

RESEARCH PAPER

Defence Policy and Procurement

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Image: Eurofighter Jet

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EXECUTIVE SUMMARY

- The Ministry of Defence (MoD) spent £24.9 billion with outside suppliers in 2009/10.
 - The MoD's biggest supplier, by a significant margin, was BAE Systems.
 - Despite Britain's open defence market, the majority of the MoD's top suppliers are British companies. The remainder are either American or non-UK EU suppliers.
- The MoD has had a long history of getting bad value for money in defence procurement. This was exacerbated by the relatively protectionist approach of the Defence Industrial Strategy introduced by the previous Labour government in 2005.
- Following the cuts in defence spending resulting from the 2010 Strategic Defence Review the Coalition Government decided on a new more free market defence procurement policy. The 'National Security through Technology' White Paper it published in February 2012 strikes a good balance between using competition to deliver better value and making sure the UK retains domestic technology in relevant areas. It focuses on two main principles:
 - The principle of 'Open Procurement' to buy, where possible, on the open market. What matters is operational capability and value for money. Where a product is made should normally be irrelevant.
 - The principle of 'Technology Advantage' that British products should be bought in critical areas where the UK needs to support or protect an advanced technology or to secure its freedom of action, particularly during operations, or to minimise its dependence on other countries.
- The UK's new Open Procurement principle in defence seems certain to lead the UK towards purchasing more off the shelf equipment from America. This makes good sense given the continuing central importance of NATO and the USA to the UK's defence interests.
- Large European defence projects such as the Eurofighter Typhoon and Airbus have been expensive mistakes suffering from massive cost increases and delays. Their high sunk costs and the political implications of pulling out of them at a late stage mean that the UK is now irrevocably committed to them. Binding the UK to a Europe-wide defence policy and supporting further EU defence integration would not be in the UK's interests.
- Article 346 of the Treaty on the Functioning of the EU includes a clause exempting defence equipment from EU public procurement laws. However, the European Commission has recently adopted two new defence directives to enhance European defence integration.
 - The Directive on Defence and Sensitive Security Procurement, seeks to clarify and limit the scope for national governments to exempt defence equipment from EU procurement laws.
 - The Directive on Intra-Community Defence Transfers seeks to enhance the European market for defence products by establishing a common EU regime for intra-EU defence equipment transfers.

- Many of the MoD’s failures to get value for money do not stem from bad procurement policy but from cultural and institutional problems. These are harder to tackle and have persisted at the MoD for decades.
 - The MoD should follow the Public Accounts Committee’s advice in order to get better value and clearer risk assessment from its projects.
 - The MoD should take steps to stop defence contractors competitively underbidding in order to win contracts and then increasing costs once the contract has been signed.
 - The MoD and defence contractors should be made more accountable through Parliamentary hearings in the event of a project running over budget or suffering major delays. They should have to explain to such hearings why they have failed and how they will correct and learn from the mistakes made.
- Leaving the EU would of itself have little impact on the UK’s defence procurement policy. However, it would enable the UK to take a more objective approach to future large pan-European defence projects, free from the pressure of European defence integration. And the UK would become freer to pursue a strong Atlanticist approach, with NATO remaining at the heart of the UK’s defence strategy.

THE COALITION’S NEW DEFENCE PROCUREMENT POLICY

When the Coalition Government came to power in May 2010, it immediately announced a new Strategic Defence Review to help decide the future needs of the UK armed forces. This review was duly published in October the same year. Given the Coalition’s need to deal with the record budget deficit it inherited from the previous Labour Government, it was no surprise that it prescribed a major downsizing of all three armed forces with significant cuts in both capital expenditure and personnel numbers. Several large scale procurement projects were either cancelled or scaled back dramatically¹.

It was against this background that the Coalition Government released in February 2012 a new White Paper on defence procurement entitled ‘National Security through Technology: Technology, Equipment, and Support for UK Defence and Security’. The paper signals a shift back to a more free market or competitive procurement process. It states that:

“In many respects, the UK’s defence and security requirements are just like the requirement of the National Health Service to procure the equipment it needs to treat patients or the requirement of the Fire and Rescue Services to procure the equipment they need to handle emergencies. Our general policy in these and many other fields of public procurement is to use open competition to achieve value-for-money – obtaining the best products and services at the lowest possible cost to the taxpayer.

Our starting point for defence and security procurement is the same. The Open Procurement principle is:

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

¹ [Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review, October 2010](#)

In doing so, we will also seek to:

- buy off-the-shelf (an existing product already available in an open market) where appropriate, in accordance with the policies set out in this paper;
- use a common set of open principles, rules, and standards wherever possible, to ensure that we have the flexibility and agility to upgrade capability incrementally and to ensure interoperability with our key allies;
- make defence and security procurement as accessible as possible to small- and medium-sized enterprises (SMEs); and
- ensure that support services provided by industry are increasingly integrated with our defence and security agencies so they can provide assured availability during operations.

We believe that applying the principle of open procurement will result in the greatest possible value-for-money for our defence forces and security agencies. Open procurement also offers the best catalyst for UK-based industry in the defence and security sectors to be efficient and competitive – and provides them with the best chance of gaining export markets, increasing their profits and market share, and reducing the taxpayer’s cost of purchase.”²

However, the principle of “Open Procurement” is a qualified one:

“Open procurement cannot, however, be the whole answer, because the defence and security sectors are in two fundamental respects different from other fields. To defeat our adversaries and to protect ourselves at times when we most need to do so:

- we often need superior technology and other forms of battle-winning edge (so-called “operational advantage”); and
- we must be able to operate, maintain, and refresh certain capabilities effectively, without being dependent on others (so-called “freedom of action”).

As with all acquisition choices, this is subject to affordability and value-for-money. The extent to which we choose to protect our operational advantages and freedom of action always involves a balance of risk and opportunity cost.

Our principle of Open Procurement will, therefore, 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.

In doing so, we will:

- identify and, if essential for our national security, take action to protect the critical areas where the UK needs either an advanced technology to counter our adversaries or special products or services to maintain our freedom of action, particularly during operations;
- protect our ability to evaluate independently the effectiveness of technologies and equipment;

² The Ministry of Defence, ‘National Security through Technology: Technology, Equipment, and Support for UK Defence and Security’, February 2012, p13

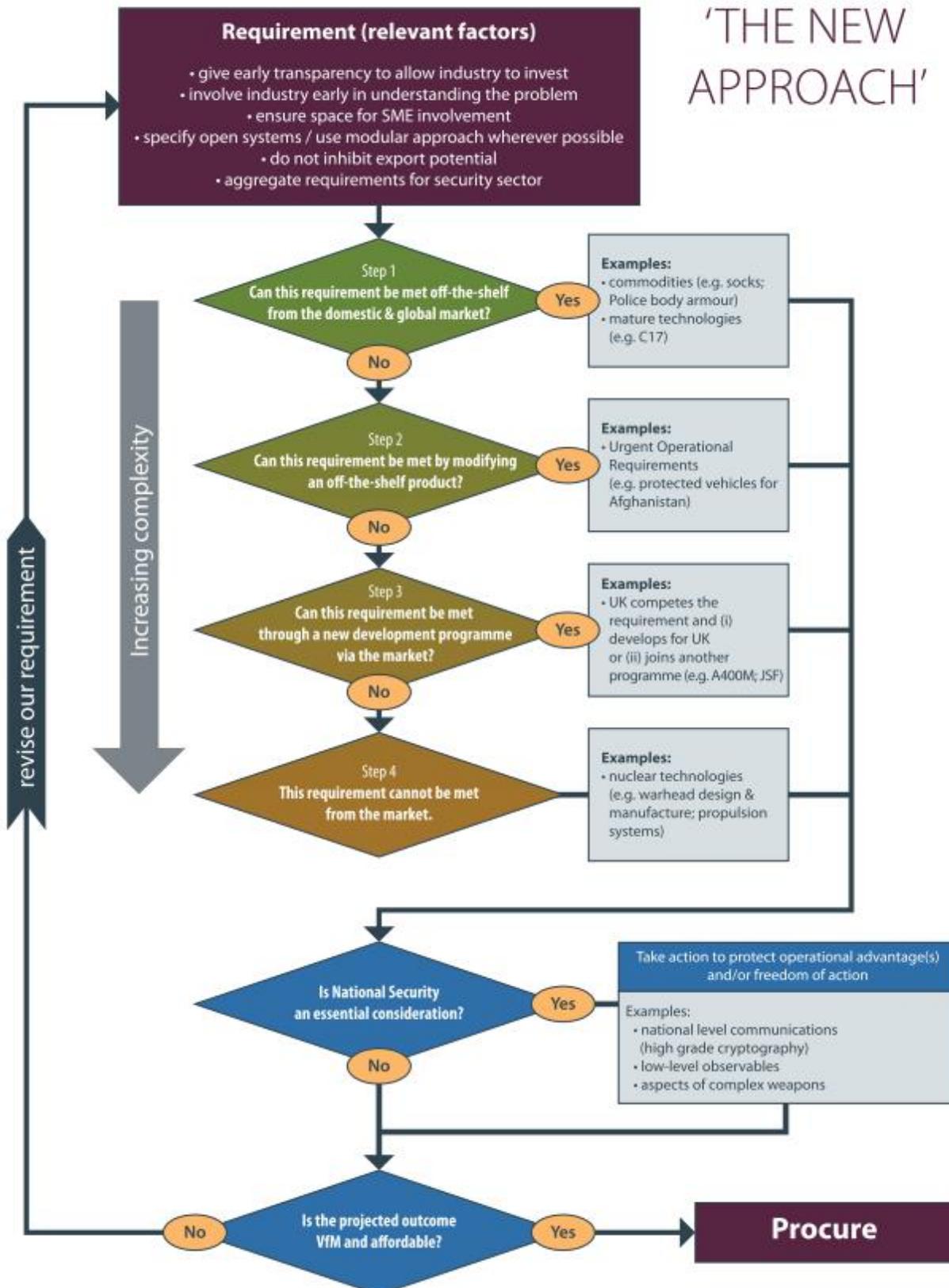
- work with close allies to develop technology, equipment, and support arrangements that meet our mutual defence and security needs;
- preserve a lean but effective group of highly skilled people within our defence and security establishment who are capable of acting as intelligent customers for such advanced technologies and support services;
- retain within Government research organisations those specific capabilities which are essential for our national security and use these organisations in a more coherent way to give us the greatest possible scope for technological advance; and
- work closely with potential suppliers to ensure that they have a full understanding of our future requirements, so that they can develop appropriate advanced technologies and healthy supply chains.

We will also seek to minimise the costs of obtaining operational advantage and freedom of action by, wherever possible:

- integrating advanced technologies into standard equipment purchased through open procurement;
- sharing and developing appropriate technologies with our key allies;
- seeking the best and most advanced civilian technology that can be adapted and incorporated into defence and security equipment to give us operational advantage; and
- making the greatest possible use of synthetic training and simulation to reduce the cost of training personnel, particularly when applying advanced technologies to new capability needs.”³

³ The Ministry of Defence, ‘National Security through Technology: Technology, Equipment, and Support for UK Defence and Security’, February 2012, p14-15

The following diagram illustrates the new decision making process to be taken in meeting both the “Open Procurement” and “Technology Advantage” principles⁴:



⁴ The Ministry of Defence, 'National Security through Technology: Technology, Equipment, and Support for UK Defence and Security', February 2012, p16

The White Paper's approach of balancing Open Procurement with Technological Advantage does not seek a revolutionary change to defence procurement, but instead to rebalance the perceived problems with the Defence Industrial Strategy, moving the focus back onto competition, but with some of the qualifications that the DIS brought to the forefront of its defence procurement approach. It should ensure that the UK receives better value for money while maintaining an important level of UK based technological advantage.

While operational independence should be considered, the White Paper's focus on Open Procurement is the right one. The comparison with the NHS is also apt – few people care if the drugs they take were developed in America or the MRI scanner they use was built in Germany – they care about whether they are made healthy or not. The same is true of our armed forces, as former Defence Select Committee Chairman, Bruce George MP puts it, “the soldier wounded on the battlefield does not think ‘Good, this field ambulance was made in Cambridge or Solihull’ but ‘Is this ambulance going to save my life?’⁵

What matters is operational capability and value for money; where the product was made is largely irrelevant. Where it can be argued that ‘not buying British’ would result in a serious loss of technology or capability, the principle of ‘Technological Advantage’ will mean that this is an important consideration for such contracts.

⁵ Antonia Cox, ‘More bang for the buck: How we can get better value from the defence budget’, Centre for Policy Studies, January 2009, p14

WHO SUPPLIES THE MOD

According to Freedom of Information (FoI) requests, The Ministry of Defence spent £24.9 billion with outside suppliers in the year ended 5th April 2010⁶. This includes suppliers of non-military equipment and services (e.g. IT systems) as well as military suppliers.

The supplier with the largest revenues from the MoD was BAE Systems, which received nearly £4 billion in defence contracts, nearly four times as much as its nearest competitor, Babcock. As such, BAE Systems is probably the largest commercial supplier to the UK government.⁷

The table below shows the MoD's top 14 suppliers (those with contracts worth over £0.1 billion) in the year to 5th April 2010.

Supplier (including subsidiaries)	Aggregate value of contracts awarded Year to 5 th April 2010 £ billions	Proportion of total MoD spend with outside suppliers %
BAE Systems (UK)	3.98	16.00
Babcock (UK)	1.11	4.46
Serco (UK)	1.05	4.22
Finmeccanica (Italy)	0.81	3.26
Thales (France)	0.43	1.73
Rolls Royce (UK)	0.36	1.45
Interserve (UK)	0.34	1.37
US Government and Treasury (USA)	0.33	1.33
Carillion (UK)	0.31	1.25
Boeing (USA)	0.25	1.01
VT (UK – acquired in July 2010 by Babcock)	0.23	0.92
Lockheed Martin (USA)	0.21	0.84
Le Grand Annington (UK)	0.16	0.64
Cobham (UK)	0.10	0.40
Others	15.20	61.12
Total	24.87	100.00

Most companies in the above table are suppliers of defence equipment. However, Serco provide a large variety of services, while Interserve are involved in construction and support services and Le Grand Annington build housing for soldiers.

Despite the UK having one of the world's most open defence procurement markets, British firms still dominate the list of top suppliers. BAE Systems, Babcock and Serco, the MoD's three largest suppliers are all British. Altogether six of the top 10 suppliers are UK based. This is in spite of America being home to most of the world's biggest defence contractors, which have clear economies of scale compared to BAE Systems. Lockheed Martin, the world's largest defence contractor and the designer of Trident, ranked only 12 in the above table.

⁶ The Guardian datablog, 'Mod top 100 suppliers', December 2010:

<http://www.guardian.co.uk/news/datablog/2010/dec/01/mod-top-suppliers-bae>

⁷ No central figures are produced by the government on public procurement. But as the largest supplier to the MoD, a department with very high procurement spending, it seems probable that BAE Systems is the UK Government's largest supplier.

RECENT HISTORY OF UK DEFENCE PROCUREMENT POLICY

Prior to the new White Paper on 'National Security through Technology: Technology, Equipment, and Support for UK Defence and Security', UK defence procurement had been through two distinct phases since the 1980's. The first was the policy of introducing greater competition, brought in by Lord Levene when he became Chief of Defence Procurement in 1985. The second, the 'Defence Industrial Strategy' (DIS) was introduced by the Labour Government in the December 2005 White Paper of the same name and lasted until it was replaced by the Coalition Government's new White Paper.

Levene Reforms (1985)

Peter Levene (now Lord Levene) served as Chief of Defence Procurement for 6 years between 1985 and 1991 in Margaret Thatcher's government and undertook major reform of defence procurement. Levene scrapped the old system of "cost plus contracts" where the contractor was paid for the value of its goods in addition to an agreed profit. This was replaced by "fixed price contracts", which transferred the burden of risk to the contractor, as a fixed price was agreed in advance so that if costs overran the contractor would not see a profit. The previous concept of "national champions", i.e. favoured British industries, was abandoned, and open competition became the prime principle in defence contracts. This made Britain the "only truly open defence market of any size"⁸, where domestic and foreign firms competed on a level playing field.

Levene's reforms were generally thought to be a success, generating a more commercial culture and achieving cited savings of 10 per cent across procurement contracts. However many of the projects tendered during the late 80's and early 90's suffered from severe delays and overruns, with contracts being renegotiated privately to ensure the companies could still deliver, leaving the MoD with extra costs which were not publicly disclosed. In some cases savings were made by simply reducing the quantities ordered.⁹

However, despite the focus on competition, exceptions were sometimes made in order to promote UK industrial and technological interests, even when overseas competitors had clear cost advantages. An example of this was in 1995 when the Government decided to split an order of helicopters between the UK based Westland (with whom they ordered 22 relatively expensive EH101s) and the American based Boeing (with whom they ordered eight less expensive Chinooks).

Malcolm Rifkind, Defence Secretary at the time gave the following explanation, "The costs of introducing an additional helicopter type into service and creating a mixed fleet are inevitably higher than those of an all-Chinook fleet. In reaching this decision, the Government have also taken full account of the wider implications for the aircraft industry. They have invested some £1.5 billion in the development of the EH101 family, which is central to Westland's comprehensive design and manufacturing capability...and it will help to secure the future of the United Kingdom helicopter design and manufacturing capability and so strengthen the United Kingdom's aerospace industry."¹⁰

Westland Helicopters had also been at the centre of the 'Westland scandal' in 1986 when Defence Secretary Michael Heseltine resigned from Margaret Thatcher's Government due to a conflict over a foreign bailout for Westland. Heseltine had wanted a consortium of EU companies to help the struggling UK company, while Thatcher and Trade and Industry Secretary Leon Brittan favoured the American firm, Sikorsky. Heseltine felt that there needed to be a strong European defence industry and didn't want the

⁸ Graham Warwick, 'Best of British' in 'Flight International', 6th July 2004:
<http://www.flightglobal.com/news/articles/best-of-british-183822/>

⁹ Dr Steven Schofield, 'The UK Defence Industrial Strategy and Alternative Approaches', British American Security Information Council, March 2006, p4

¹⁰ Ibid, p5

UK to become militarily dependent on America. This argument over the need for Britain to choose between a more Atlanticist outlook and European integration still punctuates much of the defence debate today. Ultimately in the case of Westland, Heseltine's resignation failed to change the Prime Ministers' support for Sikorsky, who successfully secured the deal to invest with Westland.

Defence Industrial Strategy (2005)

The Defence Industrial Strategy (DIS) was introduced in 2005, following on from Labour's earlier Defence reforms like 'Smart Acquisition', which did not fundamentally alter Levene's policy but aimed to promote a more cooperative relationship with defence suppliers. The DIS sought to alter the procurement policy Levene's reforms had left in place. The White Paper sought to "consider carefully which industrial capabilities we need to retain in the UK to ensure that we can continue to operate our equipment in the way we choose to maintain appropriate sovereignty and thereby protect our national security."¹¹ It also aimed to "promote a sustainable industrial base, that retains in the UK those industrial capabilities needed to ensure national security."¹² Open competition was to be replaced with maintaining British strategic interests.

However the importance of competition and achieving value for money was not abandoned: "We also recognise that the bedrock of our procurement policy has to be long-term value for money. Competition is often a useful mechanism to establish this, but is not always appropriate, and needs to be used intelligently, alongside other models, considering the nature of the marketplace."¹³

The DIS sought to maintain "sovereign capability" (the ability for Britain to take independent military action, in its own national interests, without being reliant on other countries) and revived the idea of "national champions" – companies who would be leading innovators and suppliers in providing UK defence equipment. The DIS pinpointed specific sectors of the defence industry where being dependent on foreign suppliers had the possibility of harming Britain's ability to act independently and undermine our sovereign capability.

Dr Steven Schofield, a researcher for BASIC (the British American Security Information Council), highlighted the DIS's "great clarification" towards the "policy of protecting those industrial and technological capabilities deemed essential for national security."¹⁴ The DIS identified such capabilities as including "the design of complex ships; nuclear submarines; armoured fighting vehicles; fixed-wing aircraft; helicopters; general munitions; complex weapons; command and control; chemical, biological, radiological and nuclear protection; and test and evaluation",¹⁵ All of these involved "high-technology capabilities and a long-term commitment by the government to support military R&D and procurement in the UK."¹⁶

The DIS was widely seen as confirming BAE Systems' previously tacit position as the UK's leading "national champion" in defence procurement. After the publication of the DIS, the then CEO of BAE

¹¹ The Ministry of Defence, 'Defence Industrial Strategy', December 2005, p2

¹² *Ibid*, p6

¹³ *Ibid*, p7

¹⁴ Dr Steven Schofield, 'The UK Defence Industrial Strategy and Alternative Approaches', British American Security Information Council, March 2006, p7

¹⁵ *Ibid*, p7

¹⁶ *Ibid*, p7

Systems, Mike Turner said “If we didn't have the DIS and our profitability and the terms of trade had stayed as they were... then there had to be a question mark about our future in the UK.”¹⁷

Although the DIS represented a move away from the procurement policy he had introduced, Lord Levene commented that in trying to balance value for money and competition with maintaining a viable industrial base and sovereign capability, the DIS “tries as well as it can to steer a middle course and to achieve as much as it can in both directions. ...We will never have a perfect solution.”¹⁸ Levene’s comments suggested the reforms did not totally disregard his earlier focus on competition, but in keeping with New Labour’s classic approach, sought to carve out a ‘middle way’.

A RUSI (Royal United Services Institute) paper analysing the defence industry’s response to the DIS found that “Industry widely sees DIS as a very positive initiative in addressing the realities of a changing defence market for the UK and in identifying realistic courses of action. Industry is impressed that the White Paper was clearly born of a business mindset and that industry was engaged in its development.”¹⁹ The RUSI paper also concluded that, “Appropriate sovereignty implies a premium to retain industrial capability onshore”, recognising thereby that the DIS focus on “sovereign capability” inevitably entailed higher procurement costs than the previous ‘open tendering’ approach.

THE EU AND DEFENCE PROCUREMENT

Defence procurement in the EU has historically seen EU member states purchase products on the basis of their own national contract rules and negotiations. This has meant there have been significant differences in the tendering processes and the criteria for winning contracts between different member states. However, the European Commission continues to push for further EU defence integration with the aim of creating a European defence market and more common rules across the EU.

EU defence procurement law

General public procurement across the EU falls under the scope of Directive 2004/18/EC. However under Article 346 of the Treaty on the Functioning of the EU (TFEU Lisbon), previously Article 296 of the Treaty establishing the European Community (TEC), the procurement of equipment, supplies, services and works intended for defence or military purposes or deemed of importance to national security can be made exempt from the Directive. This allows Member States to largely set their own rules for the tendering of defence related contracts. Article 346 provides that:

1. The provisions of this Treaty shall not preclude the application of the following rules:

(a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security;

(b) any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

¹⁷ Douglas Barrie, ‘British Defence Industrial Strategy secures BAE systems as UK champion’ in ‘Aviation Week’, December 17th 2005:

http://www.aviationweek.com/aw/generic/story_generic.jsp?channel=awst&id=news/12195p1.xml

¹⁸ Duncan Macrae, ‘New deal for UK industry: the MoD’s new Defence Industrial Strategy offers opportunities at least for the primes, but implementation will be key’, Aerospace Media Publishing, Summer 2006:

http://findarticles.com/p/articles/mi_hb3126/is_684/ai_n29276249/

¹⁹ RUSI, ‘The Defence Industrial Strategy: An analysis of Industry responses’, p3

2. *The Council may, acting unanimously on a proposal from the Commission, make changes to its list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply.*

As the House of Commons Library explains, “Under the provisions set down in clause 1 (b), civilian goods or those not intended for military purposes, even if purchased by the defence ministry of a Member State, are not covered by the exemption” provided under the above-mentioned paragraph 1 (b).

Member States have tended to adopt a broad interpretation of Article 346, applying the exemption to the vast majority of defence procurement contracts. Consequently, defence procurement has been conducted on the basis of individual Member States regulations and guidelines, which differ extensively. Some Member States have a greater focus on security of supply and securing domestic jobs (workshare), while in other countries these factors are given little weight. The UK has generally pursued a largely free market approach (even the DIS was more market orientated than many EU equivalents), with an emphasis on competition to secure value for money, while other Member States have more protectionist practices.

However the European Commission has continued to seek further integration of EU defence procurement. In 2005 it published new proposals for improving efficiency and competition in the EU defence market. More recently it has taken various measures to open up the European market and to clarify the types of exemption available under Article 346, including its 1958 list. In particular there have been two recent directives specifically aimed at defence procurement.

EU Directive on Defence and Sensitive Security Procurement

The first of these directives was the EU Directive on Defence and Sensitive Security Procurement²⁰ which was adopted in July 2009. This directive amended EU Directive 2004/18/EC by bringing harmonised rules on the procurement of defence and security sensitive equipment with the express aim of restricting use of the Article 346 exemption to “clearly exceptional cases.”²¹ It laid out a unique defence and security sector procurement framework with the aim of limiting the areas where a member state’s essential security interests could be held to be at risk, e.g. security of supply.

The Directive’s remit covers all military equipment detailed in the Commission’s 1958 list, although its guidance notes state that “the 1958 list does not necessarily give an exhaustive description of its scope with regard to the supply of military equipment.”²² The Directive states that the list “is to be interpreted in a broad way in the light of the evolving character of technology, procurement policies and military requirements which lead to the development of new types of equipment.”²³ This provision allows for technological advances in military equipment since the original 1958 list, in IT software for example.

Where the protections provided in the Directive are deemed insufficient to protect a Member State’s ‘essential security interest’, the state in question will be able to invoke the protections outlined in Article 346. Member States will have the sole responsibility for determining what is deemed an ‘essential security interest’, but must take decisions based on a case by case basis and against guidance laid down in the Interpretative Communication attached to the Directive and set down in ECJ case law.

²⁰ The Directive is officially titled, ‘Directive 2009/81/EC of the European Parliament and of the Council on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security.’

²¹ European Commission, ‘Directive 2009/81/EC, Guidance Note’, p2

²² *Ibid*, p4

²³ *Ibid*, p4

EU Directive on Intra-Community Defence Transfers

The second of the Commission's recent defence directives was the EU Directive on Intra-Community Defence Transfers²⁴, which was adopted in May 2009. According to Article 1 of the Directive "the aim of the directive is to simplify the rules and procedures applicable to the intra-EU transfer of defence-related products in order to ensure the proper functioning of the internal market"²⁵.

The Commission argued that the introduction of such legislation would increase the competitiveness of the defence industry; benefit SMEs access to the defence market; offer economies of scale; benefit large industrial groups with subsidiaries in several Member States and enable those States to meet military needs at lower cost and enhance security of supply. Facilitating intra-community transfers was also regarded as an important step towards making the defence market more effective by eradicating the possible risk that sourcing from a European competitor instead of a national producer would carry an administrative burden thereby persuading a Member State to procure from the latter.

The right for Member States to issue or reject export licenses remains at their discretion with export control policies being decided nationally. However the Directive requires the 27 national regimes which exist for intra-community defence transfers to be replaced by a single EU wide licensing authority. But Member States retain a safeguard option of individual licensing for areas deemed as 'essential national interests'.

EUROPEAN DEFENCE PROJECTS

While the European Commission has sought further integration of the European defence market to provide more effective procurement and competition, this has not always had the outcomes it desired. Many pan-European defence projects have proved to be costly mistakes, driven by the desire for a grand 'European project' rather than by the needs of the armed forces.

Eurofighter Typhoon and Airbus

The Eurofighter Typhoon project, a pan-European defence programme to build a new fighter jet and perhaps the most high profile and public example of pan-European defence procurement, has rightly been criticised for being both massively costly (with many overruns) and now strategically defunct.

The Public Accounts Committee April 2011 report on the Eurofighter Typhoon project highlighted its delays and cost increases. As of April 2011 the overall cost of the project had risen to £20.2 billion from an initial estimate of £16.7 billion. Due to budget constraints the UK had also cut its order from 232 planes to 160. This has meant the cost per plane increasing by 75 per cent from £72 million to £126 million. Thus, since the project's inception in the 1980s, the project's cost has risen by £3.5 billion whilst the number of planes to be delivered has fallen by nearly one third²⁶. The appropriateness of the project is also in question as Typhoons are designed to maintain air superiority in dogfights with Russian MIGs rather than carry out ground attack missions. Adapting the Typhoon to increase its air to ground capabilities would add further delays and costs to the project.

²⁴ The Directive is officially titled, 'Directive 2009/43/EC of the European Parliament and of the Council on simplifying terms and conditions of transfers of defence-related products within the Community'

²⁵ European Commission, 'Directive 2009/43/EC', p4

²⁶ Public Accounts Committee, 'Management of the Typhoon Project', 4th April 2011:
www.publications.parliament.uk/pa/cm201011/cmselect/cmpublic/860/86003.htm

The American Joint Strike Fighter (JSF) could have easily provided a cheaper and more versatile alternative. As its name suggests, the JSF is capable of both air defence and air to ground roles. Its estimated cost of £25 million per unit would have been only *one fifth* of that of the Eurofighter Typhoon²⁷. However, there is little possibility of switching to the JSF, owing to the high sunk costs and the political implications of abandoning the project at such a late stage. An earlier decision to forego a European alternative in favour of the American JSF would have saved the UK taxpayer billions and increased the RAF's operational effectiveness. Instead the European project has ended up a costly mistake.

In 2004, Sir John Nott, Defence Secretary from 1981-83 said that the Eurofighter project was kept alive for protectionist rather than national security interests, "if we didn't do something to keep the design teams going at Warton (the British Aerospace facility in Lancashire) probably the military aircraft capability in this country was going to fold and I don't think I wanted that to happen, because of jobs." But in retrospect he saw his decision to keep the Eurofighter project going as "one of the worst decisions I made at the MoD."²⁸

Another example of the follies of building up 'domestic' European defence can be seen in the £17 billion Airbus A400M project. This military transport aircraft is already four years late and over £850 million over budget. Buying the American alternative, the US C-17, would have saved time, money and ultimately soldiers' lives.

It should be noted that both the Eurofighter and Airbus are inter-governmental rather than European Union projects, but they serve as ready examples of the perils of trying to build up domestic European industry instead of buying off shelf alternatives from the Americans or other allies. The combination of protectionism and European defence integration serves neither the interests of the UK taxpayers nor its armed forces. As Bernard Jenkin MP says, "If there is a piece of kit available from the US there is simply no point in reinventing the wheel at an exorbitant cost to protect European industries."²⁹

The UK's new aircraft carriers

Failures in defence procurement have not been limited to complex inter-country projects. There have been massive problems developing the UK's new aircraft carriers and the planes that will operate on them.

The 1998 Strategic Defence Review took the decision to replace the UK's three 'Invincible Class' aircraft carriers with two larger and more versatile carriers, capable of carrying longer range fighters. The Labour Government signed contracts with delivery dates of 2016 for the HMS Queen Elizabeth and 2018 for the HMS Prince of Wales. The carriers are being constructed by 'Aircraft Carrier Alliance', a joint venture between three companies, BAE Systems, Thales UK and Babcock.

The 2010 Strategic Defence Review took the decision to 'mothball' the first new carrier and keep it in place as a reserve, while the second carrier will now only enter into service in 2020. In addition the Government decided to retire the existing Invincible Class carriers and Harrier planes in order to save £1.6 billion. Chairman of the Public Accounts Committee, Margaret Hodge MP, summarised the result as follows: "Rather than two carriers, available from 2016 and 2018, at a cost of £3.65 billion, we will now

²⁷ Bernard Jenkin, 'A Defence Policy for the UK: Matching commitments and resources', Conservative Way Forward, November 2007, p50

²⁸ Antonia Cox, 'More bang for the buck: How we can get better value from the defence budget', Centre for Policy Studies, January 2009, p12

²⁹ Bernard Jenkin, 'A Defence Policy for the UK: Matching commitments and resources', Conservative Way Forward November 2007, p56

spend more than £6bn, get one operational carrier and have no aircraft carrier capability until 2020 - almost a decade.”³⁰

In the interim period Britain will rely on the French ‘Charles De Gaulle’ carrier for aircraft support, having signed an agreement on defence cooperation in November 2010, with shared use of aircraft carriers being an area earmarked for further cooperation.

The Government also took the decision to convert the two new carriers to carry a different type of Joint Strike Fighter (JSF) aircraft. Initially the carriers had been designed to carry Short Take-Off and Vertical Landing (STOVL) planes, the Lockheed Martin F-35B, but then the Coalition Government decided to convert the carriers to use the F-35C variant, known as the ‘cats and traps’ version, which launches by catapult. The Government hoped that this conversion would save money and allow greater interoperability with both American and French carriers and planes that use the catapult system.

However, the estimated costs of converting the carriers soon increased dramatically. Consequently, in May 2012, Defence Secretary, Philip Hammond, announced that the Government would reverse their decision and go back to the original plan of using the STOVL planes, as the increased costs of converting the carriers to launch the ‘cats and traps’ variant would wipe out any potential savings. Luke Coffey, a Special Advisor to former Defence Secretary to Liam Fox said that “during the SDSR process Ministers were told by MoD officials that the estimated cost for installing ‘cats and traps’ on just one of the new Queen Elizabeth Class carriers was between £350m to £500m. Although installing ‘cats and traps’ meant a slight delay to the carriers it seemed to be worth it. There was a view that for once decisions needed to be taken in the long-term interests of defence and not in the short-term interests of politics.”³¹ However, this soon changed; “We now know that this decision was based on poor advice to Ministers. Only 12 months after the SDSR was published the estimated cost of installing ‘cats and traps’ on one carrier had increased to £2 billion—more than the Foreign Office’s annual operating budget.”³²

Shadow Defence Secretary, Jim Murphy said that Coalition Government’s u-turn on the carriers planes amounted to “one of the biggest public procurement messes for many decades.”³³ Luke Coffey made clear that it was not an uncommon occurrence; “Sadly, I saw similar examples of this play out time and again whilst working in the MoD. Advice would come up to Ministers that would regularly change or simply be incorrect. This would make Ministers hesitant to make definitive statements on matters of policy for the fear that they would later be told that what they said was wrong. Many times, especially during the pressure cooker environment that preceded the SDSR’s publication, officials would tell Ministers more of what they wanted to hear, instead of what they needed to hear.”³⁴

It is clear from what has happened with the aircraft carriers that significant problems in defence procurement are not confined just to large European projects, but are also common to most UK large scale defence projects. Nevertheless European scale defence projects are likely to be particularly vulnerable to long delays and cost increases owing to their huge inter-governmental scale.

THE IMPORTANCE OF NATO, AMERICA AND THE EU

Looking at the UK’s wider defence interests, the importance of the USA and more generally NATO to the UK’s larger defence strategy cannot be overlooked. The UK has not conducted any large scale military

³⁰ Margaret Hodge, quoted by the BBC, ‘Defence Cuts: Carrier ‘fully operational in 2030’, 29th November 2011:

³¹ Luke Coffey, [‘The Government made the right decision on the Joint Strike Fighter’](#), Conservative Home, 12th May 2012

³² Ibid

³³ The Daily Telegraph, [‘Cameron is advised to ditch fighter jet plan’](#), 19th March 2012:

³⁴ Luke Coffey, [‘The Government made the right decision on the Joint Strike Fighter’](#), , 12th May 2012

action in the past 30 years without the USA. The Gulf War, Bosnia, Kosovo, Afghanistan, Iraq and most recently Libya, have all been operations conducted with either American support or led full on by America. Europe at large has only had a smaller role in supporting such conflicts for example in Afghanistan, and where it has been involved it has been through NATO. In other cases, such as in Bosnia, Europe has only dragged its feet or been outright opposed as in the case of Iraq. The UK's strategic interests have therefore always tended to lean towards a closer relationship with the USA.

Consequently, seeking to promote a united 'European defence' or defence industry as a way forward for the UK, runs counter to our interests. Buying European, or participating in costly pan European defence initiatives is not only a waste of taxpayers' money, as the Eurofighter project demonstrates, but also far more likely to limit our operational capability than buying American.

More widely the UK's commitment to NATO, which the UK Foreign and Commonwealth Office describes as "the bedrock of our defence"³⁵, already implies a limit on our ability to act unilaterally. Given historic precedents and current strategic commitments, neither procuring from American suppliers nor procuring from European suppliers would be likely of itself to have serious adverse consequences for the UK's freedom of action although, as argued above, a specific policy to 'Buy European' would have. We remain highly reliant on the USA for the operational capability of our Trident-based nuclear deterrent, arguably our most vital single source of national security. Given our already interdependent relationship with America and Europe through NATO, it would surely be both costly and unwise for the UK also to participate directly in the build-up of a domestic European defence industry,

THE MOD'S FAILURE TO GET VALUE FOR MONEY

While defence procurement has undergone several structural reforms, there has been a consistent failure to deliver projects on time and on budget. There have been endless examples of waste, delays and contracts being cancelled with billions already spent.

The Public Accounts Committee (PAC), which scrutinises public spending, has highlighted numerous failings in the MoD's ability to deliver. In its most recent report it concludes that "The Ministry of Defence (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."³⁶

The PAC report looked at the MoD's biggest procurement projects. It found that in the year to 5th April 2011 alone the forecast cost of completing the 15 largest defence projects increased by £466 million. Their aggregate cost had increased by 11 per cent since their original approvals, from £54 billion to approximately £60 billion. The aggregate delay in the 15 projects compared to their originally planned completion dates was no less than 27 years.³⁷

Looking at specific projects, the PAC report found that larger, big ticket items tend to be more prone to running over budget or experiencing serious delays, "Large defence equipment projects have contributed disproportionately to overall cost growth. In the past, the Department has repeatedly failed to challenge unrealistically low estimates for the largest and most complex equipment projects from suppliers. The Astute submarines have been delayed, leading to increased costs of £1.9 billion. The cancellation of the Nimrod surveillance plane project following the 2010 Strategic Defence Review resulted in £3.4 billion

³⁵ Foreign and Commonwealth Office, '[NATO and the UK](#)'

³⁶ House of Commons Committee of Public Accounts, "Ministry of Defence: The major projects report 2011', Feb 2012, p3

³⁷ *Ibid*, p3

being wasted with no new capability being added. In the case of the Queen Elizabeth aircraft carriers the forecast cost has so far risen by £2.8 billion since they were first approved in 2008. The taxpayer has had to pick up the bill when decisions on these projects were taken.”³⁸

However, some progress had been made in reducing these failures: “Projects approved since 2002 have shown significantly lower overall cost growth than those approved before this date and since 2008 there has been no overall cost increase from project-specific technical issues.”³⁹ The PAC report also concluded that the MoD has managed to get its budget “broadly in balance”, successfully closing the large deficit in its accounts; however the PAC remains critical, saying that the future of the MoD’s budget is still uncertain despite the 2010 Strategic Defence Review and two further efforts to make savings. Overall it commented that, “The Department needs to be much better in managing its contracts by identifying and managing risks. The Department should better understand their contractors’ costing assumptions to ensure a sufficiently robust challenge to those assumptions.”⁴⁰

Additionally, the PAC identified the problem of the “Senior Responsible Owners” (SROs) who manage contracts being continually overstretched. “The Department has yet to make formal changes to ensure that SROs remain in post during key phases of a project lifecycle. We have heard evidence that some SROs still have responsibility for too many multi-billion pound projects, and are concerned that SROs are not sufficiently empowered and do not have the necessary authority and status. In future, we expect the Department to be able to show us that the turnover of SROs has slowed and that it is increasingly rare for an SRO to oversee too many projects.” In order to ensure a more effective system of scrutiny and oversight into contracts and problems they may face changes must be made to the way SROs operate. Keeping the same SRO in charge of a contract throughout its lifecycle and ensuring SROs have the time to concentrate on just one or two contracts rather than half a dozen will provide a better system of procurement.

Changing an institutional culture is a difficult task, and one that cannot be brought about simply through changes in policy. However, these smaller changes, combined with a longer term change in the MoD’s culture to include greater foresight and risk perception should gradually see these problems reduced.

The current Defence Secretary, Philip Hammond, appointed in October 2011, also points to an institutional problem at the MoD: “the big problem we have had in the past is what I call the conspiracy of optimism between the military, the MoD and the defence contractors.”⁴¹ Hammond believes this culture of unwarranted optimism has meant expensive delays and cost overruns, as all parties involved in the defence contracts overlook potential problems or pitfalls.

Even as long ago as 1961, the Gibb-Zuckerman report on MoD research and development was detecting problems still familiar today such as poor initial estimates of time and cost, failure to define the capability required and to define performance parameters and failure to identify technical risks⁴². The ‘conspiracy of optimism’ continues to cause such crucial areas to be overlooked. MoD officials remain keen to strike low cost/high delivery deals and, as the Public Accounts Committee also explain, later get promoted without having to see through the end of long term contract. This is a particular problem in the case of Senior Responsible Owners, who oversee entire projects. If costs balloon in later years they will already be working on something else and no longer be accountable for the project.

³⁸ Ibid p3

³⁹ Ibid, p5

⁴⁰ Ibid, p6

⁴¹ Philip Hammond, Interview in ‘The Daily Telegraph’, 3rd March 2012

⁴² Antonia Cox, ‘More bang for the buck: How we can get better value from the defence budget’, Centre for Policy Studies, January 2009, p23

Defence contractors have a similar tendency to overlook such problems, adopting a ‘must win/bid low’ strategy in order to secure contracts. In the knowledge that cancellations are rare, because they are both costly and embarrassing to the MoD, contractors can knowingly underbid to win contracts knowing that should problems arise the MoD will stump up the money in order to complete the contract. The incentives to submit over optimistic bids are strong.

The late Sir Raymond Lygo, former head of British Aerospace (now BAE Systems) confirmed that BAE used to deliberately underbid in order to win contracts. “It’s a well-known fact, whether anybody admits it or not, [that] you’ll never get any programme through government if you ever revealed the real cost. Whatever you want to get through government, you first have to establish what is the Treasury likely to approve of in terms of money? And then you think, what can you offer for these terms within the parameters that have been set?” As a result, Lygo said that BAE would submit low bids in order to win a contract and then inflate the contract’s price after a deal had been agreed and it would be politically difficult to cancel it; “And so then the price goes up and they have a decision about whether they are going to continue or cancel. And then the cancellation costs will be greater than continuing with it. So normally you say ‘Ok we’ll continue.’ But that’s life in Whitehall, I’m afraid.”⁴³

In her pamphlet, ‘More Bang for the Buck’, Antonia Cox suggests that “the lack of transparency, both in the MoD and in industry has the effect of allowing mistakes to go unpunished.” In order to bring about the cultural change necessary to relieve the ‘conspiracy of optimism’ more openness is needed. Cox points to US practise as offering a good solution; “In the US, when a programme breaches its cost ceilings, the Department of Defence has to testify before Congress that there are no alternatives to continuation. A similar approach here would encourage less unrealistic forecasts.”⁴⁴ Clearly, subjecting the failures of both civil servants and defence contractors to parliamentary scrutiny would be a welcome step forward. Making the relevant parties publically reveal where things had gone wrong (for example, with delays or increased costs to a project), how they would fix them and how future mistakes would be avoided would boost accountability and ensure that deliberate underbidding was avoided.

CONCLUSIONS – WHAT IF THE UK LEFT THE EU

In practice the EU currently has little impact on UK defence policy, which tends to be more open to competition than is required by EU directives. Consequently, leaving the EU would have little impact on UK defence procurement. Of greater importance is wider European Defence co-operation, which the UK could still play a significant part in outside the EU given its largely intergovernmental nature. However given the previous poor performance and value for money of such projects, most notably Eurofighter, the UK would often be better opting for readily available American alternatives, rather than seeking to procure a European product with the costs and time this entails.

The sunk costs of the UK’s current European projects like the Eurofighter, and the further cancellation costs that would be incurred by abandoning them, mean that it would not be worthwhile cancelling them so far down the line. However in future, freed from EU pressure for further defence integration, the UK would not need to take such costly risks.

By leaving the EU, the UK would be free of the European Commission and others like Angela Merkel who are calling for a ‘European Army’, and its operational sovereignty would subsequently be strengthened. NATO would continue to be at the heart of the UK’s defence policy and with Europe’s largest defence budget, the UK would remain of key importance to the NATO alliance.

⁴³ The Daily Telegraph, ‘Admiral Sir Raymond Lygo – Obituary’, March 23rd 2012

⁴⁴ Antonia Cox, ‘More bang for the buck: How we can get better value from the defence budget’, Centre for Policy Studies, January 2009, p26