An introduction to defence procurement

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Summary

The Ministry of Defence spent over £15bn on defence equipment and support 2017/18. This equates to 42% of its annual budget for the year. The armed forces will take delivery of a range of major platforms over the next decade. However, successive Governments have consistently struggled to deliver key equipment capabilities within agreed costs and timescales. The National Audit Office has assessed the MOD’s latest Equipment Plan (2018 to 2028) as unaffordable. MPs have questioned the Government’s approach to procurement, the level of single-source contracting and sovereign capabilities.

This briefing paper provides an introduction to defence procurement in the UK.

Affordability of the Equipment Plan

The MOD publishes an annual Equipment Plan looking ahead for a period of ten years. It has allocated £186bn for equipment and support for 2018 to 2028. However, the MOD says the forecast costs of the plan exceed the allocated budget by £7bn over the ten years. This could rise to £14.8bn in a worst-case scenario if all the identified risks materialise. These risks include exchange rate fluctuations, failing to achieve required efficiency savings and programme cost increases. Pressure on the whole defence budget means there is little room for manoeuvre.

Shortfalls in the equipment budget can significantly affect the armed forces. The MOD has in the past delayed or reduced the scope of major projects to find short-term savings which can end up adding to the overall cost of the programme and additional costs as the life of in-service equipment is extended to compensate for a delayed replacement.

But it isn’t just the affordability of the Equipment Plan that interest’s MPs and defence experts.

Approach to procurement

The MOD’s approach to procurement comes under regular scrutiny. Whilst open competition is the MOD’s stated preferred option, defence procurement is unusual in that a significant proportion of contracts (by both value and number) for defence materiel are awarded non-competitively. A third of the MOD’s total procurement spend in 2017/18 was on non-competitive contracts (£8.6bn out of £24.3bn). A few big suppliers dominate the defence industry – over 42% of total MOD procurement expenditure was with 10 suppliers.

The Government can exempt contracts from the usual procurement requirements of competition for reasons of national security, to maintain sovereign capabilities and to protect the UK’s operational advantage and freedom of action.

MPs have discussed in Parliament what defines a sovereign capability and what, if any, action should be taken to provide that capability. During the 2017-19 Parliamentary session the naval shipbuilding industry debates have demonstrated many of the wider issues about procurement and Government support to domestic industry and the balance between competition and single-source awards.

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2 Ministry of Defence ‘Finance and economics annual statistical bulletin: trade industry and contracts 2018’, 6 September 2018, figure 2a
The Labour party is calling on the Government to undertake a full defence industrial strategy. The Government refreshed its defence industrial policy in 2018 and has published sector specific strategies for shipbuilding and the combat air sector. It says it will produce a new strategy on competition in 2019.

The Defence and Public Accounts Committees have published reports on defence acquisition and non-competitive procurement.

**Regulatory framework**

In 2014 new regulations were introduced for single source procurement and a new independent body established to oversee these regulations. The Government is required by statute to review this legislation and is expected to publish the review in 2019. It has already begun amending secondary legislation to accommodate changes identified in the review process.

The Government laid draft legislation in December 2018 amending the *Defence and Security Public Contracts Regulations 2011* to account for the UK leaving the European Union.

**Multinational collaboration**

Major platforms can be very expensive. The Government can offset these costs by developing new capabilities in partnership with one or more countries. The RAF’s recent combat aircraft fleet have all been developed with other nations and the Government is currently exploring options with potential partners for its next combat air system.

**Leaving the European Union**

The paper concludes by examining defence procurement in the context of the UK’s withdrawal from the EU.

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**Box 1: Library papers on defence procurement**

- *A brief guide to previous British defence reviews*, CBP7313, 9 July 2018
- *Defence Capability Review: equipment*, CBP8112, 17 October 2017
- *Defence Equipment and Support (DE&S)*, SN06903, 3 June 2014
- *British defence policy since 1997: background issues*, RP08-58, 27 June 2008
- *UK Defence Procurement Policy*, RP03/78, 20 October 2003
1. Background: reforming defence acquisition

**Summary**

Equipment acquisition is a complex process beset by financial and time constraints, the political impact of legacy programmes and is influenced by both strategic perceptions and domestic industrial priorities. Successive governments have struggled with these often-conflicting dynamics and made various attempts over the years to improve the process.

Successive Governments have consistently struggled to deliver key equipment capabilities within agreed costs and timescales.

The Defence Committee said in 1998 procurement is “prone to escalating costs and late delivery”. The Public Accounts Committee said in 2005 the MOD “has yet to demonstrate that it can consistently manage individual projects to deliver the planned operational benefits to the Armed Forces to cost and time.” In 2009 Bernard Gray, commissioned by the Government to review defence procurement concluded:

> The Ministry of Defence has a substantially overheated equipment programme, with too many types of equipment being ordered for too large a range of tasks at too high a specification. This programme is unaffordable on any likely projection of future budgets.

The Public Accounts Committee observed in 2011 the Department “continues to struggle with managing its equipment programme on an affordable basis, resulting in the cancellation or deferral of major projects and a damaging impact on value for money.”

More recently, the National Audit Office warned in early 2017 “the risks to the affordability of the Ministry of Defence Equipment Plan are greater than at any point since reporting began in 2012”. The NAO has assessed the 2017 and 2018 Equipment Plans to be unaffordable.

### 1.1 Identifying the problem

Bernard Gray, in his 2009 report, wryly observed “acquisition reform, as it is generally known, is a subject only about 5 minutes younger than the acquisition of military equipment itself”. Tom McGuffog, in his

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6. Review of Acquisition for the Secretary of State for Defence, October 2009
10. Review of Acquisition for the Secretary of State for Defence, October 2009
analysis of defence procurement, pointed out Samuel Pepys, in 1660, was among the first to attempt to inject some rigour and financial acumen into the procurement system.11

The causes are well-known, if not easily resolved, and identified by Gray in his report.12 Defence equipment takes a long time to develop and introduce into service. Redefining requirements (as perhaps threat/need assessments shift) can inflate costs and extend project times and create additional unplanned expenditure to support and maintain aging equipment in-service. Extended military operations may consume money intended for longer-term programmes. More projects are planned than can be paid for, resulting in an ‘overheated equipment programme’. Staff lack sufficient business, project management and contract negotiation skills to ensure the armed forces receives value for money.13

History is littered with examples of programmes that have gone way over budget and/or far beyond their expected in-service date. In 1997 the National Audit Office estimated that many the top 25 defence equipment projects were over budget and would not achieve their in-service date.14

### Box 2: Delays and cost increases

The Equipment Plan provides a short summary of selected major projects. This includes the difference between the expected cost at approval and current forecast cost to completion and delays to the expected in-service dates. Historical information can be found in pre-2014 National Audit Office **Major Projects Reports**. Examples from the Equipment Plan 2018:

- **Protector (unmanned aircraft):** £278m increase from expected costs at approval to current forecast cost to completion with a two-year delay in in-service dates (additional £278m a result of a decision to save costs of £100m in 2017/18 which has added increased overall cost by £162m, plus £56m for foreign exchange movements and £60m for an enhanced sensor fit).
- **Aircraft Carriers:** £2.7bn increase from expected costs at approval to current forecast cost to completion (£3.5bn to £6.25bn)
- **Astute Boats 4-7 (attack submarines):** A £1bn increase in costs to £6.8bn with a 48-month overall delay in the programme (in-service dates have slipped from August 2015 to August 2019)

### 1.2 Reforms under the Labour Government

The Labour Government (1997-2010) made the reform of procurement policy a major objective of the Strategic Defence Review and introduced several initiatives intended to bring the defence equipment budget under control. It introduced the ‘Smart Procurement Initiative’ that evolved into ‘Smart Acquisition’ to try to reduce cost and budget overruns. The Government also created two new organisations in 1999: the Defence Procurement Agency (DPA) and the Defence Logistics Organisation (DLO).

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11 T McGuffog, "Improving value and certainty in defence procurement", Public Money and Management, 14 September 2011, vol 31: 6
12 As well as by numerous past analyses of procurement. See Commons Library Research Paper UK Defence Procurement Policy, RP03/78, 20 October 2003
13 These were acknowledged by the then Defence Secretary in 2012 when he introduced the Defence Material Strategy HC Deb 17 July 2012 c124WS.
Later, a Defence Acquisition Change Programme was introduced to deliver aspects of the Defence Industrial Strategy in a 2006 report *Enabling Acquisition Change*. One of the most significant organisational changes to emerge from the Change programme was the merger of the DPA and the DLO to form the Defence Equipment and Support (DE&S) in 2007.\(^\text{15}\)

The Government commissioned Bernard Gray to examine progress made under the Acquisition Change programme.\(^\text{16}\) His ‘Review of Acquisition for the Secretary of State for Defence’ was published in October 2009 and was largely critical of the way defence acquisition was conducted by the MOD. The Gray Review studied 40 programmes and found that on average, these programmes cost 40% more than they were originally expected to and are delivered 80% later than first estimates predicted.\(^\text{17}\)

The Government at the time rejected his proposal to establish DE&S as a Government-owned, Contractor operated entity. However, it did set out its initials thoughts and recommendations for change in the ‘Defence Strategy for Acquisition Reform’, a complementary document to its Green Paper published February 2010 entitled ‘Adaptability and Partnership: Issues for the Strategic Defence Review’.\(^\text{18}\)

All three main political parties promised to undertake a Strategic Defence Review after the 2010 election.

### 1.3 Reforms under the 2010-15 Government

The Coalition Government announced a wholesale review of the Ministry of Defence shortly after taking office. The Strategic Defence and Security Review, published in October 2010 (Cm 7948), said a review of defence acquisition would be considered as part of the overarching programme of defence reform.

There followed a raft of reviews and policy documents, including the Materiel Strategy, led by the new Chief of Defence Materiel Bernard Gray (the author of the 2009 Review of Acquisition), the 2011 Levene Review, two White Papers, and the Defence Reform Act 2014 (See box 4 for a timeline).

#### 2012 White Paper

The ‘*National Security through Technology* (Cm 8278) White Paper outlined the underpinning approach towards defence procurement.

Briefly, competition is the Department’s default position, buying off-the-shelf where possible. This is qualified by the principle of Operational

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\(^{16}\) HC Deb 11 December 2008 c67WS

\(^{17}\) Review of Acquisition for the Secretary of State for Defence, October 2009

Sovereignty, by which the Government will protect the UK’s technological advantage where essential for national security:

Wherever possible, we will seek to fulfil the UK’s defence and security requirements through open competition in the domestic and global market

which will be qualified by the principle of Technology Advantage:

We will take action to protect our operational advantages and freedom of action, but only where this is essential for national security.  


Defence Materiel Strategy and reforming DE&S

Bernard Gray was appointed the MOD’s Chief of Defence Materiel and head of Defence Equipment and Support (DE&S) in December 2010, the first civilian appointed to the post. The appointment was regarded at the time as a “radical overhaul of the way the Department operates” and he was subsequently asked in 2011 to lead the Materiel Strategy.

The Strategy resulted in a range of options to transform DE&S, one of which was to transform DE&S into a Government-owned, Contractor-Operation (GOCO) operation (as Gray had previously suggested and favoured in his 2009 Review of Acquisition). Unlike Labour, the Coalition Government endorsed this argument, outlining its plans in a White Paper, Better Defence Acquisition (Cm 8626), in June 2013. Enabling legislation was introduced the following month in The Defence Reform Bill, concurrent to a competition. The proposal drew considerable debate among MPs during the Bill’s progression.

However, the competition was halted in December 2013 after only one bid was received. The MOD instead opted to transform it into a bespoke trading entity, an arms-length body of the MOD, which it became in 2014. One immediate change was giving DE&S some flexibility in setting staff salaries, to compete with the private sector. Library briefing paper ‘Defence Equipment and Support (DE&S)’ examined the GOCO proposal and the proposed transformation into a trading entity. The Defence Reform Act 2014 received Royal Assent in May 2014.

New Operating Model and delegated budgets

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19 National Security through Technology: Technology, Equipment, and support for UK Defence and Security, Cm 8278, 1 February 2012, para 4
20 “MOD critic to lead defence procurement”, The Financial Times, 17 December 2010
21 “New defence materiel strategy announced”, Ministry of Defence, 31 May 2011
22 See Commons Library briefing paper ‘In brief: outsourcing defence procurement’, SN06633, 10 May 2013
In June 2011 Lord Levene published his independent review of the Ministry of Defence. The key change affecting procurement emanating from the Review was to operate a delegated model, with Single-Service Chiefs given responsibility for managing their budget, including equipment.

The MOD is reviewing its operating model outlined in the publication ‘how defence works’ to ‘strengthen the role of Head Office’. This will be completed in March 2019 and will result in a new edition. More detail is provided in the defence equipment plan 2018.

**Box 3: The acquisition system**

The acquisition system is explained in the MOD’s operating model ‘how defence works’ (2015 edition). The organisations involved in the acquisition system are divided into three groups:

**Head Office** - responsible for setting strategy and making high-level investment decisions. A subcommittee of the Defence Board, the Investment Approvals Committee, is responsible for considering major investment proposals on behalf of the Defence Board. The committee is chaired by DG Finance and can make recommendations to ministers on particularly expensive, complicated, innovative, risky or contentious projects. Work under the Modernising Defence Programme will create a “stronger and more strategic Head Office to provide clear, strategic central direction with delegation of military capability budgets and decision-making responsibility to the Services in the four Front Line Commands”.

**Top-Line Budget Holders** – the four front-line military commands (Air, Army, Navy and Joint Forces) plus the Director of Strategic Programmes (based in Head Office) and the Defence Nuclear Organisation. The TLBs specify their equipment requirements and manage their equipment budgets.

The MOD sets each TLB a “tight but realistic budget to incentivise better cost control and better reflect historical spending trends”.

**The Delivery organisations** – They procure and sustain equipment on behalf of the TLBs. These are Defence Equipment and Support (DE&S), Information Systems and Services, Naval Bases, the Submarine Delivery Agency, and the Warheads Delivery Team. They manage relationships with industry. DE&S is the primary equipment procurement body for the armed forces.

A ‘senior responsible owner’ is responsible for each project.

**New framework for single source procurement**

Historically the MOD has awarded a significant proportion of contracts on a single source basis i.e. without an open competition. Most commonly this is for reasons of national security, or because the required equipment is so specialised only one supplier is available.

Lack of competition means the MOD may have difficulty ensuring it is receiving value for money. The Defence Reform Act 2014 established a new statutory framework for single source procurement together with an independent regulator to oversee the framework.

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24 Commons Library briefing paper, Defence Reform, SN06036, 18 July 2011; Levene’s report, and subsequent annual reviews, can be found on gov.uk: Defence Reform reports 2011 to 2014.
25 Defence Equipment Plan 2018, p18
26 ‘How Defence Works,’ December 2015, version 4.2.1
27 PQ194627, 27 November 2018
28 National Audit Office, Defence Equipment Plan 2018, para 1.4
29 National Audit Office, Defence Equipment Plan 2018, para 10
30 Defence Equipment Plan 2018, p9
The Defence and Public Accounts Committees and the NAO have examined single source procurement during the 2017-19 Parliament.

The Government is currently reviewing the underpinning legislation and legislative changes may be forthcoming. Section 6.2 has more on this and single source procurement will be the subject of a forthcoming library paper.

An annual equipment plan

In 2012 the MOD began publishing an annual Equipment Plan outlining expenditure for the next decade. All the EP’s from 2012 onwards are collated on the Gov.uk website: Defence Equipment Plan reports.

The National Audit Office examines the underpinning assumptions of the Equipment Plan in its own report published alongside the MOD’s plan.

Philip Hammond, as Defence Secretary, announced the first equipment plan in May 2012. Declaring he had balanced the defence budget, he promised “under-programming rather than over-programming” with a contingency reserve within the nearly £160bn total planned spend over the next decade. The Equipment Plan was subsequently published in January 2013. The NAO observed in its accompanying report “since the beginning of 2011 the Department has substantially revised the way it compiles and manages the Equipment Plan and is now approaching the task on a more prudent basis”.

The Defence Growth Partnership

The Government set up the Defence Growth Partnership in July 2014, a partnership between government and industry to encourage innovation and support defence exports. It was originally set up with a £30 million pot over three years from 2015 onwards.

1.4 The Government 2015 to present

The Coalition Government pledged in the 2010 Strategic Defence and Security Review to undertake further reviews every five years to coincide with the expected five-yearly election cycle. Following the 2015 election, the new Conservative Government duly unveiled its National Security Strategy and Strategic Defence and Security Review in November 2015 (hereafter SDSR).

The Equipment Plan is ‘not affordable’

Unlike its predecessor, the 2015 SDSR boosted the armed forces equipment holdings rather than cut them. It added £12bn to the forward Equipment Plan, which had been published only a few weeks after

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31 HC Deb 14 May 2012 c263
33 Delivering growth: implementing the strategic vision for the UK defence sector, July 2014
earlier. Instead of the £160bn laid out in the 2015-25 plan, the SDSR outlined an anticipated spend of £178bn on equipment (and support) for the next decade. This would be funded in part by £5.8bn in savings.

The NAO had warned in its assessment of the 2015 Plan the MOD should “remain vigilant” for future cost increases. Three years on, the Joint Committee on the National Security Strategy criticised what they saw as a return to the poor practices of the past: “the 2015 NSS & SDSR perpetuated a longstanding failure to match ambition with capabilities and funding, relying instead on unrealistic promises of efficiencies and reduced contingency funding”.35

The National Audit Office has echoed these concerns. In 2016 it warned “the affordability of the Equipment Plan is at greater risk than at any time since its inception”, pointing out there is little room for unplanned cost growth and called on the MOD to “actively guard against the risk of a return to previous practice where affordability could only be maintained by delaying or reducing the scope of projects.”36 The NAO has since assessed the 2018 plan as unaffordable, with forecast costs exceeding budgets by over £7bn over the next decade.

The Modernising Defence Programme

The early election in 2017 prompted calls for a fresh Strategic Defence and Security Review. Instead, the Government opted for a National Security Capability Review (NSCR), out of which spun a separate strand on Defence that became the Modernising Defence Programme.

Driven in part by the need to better reflect the rapidly changing security environment and by the affordability gap identified in the Equipment Plan, the MDP took a year and was published in December 2018.

Despite hints in the Defence Secretary’s headline conclusions statement of July 2018 and the 2018 Equipment Plan, the MDP did not cut or explicitly change any major defence procurement programmes.

It did talk at length of innovation and needing to keep on top of technological advances. With that in mind, the MDP announced a new Defence Transformation Fund, ring-fenced with £160m from the defence budget in its first year “for innovative new military capability”. The Defence Innovation Fund also received a financial boost, from £20m in 2017/18 to £50m in 2018/19. The MOD hopes to further boost the Defence Transformation Fund with a further £340m but that is subject to the 2019 Spending Review.

The MOD will also launch new ‘Spearhead’ Innovation Programmes to “exploit cutting-edge technologies at speed”, citing combating sub-surface threats to submarines, autonomous systems, network sensors, artificial intelligence and machine learning. No money is attached to these programmes in the MDP. Library briefing paper ‘The Modernising Defence Programme’ looks more closely at the MDP.

New Strategies

Since 2017 the Ministry of Defence has published several strategy documents that affect defence procurement. These have either fuelled or facilitated discussion in Parliament on sovereign capabilities, supporting domestic industries (particularly shipbuilding), value for money and competitive tendering.

The Government published a National Shipbuilding Strategy in September 2017, fulfilling a commitment made in the 2015 Strategic Defence and Security Review. The Strategy was informed by Sir John Parker’s independent report on shipbuilding (November 2016). Sir John was deeply critical of the procurement of naval ships and recommended overhauling the Navy’s procurement process for its surface vessels, starting with the new general-purpose frigate (the Type 31e). The Government accepted all of Sir John’s recommendations. The Type 31e contract is currently being competed among UK-only yards, a break from the previous single-source preference. A more detailed analysis can be found in Commons Library briefing paper ‘The National Shipbuilding Strategy: January 2018 update’.

Shortly before Christmas 2017, the Government refreshed its defence industrial policy with a view to fulfilling National Security Objective three: #to promote our prosperity’. Industry for Defence and a Prosperous Britain reaffirmed “competition and strategic choice remain at the heart of our approach to defence procurement” but also recommitted to take measures to protect freedom of action and operational advantage on national security grounds.

In July 2018 the Combat Air Strategy laid out the Government’s ambition to be at the forefront of developing a new combat air system for the 2030s. This will replace Typhoon when it leaves service in 2040. ‘Team Tempest’, an MOD/industry working group, is driving the initial examination of options.

The Government commissioned former defence procurement minister Philip Dunne to examine how defence can grow its contribution to UK prosperity. The Dunne Report was published in July 2018 and made 41 recommendations. The Government has yet to publish its response.

The MOD has also promised a strategy for ‘Maximising Competition in Defence Procurement’. This will be published in 2019 “on completion of the acquisition review elements of the Modernising Defence Programme”.37

Notwithstanding the above, the Labour party has consistently called on the Government to develop a full, overarching defence industrial strategy. The Shadow Defence Secretary has urged the Government to consider the economic and employment benefits to the UK when awarding contracts, and to restrict the Fleet Solid Support Ships contract to a UK-only competition to support domestic shipbuilding.38

37  PQ198141, 17 December 2018
38  Speech at RUSI, 25 June 2018, HC Deb 11 July 2018 c1032; tweet sent 30 October 2018;
committed to undertake a full strategic defence and security review in its 2017 election manifesto.

A more dangerous world?

One aspect of procurement this briefing paper deliberately avoids is a consideration of the factors that drive decisions on what the Government should be buying for the armed forces as it is beyond the remit of this briefing paper. The Government’s [National Security Capability Review](March 2018) and [Modernising Defence Programme](December 2018) updates the 2015 National Security Strategy and Strategic Defence and Security Review’s threat assessment.

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**Box 4: Chronology of main developments**

- 1 April 2007 – Defence Procurement Agency (DPA) merged with the Defence Logistics Organisation (DLO) to form Defence Equipment and Support (DE&S). 39
- 15 October 2009 – A [Written Ministerial Statement](https://www.gov.uk/government/publications/defence-acquisition-and-supply-reform) sets out the MOD’s initial responses to the Gray report. At the time the MOD rejected the recommendation that DE&S be restructured into a GOCO.
- October 2010 – [The Strategic Defence and Security Review](https://www.gov.uk/government/publications/the-strategic-defence-and-security-review). It acknowledges the earlier Green paper on acquisition reform and announces that defence acquisition will be considered as part of the overarching programme of defence reform.
- December 2010 - Consultation paper ‘Equipment, Support and Technology for UK Defence and Security’ (Cm 7989).
- December 2010 – Bernard Gray appointed Chief of Defence Materiel.
- 1 April 2014 – DE&S becomes a bespoke government trading entity

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39 Previously the MOD Procurement Executive, the DPA was established on 1 April 1999 as one of the recommendations of the 1998 Strategic Defence Review. Forming DE&S was one of the main recommendations of the 2006 report *Enabling Acquisition Change*. 
2. A defence Industrial Strategy?

Summary
The Labour party is calling for a full defence industrial strategy. The Government refreshed its defence industrial policy in December 2017 and has published some sector specific strategies. Factoring in socio-economic factors into procurement decisions has been a constant in recent debates on defence industrial policy. The 2015 SDSR introduced ‘promote our prosperity’ as a national security objective. The Government has created various vehicles to encourage investment in new technologies and promote the domestic defence industry. However, a Government commissioned independent panel found a “dissonance between the Department’s innovation rhetoric and its resources”.40

This section does not attempt to provide a comprehensive examination of the way in which Defence engages with industry. Further resources are provided at the end of the section for those wishing to explore this topic further.

2.1 Labour calls for a defence industrial strategy
The Labour Party is calling for a full defence industrial strategy and moved a motion on 11 July 2018. Nia Griffith, the shadow Defence Secretary, argued there is an “overwhelming case” for a strategy that “recognises the immense value of building in Britain and takes a longer-term view of the orders that the Government will place, giving industry the confidence to invest in the UK and to plan for a steady stream of work”.41

Defining ‘good value’
Specifically, Labour wants to expand the definition of “good value” to include wider employment, industrial or economic factors when making procurement decisions: “buying British is not just about the basic fact that a UK-based company will pay UK tax; it is also about the broader economic and social benefits, and the value of the skills and apprenticeships that the industry creates”.42

Labour is calling for procurement decisions to factor in the potential return to the Treasury in tax receipts from UK-based employees. The GMB trade union estimates up to £285 million of the £800 million potential spend on the Fleet Solid Support ships could be returned to the Treasury through income tax, national insurance contributions and lower welfare payments if the contract was awarded to UK shipyards.43

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40  Defence Innovation External Advisory Panel Report – April 2018, Ministry of Defence, April 2018
41  HC Deb 11 July 2018 c1033
42  HC Deb 11 July 2018 c1033
43  “Turning the Tide”, GMB research report, April 2018
Philip Dunne recommended the MOD commission work to examine whether tax revenues should be considered, in his report for the Defence Secretary on defence and UK prosperity:

The MOD should commission academic work to inform a discussion with the Treasury to settle the question of whether additional tax revenues flow back from procurement spend in the UK and whether a cost premium applies to maintaining freedom of action and operational advantage from UK manufacture.44

Treasury rules prohibit taking associated tax revenue into account when making tax decisions, MOD officials told the Defence Committee in October 2018.45

Dunne recommended the MOD to give clearer, practical guidance on the prosperity factors defence is most likely to consider and be flexible in how they are weighed for each major procurement.46

The Defence Committee also called on the MOD to adopt a broader definition of ‘value for money’ in its 2017 report on defence procurement. Specifically, it recommended ‘local value’ be taken into account.47

Library briefing paper Public procurement and contracts explains Treasury rules regarding procurement and discussions on ‘buying local’ and ‘social value’.

2.2 Defence Industrial Policy refresh

The 2015 SDSR promised to refresh the defence industrial policy. This was reaffirmed in the Government’s wider Industrial Strategy Green Paper in early 2017 and the refresh itself was published in December 2017.

Entitled ‘Industry for Defence and a Prosperous Britain’ it laid out a three-pronged refresh of industrial policy:

• Improving the way defence delivers wider economic and international value, and national security objectives
• Helping UK industry in its plans to be internationally competitive, innovative and secure
• Making it easier to do business with defence, particularly for innovators, small and medium-sized enterprises and non-traditional defence suppliers

The Refresh reaffirmed “competition and strategic choice remain at the heart of our approach to defence procurement” but also recommitted

to take measures to protect freedom of action and operational advantage on national security grounds.

However, defence industry analysts John Louth and Trevor Taylor of RUSI argue the defence industrial policy is not a strategy:

The Government has articulated its policy, but the document does not amount to a costed and resourced programme of implementation – a strategy - to deliver that policy.48

### 2.3 ‘Promoting our Prosperity’ objective

The 2015 SDSR introduced ‘promote our prosperity’ as one of the three national security objectives.

Supporting exports is now a core task of the MOD and this objective is appearing in government defence procurement literature and incorporated into sector specific strategies. The Shipbuilding Strategy, for example, devoted an entire section to exports and asserted “ships will be designed with exports in mind from the outset”. The Combat Air Strategy laid out a ‘National Value Framework’ which it says will help determine the value for money of different options and inform trade-offs and avoid prioritising sovereign capabilities at the expense of prosperity and exports.49

### 2.4 Defence Innovation

The Industrial Policy Refresh also documents the different ways the MOD engages with industry from the Defence Suppliers Forum to the Defence Growth Partnership. In 2016 it launched a Defence Innovation Initiative, supported by an £800m fund (spread over a ten-year period), and a Defence and Security Accelerator based at Porton Down, to work with industry to identify and develop “innovative solutions to our most pressing challenges”.50 The Modernising Defence Programme also announced new ‘Spearhead’ innovation programmes to “exploit cutting-edge technologies at speed”. One notable area this will examine is exploring how to combat sub-surface threats to submarines.

An independent panel found a “dissonance between the Department’s innovation rhetoric and its resources” and warned that while it has a proud history of innovation (radar, jump jets) Defence is slipping behind its adversaries when it comes to innovation. Commissioned to assess the Defence Innovation Initiative, an independent advisory panel issued its first annual report in April 2018. It warned Defence faces two major, concurrent challenges in this area: pace of modernisation and affordability. It found that while Defence is becoming more innovative and responsive, it is still “hugely structured and bureaucratic”, and called on UK Defence to “step up its response” and innovate quickly.

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48 John Louth and Trevor Taylor, “A Defence Industrial Strategy for the UK”, RUSI Occasional Paper, April 2018

49 Combat Air Strategy, July 2018, chapter 4

50 2015 SDSR, January 2016, factsheet 13
The Panel concluded a fundamental change is needed if the MOD wishes to become truly equipped for an information warfare age.  

2.5 Further resources

Those looking for an overview of the defence sector can find a brief summary in the Government’s ‘Defence Sector Report’ submission to the Committee on Exiting the European Union.  

A more detailed analysis of defence’s contribution to UK prosperity, including a helpful breakdown of the defence footprint in the UK by nation and region (with maps), is contained in Philip Dunne’s report for the Defence Secretary published in July 2018. Dunne was Minister for Defence Procurement in 2015-16. ADS, the trade body for aerospace, defence and security industries, publishes an annual ‘facts and figures’ with its assessment of the UK’s defence industry.

Trade Unions provide analysis of their own sectors. GMB published a report on the defence shipbuilding industry in 2018. The CSEU (Confederation of Shipbuilding & Engineering Unions) represents unions working in sectors prominent in defence – aerospace, engineering and shipbuilding and ship repair.

RUSI, the defence thinktank, produces regular analyses the defence industrial base. John Louth and Trevor Taylor presented a ‘Defence Industrial Strategy for the UK’ in April 2018 and have previously examined the Government’s role as customer, sponsor and regulator of the defence sector in a 2013 book ‘the Defence Industrial Triptych’.

Andrew Dorman, Matthew Uttley and Benedict Wilkinson assess the security, economic and strategic value of Britain’s defence industry in “A benefit, not a burden” for King’s College. An opposing argument is put forward in Paul Holden et al ‘Indefensible: Seven Myths that sustain the Global Arms Trade’ which disputes the argument that the defence industry is a key contributor to national economies.

Comparisons of procurement systems in other countries can be found in a Library of Parliament of Canada publication: “Defence Procurement Organizations: A Global Comparison” (2014).

Dorman et al write at length of the dearth of statistical information on the UK’s defence industry. They collated what data was available for their 2015 article “A benefit, not a burden”.

The MOD stopped publishing annual figures on regional MOD expenditure and employment in 2009. However, it has now resumed this and statistics are available from 2015/16 on the gov.uk website: MOD regional expenditure with UK industry and supported employment

The MOD publishes annual trade and industry statistics which provide information on MOD spending with industry including numbers, types

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51 Defence Innovation External Advisory Panel Report – April 2018, Ministry of Defence, April 2018
52 “Sector report – defence sector”, Committee on Exiting the European Union, 21 December 2017
53 Philip Dunne, “Growing the contribution of defence to UK prosperity”, 9 July 2018
and values of contracts placed by MOD; major equipment projects and payments made by MOD to its suppliers during 2017/18.

The MOD provides guidance on Gov.uk to those looking to become a supplier or contractor.
3. Approach to defence procurement

Summary

Defence procurement is unusual in that a significant proportion of contracts for defence materiel are awarded non-competitively. The Government can exempt contracts from the usual procurement requirements of open competition for reasons of national security, to maintain sovereign capabilities and to protect the UK’s operational advantage and freedom of action. This section explores what these concepts mean.

The current Government’s approach to defence procurement is encapsulated in the 2012 White Paper *National Security Through Technology*:

Wherever possible, we will seek to fulfil the UK’s defence and security requirements through open competition in the domestic and global market, buying off-the-shelf where appropriate, in accordance with the policies set out in this paper. Procurement in the defence and security areas is, however, fundamentally different from other forms of procurement, so we will also take action to protect the UK’s operational advantages and freedom of action, but only where this is essential for our national security.

This principle was reaffirmed in the 2015 Strategic Defence and Security Review (SDSR) and the 2017 Defence Industrial Policy. The latter stated:

We strive to obtain the best value capabilities we can afford, wherever possible through open competition, and protect the UK’s freedom of action and operational advantage on support of our national security.

What is meant by freedom of action and operational advantage?

Operational Advantage is defined as “the ability to find and maintain an edge over potential adversaries” to increase the chances of success and increase the protection of UK assets and people. Freedom of Action is defined as “the ability to determine our internal and external affairs and act in the country’s interests free from intervention by other states or entities, in accordance with our legal entities”. The MOD describes this freedom as “the essence of national sovereignty”. The UK has a long history of developing or buying technologically advanced systems to provide the operational advantage and freedom of action it seeks.

John Louth and Trevor Taylor explain the importance of a domestic defence industry:

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54 “National Security through Technology: Technology, Equipment, and support for UK Defence and Security”, Ministry of Defence, February 2012, Cm8278, p8

55 “Industry for Defence and a Prosperous Britain: Refreshing Defence Industrial Policy”, 20 December 2017, para 15

56 ‘National Security through Technology: Technology, Equipment, and support for UK Defence and Security’, Cm 8278, 1 February 2012, section 3.1.1
On-shore defence industries... offer a country more control of its critical supply chains and is less vulnerable to embargoes or other restrictions on supply. Moreover, a national defence industrial sector enables a range of tasks to be undertaken, including the modification of equipment, the acceleration of development into the production phase, the surged production of some items, such as ammunition, and the deployment of industrial personnel to support equipment in-theatre.  

Andrew Dorman et al argue that without a “thriving domestic defence industrial base” the UK jeopardises its freedom to act and the armed forces risk losing their technological advantage over their potential opponents.

However, it is neither financially viable nor realistic for the UK to buy all the equipment the armed forces need from UK-based companies or for UK companies to be expected to fulfil such a requirement. UK resources are finite, so investing in one sector deemed essential for national security will inevitably affect Government investment in other fields. The Government therefore must “balance the potential benefits of taking a particular acquisition approach for a specific defence or security capability against the possible risks to our freedom of action”.  

The MOD said in late 2017 making these judgements is an area that needs work and it is “strengthening the process for understanding and managing those aspects of capability which are critical in delivering our operational advantage or freedom of action”.  

The capabilities identified as such are sometimes referred to as sovereign capabilities.

**Sovereign capabilities**

Recent procurement decisions have brought to the fore discussions on what is and what isn’t considered to be a sovereign capability – what should be designed and built solely in the UK to protect the UK’s operational advantage and freedom of action. The Government may exempt some defence contracts from the usual competition rules for reasons of national security under Article 346 of the Treaty on the Functioning of the EU.

The 2005 Defence Industrial Strategy explicitly identified the industrial capabilities the Government considered necessary to protect national security and therefore required to be ‘sustained onshore’. As an illustration, the industrial capabilities the Government required to be sustained onshore for shipbuilding included maritime systems engineering resource; shipbuilding and integration; submarines;

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57 John Louth and Trevor Taylor, ‘A Defence Industrial Strategy for the UK’, RUSI Occasional Paper, April 2018
58 Andrew Dorman, Matthew Uttley and Benedict Wilkinson “A benefit not a burden: the security, economic and strategic value of Britain’s defence industry”, King’s College London, April 2015
59 ‘National Security through Technology: Technology, Equipment, and support for UK Defence and Security’, Cm 8278, 1 February 2012, section 3.1.1
60 “Industry for Defence and a Prosperous Britain: Refreshing Defence Industrial Policy”, para 35
maritime combat systems; maritime support and maritime systems and technologies.\textsuperscript{51}

\textit{National Security through Technology}, in a move that “stunned the defence industry”, broke from this by removing this list.\textsuperscript{62} It argued in favour of taking decisions on a case-by-case basis depending on the nature of the threat and capabilities required. Instead, it identified four general cases which it expected to need to act in the interests of national security. More recently, the 2015 SDSR provided the following list of exceptions to the principle of open competition:

- Highly classified or sensitive technologies, or those governed by export control or treaty restrictions.
- Capabilities necessary to maintain interoperability with important allies, but which they cannot or will not provide to the standard required by our Armed Forces.
- Capabilities where there is strategic, military and economic benefit for the UK from long-term collaboration with other nations.\textsuperscript{63}

There is therefore no definitive list of sovereign capabilities available.

Having said that, some capabilities are obvious. Nuclear-powered submarines and complex weapons are procured on a single-source basis from BAE Systems and MBDA respectively and manufactured in the UK. The Government has identified cyberspace as a sovereign capability. And it is important to note that sovereign capabilities do not necessarily mean the whole platform but may apply to specific sub-systems or components.

Dorman et al argue the Government should clearly identify which capabilities are critical and should be domestically sourced.\textsuperscript{64} The MOD says it is examining “the balance between where sovereign capabilities are essential and where military and commercial off-the-shelf solutions would be wholly adequate.\textsuperscript{65}

The question of what, and how much, support the UK Government should give to certain domestic industrial sectors has been discussed at length by MPs. These discussions are influenced by other factors beyond the military assessment. Many MPs argue the Government should do more to support domestic industry and restrict competition to UK suppliers.

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\textsuperscript{51} ‘Defence Industrial Strategy’, Cm 6697, December 2005

\textsuperscript{52} “Military weaponry won’t have to be made in Britain”, The Times, 2 February 2012

\textsuperscript{53} 2015 SDSR, Cm 9161, para 6.54

\textsuperscript{54} Andrew Dorman, Matthew Uttley and Benedict Wilkinson “A benefit not a burden: the security, economic and strategic value of Britain’s defence industry”, King’s College London, April 2015

\textsuperscript{55} Ministry of Defence, “The Defence Equipment Plan 2018”, 5 November 2018
4. Parliamentary scrutiny and debate

Parliamentary interest in defence procurement tends to focus on major equipment programmes. In part this is because of the huge sums involved. But these major programmes also bring to the fore some of the core questions surrounding defence procurement, in particular how the Government:

- balances the competing demands of preserving sovereign capabilities while adhering to the principle of competition
- regulates single source procurement
- ensures it receives value for money when placing contracts non-competitively
- weighs socio-economic factors when deciding on a procurement route
- what, and how much, support should it give to certain domestic industrial sectors
- provides a transparent process for industry
- ensures it can afford to buy the equipment it needs, and that equipment is brought into service on time and in budget.

During the 2010-15 Government Members largely concentrated on the operational impact of the cuts to equipment holdings laid out in the 2010 SDSR. The gaps in maritime patrol aircraft and aircraft carrier capabilities were frequently raised in Parliament.

Since the 2015 SDSR the debate has tended to crystallise around a few major programmes and specific industries. Shipbuilding has been the subject of multiple debates, reflecting both the interest in the Shipbuilding Strategy and Members interest in the domestic shipbuilding industry (See box 5). Notable debates on this topic include:

- the [defence aerospace industrial strategy](#) in November 2017
- the [Shipbuilding Strategy](#) on January 2018
- the [Defence Industry and Shipbuilding](#) in July 2018
- ‘that this House has considered UK sovereign capability’ in November 2018.

The following gives a flavour of Members views articulated in these debates.

Paul Sweeney and Kevan Jones asked the Government to clearly identify and define what should be procured and manufactured in the UK as a sovereign capability. Luke Pollard warned “our sovereign defence capability is at risk” and (on a separate occasion) has called on the

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66 HC Deb 20 November 2018 c313-315WH
67 HC Deb 20 November 2018 c313-317WH
Government to preserve “Britain’s sovereign defence capabilities to design, build, equip and repair complex and important ships.”68 Ruth Smeeth has spoken more broadly about skills and technology and the importance of procuring from UK industry “so that we can retain domestic skills to design, develop and produce cutting-edge defence technology”.69 Jack Lopresti made a similar point when he said, in the context of a debate on the defence aerospace industry: “we must also have the sovereign skills capacity to continue to manufacture platforms and to innovate in Britain far into future”.70 Vernon Coaker warned the Government not to view the defence aerospace industry as a “tap that is turned on and off” when he called on the Government to maintain and sustain an air capability.71

The Defence Committee is “always concerned by reports that significant procurement decisions are being considered without a competitive tender”72 and has taken a keen interest in the procurement of AWACS and Army vehicles.

The MOD told the House in late 2018 it had begun discussions with Boeing about the potential for its E-7 Advanced Early Warning and Control ‘Wedgetail’ aircraft to replace the current Sentry fleet. The MOD had been hoping to upgrade Sentry to keep it in service until the mid-2030s but for cost reasons is now looking to replace it.73

Both the Shadow Defence Secretary and the Defence Committee have questioned this decision. Nia Griffith asked why the contract “will be gifted to a company without competition“ and called for an open competition.74 Dr Julian Lewis said the committee was “persuaded that a competition would be appropriate”.75 Industry competitor Saab also took the unusual step of publicly expressing its unhappiness with the lack of competition for the capability.76

The Committee has also questioned the MOD’s decision to re-join the Boxer programme to fulfil the Army’s Mechanised Infantry Vehicle requirement rather than openly compete the contract.77 The MOD has not signed yet a contract but announced in 2018 it was re-joining the Boxer programme and signalled it intends to buy over 500 vehicles. The programme is managed by OCCAR and manufactured by the ARTEC GmbH consortium. The Committee produced a report on defence

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68 HC Deb 11 July 2018 c1067
69 HC Deb 11 January 2018 c539
70 HC Deb 16 November 2017 c675
71 HC Deb 16 November 2017 c677
72 Letter dated 26 June 2018 from Chairman to Min (DP) relating to Sentry AWACS aircraft, published 3 July 2018. The Minister’s response was published on 13 September 2018
73 HC Deb 17 July 2018 c242
74 HC Deb 17 July 2018 c242
75 Letter dated 26 June 2018 from Chairman to Min (DP) relating to Sentry AWACS aircraft, published 3 July 2018. The Minister’s response was published on 13 September 2018
76 Defence Committee, ‘Letter from Andrew Walton, head of Saab UK to the chair of the Defence Select Committee’, 15 October 2018
77 Further information is available in library briefing paper ‘Modernising the Army’s armoured vehicles’.

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Airborne Early Warning aircraft, also known as AWACS (airborne warning and control system) provide an ‘eye in the sky’, tracking, gathering and sharing intelligence on aircraft and maritime vessels. The role is currently provided by the Boeing E-3D Sentry, recognisable by the large radome on top of the fuselage.
acquisition in December 2017 that looked at DE&S, the equipment plan, the SSRO and defence industrial policy (HC 431 2017-19).

The Public Accounts Committee examined non-competitive procurement for its 2018 report ‘Ministry of Defence Acquisition and support of defence equipment’ (HC 724 2017-19).

Parliamentary interest in the perennial topic of the defence budget is examined in the next section in the context of the Equipment Plan.

Box 5 Case-study: procurement of the surface fleet

The different procurement methods taken for the two new classes of Royal Navy frigates and Royal Fleet Auxiliary Fleet Solid Support Ships neatly illustrates the debate about sovereign capabilities, single source contracting, restricting competition to the UK and open competition.

Different procurement methods

- **Type 26 frigate:** The eight anti-submarine warfare frigates are contracted to BAE Systems and will be built at its yards on the Clyde in Scotland. The contract for the first three was signed in 2017 with delivery to begin around the mid-2020s. The contract was not competed.

- **Type 31e frigate:** The design and build of the Type 31e general purpose frigate will be open to competition but restricted to UK shipyards. The competition was launched in 2018.

- **Fleet Solid Support Ships (FSS):** The contract for at least two supply ships for the Royal Fleet Auxiliary is being competed internationally. The contract for customisation will be to UK shipyards. The Government says the exemption under Article 346 does not apply to naval auxiliary vessels.  

Policy development

The Government’s approach to shipbuilding has shifted considerably since the turn of the century, most markedly with the 2017 National Shipbuilding Strategy. The strategy broke BAE Systems monopoly of shipbuilding encapsulated in the 2009 Terms of Business Agreement. Schedule 3 of the Agreement identified the vessels which the company would be the exclusive Lead Contractor for: aircraft carriers, amphibious vessels, destroyers, frigates, mine countermeasures, minor vessels (including patrol ships) and complex auxiliaries (logistics and joint casualty treatment) but not simple auxiliaries (including Solid Support and tankers) or small craft. The TOBA is no longer in force.

The Shipbuilding Strategy completely overhauled procurement of Royal Navy and Royal Fleet Auxiliary surface vessels. It continued the policy of successive governments to build warships only in the UK but from now on these contracts would be competed rather than placed on a single source basis. Contracts for all other surface vessels will be subject to open competition, although customisation and the integration of sensitive UK-specific systems will be undertaken in the UK.

This shift in approach is reflected in the different procurement methods outlined above for the two new class of frigates which straddled the publication of the strategy. And, reflecting the broader approach to competition by default for non-warships, the contract for the Fleet Solid Support ships is being competed internationally.

Different views on the FSS contract

Labour, the SNP, the GMB union and the Confederation of Shipbuilding and Engineering Union have called on the Government to restrict the FSS competition to UK shipyards. Their arguments are: the FSS are warships and therefore the Article 346 exemption can be applied; other countries apply the Article 346 exemption to support ships; the Government should support UK shipbuilding, jobs and skills by placing the order with domestic yards; the UK will benefit financially from returns to the Treasury in the form of taxes and national insurance contributions; and UK shipyards are at a disadvantage in an open

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78 PQ 165494, 23 July 2018

79 BAES and the Government agreed in 2014 that the TOBA would be extinguished on signature of the Type 26 Manufacture Phase 1 contract and there were no costs associated with it being extinguished, according to a letter by Defence Minister Tobias Ellwood to Paul Sweeney in October 2017 (DEP2017-0693). The Government signed a contract for the first three Type 26’s in July 2017.
An introduction to defence procurement

competition because “many foreign yards are either state owned or receive significant direct or indirect subsidy”. The Government has said there is no national security interest in limiting the competition to UK companies.


These arguments were made by MPS in the following debates: UK Sovereign Capability on 20 November 2018; Defence Industry and Shipbuilding, 11 July 2018; Shipbuilding Strategy, 23 January 2018 and in GMB’s report “Turning the Tide”, April 2018. See also Commons Library briefing paper ‘Fleet Solid Support Ships’, CBP8351, 6 July 2018.

5. The Equipment Plan

**Summary**

The MOD has allocated £186bn to spend on equipment and support for the ten-year period from 2018/19. However, it estimates the cost of the plan to exceed the allocated budget by an average of 3.7% (£7bn) over the ten years from 2018/19. The shortfall is greatest in the four years from 2018/19. The National Audit Office believes the plan is unaffordable.

The MOD has already delayed some programmes to make in-year savings. Additional pressure on the equipment budget comes from foreign currency fluctuations, funding the budget from savings yet to be fully realised and the lack of room elsewhere in the defence budget to supplement the equipment plan.

The Plan accounts for more than 40% of the Department’s spending, and this is set to rise to 49% in 2021-22.

The Ministry of Defence has published an annual Defence Equipment Plan every year since 2012. The National Audit Office publishes its assessment of the Plan alongside the Equipment Plan. The Public Accounts Committee usually takes evidence on the Equipment Plan using information provided by the National Audit Office and produces a report. Past reports can be found on the PAC website.

The latest plan was published on 5 November 2018 and is summarised in box 6. All the EP’s from 2012 onwards are collated on the Gov.uk website: Defence Equipment Plan reports. The next plan is likely to be published towards the end of 2019. The author does not intend to update this section with each new Equipment Plan.

5.1 What does the Equipment Plan tell us?

The plan sets out the equipment budget and forecast expenditure on equipment over a ten-year period. It includes spending on both new equipment and support costs for in-service equipment.

Spending is broken down annually by each command and by sector but does not provide detailed costings for individual programmes. The 2017 and the 2018 Plans provide a project performance summary table listing a selected number of major projects with details of cost variations and time delays. For example, it shows that the attack submarines Astute Boats 4-7 programme is £1bn more than expected at approval 48 months behind schedule.

Each iteration of the EP has been slightly different. The 2018 plan is far more detailed than its predecessors. Cat Little, the MOD’s DG Finance, told MPs before publication it is intended to be “a much more readable,

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83 Defence Equipment Plan 2018 figure 22. Additional information on individual projects can be found in the Government’s Infrastructure and Projects Authority’s major projects annual reports.
transient comprehensive assessment of both value for money and affordability”. The NAO agreed the 2018 plan was “more transparent” and its approach to forecasting costs is “more realistic” than previous years. It also welcomed the affordability risks outlined by the MOD for ‘the first time’ in the Plan.

5.2 Is it affordable?

The National Audit Office has assessed the last two Equipment Plans as unaffordable.

In 2017 the NAO concluded – for the first time – that the Equipment Plan was unaffordable by between £4.9 billion and £20.8 billion in the ten years 2017 to 2027.

The latest plan, for the period 2018/19 to 2028/29, outlines an allocation of £186bn on equipment and support. However, the MOD says the forecast costs of the plan exceed the allocated budget by an average of 3.7% (£7bn) over the ten years. The MOD says the difference between the planned budget and the estimated cost of programmes ranges from £2.5bn and £14.8bn.

The pressure on the equipment budget is greatest in the first four years from 2018/19, with annual variances to the planned budget and the expected cost between 6.5% and 10%.

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86 National Audit Office, Departmental Overview: Ministry of Defence, October 2018, p14
87 Ministry of Defence, Defence Equipment Plan 2018, 5 November 2018, section 2.5
Risks to the Plan identified by the MOD and the NAO include future exchange rate changes and a failure to achieve the £13.4bn reduction in cost in the plan the MOD believes it will achieve through efficiency initiatives.

Dreadnought and nuclear-related projects have the potential to destabilise the plan, the National Audit Office warned in May 2018. Nuclear programmes represent around a quarter of the Department’s overall spend in the Equipment Plan. Library briefing paper ‘Replacing the UK’s nuclear deterrent: Progress of the Dreadnought class’ provides further analysis of the costs and delivery of this programme.

The MOD also acknowledges pressure on the defence budget could negatively affect the equipment plan, suggesting there is no room elsewhere in the budget to supplement the equipment plan:

The overall defence budget is under significant pressure as additional costs must now be managed within the budget agreed at Spending Review 2015. To ensure that defence spending remains affordable the department may need to reduce the budget allocated to the Equipment Plan.

While welcoming improvements in forecasting and understanding of affordability risks, the NAO says it “still lacks full confidence in the robustness of some of its underlying assumptions, particularly around efficiencies”.

Box 7: Foreign currency risks

Fluctuations in foreign currency exchange rates can affect the cost of individual programmes and thus the entire Equipment Programme. The forecast costs of Protector have increased by £56m because of foreign exchange movements.

Foreign currency denominated contracts cover between 8% and 19% of forecast equipment and support costs for each of the next ten years (2018-2028) and a large proportion relates to US dollar transactions ($30.4bn compared with €6.2bn).

The MOD acknowledges exchange rate changes “present a risk to the affordability of the Plan” and manages this risk by using a forward purchase mechanism. However, it estimates currency fluctuations could increase the cost of the 2018 to 2028 Equipment Plan by around £1bn. Foreign exchange rate fluctuation is a major budgetary risk to the Air programme in particular because of high number of air-managed programmes with large requirements for foreign currency, notably Lightning.

Delaying programmes?

The MOD has in the past delayed or reduced the scope of major projects to find savings which can end up adding to the overall cost of the programme and additional costs as the life of in-service is extended to compensate for a delayed replacement (see box 2). The NAO has warned of the dangers of returning to past poor practices by setting the

89 Ministry of Defence, Defence Equipment Plan 2018, 5 November 2018, section 2.3
91 “The Equipment Plan 2018 to 2028”, the National Audit Office, para 2.11
budget lower than forecast costs and said relying on in-year decisions “creates greater uncertainty over costs and increases the likelihood of decisions focusing on short-term affordability rather than longer-term value for money”.  

The 2018 Plan said the Modernising Defence Programme was looking at options to ‘help create headroom’ that include delaying, deferring or de-scoping areas of the forward defence programme and removing early from service capabilities which are “uneconomic to maintain”. The NAO explicitly called on the MOD “to make the decisions required to defer, de-scope or delete programmes as soon as possible to address this affordability challenge”.

The MOD is already delaying some programmes to make in-year savings. Protector has already been mentioned in this briefing paper. The Multi-Role Vehicle Programme (MRV-P or Joint Light Tactical Vehicle) is also being reviewed in light of the MDP but no decisions have yet been taken.

**Achieving savings?**

The MOD has laid out £13.4bn in efficiency savings targets over the ten years of the 2018 plan. It expects to achieve £9.5bn of this target, of which £7.3bn has been realised and a further £2.2bn expected. The NAO is sceptical of the MOD's ability to track progress in identifying and achieving the proposed savings.

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93 National Audit Office, Defence Equipment Plan 2018, para 9
94 Ministry of Defence, Defence Equipment Plan 2018, 5 November 2018, section 1.2
95 National Audit Office, Defence Equipment Plan 2018, para 14a
96 Defence Committee, ‘work of the Chief of the Defence Staff’, 15 January 2018, written evidence CDS0001
6. Methods of procurement

Summary
Recent debates in Parliament over procurement decisions for naval and auxiliary vessels, armoured vehicles and airborne warning system aircraft have highlighted how contentious a chosen method of procurement can be.

Whilst open competition is the Government’s stated preferred option, defence procurement is unusual in that a significant proportion of contracts for defence materiel are awarded non-competitively. The highly specialised nature of defence equipment may mean only one trusted supplier is available, further limiting opportunities for competition.

This section looks at the different procurement routes used by the MOD, including competition, sourcing equipment non-competitively, or via bilateral or multinational collaborative programmes.

Historically the MOD has spent a significant proportion of its procurement budget without an open competition, roughly amounting to 40% per annum. A third of the MOD’s total procurement spend in 2017/18 was on non-competitive contracts (£8.6bn out of £24.3bn). Although both the proportion and value of contracts placed non-competitively can vary considerably year-on-year:

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98 Ministry of Defence ‘Finance and economics annual statistical bulletin: trade industry and contracts 2018’, 6 September 2018, figure 2a
The defence sector is dominated by a handful of big companies. This is partly a result of significant rationalisation and consolidation over the years, the highly specialised nature of its work and the limited customer-base. In 2017/18 over 42% of total MOD procurement expenditure was with 10 suppliers. This pattern has not changed much over the years – the same suppliers received 37% share of payments in 2008/09. BAE Systems is the largest defence supplier in terms of annual spend. It received over 14% of all MOD procurement expenditure in 2017/18 and over the last ten years has received payments from the MOD worth between 15 and 23% of its global revenue.99

Box 8: CADMID cycle
The procurement of defence equipment in the UK is largely conducted in accordance with the generic CADMID cycle, which comprises six phases in a project and two main investment decision points, or ‘gates’: Concept and feasibility phase followed by Initial Gate; an assessment phase followed by Main Gate; demonstration; manufacture; in-service and disposal.

6.1 Open competition
The MOD’s stance towards competition has evolved over the decades. Keith Hartley and Gianni De Fraja, writing in the mid-1990s, point out competition only became central to procurement policy in the early 1980s. Prior to this defence procurement was characterised by preferential purchasing or a ‘buy British’ policy:

- by the 1970s UK defence contracting had acquired a reputation for being a highly lucrative and not very competitive business. The MoD was regarded as a not very demanding customer: it had a ‘cosy relationship’ with UK defence contractors, it bore most of the risks and was failing to obtain good value for money reflected in cost escalation, delays, and poor performance of equipment.100

Extensive reforms of procurement practices in the mid-1980s under the Levene Reforms encouraged greater competition and the use of fixed-price rather than cost-plus contracts.101

Open competition is now the MOD’s default setting, subject to operational advantage and freedom of action. The 2017 Defence Industrial Policy Refresh states “Defence competition and strategic choice remain at the heart of our approach in defence procurement”.

99 Ministry of Defence ‘Finance and economics annual statistical bulletin: trade industry and contracts 2018’, 6 September 2018
A new strategy for ‘Maximising Competition in Defence Procurement’ is expected to be published in 2019.102

The regulatory framework

Article 346 of the Treaty on the Functioning of the EU allows Member States to exempt some defence contracts from the usual procurement rules for reasons of national security. What constitutes “essential security interests” remains the sole responsibility of Member States. Motivated in part to reduce the use of Article 346 by Member States, and to encourage a more open and competitive market, the European Commission passed two defence directives in 2009 aimed at regulating defence procurement across the EU and the intra-community transfer of defence goods and services.103

Box 9: Defining military equipment

Article 346(2) states its provisions apply to products contained in a list drawn up by the Commission in 1958 (decision 255/58 of 15th April 1958). This list has never been amended and views differ on whether it is out of date or sufficiently generic to cover new technology.104 The DSPCR 2011 (part 1, section 3) refers to the list when it defines military equipment as:

- equipment specifically designed or adapted for military purposes and intended for use as arms, munitions or war material including equipment:
  - (a) listed in the Common Military List of the European Union as amended from time to time; or
  - (b) within the product types included in the list of arms, munitions and war material adopted by the Council in its decision 255/58 of 15th April 1958.

The Defence Security Directive (Directive 2009/81/EC) was introduced to harmonise EU rules on the procurement of defence and sensitive non-military security equipment. The Directive was transposed in UK law as the Defence and Security Public Contracts Regulation 2011. It governs the contract award procedures for military equipment.105

To illustrate how it applies in practice, the Government said it is required to procure the future Fleet Solid Supports Ships through international competition “under our obligations set out in the Defence and Security Public Contracts Regulations 2011”.106 The MOD has also cited procurement regulations when pressured to require Auxiliary vessels to be built with British steel: “under European and UK procurement regulations, the Department could not mandate the use of particular suppliers as part of the contract”.107

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102 PQ198141, 17 December 2018
103 The introduction of these was examined in Commons Library briefing paper “EC Defence Equipment Directives”, SN04640, 3 June 2011
105 The Government laid a draft Statutory Instrument on 13 December 2018 amending the DSCPR 2011 to account for the UK leaving the EU. See section 7.1 for more on this.
106 PQ177206, 17 October 2018
107 HC Deb 6 March 2012 c662W
The Government published a five-year review of the DSPCR in December 2016. The Review found that while a clear majority of MOD procurement falls under the DSPCR and the separate Public Contracts Regulations (PCR) 2015 it has not resulted in significant increase in cross border procurement “as most suppliers seem reluctant or unable to bid across national borders”. The MOD said this was primarily due to the inherent difficulties of international business rather than any failings in the regulatory framework.

The Review found the MOD had achieved another objective of the Defence Security Directive, which was to limit the use of exemptions (under Article 346). The Review found the number of exemptions reduced from 55% to 25%. The MOD said there are no publicly available figures on numbers of exemptions used by other EU Member States and therefore cannot compare its reduction to others.108

The second Directive (2009/43/EC) simplifies national licensing procedures governing the movement of defence products and services within the EU. It was transposed into UK law through The Export Control (Amendment) (No. 2) Order 2012 S.I. 2012/1910.

Library Paper ‘Public Procurement and Contracts’ provides a broader examination of the legislation and guidance that governs (non-defence) procurement.

Advertising contracts

Tender opportunities and contracts valued at £10,000 and above are advertised on the Government’s Contracts Finder portal and on the specialist Defence Contracts Online (DCO) portal. Where applicable contracts are also advertised in the Official Journal of the European Union - The Defence & Security Regulations 2011 require contracts above certain thresholds should be advertised on the OJEU. These thresholds are set annually and can be found here.

The Government says once the UK has left the EU contract opportunities that would have been published on the OJEU will be published on a new UK e-notification service.109

6.2 Single-source procurement

Single-source procurement can be used to develop, manufacture and support a sovereign capability (such as submarines); meet urgent requirements; secure long-term partnerships with industry; contract directly with the owner of the intellectual property. The consolidation of the defence sector also means there are fewer national companies producing the high-end equipment defence needs, meaning there is sometimes only one trusted national supplier available.110

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109 Explanatory Notes to The Defence and Security Public Contracts (Amendment) (EU Exit) Regulations 2019, December 2018, para 7.24

However, the absence of competition means the MOD may not receive value for money; suppliers can set prices without the worry of being under-cut by competitors and lack incentive to improve performance or efficiency. This is not new. One analyst commenting in the late 1990s observed “the defence contractors, assured their prosperity is vital to national security, have a captive customer and no incentive to cut costs”. 

Industry competitors may also complain of an unfair playing field. Saab UK took the unusual step of publicly expressing its unhappiness with the lack of a competition for Sentry’s replacement, suggesting its “significant investment” in the UK was premised on the expectation that the MOD’s procurement methods “reflect the Government’s commitment to fair and transparent free-market competition”. 

Over the next few years the armed forces will take delivery of a raft of new equipment procured on a single source basis including submarines, maritime patrol aircraft and attack helicopters.

The regulatory framework

The Government reformed the framework for single source procurement in 2014, introducing new regulations and creating a new oversight body. The Government is currently reviewing the underpinning legislation and legislative changes may be forthcoming.

Before 2014 the governance of non-competitive contracts was reliant on a non-legally binding framework dating from 1968, known as the ‘Yellow Book’, which was overseen by the Review Board for Government Contracts. A review by Lord Currie led to the Better Defence Acquisition White Paper in 2013 and the new framework was brought into effect in The Defence Reform Act 2014 and the Single Source Contract Regulations 2014.

The new regulations place new reporting requirements on contractors to improve transparency on costs, including requiring contractors to prove costs are appropriate, reasonable and attributable, and allows the MOD to impose civil penalties if contractors do not comply. It also establishes statutory rules on contract pricing.

The regulations are overseen by a new body created by the Defence Reform Act: The Single Source Regulatory Office. The SSRO’s purpose is to ensure value for money is obtained by the Government and industry is paid a fair and reasonable price. Its functions include recommending a baseline profit rate for qualifying contracts; guidance on allowable costs; and providing opinions or a determination on issues referred by the MOD or contractors.

112 Philip Stephens, “Short range target: Tony Blair’s defence review has taken the politics out of the issue but has missed the opportunity to think 10 years ahead”, The Financial Times 25 May 1998
113 Defence Committee, ‘Letter from Andrew Walton, head of Saab UK to the chair of the Defence Select Committee’, 15 October 2018
Qualifying contracts

Not all single-source contracts come under the Single Source Regulatory Framework, however. The framework only applies to primary contracts and non-competed sub-contracts resulting from those primary contracts if they meet certain criteria. A Qualifying Defence Contract (QDC) must have a value of £5m and above (and a Qualifying Sub-Contract (QSC) a value of £25m and above) and the contract must be for goods, works or services being procured for defence purposes.

Contracts with foreign governments; for land/buildings; or those made within the framework of a cooperative international defence programme are excluded. In addition, the Secretary of State has the power to exempt a contract from the regulatory framework.114

Only 15-20% of MOD single source expenditure fell within the SSRO regime in 2016. The SSRO told the Defence Committee “having over 80 per cent of single source expenditure not subject to the price controls and transparency of the regime runs contrary to the aims of Act”.115 The Committee in turn recommended the SSRO be given the ability to inspect all single source contracts, save for exceptional circumstances.116

The Public Accounts Committee reflected the SSRO’s concern in its report: “there are still too many contracts which the Department has not brought within the scope of the regulations” including contract signed before 2014 that can be brought into the regime ‘on amendment’.117 The Government said it had a target of bringing 100% of all eligible contracts within the regulations by March 2020.118

Reforming the framework: new legislation

Section 39 of the Defence Reform Act 2014 requires the Secretary of State to review single source procurement legislation within three years of it coming into force (December 2014) and thereafter at five-year cycles, and for the SSRO to keep under review the single source contract regulations.

The SSRO submitted its review to the Defence Secretary in June 2017 (the review was published in January 2018). The SSRO recommended 14 changes to the framework, requiring amendments to both primary and secondary legislation.119

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115 Defence Committee, “Gambling on ‘efficiency’: Defence Acquisition and Procurement, 17 December 2017, HC 431 2017-19, Ev ACQ0008
118 Public Accounts Committee, “Treasury Minutes on the Government response to the Twentieth to Thirtieth Reports from the Committee of Public Accounts”, 23 May 2018, Cm 9618
The Government has not at the time of writing published its review. The Defence Secretary said in September 2018 the review of single source legislation was completed in December 2017, but he had asked for further work on the implementation of some of the recommendations made. He said the response to the SSRO’s review would be published shortly. The Government has begun to amend the regulations, however.

The *Single Source Contract (Amendment) Regulations 2018* (August 2018) narrows the criteria of the exemption for contracts made within the framework of an international co-operative defence programme and replaces the exclusion of contracts made wholly for the purposes of intelligence activities with an exclusion of those contracts where the Government thinks there is a real risk to national security. It also excludes contracts which are new but in substance a continuation of older contracts which were not qualifying defence contracts. This is expected to bring a further 8-10% of annual single source spend (£650 million to £800 million) to become Qualifying Defence Contracts. The SI was laid in June 2018 under the affirmative procedure and came into force on 1 August 2018.

Further amendments to the regulations were made in the *Single Source Contract (Amendment) (No.2) Regulations 2018*. This SI was laid in December 2018 under the negative procedure. The explanatory notes explain the principle changes made in this instrument relate to pricing amendments within the Framework and amending the time limits for making determination referrals.

Further changes to legislation are planned for 2019.

**Other issues: profit rate, savings target and tensions**

Industry have raised concerns about the baseline profit rates recommended by the SSRO. The baseline profit rate has been on a downward trajectory since the SSRO was established, from 10.60% in 2015 to 6.81% in 2018. ADS, the defence trade body, has warned further reductions could put long-term investment in the industry at risk.

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120 PQ172474, 10 September 2018
121 Letter from Tobias Ellwood to Wayne David, dated 6 September 2018, DEP2018-0873
122 Single Source Contract (Amendment) Regulations 2018 explanatory note. SI 2018/1350 was debated the House of Lords on 9 July 2018 and in the Commons on 17 July 2018. To go through the ‘affirmative procedure’ refers to statutory instruments which must be approved by both the House of Commons and the House of Lords to become law. Conversely the ‘negative procedure’ refers to statutory instruments which automatically become law unless there is an objection from either House.
123 HCWS367, 11 March 2015 and HCWS550, 15 March 2018. See also SSRO guidance on the 2018 contract profit rate and a Q&A explaining how the baseline profit rate is just one of six steps that contribute to the calculation of the contract profit rate, and that the actual profit rate achieved may be higher or lower than the agreed contract profit rate.
and called on the Government to ensure the framework incentivises innovation.124

The Public Accounts Committee has questioned the robustness of the £1.7bn savings targets the MOD believes the regulatory framework will deliver over a ten-year period.125 The MOD said it was “confident” it would meet the objective of saving £637m by 2020 and the ten-year target of £1.7bn “but this will depend on bringing the management of single source contracts under the framework”.126

Both the National Audit Office and the Defence Committee reported tension between the SSRO and industry, identifying the “SSRO’s sometimes confrontational tone”, reluctance from some suppliers to fully engage or comply with the regulations, and industry’s unhappiness with the SSRO’s interpretation of its remit. This has prompted all sides to commit to making a ‘fresh start’ in their relationships.127 George Jenkins, the SSRO’s Chairman, has said his priority is to build trusted relationships with all stakeholders.128

6.3 International collaboration

International collaboration has long been a feature of defence procurement. The most obvious reason for this is cost – big ticket items like combat aircraft are extremely expensive and additional partners can help (in theory) to diffuse both developmental and through-life costs. It can maximise capabilities, support cooperation in research and technology and increase interoperability. The drawback is the potential for complicated management structures, slow decision making and political issues, particularly if a consensus is required from all the partner nations.129

Both NATO and the EU actively encourage greater collaboration amongst Allies and Member States. Both recognise the need to increase spending on defence capabilities in Europe. NATO, for example, has long had a target for individual countries to spend 20% of its defence budget on equipment.130

The Government may look to develop capabilities bilaterally. The UK and France, for example, agreed a package of joint initiatives in the 2010 Lancaster House Treaty. The Defence Committee and its French

124 “ADS response to new baseline profit rate for single source contracts”, 15 March 2018
128 “Interview: George Jenkins”, Jane’s Defence Weekly, 14 November 2018
129 The National Audit Office found the collaborative decision making on the Typhoon was inefficient: “Management of the Typhoon project”, National Audit Office, HC 755 2010-2011, 2 March 2011. The 2012 Defence White Paper National Security through Technology acknowledged the advantages and disadvantages of multilateral collaboration, Cm 8278, February 2012, para 87
130 “The two NATO targets: Which countries are hitting the mark?”, Commons Library Insight, 29 August 2018; NATO Wales Summit 2014 Declaration, para 14
equivalent, the Assemblée nationale’s Standing Committee on National Defence and the Armed Forces, examined one of these initiatives - the Future Cruise/Anti-Ship Weapon Programme – in a joint report in December 2018.

The UK buys a significant amount of equipment (by value) directly from the US Government via its Foreign Military Sales programme. Current examples include the new P-8A Poseidon maritime patrol aircraft and AH-64 Apache helicopters. The MOD said that as of July 2017 it had more than 300 Foreign Military Sales agreements relating to equipment and support with a total value of just under $12 billion. The 2010 US-UK Defence Trade Cooperation Treaty, which came into force in 2012, simplifies transfer arrangements for certain categories of technology.

Multinational collaboration is usually undertaken by an established body or a dedicated vehicle.

Established bodies include OCCAR, the Organisation for Joint Armament Co-operation, set up in the 1990s by the UK, France, Germany and Italy (and now includes Belgium and Spain). OCCAR is not a procurement agency but manages programmes for its members. These include the A400M transport aircraft, in service with the RAF as Atlas, and the Boxer programme, which the UK has re-joined to fulfil its mechanised infantry vehicle requirement. The MOD, when questioned about oversight of the Boxer contract by the Defence Committee, said the OCCAR treaty “contains similar arrangements for collaborative programmes for participatory states. These arrangements afford the UK similar rights for transparency, cost assurance audits and progress reporting mechanisms as those required by the Single Source Regulations Office.”

The UK is currently a participating member of the European Defence Agency. The EDA is an intergovernmental agency of the Council of the European Union. It runs several capability programmes, focusing on air-to-air refuelling, remotely piloted aircraft systems, satellite communications and cyber defence. The potential impact of the UK’s withdrawal from the European Union is examined in section 7 of this paper.

Industries and nations may create dedicated vehicles to manage the production and export of a platform. Box 9 illustrates how such vehicles have been used to develop combat aircraft for the RAF.

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Box 10: International collaboration case study: Combat aircraft

The RAF’s current combat aircraft were all developed in collaboration with other nations and the Government says ‘effective international partnering’ is central to its plans for a new combat aircraft for the 2030s, as set out in the 2018 Combat Air Strategy. **Tornado** was developed as part of a three-nation development between the UK, (then) West Germany and Italy. A tri-nation consortium was formed known as Panavia Aircraft GmbH with industry partners.

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131 PQ 4693, 21 July 2017
132 HC Deb 13 September 2013 c888W
FIAT Aviazione (later Aeritalia then Alenia Aermacchi, Finmeccanica, now Leonardo), British Aircraft Corporation (later British Aerospace now BAE Systems) and MBB (later Deutsche Aerospace then EADS, now Airbus Defence and Space).

**Typhoon** is the result of a multinational collaboration between Germany, Italy, Spain and the UK, dating from the 1980s. As with Tornado, the industry partners are BAE Systems, Airbus and Leonardo. **Eurofighter** Jagdflugzeug GmbH co-ordinates the programme on Industry side while the NATO Eurofighter and Tornado Management Agency (NETMA) acts as the single point of contact for customers and governments.

The **F-35 Lightning** is a multinational collaboration with eight partner countries, led by the US via a Joint Programme Office. The UK was the only tier 1 partner nation in development of the F-35 programme. UK-based companies will build 15% (by value) of each of the estimated 3,000+ aircraft and more than 100 UK-based companies are involved in the programme.

‘**Team Tempest**’ is the Government/industry team driving Typhoon’s replacement for the mid-2030s. The Combat Air Strategy clearly states it expects the next combat air system will be designed with other nations. Doing so, it states, “offers the UK the best opportunity to deliver military capability and our wider national objectives, while maintaining operational advantage and freedom of action”. But it also notes the risks: “if badly conceived, collaboration can increase programme overheads, cause delay, increase cost and deliver sub-optimal capabilities”.

Further reading: Commons Library briefing papers ‘**The Combat Air Strategy: From Typhoon to Tempest?**’ CBP08391, 31 August 2018 and ‘**Prospects for combat air: what follows Typhoon and Lightning?**’ CBP08304, 15 May 2018
7. Brexit and defence procurement

The defence industry will be as affected as any other industry if/when the UK leaves the European Union and these issues are well-covered by other Commons Library briefing papers (for example Brexit: Public Procurement, The UK’s EU’s Withdrawal Agreement and What if there’s no Brexit deal? among many others).

7.1 Regulations

The Defence and Security Directive and Article 346 of the TFEU are the two most prominent pieces of EU legislation affecting defence procurement. The DSD has been transposed into UK law as the Defence and Security Public Contracts Regulation 2011.

Draft statutory instrument amending DSPCR

The Government laid a draft Statutory Instrument on 13 December 2018 amending the DSPCR 2011 to account for the UK leaving the EU. This is entitled The Defence and Security Public Contracts (Amendment) (EU Exit) Regulations 2019 and is under the affirmative procedure.134

The Explanatory Notes state changes will ensure the legislation continues to operate effectively after the UK leaves the EU. It amends provisions that are redundant, inappropriate or otherwise deficient within the meaning of Section 8 of the EU (Withdrawal) Act 2018. For example, it removes references to the Official Journal of the European Union and instead refers to the new single UK e-notification service, which will advertise contract opportunities.

It transfers certain powers that are exercised by the European Commission to the Secretary of State. This includes making changes to the 1958 List.

The Government also intends to amend the main legal framework for government procurement, the Public Contracts Regulations 2015, at the same time to ensure changes to both are consistent.

The text of Article 346 (with some minor adjustments to make it operable) is inserted into the draft SI (regulation 3(b)) to ensure the 2011 Regulations can still be disapplied to protect the UK’s essential security interests.

The draft SI also corrects or removes some outdated references in legislation which are not connected to the withdrawal from the EU.

134 The link to the ‘Laid before the House of Commons’ on the SI’s Parliament webpage erroneously links to the Votes and Proceedings for the 12 December 2018. The correct link should be to the Votes and Proceedings for the 13 December 2018. The Find Statutory Instruments webpage lists current SIs and can be searched by Department.
The Explanatory Notes state that the changes to the Regulations do not involve policy changes and there are no significant changes to the procedures. Further guidance will be available on the Gov.uk website.

The Government’s submission on the Defence Sector to the Committee for Exiting the European Union in November 2017 discusses other regulations and provisions affecting the defence sector including on import duties, competition law and intellectual property rights, among others.  

Directive 2009/43/EU, which provides the regulatory regime within the EU for transfers between Member States of defence products listed in the EU Common Military List, was transposed into UK law as an amendment to Export Control Order 2008. The Government’s Defence Sector report said the benefits of this Directive have been minimal as most nations continue to use individual export licenses for much of their activity.

7.2 The WTO Government Procurement Agreement

Commons Library briefing paper Brexit: Public Procurement discusses the World Trade Organisation Government Procurement Agreement in more detail, but it is worth noting here that military materiel is largely excluded from the GPA. Similar in style to Article 346 of the TFEU, Article III.I of the GPA allows any Party to take any action it considers necessary “for the protection of its essential security interests relating to the procurement of arms, ammunition or war materials, or to procurement indispensable for national security or for national defence purposes”.  

When asked about the effect of the GPA on UK defence contracts, Defence Procurement Minister Stuart Andrew said:

> The UK intends to accede to the World Trade Organisation Government Procurement Agreement on the same terms as is currently the position for the UK as an EU Member State. The UK’s final market access offer was agreed in principle on 27 November 2018. As a result, while the treatment of defence contracts is expected to remain unchanged, the Ministry of Defence is contributing to work across Government to understand the implications and opportunities of accession.

7.3 UK-EU Security Partnership and No Deal

In November 2018 the Government published an assessment comparing the UK-EU Future Security Partnership with a no deal scenario (Cm 9743). Under defence capabilities development it states:

> The UK and the EU will preserve their respective autonomy while collaborating on projects to promote the effectiveness of their

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135  “Sector report – defence sector”, Committee on Exiting the European Union, 21 December 2017
137  PQ201615, 20 December 2018
armed forces. This may include research and industrial cooperation through the European Defence Agency (EDA), European Defence Fund (EDF) and Permanent Structured Cooperation (PESCO). In a no deal scenario, the UK would not be able to participate in projects through these frameworks. The UK will continue to work to support its defence industrial base irrespective of the outcome of negotiations with the EU.

7.4 EU preparedness notices
The European Commission has published a range of Brexit preparedness notices.

The notice on Public Procurement, published in January 2018, warns the UK may be excluded from bidding for defence and security contracts in the EU and Member States will not be obliged to recognise security clearances:

As clarified by Recital 18 of Directive 2009/81/EC regulating procurement procedures by contracting authorities or entities in the field of defence and security, EU Member States will retain the power to decide whether or not their contracting authorities/entities may allow economic operators from third countries to participate in their defence and security procurement procedures. Economic operators from the United Kingdom may therefore be excluded from bidding for defence and security contracts in the EU.

Furthermore, Article 22 of Directive 2009/81/EC provides that Member States shall recognise the security clearances which they consider equivalent to those issued in accordance with their national law. Since, as of the withdrawal date, the United Kingdom ceases to be a member of the Union, EU Member States will no longer be under the obligation to recognise security clearances obtained by an economic operator in the United Kingdom, even where they could consider them as equivalent to their national security clearances. This may lead to the exclusion of operators relying on a United Kingdom security clearance in EU defence and security public procurement procedures.

The Commission also prepared a note on import/export licenses.

7.5 The UK/EU Withdrawal Agreement
The text of the negotiated Withdrawal Agreement, together with the Political Declaration on the framework for future EU-UK relations, was endorsed by EU leaders at a specially convened European Council meeting on 25 November 2018.

Library briefing paper ‘The UK’s Withdrawal Agreement’ (CBP0843) looks at the Agreement in detail including Common Foreign and Security Policy (section 5.9) while ‘The Political Declaration on the Framework for Future EU-UK Relations’ examines the principles of future cooperation in foreign policy and defence (section 5.1).

This section does not intend to replicate these briefing papers. It is worth noting what the Political Declaration says about collaboration, however. This is contained in paragraph 104 of the Declaration:

The future relationship should benefit from research and industrial cooperation between the Parties’ entities in specific European
collaborative projects to facilitate interoperability and to promote joint effectiveness of Armed Forces. In this regard, while both Parties should preserve their respective strategic autonomy and freedom of action underpinned by their respective robust domestic defence industrial bases, the Parties agree to enable to the extent possible under the conditions of Union law:

a. the United Kingdom’s collaboration in relevant existing and future projects of the European Defence Agency (EDA) through an Administrative Arrangement;

b. the participation of eligible United Kingdom entities in collaborative defence projects bringing together Union entities supported by the European Defence Fund (EDF); and

c. the United Kingdom’s collaboration in projects in the framework of Permanent Structured Cooperation (PESCO), where invited to participate on an exceptional basis by the Council of the European Union in PESCO format.

Under the current governance rules of the European Defence Fund, upon exiting the EU, UK industry will no longer be eligible to bid for either strand of EDF financing. The eligibility criteria for the EDIDP are strict and funding is only available to EU nationals and entities. The Defence Secretary suggested in late 2018 the EDF is “not necessarily something we will choose to participate in”.  

The Commons Library discusses this further in EU defence: where is it heading? (section 4.1). The Library has also written a paper on Pesco: ‘EU Defence: the realisation of Permanent Structured Cooperation (PESCO)’ which provides analysis of the Government’s position.

The Government confirmed that under a No-Deal scenario the UK “would not be able to participate in research and industrial cooperation or projects through the European Defence Agency, European Defence Fund, or Permanent Structured Cooperation”.

### 7.6 Commentary

Philip Dunne, in his report for the MOD in July 2018, suggests Brexit offers an opportunity for the MOD to look again at the procurement process and culture and consider operating as if the Defence and Security Directive and Article 346 continue to apply:

There should be a conscious strategic decision as to whether and how to take advantage of any new dispensation, rather than just a rolling over of the substance of the current process.

Dunne also suggests the MOD should consider whether and how any differing UK prosperity weighting and criteria should apply to major procurements expected to be placed after the implementing period following Brexit (if there is one) and calls on the MOD to take early

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138  HC Deb 26 November 2018 c16  
139  PQ 205231 9 January 2019  
action to “safeguard its freedom of manoeuvre in procurement post Brexit”.  

Andy Johnson of ADS similarly suggests Brexit provides an opportunity to “tweak” the current approach, specifically to modify procurement regulations to give greater weight to the prosperity impact in the UK when judging bids: “the UK must develop an approach to international defence industrial cooperation that both boosts UK business through supportive procurement legislation, and remains aligned with the regulations and standards of key target markets”. 

ADS, the aerospace, defence and security trade body, has previously described a no-deal exit to be the “worst possible outcome” for its sectors: 

The UK’s Aerospace Defence, Security and Space sectors operate pan-European, deeply integrated supply chains with just-in-time processes. Any additional administrative costs or delays, however small, in their supply chains, in delivering services or sending goods to customers would have significant commercial costs for UK companies. 

The Commons Library has compiled a Brexit Reading List on defence and security issues which is updated periodically.

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142 Andy Johnson, “A balancing act: UK defence procurement post-Brexit”, ADS blog, 5 September 2018
143 “Building Brexit: Priorities for the future UK-EU trading relationship”, ADS, October 2017. ADS has developed a Brexit Hub with information for industries in its sectors.
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