aside to design and manufacture these new submarines.

Trident is always politically divisive. The Conservatives and Labour support the renewal of Trident but other parties like SNP and Plaid Cymru want to scrap Trident. And some argue the money would be better spent on conventional weapons or other parts of the Armed Forces, or on other parts of Government spending entirely, like education or health.

ED Now we are talking on a day in which MPs are taking part in the second round of indicative votes on Brexit options, so it's very difficult to predict what might happen in the near future, but what impact might Brexit have on defence spending?

LB-H Well Brexit will certainly affect the defence industry. It has a global supply chain like many other industries but at the time of the recording we can't really know what the future relationship is going to be. But the Government has already begun amending regulations to account for the UK leaving the EU, so the wording of Article 345 has been inserted in the draft Defence and Security Public Contracts Amendment EU Exit Regulations 2019 to allow government to continue to exclude some contracts from their regulations, as is currently the case.

And, more broadly we will be keeping an eye on the future UK/EU relationship and how it affects defence.

ED Thank you very much for joining us today, Louisa.

LB-H Thank you for having me.

ED That's it for this episode of the Commons Library Podcast. For relevant briefing papers, including Louisa's Introduction to Defence Procurement, remember to look at the episode notes published alongside the recording. And to keep up to date with what our researchers are working on visit commonslibrary.parliament.uk and follow us on Twitter [@commonslibrary](https://twitter.com/commonslibrary).

Next week we will be joined by David Torrance from the Library's Parliament and Constitution Centre and we will be discussing devolution in Northern Ireland.

The Commons Library podcast is a House of Commons production. The producer is Grace Rowley, the editor is Chris Blanchett and presenters are Andrew Mackley and Eleanor Davis. Music is by Tom Mackley.