HOUSE OF COMMONS

Defence Committee

Oral evidence: Shifting the goalposts? Defence expenditure and the 2% pledge, HC 494

Tuesday 13 October 2015

Ordered by the House of Commons to be published on 13 October 2015.

Watch the meeting – Shifting the goalposts? Defence expenditure and the 2% pledge

Members present: Dr Julian Lewis (Chair); Richard Benyon; Douglas Chapman; Mr James Gray; Mrs Madeleine Moon; Jim Shannon; Ruth Smeeth; Mr John Spellar; Bob Stewart

Questions 1–35

Witness[es]: **Professor Malcolm Chalmers**, Royal United Services Institute, **Professor Keith Hartley**, University of York, and **Dr Robin Niblett**, Director, Chatham House, gave evidence.

Chair: It is my pleasure to open this first session. I am very grateful to the witnesses who have come to assist us in our inquiry, which is entitled: "Shifting the goalposts? Defence expenditure and the 2% pledge". "Shifting the goalposts?" is not a statement; it is a question. I would like to ask our three witnesses to introduce themselves briefly for the record.

Professor Chalmers: I am Malcolm Chalmers, the director of research at RUSI.

Professor Hartley: Keith Hartley. I was previously professor of economics at the University of York; I am a defence economist, and also director of the centre for defence economics there. I retired; I have been given this rather nice sounding title emeritus professor, but they do not pay me for it. But I am still interested in working on defence. I have recently completed a project on the economics of military outsourcing, another piece on UK defence inflation and cost escalation and I am currently working on the pricing of single-source contracts and defence budgets.

Dr Niblett: I am Robin Niblett, the director of Chatham House, the Royal Institute of International Affairs. I am not a defence economist, as will become very clear.

Q1 **Chair:** I will start with a brief, open question. How do each of you feel the new definition the Government propose to give to what is counted as part of Britain's contribution to defence spending as a percentage of GDP has changed from previous practice?

Professor Chalmers: My understanding is that this financial year, 2015-16, the Government has widened the items which it has included in its return to NATO on UK defence spending. So for 2015-16, the NATO return was for just over £39 billion of spending—an estimated figure, since that year has not yet concluded—and what you have to ascertain is how that figure comes from a spending review baseline for 2015-16 which was £32.6 billion. So you get from £32.6 billion to £39.0 billion.

Part of that is things which would already have been included in previous years: Armed forces pension scheme contributions, the cost of military operations, budget exchange and so on. But the new items that have been included in the NATO return this year for the first time, as I understand it, are: war pensions, which amount to some £820 million; UN peacekeeping contributions through the Foreign Office of £400 million; an estimate of the cost of pensions for former MOD civilians of around £200 million and; and some part of MOD income of around £800 million. Adding all those in, and with some of the special factors that pertain to the 2015-16 budget because of budget exchange and the Defence Recuperation Fund, you get the £39 billion.

Chair: Any other contributions?

Professor Hartley: The only comment I have is more cynical: I am not surprised. All Governments of all persuasions adjust and play any games. They will try to maximise their advantage in giving the best view they can of any item of public expenditure, particularly one that is highly sensitive.

Just historically, on the equipment budget, for example, you remember all Governments for many years shifted the programme to the right. We met the equivalent budget problems by shifting it to the right, increasing delays, reducing numbers and relaxing operational performance. So I am not surprised that we are going to get similar sorts of pressures arising for the main defence budget.

Dr Niblett: I would first ask: what are costs? If the bulk of these are real costs to the MOD—pensions in particular in the US and all over the world are consuming increasing quantities of defence budgets—you might as well include them. They might not include operational capacity, but they are real costs to the MOD.

Secondly, how do you define defence and security? As most defence experts and military officials will point out, we are dealing with a spectrum of threats these days. To include secret intelligence account quantities in there when they are connected to British security, much as the Americans do—as I understand it, up to 90% of some of their intelligence amounts are included in their defence estimates—again, if that is helping to provide defence to the UK, yes. We are trying to hit a 2% target; there is a bit of stuff going on there, but the purpose behind it I think is fair.

Professor Hartley: There is a general question that we cannot ignore in terms of how we measure defence output, and what is the impact of different budgets—however we define them—on defence capability? That seems to me a more central question.

Q2 **Chair:** Yes, but if we are going to have any sort of measure of comparison, however crude, NATO has provided us with this 2% minimum guideline. Given that the terms of the debate are focusing on that, I think we would all agree that we have to examine to what extent we are or are not comparing like with like. Before I bring in Colonel Bob Stewart, I would like to ask: how does the NATO definition of defence spending differ from the definition that we have generally used?

Professor Chalmers: I think part of the problem is that, in contrast to aid, where the OECD does publish quite a bit of detail on what it expects OECD member states to report, NATO does not publish a detailed definition; therefore, it is not clear from outside how it works.

Clearly, the UK has felt that items that it did not include in the past can be covered by NATO this year—the additional items I mentioned—and NATO has accepted that, because it has published those figures in its spending report, but we do not know how they differ. Clearly, however, not only in the UK but in a number of other cases, the NATO reported figure is higher than the figure reported to national parliaments, and that is true in our country.

Chair: Any other comments?

Dr Niblett: NATO has made a point of trying to subdivide that 2%, as you know, into at least a 20% target towards acquisition, but I think Keith's point is a fair one. You might spend on acquisition of equipment that is not particularly useful in terms of capability for the collective good of the alliance or necessarily of the nation itself. These measurements are all pretty fungible in that sense.

Chair: I can assure you that we will be looking at the value for money in terms of military outputs but we have to examine each facet of the defence scene in sequence. Colonel Bob Stewart.

Q3 **Bob Stewart:** Just to be proper, are you all professors, or can I call you Malcolm, Keith and Robin?

Dr Niblett: That suits me.

Professor Chalmers: *indicates assent.*

Professor Hartley: *indicates assent.*

Bob Stewart: Fine. Can I kick off then a general discussion that others might come in on, to tear apart the 2%? Some people say that is a challenging target; I think it is a minimum target. May I ask you, Keith, as a defence economist, whether in your view we could actually get our proposed defence capability out of a 2% target in, say, 2020?

Professor Hartley: Yes, I have two or three reactions to that. First, I go back to the point that I made about what the defence output is. Economists cannot give you an answer and say, "Right, we should spend x on defence." What we can say is, "If we spend 2.1%, 2.2% or, going the other way, 1.9%, 1.8%, what are the impacts on defence capability?" Ultimately, Governments then have to make a choice about the appropriate level. Economists cannot tell you what the best level is, just as I cannot tell you and you cannot tell me what my best level of expenditure is on a motor car, or which type to buy. What we can do is to question the efficiency with which we are spending the existing defence expenditure, the 2%—we are about 2% or 2.1%.

A lot of the debate about 2% at the moment is symbolic. We are already spending it, and we were spending more than that over the past two years—so we are slightly above. The question is really what will happen, or what would have happened, to defence spending over the next five years in the absence of the 2% commitment.

Q4 **Bob Stewart:** Okay. That is really good and I thank you for that. May I therefore ask Malcolm a question? I am really concerned about the Royal Navy, which is in a perilous situation—they all are, but the Royal Navy in particular. In your opinion, will we be able to man, equip, fly from, sustain and protect aircraft carriers in 2020, on 2%?

Professor Chalmers: Of course you can, but it depends on choices within the defence budget as well as on the total—

Bob Stewart: You mean you put just one aircraft on!

Professor Chalmers: No. From 2010 onwards, the Ministry of Defence was planning on the basis that after this year the equipment budget in total would rise by 1% in real terms and the rest of the budget would be level in real terms, so actually adding up to an overall growth in the defence budget of 0.4% in real terms; therefore the budgetary settlement in the summer Budget of 0.5% in real terms through to the end of the Parliament is more or less exactly there.

In addition, there is the unexpected bonus for the defence budget of the public sector pay restraint well below the rate of inflation for the next four years. I think it is fair to say that people in the Ministry of Defence—you can ask them yourselves—are in a significantly better budgetary position than anyone anticipated before the summer Budget. Will that buy everything that the different services wish for? Of course it will not, but it will mean that compared with the plans that were in place before that summer Budget announcement, the Ministry of Defence is in a pretty good position. It will still have to make difficult choices, but the choices will be much less difficult than most people anticipated before the Budget announcement.

Professor Hartley: Just to reinforce that, if I may, you could have a larger Navy or Air Force or Army, but the other services would perhaps have to go with a given defence budget. Do you have a smaller Army or a smaller Air Force? With the Air Force being cut back to a very small number of fast-jet squadrons anyhow—I am sure the Navy would argue the same in terms of warships—from that budget you are going to have to make some difficult choices.

Q5 **Bob Stewart:** We want to have our cake and eat it in the Defence Committee. Robin, do you see 2% working from a strategic point of view from Chatham House level?

Dr Niblett: The first thing to say is that it is an important political commitment to be making in the current climate—the domestic climate, the European climate, or the NATO/international climate—even if the numbers have arrived conveniently at that level. I note, however, that if UK GDP keeps growing at the rate at which it has been growing—some of the numbers have been adjusted upwards in recent years—the 2% becomes an increasingly significant number vis-à-vis other numbers, as we have discovered with the overseas official development assistance budget. So I think that the 2% target is important at that level.

Does it buy you what you need? I am conscious that the UK has a big pipeline of big ticket items coming up. I suppose my question would be, will they be on budget? If they are not on budget, you are going to find that things could then crunch in the outer years of the commitment. What personnel choices are going to be made? The Army has been cut to a bit below 82,000 reasonably quickly, but there will probably be a lot of pressure to sustain certain regiments and groups at those levels.

Bob Stewart: Mine in particular!

Dr Niblett: There you go. That may therefore put even more pressure on the Navy and on the Air Force, which has had a big cut in personnel in recent years. Something that a number of people have noted—Malcolm and I were in an off-the-record conversation about this recently—is that you could end up with all the nice equipment and even the personnel, but without the operational capability to sustain them—ammunition, logistics, and so on, the operational costs of being in the field. The whole pay issue is another issue.

My sense is that 2% is good politically. There is a challenging pipeline of acquisitions coming up. Within that you are going to get additional pressures on the 2% that are beyond equipment that may find themselves constrained. Probably, 2% is under what you would need if you are really going to say that security is a key problem for the world going forward, and the UK as a permanent member of the UN Security Council needs to contribute to it, but I still think it is a big improvement on where people expected us to be.

Bob Stewart: Chair, I think we have been pretty well through the questions that I was going to ask, so I will shut up.

Q6 **Mr Spellar:** Malcolm, you said that the summer Budget put the MOD into a better position. How much now would you say of its budget is actually new money?

Professor Chalmers: The new money for the MOD as a result of the summer Budget has two components. The first is the commitment to a 0.5% annual real increase through the spending review period for four or five years—it is not entirely clear. That is new money, and in the context of an overall spending review in which quite a number of other Departments are being asked to produce scenarios for cuts of 25% and 40%, it is very significant indeed.

What is most significant, I think, is that defence has been moved from the category of unprotected Department to the category of protected Department. Indeed, one of the main reasons for the significant fiscal loosening in the summer Budget—the pushing back of the target for a large budgetary surplus at the end of the decade—is to provide money for that extra defence commitment, because previously defence, as an unprotected Department, would have had to suffer real-terms reductions. The proper comparator, then, is not between 0.5% and zero, but between 0.5% and the prospect of a cut comparable to the 2010 cut of about 8% in real terms.

The second significant announcement in the summer Budget, the meaning of which is less clear, is the commitment to create a Joint Security Fund, which would provide up to £1.5 billion per year by the end of the spending review period. Although the Government have not spelled out in detail how that will be used, certainly my expectation is that a significant part of it would be available for the Ministry of Defence at some stage during this spending review period.

Between the two of those, that is actually quite a significant increase in defence spending. In terms of the core budget, it takes us back to the level of growth that we had before the financial crisis.

Q7 **Mr Spellar:** Surely that is true only if we are actually comparing like with like on commitments and responsibilities. If they are increased, then although money has been transferred, so have certain responsibilities. For example, you talk about the security budget; how does that relate to the previous contingency fund? If other items, as you have described, are being moved across, and the responsibility for those is being moved, that money very quickly evaporates, does it not?

Professor Chalmers: The extra items I mentioned earlier which are being counted in the NATO return as part of our defence spending are not part of the defence budget. I think you have to separate out the budgetary process within the UK Government, which has not changed—the MOD has not been given significant new responsibilities which it has to discharge for the same amount of money. What is happening is that things that were previously not counted in our return to NATO are now being counted: civilian pensions, peacekeeping contributions and so on. Those are still all dealt with in other parts of the Government budget. In terms of capabilities, it is not the 2% commitment that counts, it is the commitment to 0.5% annual real increase on one hand and the commitment to the Joint Security Fund on the other. That is the real money that will fund UK defence capabilities.

Q8 **Mr Spellar:** That is helpful, but going back to the 2%, you described a number of areas of budget that have been transferred in order to meet the 2%. Are you aware of any other areas of budget that might potentially be available in order to make up the figure of the return for NATO but that have not been included in this current exercise?

Professor Chalmers: Yes. Given the commitment to grow the core defence budget by 0.5% per annum, and as Robin already hinted, in a context in which GDP is due to grow by 2.3% or 2.4% per annum in real terms, 0.5% per annum will not keep pace with GDP growth. Moreover, there is a significant amount of money—around £1.5 billion of spending in the 2015-16 budget—which is one-off and is not in the baseline for the spending review. The Defence Recuperation Fund is worth £500 million in 2015-16 and that is a one-off payment this year and last. There is also around £1 billion of budget exchange money—money which was not spent back in 2012-13 but is being used in 2015-16—which again is not part of the spending review baseline. That £1.5 billion will drop out of the budget in 2016-17, although the core will grow by 0.5%. So in order to meet the 2% target in 2016-17, I think the Government will have to include more items in the NATO return than they have previously. That is my anticipation, unless there is large operational spending.

The area in which, as you know, there has clearly been some speculation, and which the summer Budget rather explicitly suggests will be looked at, is elements of spending by the security and intelligence agencies. I do not mean that their entire budget will be included, but the summer Budget makes it pretty clear that the Treasury's anticipation is that elements of SIA spending will be included in the defence budget in future years, although it is not, as I understand it, included this year.

Q9 **Mr Spellar:** Finally, therefore, following on from that, but also from Colonel Stewart's questions, do you actually think that the 2%, which is actually relatively low in comparison with historic levels, is a meaningful commitment, or do we need to be looking at a more challenging target?

Professor Chalmers: I think it is a meaningful commitment in terms of the political impact there would have been if, having played as a country a key role in putting that target in a NATO Heads of Government statement for the first time—the 2014 Wales summit was the first time that NATO Heads of Government, at their summit, committed to that target—and having pushed for that as a country, we had then not met it, I think that that would have been damaging to our reputation politically. Clearly, most NATO states do not meet the 2% commitment and are most unlikely to do so in the immediate future, so for other NATO countries what is more relevant is that the Wales summit also committed all member states that did not meet the 2% commitment to stop their real-terms reduction in defence spending. Again, I think there has been some progress—not enough, but some—by some other NATO states in stopping their real-terms decline. We can argue how far this is a result of what NATO says, and how far it is a result of increased threat perception as a result of events in Ukraine. I suspect that it is, most of all, because most NATO states feel we are in a more difficult strategic environment than we were before the events of early last year.

Professor Hartley: To reinforce quickly what Malcolm says, the UK is one of only four NATO states, as published by the MOD, which actually spend 2% or more on defence. The others are the USA, Greece and Estonia.

Dr Niblett: Poland, I think, will get there soon. That is a large-ish country.

Professor Chalmers: Poland does meet it.

Dr Niblett: Yes, it is at 2% now and it is important because it is big. Sorry, Chairman, but I have a question. Is the Conflict Security and Stability Fund accessible as well? Do you see what I am saying? There is about £1 billion in there.

Professor Chalmers: Yes, elements of that could count as defence spending.

Dr Niblett: The reason I mention that is that there is almost a conscious effort to reflect the reality that, as I said earlier, defence and security are more fungible that they were. If we look at what defence engagement is going to be in future, there may be aspects of DFID money that might be appropriate in terms of capacity-building or institution-building if you are helping to develop better civil military relations. In particular countries, the DFID budget has certainly been co-used—to use a non-verb—by the FCO in recent years in their time of strapped funding. I am just wondering whether there will be other elements of flexibility to compensate for the fact that, as you both noted, the £1.5 billion Joint Security Fund and what was the contingency fund may be a little bit fungible. So that may not be a gain.

Professor Chalmers: Could I just come in on this? It is important to remember that, while we have reported these numbers to NATO for very many years, the salience of the 2% target has increased quite significantly in recent years. At the same time, the UK, partly because of the 2010 cuts and partly because of drawdown of Afghanistan-related spending, has been getting closer and closer to that level. As a result, the MOD—the Government as a whole—has looked more carefully at its return to NATO than it would previously have done and discovered that there actually are things that it could include that, in the past, it didn't bother including. It wasn't that long ago—2005—that we didn't include military pensions at all and then we included them and our number went up accordingly. We should not overstate the extent to which these numbers have had political salience until quite recently.

Professor Hartley: One very brief point: the long-term trend cannot be ignored. Going back a long time to the early 1950s, we spent 10% of our GDP on defence. In the mid-1980s, it was about 5%. We are down to 2%. The long-term trend will be further reductions.

Q10 Chair: I am very glad that you have raised that point, because one of the aspects of this report will be to set it in the historical context. Throughout the 1980s, for example, we always spent between 4% and 5% of GDP on defence.

Before I bring in Madeleine Moon, I would just like to ask one thing. In relation to the ongoing effects of the last strategic defence and security review, I have heard suggestions that they are still rumbling on and there is a danger of a continuing hollowing-out of the armed forces with further reductions to be made as a result of the previous SDSR before we get on to any extra funding that might be available as a result of the new 2% commitment. Have any of you heard suggestions of that? Do they have any basis?

Professor Hartley: I think they probably have some basis. I tend to take the view that, compared with the private sector, the armed forces are very slow to adjust to change. They are very slow to offload surplus and spare capacity. I suspect that all the armed forces have accumulated and retained more assets than perhaps they require. I have doubts about whether the Air Force needs so many Chinook helicopters, whether the Army needs so much training land—Colonel Stewart might differ from me on that—and whether the Navy needs so many ships and other supporting facilities. I am certain that the armed forces are not operating efficiently.

Chair: Any other comments?

All witnesses: No.

Q11 Mrs Moon: Just following on from that, is one of the things that we ought to do, rather than looking at percentage, look at effectiveness and risk? Is that the new way that we should be assessing the amount of budget that we need? Richard Benyon and myself came back late last night from the NATO meeting in Stavanger, where budgets were very much on the agenda, as were effectiveness and risk. I would welcome your comments on whether our focus on percentages is the right one.

Professor Chalmers: I am sure it should not be the main focus. The main focus should be elsewhere, not least because in relation to Russia the main element of NATO deterrence of Russia is not how much we spend. We could spend twice as much as we do now on defence, and if article 5 guarantees to exposed states were not credible then all that money would be for nothing. Similarly, we could spend no more than we do now and, by the measures we took, increase the degree of certainty in Russian leaders' minds that we would respond to aggression effectively, which would make a big difference. NATO as a whole, of course, has very significant military capability, but it is not necessarily in the right place and would not necessarily be there at the right time.

Now, enhancing the military capability in relation to Russia or other threats does require resources to be devoted to particular purposes, whether those resources are delivered through reallocation from other areas of defence or through an increment. In practice it probably has to be a bit of both because there is rigidity across a whole range of capabilities. If we were now in a situation in which most NATO countries were continuing to reduce their defence budgets in real terms, it would be much harder to generate the resources necessary for the increments we need in key areas related to deterrence.

Professor Hartley: But I agree your general point is right, in that we ought to move away from a focus on 2%, which I regard as an input measure, and focus on outputs; but then as an economist I do not have a decent measure of output. I know what defence is—I know it provides peace, protection, security, prevents conflict, those aspects—but I do not know of any means of placing a monetary value on those aspects of output. The health service argues that they have solved the problem through QALYs—quality-adjusted life years. In my mischievous moments I think we could actually, in defence, erect what I call a PALY system—protection-adjusted life years—but that is a long-term research project, if ever.

Professor Chalmers: Which requires much funding.

Professor Hartley: Oh, it does require much funding, yes. More than 2%.

Dr Niblett: The 2% budget might fund it. Look, the obvious thing to say is that more equipment and higher spending on defence does not necessarily equal results. The United States is spending perhaps 3.5% of GDP on defence. It has got some of the most sophisticated equipment in the world. If you ask most Americans whether their military interventions and activities in recent years have been helpful or not, many Americans will say no, they have not, including even on deterring a more aggressive, assertive Russia at the same time.

The politics become incredibly important. The political will and commitment is perhaps not as important as any size of defence budget—I will make my point about that in a minute—but what is behind the amount that you are spending is as important as what you are spending. Obviously you want to spend it on the right equipment. If you do not have the capacity to follow up a threat or a sanction or a deterrent with military capacity, your political commitment is meaningless, but a larger defence commitment with a weak political backing for it in a post-Afghanistan-Iraq context does not make that 2% or 3% more powerful. I think the United States is a classic example of that.

What do you need for deterrence in 2015 or 2020? How do you help deter? First of all I would say the UK is not going to be able to deter much by itself. It is going to have to deter with its NATO allies, and there are certain types of threats that it will have to deal with with European allies, and even in collaboration with EU structures, I would argue. I think thinking creatively about how you use the limited resources you have got, and making sure the mix is right across a spectrum of threats, is going to be absolutely critical.

One thing we do know is that command, control, surveillance and target acquisition stuff is expensive but very important. Skilled forces to be able to operate these types of equipment are highly important. The capacity to be able to project quickly, to react to a political decision is important. Whether it is 2% or 3% at that moment is, I think, not critical. There is a minimum level below which you just have not got the credibility to be credible, but after that the maximum levels start to get into a very fungible area that I am not comfortable with.

Q12 Mrs Moon: Is there a risk that the UK is unwilling to think creatively around its budgets? There was a prime example given to us in Norway of Nordic co-operation around procurement, training, interoperability, joint forces within their region, where they were combining together. In a sense, their 2%—or whatever percentage it was—had greater bang for their bucks, because you had three nations combining together rather than one. Is that part of our weakness? Secondly, in terms of the geopolitical threats, is that not an impetus to start thinking in that creative, joint force, joint interoperability training procurement way rather than in silos of 2% national budgets?

Professor Hartley: Two or three comments on that. I agree with what you are saying. We do actually have collaboration within equipment: the Typhoon is a collaborative programme and the Tornado and so on were, so we have made a bit of progress with equipment, but mostly aerospace equipment, which is interesting. We do very little European collaboration in land and sea systems. In particular, we have nothing in land, and we have not made much progress there. We will have to ask ourselves why not, but that is equipment.

You are right to focus on the possibilities of sharing very costly assets between a number of nations. I think NATO is a very good example of a military organisation that is perhaps effective but highly inefficient, characterised by massive duplication. To the man or woman who comes from Mars down to Earth and says, "How would we reorganise NATO differently?" I would start with principal specialisation based on comparative advantage.

If a nation is good at, say, special forces, let that particular nation provide special forces to the whole of NATO. Let one or two nations specialise in providing a deterrent. But the problem with that is trust. Can we assume that, when it comes to a problem, all the nations will turn up? That is a major flaw in the economists' notion of specialisation. But certainly I think there is more scope for sharing the activities within NATO and within Europe. We collaborate in equipment. We did, for a period of time, collaborate in training for the Tornado programme. But then for the Typhoon programme we do not have any co-operative training. So you would have thought that perhaps in the support areas we could move it further forward. But these are very modest requirements and not very challenging and they would not produce massive savings, but we have not got there yet.

On the really big items, in terms of my notion of specialisation, Britain provides the carriers, and the Netherlands, perhaps, in principle, might provide all the escort vessels. We need not have a large number of warships available in Britain; we let other nations provide that. But that is speculation. I think we are a long way from that.

Professor Chalmers: Could I add something to what Keith said? First of all specialisation is a more attractive option for smaller countries that do not have the ability to develop a wide-spectrum intervention capability in any case, but do want to do some intervention. It is less attractive to medium-sized countries like the UK. One of the reasons we spend more on defence than other NATO European countries is that we want some national options. We want to be able to do things by ourselves, or perhaps with some smaller neighbours, as we did in Helmand, for example, and we do not want to have to wait for the permission of the French or the Germans or others before we can do something. That is part of being on the Security Council and part of being a major expeditionary power. There is more we can do in co-operation. There is always more that we can explore, particularly in relation to being a framework nation which brings some smaller states along with it—the Scandinavians, the Dutch and so on—to bulk up numbers. That is the first point.

The second point is I think there is a risk in this SDSR that, because the budgetary settlement is more or less what was always being assumed for Future Force 2020, we could end up with the force in 2020 that we were planning for in 2010 and take no account of the ways in which the world has changed in the past five years, which was the point of this whole SDSR process. The fact that we have got personnel numbers more or less fixed will increase the forces of conservatism in this review, so I think when we look at the outcome of the SDSR, given that the budgetary situation is better than had been anticipated, it will be very interesting to see whether there are many up arrows or down arrows, or whether we actually end up with something giving all the forces who want to keep things on track as they have been exactly what they want. In a way that is the path of least resistance—having a review that sticks to the plans of 2010.

Professor Hartley: Just to reinforce that, the point I made earlier was that the armed forces are very slow to adjust to change. The steelworks at Redcar did not have that length of time—they are closed, bankrupt, out of business. The armed forces are still adjusting to the 2010 strategic defence review. A five-year adjustment period is taken as typical. Redcar closed in 24 or 48 hours, or a few days—those sorts of hours.

Dr Niblett: I agree entirely with the points. I would like to second what Malcolm said about big states versus small states. It is easier to co-operate if you are smaller. It is not simply for the flexibility of military action that Malcolm mentioned, but we also have our own defence industry, a sizeable defence industry. We feel that we need to pay the cost to have that capability, as well as the military capability, which comes to Keith's point about our failures to collaborate perhaps as much as we should do on defence programmes with other European countries. As Keith and I know, they are often more expensive and take longer to run. The A400M is probably a classic example of the costs of collaboration, not just the benefits thereof.

A last point is about something to study more, which is the framework nation concept. The adjustment made at the world summit—the idea of Germany as well stepping up to be a framework nation around which others can organise on interoperability, training and logistics—could be an innovation that, although it has been talked about for a long time, will become quite real in the next two to five years.

Professor Hartley: Very briefly, we cannot ignore one elephant in this room: the rising cost of equipment. The long-term trend in real terms has been upwards. Augustine said a long time ago: "a single tank army, a one ship navy and Starship Enterprise for the air force". Some nations have already faced up to that and opted out of a capability. New Zealand no longer has fighter aircraft. I can see in the future that the UK will find it very, very costly—and France and Germany—to replace its Typhoons, if they are to be replaced.

Chair: Before turning to Ruth Smeeth, Colonel Bob wants to bring in—

Q13 Bob Stewart: A quick point on national specialisation. The real reason why medium-sized countries like ourselves are not particularly in favour of specialisation is that something bloody well always turns up—like the Falklands. The French would not have helped us there. The Belgians did not want to sell us ammunition during the Iraq war. We would have had damn-all help as a framework nation in those sorts of situations.

Dr Niblett: I was nodding away with you all the way there until you said the thing about framework nation, but the framework nation would not stop the UK from having the capacity to do all those things itself.

Bob Stewart: Okay, sorry, poor use of language, but that is why we are not particularly keen on specialisation. The other point that you raised, absolutely rightly, is that we have a bloody big defence industry, which needs to be fed, too.

Q14 Ruth Smeeth: I hate to bring us back to the 2%, but that is why we are here. Just before I move on, the use of Redcar as an example of flexibility is not appropriate, with 17,000 jobs being announced as gone today—

Professor Hartley: Sorry; I am sympathetic about that, but the point that I was making was that the private sector has to adjust very quickly—they have not had five years to adjust.

Ruth Smeeth: I suggest they adjusted too quickly, without wider interventions. Regardless—

Professor Hartley: I was not commenting on desirability; I was commenting on fact.

Ruth Smeeth: Probably not the most appropriate of responses today—

Chair: The subject of another inquiry, I think.

Q15 Ruth Smeeth: What I would like to pick up on is the 1% pay restraint, on it bringing us within the 2% and both sides of that. Is 1% actually feasible for pay restraint within the forces? Force by force, I am not sure that that is accurate—with the Navy and the RAF, there is the issue of the recruitment of engineers. Is that feasible? Also, in the long term, is a 1% pay restraint likely to be applied across the forces over the next four years? That could undermine some of the argument about the additional budget capacity that you talked about. So how that will work for the 2% is what I am interested to hear.

Professor Chalmers: That is clearly a challenge, but of course it's not an MOD-specific pay restraint; it is across the whole of government. The Government took the view, which it expressed in the summer Budget, that the margin between public sector remuneration and private sector remuneration was such that they still had some way to go in narrowing that gap, as they saw it. But of course you are absolutely right that, particularly in areas where service personnel have alternatives in the private sector, like skilled engineering personnel—people with some experience—more and more of them are likely to move elsewhere if the pay gap grows.

I guess the obverse of that is the protection of personnel numbers. There aren't going to be the significant redundancies and the job insecurity that have characterised service employment over the last five years, because overall personnel numbers are being protected, but I think it is a pressure, and it will be a growing pressure over this period. It might be that at some stage over this period the Government has to find extra resources to maintain parity with the private sector. Part of the answer depends on what real pay growth in the private sector is, and that in turn depends on a whole range of other factors. There is inevitably a lot of uncertainty, but that assumption of pay restraint is key to defence being able to acquire the capabilities it is planning for with the budget that is available.

Q16 Ruth Smeeth: So what sums of money are we talking about, in pay restraint and the impact on the wider budget, in terms of extending our capability? How much additional flexibility is this allowing in the budget? What is the impact of the 1% pay restraint?

Professor Chalmers: It depends on what the counterfactual is, but if pay levels in the armed forces were going to rise at the same rate as is being assumed for the private sector, it would be of the order of 3.5% or 4% per annum, rather than 1% per annum. You can do the mathematics in terms of the cumulative impact of that 3% per annum difference over four or five years. It is very substantial indeed for the pay bill.

Professor Hartley: But that's actually overall. There might well be, as Malcolm suggested, specific skills shortages in certain areas which require a much higher rate to continue to attract and retain those sorts of skills. IT skills, for example, are highly marketable. If you don't pay the market rate, you're going to lose those sorts of people.

Dr Niblett: One small point is that it also depends on where the inflation rate goes in the UK. You could have a UK defence budget that continues to be protected at 2% of GDP, but if there is a 1% pay increase inside that and the inflation rate were to really pick up, the crunch on the pay dimension of that packet could become that much more noticeable and the alternatives in the private sector that much more attractive.

Chair: Thank you very much indeed. I now come to Richard Benyon.

Q17 Richard Benyon: Have you an understanding of what defence capabilities and capacities will exist as a result of the announced increase in defence expenditure that would not otherwise have existed? What are we going to have and be able to do that we would not have or be able to do if we had not had the announcement we had in July?

Professor Chalmers: The answer to that, of course, depends on what the comparator is—what would have happened to the defence budget in the absence of the 0.5% increase. As I think I indicated before, right up until the day of the summer Budget—maybe, in some people's cases, a few hours or days before—the expectation was that defence faced further real-terms cuts in its budget in this spending review period. Getting 0.5% annual real growth made a very significant difference, and that comes alongside the Government's commitment to maintain regular personnel numbers and to maintain Army personnel numbers.

Exactly what we get, compared with what we would have got, will, of course, await the outcome of the SDSR, but what is clear to me at least is that if we had had an 8% real-terms cut in the defence budget, as we did in 2010, it would not have been possible to finance the protection of personnel numbers. There would have to have been significant reductions in personnel numbers. It would not have been possible to finance annual growth of 1% in the equipment budget, and therefore you would have had to make much more difficult choices between the sort of things that are currently in the equipment plan across all three services. The nuclear deterrent is the largest—Vanguard replacement is the largest single project—but there is clearly a lot of spending on aircraft, helicopters, missiles, C4ISTAR and so on. The list is significant in the equipment plan, and you'd have had to make significant cuts there to get you that 8%, so that's a saving you should have made.

Professor Hartley: You can come at it slightly differently, and I am sure you are all familiar with this. In terms of gaps, what are the capabilities we lack? Maritime patrol aircraft is one. Make sure we have or could have two aircraft carriers operating, rather than one. Put more aircraft on the carriers. Probably create more fast jet squadrons. There are a whole set of options. Armed forces would have no shortage of ways in which they could spend extra money. As I say, part of my task would be to actually challenge them to release some of the stuff they do not need.

Dr Niblett: There are two comments I was going to make. There may be one or two particular programmes that might not have happened or happened as quickly that, to my sense, are needed. Air maritime surveillance is a particular one that Keith was right to pull out. The question as well is whether the Government might be a little bit more forward leaning, operationally, which is not explicitly in the budget—the extent to which, if you know you have the £1.5 billion to dip into, you are not going to have to trade that off against other types of expense. Perhaps you can make sure the tempos you can sustain of missile use, ammunition usage and so on. It might just change the Government's outlook a little bit on future interventions if they are required.

Q18 Richard Benyon: I am intrigued by Professor Hartley's attempt to find a way of valuing defence expenditure. It is with trepidation that I go down this route, because I sense it is like picking up mercury with a fork. We do find ways of putting a price on various things now—even the natural environment. The 2% is a political figure, which we all accept, and it is not the best measure because we are concerned about capabilities and our ability to protect ourselves in a dangerous world. I would like to extend your teasing comment earlier about trying to find a way of putting an economic value on what we are talking about here.

Professor Hartley: At the moment, I have to put my hands up and say that I do not have one. Even the MOD does not have one. They recognise that there is not actually any measure of placing an acceptable monetary value on defence output.

Q19 Richard Benyon: We do this in overseas aid, don't we? We can say that we have got more children into school, that there are fewer people in poverty and those sorts of thing. Is there not a matrix that one could apply to defence spending in any form to value it?

Professor Hartley: We could certainly do a cost-effectiveness analysis. We could say, "Right. We want an air defence capability. Here are the costs of doing it in different ways." What we do not have is a means of comparing the value of air defence capability with, say, the value of warships providing anti-submarine protection, or of the military—the Army—and what sort of capacity they provide.

There are ways you could approach it. Insurance is perhaps a comparable exercise. We all take out insurance to protect ourselves against ill health, or against our homes being burgled or raided. We might buy a dog, for example, have a burglar alarm system or relocate to a crime-free area. There are ways you can proxy it. You can look at how much you spent on insurance in the round, in the way I defined it there, and say, “That might be a crude indicator of how much individuals value protection.” That goes back to peace protection.

There is a further problem with defence: it is what economists call a public good. It is very, very difficult to value public goods, which are characterised by free-riding—“If you are going to buy my defence, I am going to free-ride on your provision of defence,” as we do within NATO. We are all free-riding on, say, the American defence or the Canadians free-ride on the American defence effort within north America.

Professor Chalmers: I think Keith is absolutely right, especially in that last point. It is not clear that NATO member states that spend significantly less than us as a proportion of GDP are less safe as a result, because they have the wider framework of collective security that helps to protect them, but that is precisely why the percentage of GDP is actually quite important—not as an indicator of defence output, but as an indicator of burden sharing. The percentage of GDP is a pretty good indicator of the relative priority a society gives to defence compared with other things. When you are talking about burden sharing, the clue is in the name. For alliance cohesion, those who spend the most, who proportionately are the Americans, want to know that their partners take defence seriously and are not, as Keith suggests, free riding, or at least not free riding too much. That indicator of the pain that countries get and the sacrifices they are having to make to contribute to common defence is quite important, even though it would not matter to NATO’s total effort if its smallest states doubled or trebled their budgets. Even at three times their current level, their budgets would be so small. Politically, however, it is important that Latvia, Lithuania or Belgium make an effort to have a budget that imposes some costs on all the other things that Governments would like to spend money on.

Dr Niblett: This is not helping get the answer to the question you wanted, but it strikes me that some countries—everyone has to pay a premium. The insurance analogy is a good one to use. You are not quite sure what the value is. You say, “Our property is worth this much, and our premium value is worth that much,” although you might not replace everything and so on. Some countries are paying a premium for protection. The UK is trying to pay a higher premium for protection and the capacity to act nationally, which is what Bob was saying earlier. The UK is choosing to pay a high premium because it is trying and would like to do more with what it has got. That is the first point.

The second is the public good issue. How do you value the nuclear deterrent? How do you value the UK contribution to an alliance deterrent capability? I find it incredibly difficult to work out how you value it financially. There is the classic example of the difficulty of putting money and value together.

Thirdly, other systems do not do such a good job, either. One is trying to put a premium on ODA spending and having this many schools, but those are outputs, rather than outcomes. You might have educated 6,000 or 100,000 more women in Afghanistan, but it has not stopped the Taliban from moving into Kunduz and perhaps even taking over the country.

One part might be doing a great job, and you have said, “Well, there we are. We have met all those targets,” but the end result is not what you thought it was.

Professor Hartley: So as not to leave you in despair, there is a way forward. It is a limited and simple way, and it is a cop-out. What you can say in the case of Trident or Typhoons or F-35s is, “How much do they cost? These are the resource costs of this capability. Do we as a Government and as a society place that amount of valuation on this capability? If Trident will cost £100 billion over 50 years, do we think it will give at least £100 billion of benefits that are somehow defined—that is the valuation side—to make it a worthwhile investment?” I can work out whether it is worth while to invest in a private company, but how do we work out whether defence is a worthwhile investment? We know the costs of defence, so implicitly we are having to say, “We have to get more than 2% of GDP value if we put 2% into defence to make it a worthwhile investment.” Benefits have to be at least equal to or greater than cost. I did say it was a cop-out.

Richard Benyon: Fascinating. We could have a whole session on this.

Q20 Chair: Surely, however, if the main value of defence and deterrence is the absence of conflict, there can never be a numerical value put on that. While one certainly accepts the point that one could spend a higher proportion of GDP, but spend it in the wrong ways and have less security, it is also the case that if one is looking at the long-term trends—I believe that Professor Hartley made this point earlier in our discussion—there has been a very clear and steep decline in the amount of money as a proportion of GDP invested in this area at the same time as there has been a comparably steep increase in the amount of money invested in other high-spending Departments. If we accept the fact that we cannot realistically measure outputs, surely we have to do the best we can with measuring investment.

Professor Hartley: Agreed. We can start thinking of proxies of means to try to measure defence output. You mentioned the costs of conflict. Certainly, one of the valuations might well be avoiding conflict.

Chair: Absolutely.

Professor Hartley: We have some examples of the costs of conflict that we can feed into the equation.

Q21 Mr Spellar: Isn’t defence, in that sense, in a similar dilemma to that expressed in Robert Peel’s aphorism when setting up the police? It is the absence of crime, not the apprehension of criminals, that is the test of a good police force.

Professor Hartley: Yes. You have got the same problem in terms of measuring output throughout much of the public sector.

Q22 Mr Spellar: So why try to measure things that cannot be measured? Therefore, you just have to take a balanced decision and trust to that judgment.

Professor Hartley: Ah, but then the balanced decision emerges somehow from someone’s criteria, and I would like to know what lies behind reaching this so-called balanced decision, because your balance might be my imbalance, and mine might be your imbalance.

Bob Stewart: Bloody economists!

Professor Chalmers: Could I add a footnote? Defence provision is not only about the avoidance of conflict; it is also about pursuing military conflict successfully. Because over the past 20 years our armed forces have been involved in a number of conflicts, so you could have an economic analysis of those particular conflicts as well as of the role of the armed forces more generally.

Q23 Chair: There is, of course, one way in which one could measure outputs to some degree and that is by looking at the equipment, which is at least countable. For example, if we see that over a period since 1997 we have gone down from having 35 escort vessels—frigates and destroyers—to having only 19, that is a measure of a sort, is it not, even if it is only part of the picture?

Richard Benyon: On that back of that, surely we can also assess force elements at readiness levels. You can at least see trends of capabilities.

Professor Chalmers: This is defence output rather than defence outcomes.

Q24 Chair: Would you like to expand on that distinction? It has looked a little bit academic. Let us hear it substantively.

Professor Chalmers: In the end, the ultimate purpose of defence is not to have force elements in readiness; it is to provide security for the country. Maybe there are other elements as well, but the reason we want force elements at readiness is because it increases the probability that we will prosecute conflicts successfully in our interest, or indeed that we will prevent conflict successfully because we have the capability to prosecute them.

The most unquantifiable element in this whole business is the relationship between those defence outputs—those force elements of readiness, for example—and our ability to achieve what we want to achieve in Syria, Iraq or Afghanistan, or in deterrence of Russia, or whatever it might be.

Having said all that, it is important, and it is something that the Ministry of Defence, of course, must and should do. Given that we want force elements in readiness, how do we most effectively and cost-effectively achieve that? How can we get more for less? Is there a different way to do it that involves different aircraft and so on? You can do all that, but that ultimate step is much more difficult than in many other walks of life where you have more of a sense of it. It is an ultimate objective to have children well fed and people educated in a way that is not for defence outputs.

Dr Niblett: On the point of outputs against outcomes, in a very simple way, an output might be sending four Chinook helicopters to Afghanistan; the outcome is how many troops you were able to pull out of emergency conflict in moments, how many injured soldiers you were able to rescue, how many of them were flying at any one time. That is how you really measure the effectiveness, not just numbers. We go back to this business of the 2% and what is value. The outputs are simply the product; the outcome is the result you hope to achieve through the product. In the simplest form, it would be that.

On the business of how you measure value, you could say what the priorities are in the UK and then try to assess whether you are contributing sufficient resources towards meeting those priorities. The reason people keep coming back to the 19 active frigates and destroyers as part of the Navy is the sneaking suspicion that it does not match up against what the Government are saying is a priority, which is protecting maritime sea lanes and backing up the United States—we are a trading nation, we want to be able to show presence in a soft power sense and to be able to be there to help with natural disaster management, as well as when things hot up in the South China sea.

I am not a defence planner, but I suspect that people are thinking that that 19 might not be enough, especially if we also have two aircraft carriers that need protecting and so on. It does not take a non-defence specialist like me to say, "That is the priority. These are the resources. It looks like it is a stretched match." I am sure that could be applied across a whole range of other activities—or maybe not.

Q25 Bob Stewart: There is a seriously good defence outcome in medical. When Richard and I were young officers—him younger than me—the ratio was one dead, three wounded. Now it is one dead and between 12 and 15 wounded. That is a hell of a good defence outcome. I do not think it is an output—it is an outcome.

Dr Niblett: The output is the number of doctors who are treating them, but the outcome is what you said.

Professor Hartley: In terms of the Navy, one outcome has been the reduction in piracy off the African coast. But what valuation do we place on that? And that is only one element of the Navy's contribution.

Bob Stewart: We are dancing on a pinhead here.

Chair: Some things simply cannot be quantified, but we have to deal with those things that can—hence this inquiry.

Q26 Douglas Chapman: I want to go back to discussing gaps in capability. From your point of view, how would you describe the obstacles to achieving defence expenditure sufficient to meet the gaps in capability that we have at the moment? What specific actions could Government take to mitigate against those obstacles?

Professor Hartley: May I start with a mischievous thought? Running throughout this is the proposition about the 2% and the thought, "Is it enough? Should we have more?" I would like to hazard the thought that it might be too much. I would like the armed forces to actually start justifying themselves more. It might well be that they begin to justify themselves more when they are subject to major external shocks, one of which is the prospect of a substantial reduction in their budget; another, clearly, is the possibility or probability of a defeat in battle.

At the moment, I suspect we have a cartel operating between the Army, Navy and Air Force, with a principle of Buggins' turn operating—this year the Army is going to get all the vehicles it wants, next year it will be the Navy, and after that it will be the Air Force. How do we get them to compete? How do we get real rivalry between each of the armed forces, where they each critically assess—rather than agreeing not to critically assess, as has happened in some defence reviews—each other's major equipment programmes? I would like the Army to question the Navy's commitment to the carriers. I would like the Navy to question the Air Force's commitment to, say, Typhoon, and the Air Force to criticise the Army.

Bob Stewart: Before we had a CDS that was what used to happen. I remember all kinds of guerrilla warfare going on.

Professor Hartley: I remember when one defence review was being prepared for, not too long ago, I attended an Air Force briefing and said, "Why don't you critically assess, as an Air Force, the requirements and demands of the other services for their major equipment programme?" They said, "We have agreed not to criticise and question each other's programmes." I do not know how true it is, but I am not surprised. With a small number you are going to get a cartel-type situation—it's only three forces.

Q27 **Chair:** I must say this paints a rather different picture from the story that emerged about what happened at the time of the 2010 SDSR, when aircraft competition was intense and the outcome was decided in a very unofficial way in the corridors leading up to the rooms where the decisions ought to have been taken. I am not entirely convinced that this does not go on.

Professor Chalmers: I will make at least an attempt to answer the question. The way it should happen is that we should use the SDSR process as a way of assessing what risks we face for which there is, in part at least, a military answer, then assess how they have changed over the past five years and adjust accordingly. Perhaps the biggest area where there is a degree of choice or a trade-off, at least, involved in that process is the extent to which preparing for the possibility of conflict against peer states or near-peer states like Russia is more important than it was in 2010—more urgent—and therefore we may need to adjust in that regard; as against whether the evolving nature of conflict in the wider Middle East, most recently seen in Iraq and Syria but potentially, clearly, elsewhere, is throwing up new demands for forces and capabilities, which we do not currently have, which are not the same capabilities, not the same priorities. They are not entirely fungible with what you might need for deterrence of Russia at sea or on land, and with limited resources the UK has to make those choices given what its allies are doing—because we are not tackling problems in the Middle East or in Russia by ourselves—and given the sunk investments we already have, because we are not starting with a blank sheet.

All of which means that whatever adjustments you are likely to make are likely in their first couple of years to be relatively small. But if you are talking about a 10-year planning process, the SDSR could make a real difference to what our forces look like in 2025, depending on whether we are saying, at least to some extent, that we really need over this 10-year period to focus on wider Middle East sort of threats, which will be with weak states and sub-state actors, or whether we need to put more emphasis on NATO vis-à-vis peer states. The classic historic example of doing this would be the 1967 and '68 defence reviews where the Government at that time in the end decided that the threat from the Soviet Union was such, and the importance of maintaining the British Army in the Rhine at 55,000 was such, in terms of the UK's vital national security interests, that it had to take the risk of withdrawing from south-east Asia and the Gulf.

I happen to think that was the right trade-off at the time. You could argue that de-emphasising out-of-area was one of the reasons we ended up with the Falklands war in 1982, but, as Sir Michael Quinlan said on one occasion, he had much rather we had taken a risk with the south Atlantic than with the central front in Germany. We are not at that sort of moment now—it is not so clear—but nevertheless there is a bit of a strategic trade-off, which should, I think, inform capability decisions.

Dr Niblett: Part of the problem we face today, as many defence analysts have pointed out, is that it is all at the same time, and those trade-offs are harder to strike because of the nature of the threats. They get through to us more quickly from more varied directions, and politically, as well, they can have a big effect.

Just think of a country like Russia, which is presenting two simultaneous types of threats: the kind of state-on-state, peer-on-peer risk that you need to deter in almost a conventional sense—and we are going back to that in the NATO context—but also a form of risk that is corrosive of governance, of our allies and of our neighbours in Europe, through what people loosely term as hybrid forms of intervention that can run from undermining the police to corruption, energy security, cyber, etc. Just on that one neighbour, Russia, you have got two completely different dimensions that both require focus at this time.

I would say that when you look south, which is the other big drama and challenge for the UK, you have got the immediate threat of terrorist acts potentially affecting us—and where does defence fit in, right from migration to being able to keep track of organisations that may want to conduct attacks in the UK? But while we are doing that we are probably not thinking of the next biggest threat we might face in five to 10 years, which is what if some of the sub-Saharan states really go through the state collapse that we have seen in parts of central and eastern Europe? I can tell you if that happens we are going to see waves of people that make what we have seen coming from the Middle East seem like a walk in the park—sorry, probably the wrong analogy. The defence engagement issue actually becomes very important in that context as one part of a spectrum of answers; but to be a planner today—those choices Malcolm was describing of the mid-’80s into the ’90s were probably easier in some ways. Well, not easier; they were of a different nature, and trade-offs could be made in different ways from today.

Q28 Douglas Chapman: The pressure is on a whole range of areas, and spreading your capability across global theatres is going to prove much more difficult in the future as well, I assume. In terms of the additional funds, as well, I have a list of things. Seeing through the new aircraft carriers and getting them into service; new maritime surveillance capability; the Army Scout vehicle; we mentioned cyber-activity improving intelligence; there is the whole issue of Trident and our continuing NATO obligations: all these things represent a huge basket of capability activity that we need to maintain, but, in the words of Bob Stewart, can we have our cake and eat it? Can we afford all these things to carry on as they are, or do significant changes need to be made?

Professor Hartley: I have a stupid answer—yes and no. Yes, if we as a society are willing to spend more of our GDP on defence at the expense of schools, hospitals, social welfare spending or lower taxation. Yes, we can, but I think we will only spend substantial amounts more if we are faced with a real threat—a war.

Q29 Douglas Chapman: Within the specific budget, the increasing budget, given all these projects and the risks that we need to meet, is the budget sufficient to meet these risks that have been highlighted?

Professor Chalmers: In terms of the list you just gave, I think the current budgetary provision in the summer Budget is sufficient to invest in all those areas over this period, yes. As for the exact quantities—the number of scout, the number of maritime surveillance aircraft, and so on—nothing is infinite, but I think that because there is a real-terms increase over this period, and for all the other reasons I gave, we are capable of investing in all those areas, yes.

Q30 Mrs Moon: Okay, I am going to personally appoint you for a brief period in charge of the Ministry of Defence budget. You have time to push through one major change. What would it be and what impact would it have on the 2%?

Professor Hartley: I would put funds into maritime patrol aircraft capability. That could be funded from the 2%. That seems to be a gap that we really have, particularly if we are serious about continuing to have a world military expeditionary role.

Q31 Mrs Moon: I should explain that it does not have to be purchasing of a capability; it could be the way we do our accounting—

Professor Hartley: Oh, I have a number.

Mrs Moon: You are only allowed one. It is what your priority is.

Professor Hartley: I was going to suggest raising the retirement age to 55, 65 or 75 for military personnel. There is no reason why our military personnel must be capable of jumping in and out of trenches; increasingly, they could carry on, as they do in the private sector, until the age of 65, 70 or 75. Why do we not do that for the armed forces? Why do we suddenly have this highly valuable human capital which we pension off at the age of, is it 55, Bob?

Bob Stewart: It is 42 for a soldier.

Professor Hartley: It is even worse, then; right, okay. No, I would go for maritime patrol aircraft capability. As I say, it is a gap. It seems to me that if we are having carriers and a world role, we need a nuclear-powered submarine, we need that sort of capability, otherwise we could be calling upon the French and so on to provide it when we need it. I would like role specialisation, but I do not think we are there yet.

Chair: Any other bids?

Dr Niblett: We have to give an answer; we cannot sit up here and not give an answer, so I will give Malcolm a bit more time to think up a really sensible answer and jump in and filibuster—that has put the pressure on you, Malcolm. I do not often get to think about this; it is a challenging question. I am trying to think where things are going to change the most: the asymmetric risks to British security; the ability of few to do a lot; the ability of what we thought were less technologically capable countries to suddenly become very technologically capable in areas that can affect us.

There has got to be some nexus around, if we can get through the 2% and the next five to ten years of the platform-y stuff that was just described, we should be investing at the moment, somehow, through the MOD and through defence, more in the innovation space. Drones are at one end—maybe you do not need fighter aircraft in the future and you can do a lot more in a lot more intelligent ways; cyber-offensive capabilities as well as cyber-defensive capabilities; miniaturisation. We need to try to think one step past, one step through.

As I do not know the defence budget well enough, I do not know which bit that comes into or how it is done or encouraged, but given the fact that we have spent most of our time here talking about capabilities—which by the way are important in the insurance framework that we have just described to ourselves and in the full-spectrum-of-capabilities world that we have described to ourselves—the bit that I am worried might not get as much attention is that game-changing space. The UK has traditionally been quite good at least at looking forward to if not always at developing the capabilities.

Q32 Bob Stewart: Is that enough time, Malcolm?

Professor Chalmers: It is, yes.

Pardon, my list was too long, Madeleine. I think if I were given that freedom within the budget settlement, then I would relax the manpower ceiling for the Army—

Bob Stewart: Good man!

Professor Chalmers: —because I think it is too rigid. The overall personnel ceiling is fine and is consistent with the budgetary settlement, but having a specific ceiling on the Army regular numbers is unhelpful in terms of flexibility and trade-offs. It is likely actually to reverse some of the efficiency trends of the past five years, where front-line commands have been able to trade off between civilians and service and contracting out. So I think that that is unhelpful and I would take that away.

I would use the savings from that—this is still one thing—to enhance our capability as a state to act independently in small-scale operations of the sort that the French did in Mali. Of course the French did rely and continue to rely on others to do that, so it is as much a matter of political will and opportunity, but I think investing more in our ability to intervene independently would I think be very important for the long-term credibility of UK defence, because in the end we spend all this money on defence in order to be able to use these assets for national security.

Chair: That was—*[Interruption.]* Oh, a postscript, no less!

Dr Niblett: I might be spurned on this point. Although I do not doubt the importance of Britain being able to act nationally to the credibility we then bring more broadly, I still think that collaboration with others is going to be essential not just from a military standpoint, but from a political standpoint. You can have all the capability you want, but if you do not have the political backing for that intelligent intervention—I think that some of those intelligent interventions might be easier to do with a few other countries; it does not have to be rigidly in a big group, EU or NATO—that capacity that we talked about in the framework nation dimension earlier, that capacity to collaborate intelligently, institutionally with other countries, is a missing feature of the whole 2% debate.

Q33 Chair: That was an excellent question and three extremely valuable answers. To give Mr Shannon, who has unavoidably only just been able to join us now, a moment to think—I know he has an issue that he wants to raise—I will take it touch further. At the moment our equipment budget is committed, if I understand the situation correctly. Will the extra resources be available to change that commitment of the equipment budget in terms of, for example, ordering extra big ticket items where perhaps we were only starting off in a programme with a very small initial order of pieces of new equipment?

Professor Chalmers: If you look at the last equipment plan, published in January, then you will see that as the years progress through that 10-year equipment plan, the percentage of the budget each year that is contractually committed gets a lot smaller. By year four or five I think we are down to perhaps 30% or 35% contractually committed. There are other items pencilled in, for which there are not contracts, but the further you go down the road, the less reliable the numbers, the less firm the commitment and the less reliable the timing. So there is already quite a lot of scope beyond year three to flex between different items. If the overall envelope is growing by 1% per annum, there is, I think, some significant potential for new big ticket items, depending on how much they cost. But the other element that I think is important to bring in here is the Joint Security Fund. Certainly my understanding is that that is a place where potentially the MoD could go for equipment investment.

The problem which I think the Government has not yet adequately clarified is that, for anything but off-the-shelf purchases of relatively small items, it is difficult to believe that you will only have a one-year investment. Therefore, a biddable fund, which tends to have an annual cycle, might not be appropriate for the sort of investments which would be useful for defence; but potentially at least the JSF is a source of funding for new items which we have not thought about so far.

Professor Hartley: On large-scale projects, I would not have thought it was impossible. I am sure the industry would welcome additional contracts for, say, more Typhoons or more JSF. These can be easily awarded. It takes time, but we have already got enough capacity to keep most of our major firms busy in the short run. This gives them further work in the longer run, but of course they would be single-source contracts and you are pricing in a non-competitive situation, which is not conducive to the competitive outcome where you get lower prices and profits controlled by competition.

Q34 Jim Shannon: Apologies, gentlemen, for not being here for your presentation. Two quick questions. One of them is off the back of a visit I had to a Thales factory in my constituency. They are a big company that is involved in the cyber industry and missile technology. When I visited the factory, they said to me they wanted to make sure that in the 2% of GDP figure, they could take advantage of the equipment budget through procurement. The other thing to say is that it is good to have partners. Partners in these companies can invest money in staff and their innovative technology. These massive companies employ many people and play an important part in our economic business. How important are they to the MoD? All countries are very conscious of the importance of cyber and some countries are some steps ahead of us. What do we need to do to keep up with them?

The second quick question—I am conscious of time—is that at the summit in Wales in September 2014, the NATO allies agreed to reverse the trend of declining defence budgets and commit themselves to 2% of GDP within a decade; that was done a year ago, so what has been done to ensure that our NATO allies do reach that 2%? It is very easy to make a commitment, but sometimes I wonder whether people say, "Yes, let's do that" and then they go home and forget about it. Maybe I am being a bit facetious—I apologise if I am.

Chair: Before you reply, I have to say it is quite phenomenal that Mr Shannon had to be away for most of the meeting and yet he still came up with a question which no one had thought of before. Well done. Who would like to comment?

Professor Hartley: Certainly, the other NATO members are way short of the 2%. We have appealed for years, as have the Americans, to the Europeans to raise their defence spending, without very much success. But NATO has survived and I think it has survived for very good reasons. It is a very effective and reasonably efficient military organisation. It is the only international military organisation we have that has a decision-making organisation that has proved to have some degree of success.

You mentioned Thales and you mentioned jobs. Could I plead for a bit of caution? As economists, we get rather worried when people start saying, "Let's do this in the defence field for jobs." Let's not forget that, really, the purpose is to provide security for thee and me and not necessarily to provide jobs. Jobs are a by-product. If you really want jobs, it is far more cost-effective to put your resources into, say, construction work—roads and other sorts of construction programmes that are very labour intensive. They will employ labour. So I just caution that we ought not to be too concerned about the jobs implications. They key thing really is what the implications are for peace, protection and security for ourselves. If we get some jobs in the process, fine, but if you really want jobs and if that is your policy objective, there are better ways of getting it than putting it into some very expensive defence programmes.

Q35 Jim Shannon: The reason why I made the point was that if we advance our missile technology, for example, you can be pretty sure that Russia, China and some smaller countries are doing the same, so we need to be sure that our missile technology is up to scratch, if not better than what they are developing. We need to develop each time; that is the point I am trying to make. It is not necessarily about jobs. I agree that they are a by-product, but missile technology is so important. We need to be better than the other guy.

Dr Niblett: Keith, to play your earlier point back to you in the context of this question, you said that defence is about public goods. You cannot measure it the way you measure the private sector. Therefore, we are not really talking about jobs here; we are talking about the expertise that allows you to deliver the public goods.

I do not want to get into defining which product over what product, but if the UK is to be a serious player in defence and therefore needs to have the capacity to ensure that it can supply some of that equipment—with others if need be; Thales is a French company that is based over here and does a lot of its business here, which is great—then expertise and being able to provide some predictability in the investment climate in which people can nurture employees and give them training so that you can supply the public good is a good thing. This is not about jobs and whether you have a more productive job in construction or in designing a cyber-suite or something, although it is probably, person for person, in the latter rather than the former. Providing timelines and some predictability over time is probably a good thing in the context of companies then helping Governments to ensure that they provide the public good in defence. I would put it that way.

On your thing about what we are doing with everyone else, NATO and meeting the 2% target, if I remember the language correctly, the Wales summit target is cleverly and politically defined such as, “You will stop the decline, and you will then be on a route towards 2% in 10 years’ time.” That is what I call a really nice flexible target to aim for, but it reflects the fact that, in the end, Governments will do what Governments need to do. The pressure will be on countries, such as Britain, France and some others, that are in a stronger position now to say, “If you are serious about defence, it is not just a case of free-riding on America, which is not acceptable; you are free-riding on us.” That comes with some type of political cost if nothing else. Having others—not just Brits and the typical ones—stepping up is important. It is important that Poland is hitting the 2% target. It is nice that Estonia is, but Poland is a big country and I think that matters.

It is also important that Poland is putting money into, for example, pipeline interconnectors with the Baltic countries—I think that was in the news today. That is a form of security as well. I go back to my earlier point about the full spectrum of security and defence. Each country should be doing what it can. The 2% is useful target, a useful reminder and a political lever, but what is inside the 2% is more important than the 2%. In the end, everyone contributing to our collective security is the most important thing of all.

Chair: The final words go to Professor Chalmers.

Professor Chalmers: Two excellent questions. The first point I would make is that when we are talking about national defence capability, it does not only reside in our armed forces. It also resides in the private sector, which is critical to supporting national defence capability not only now, but in the future and in unpredictable circumstances when we may not know who our allies are in particular scenarios, although we rely on allies a lot. There are in practice some real trade-offs to be made when decisions are made on defence acquisition. Sometimes, you can get more capability from buying off-the-shelf or overseas rather than in the UK. It is important to keep our national defence industry competitive for our procurement and for export purposes, but it is of value to have the people who know how to operate our kit, maintain it and modernise it on our territory; that has to be part of the procurement dynamic.

The Wales summit was the first NATO summit that had all these specific targets. As you rightly indicate, countries that already fall below 2% are only committed to aim to meet the 2% within 10 years, and I think we have at least another four NATO summits between now and then. My guess would be that the countries that feel most exposed to Russia at present are most likely to move significantly towards the 2% target in the near term. There is quite a number of central and eastern European countries—Latvia, Lithuania, Slovakia, Slovenia and others—that only spend 1% of their GDP on defence. Some of the countries that have been most vocal in saying that we have to commit have actually have done relatively little so far, but I think those countries—particularly the Balts and Romania—are likely to move towards 2% in the next two or three years. They may even meet it.

There is little sign that other countries that are further away from Russia—countries like Germany, Spain or Italy—are going to move towards increasing the proportion of GDP on defence. Indeed, I think all of those are continuing to reduce the proportion. I do not think they will change because of a NATO policy. What would change their calculus is if their national defence priorities and national risk assessments significantly changed—if there were a real prospect of conflict in the Mediterranean or if Italy had to provide the bulk of a peacekeeping force in Libya. We can all think of scenarios in which some of those other NATO states could find themselves.

In the end, NATO is an alliance of democracies. NATO does not decide its defence budgets as a result of diktat from Brussels or Washington; it decides on the basis of national threat assessments. That is what we have done in this country. We have decided in the end, not only because of what NATO has said but because of the Government's judgment about what military forces we need for national and collective purposes, that it is important to put these additional resources into defence.

Chair: I am sure I speak for all members of the Committee when I thank our three witnesses. They have put forward a wealth of data, information and analysis that will be of huge value when we come in later sessions to question the Chiefs of Staff, Ministers and officials. I take away from this the fact that quantification is an imperfect guideline, but it is at least measurable to some extent and a legitimate part of the picture.

My mind goes back to the 1960s and the run-up to the six-day war of 1967, when all the papers showed the quantities of forces ranged against Israel, which appeared to be overwhelming but which in terms of defence outputs proved not to be. While accepting the limit, we nevertheless feel this is a legitimate part of the picture to investigate. We also intend, following the final contributions, to set on the record what other countries are doing in terms of defence expenditure and what we are doing by comparison with what we used to do in the past.

Jim Shannon: The six-day war was a good biblical example of David and Goliath. We know who won that one.

Chair: I could not put it better myself. On that happy note, the meeting is closed.