

Defence Committee

Oral evidence: [Defence Acquisition and Procurement](#), HC 698

Tuesday 15 November 2016

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Members present: Dr Julian Lewis (Chair); Douglas Chapman; Mr James Gray; Jack Lopresti; Mrs Madeleine Moon; Jim Shannon; Mr John Spellar.

Questions 123-168

Witnesses

I: Dr Warren Chin, Senior Lecturer, Defence Studies Department, King's College London, Professor Andrew Dorman, Professor of International Security, King's College London (based in the Defence Studies Department at the Joint Services Command and Staff College), Professor Trevor Taylor, Professorial Research Fellow in Defence Management, RUSI, and Professor Matthew Uttley, Chair in Defence Studies, King's College London.

Written evidence from witnesses:

- [Defence Economics Research Team \(ACQ0010\)](#)

Examination of witnesses

Witnesses: Dr Warren Chin, Professor Andrew Dorman, Professor Trevor Taylor, and Professor Matthew Uttley.

Q123 **Chair:** Good morning, ladies and gentlemen, and welcome to this, which is our second oral evidence session for the Committee's inquiry into defence acquisition and procurement. We are hoping to pursue a number of themes in accordance with our terms of reference, but first of all I would like our panel of witnesses to introduce themselves in order to record the details correctly, starting with Dr Chin.

Dr Chin: Warren Chin, King's College London, defence studies department.

Professor Dorman: Andrew Dorman, King's College London. I am also the editor of *International Affairs* at Chatham House.

Professor Taylor: Trevor Taylor. I am a fellow at the Royal United Services Institute and I still do some work for Cranfield University at the defence academy.

Professor Uttley: I am Matthew Uttley, King's College London, defence studies.

Chair: Thank you for giving up your time and enlightening us today. We will start off with Douglas Chapman.

Q124 **Douglas Chapman:** Good morning. The Government have indicated that they will spend £178 billion in the equipment plan over the next 10 years up to 2026. To do that they must make efficiency savings of almost £16 billion—I think it is £15.9 billion. How easy will it be to make these savings? How crucial is that to the overall deliverability of the plan?

Professor Taylor: I think I wrote in a piece in *International Affairs* in 2011 about the Ministry of Defence having a track record of relying on efficiency savings in order to fund the capabilities that are associated with a policy. My finding then was that, although efficiencies are always possible within defence, they are never of the scale that are needed to pay for everything that is required. I still rather keep that view.

I do not easily see where there are great savings to be made. What I see with the civil service cuts is that these are cuts rather than changes that have been put in place according to some view of how processes and responsibilities are going to be amended. So I am not optimistic on these savings. There is of course the defence estate and there will be some money from that, but whether that has been exaggerated remains to be seen.

Professor Dorman: I entirely agree with Trevor in terms of the efficiency savings from the Ministry of Defence. I think the Ministry of Defence has been engaged in efficiency savings since about 1980. At some point the



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organisation becomes super-efficient and actually what we are talking about is cuts. What we are seeing is a lot of the efficiency savings are actually cutbacks. There are big assumptions about what the defence estate will produce in terms of sale of assets and reducing the overall cost of running the defence estate.

As with all defence reviews, I think the Ministry of Defence is being optimistic—it always has been, because it is in its interests to be optimistic when thinking about future programmes. So you get this collective view of optimism. We saw in the National Audit Office report that came out this morning that the defence estate not only is unlikely to make the savings it planned for; it is also not thinking that strategically about it. It is about short-term savings.

Dr Chin: Historically speaking and going into the present day, the fundamental problem with acquisition has been the rising defence costs within the programme itself and the inability of any procurement regime to control those costs. So you have had the problem of rising costs as the programme is going through the procurement process itself and the more fundamental problem of intergenerational costs. I do not necessarily see how those fundamental problems have been addressed.

The current spate of reforms that we are looking at is the latest batch of a whole series of reforms going back to 1958, and it is a bit like reorganising the deckchairs on a sinking ship in a sense. Unless you can find a way of tackling that fundamental problem, you are still going to be faced by rising costs, no matter what efficiency savings you can produce, which means they will be cancelled out, I would think, over the duration of the projects themselves.

Q125 **Douglas Chapman:** When the MoD's financial people spoke to the Committee in the last month, they were asked a question about what keeps them awake at night of all the things they had to do and, while they would not answer the question directly—as you would expect—the clear impression we got was that it was that the efficiency savings they had to make just would not stack up at the end of the day. Professor Uttley, would you like to comment on the £15.9 billion of savings that need to be made and whether that is achievable?

Professor Uttley: I think I would definitely agree with the points already made, really. There is a risk of over-optimism in terms of savings. History tells us that efficiency targets are rarely met. As Andrew has pointed out, there are already some concerns around the defence estate. So these things collectively point to difficulties in realising those efficiency targets and therefore in the resources available in terms of the assumptions that underpin the future of the plan.

Professor Taylor: I am sure you noticed that the problem got worse with the depreciation of the pound, which we pointed out in a small piece. The calculation I had was that that took about 2% a year off MoD purchasing power, and now it is probably a bit more. So the affordability of the plan has been significantly affected by the loss of value of the pound.



Professor Dorman: The other thing to add to that is both fears of UK inflation—we are used to very low inflation, but post-Brexit we may see more significant inflation in the UK—and post-election of Donald Trump in the United States. So we may see significant rises in individual programmes because of background inflation.

Q126 **Mr Gray:** Can I drill down a little bit into estates? I saw the headlines. I have not seen the NAO report this morning—I do not know whether any of you have read it—but it strikes me that there are two particularly significant holes in the argument. The first is that many of the bases that are being cleared are going to be sold by 2032, which is wildly beyond the 10-year programme. And even once they have removed the regiments from the bases in 2032, it will take them quite a lot of years to correct them, sell them and develop them. Secondly, they have made heroic assumptions about how much of that land can be sold for housing. Much of it is completely and utterly unsuitable for housing but they seem to assume that every single inch will be sold for housing at £1 million an acre. The NAO report may address this, but to what degree is the estates thing at all robust? Is it complete fiction?

Professor Dorman: As you say, projected housing costs and the value of land is always a challenge, but having looked at that paper this morning two things strike me. One is we see that not all the things they plan to sell off are going to make money: at least some of the assets have got a net present value in negative figures. The other bit is that it seems the Ministry of Defence is focusing on trying to sell those bits of land it can make the most money out of in the short term. The problem we have got with the defence estate and its wider reflection within strategic defence and security is that it is astrategic, because actually it is looking at the short term and “What can we save quickly? What money can we make as quickly as possible?” If you think about where you want the defence estate to be, it is not just about what capabilities for the Armed Forces you are thinking about having in 20 years’ time or what estate they want; you are also thinking about what you might need beyond that. What capabilities do you need to be able to regenerate in terms of equipment and also of estate? It does not seem to me that they are thinking long term about the footprint they want for their estate in terms of the ability to regenerate and reconstitute forces as well. They are focusing on selling American air bases in high-priced areas like Cambridge, because that is where they think they will make the maximum money.

Professor Taylor: I think there are two issues. One is whether the claims about the benefits of the sales’ value are accurate. Quite a few of us are sceptical on that point. The other is that I think we all recognise that infrastructure is often, along with research, the poor relation of defence spending, because it is something you can always put off until the next year, so it tends to deteriorate.

The thing about the NAO report, which I quickly looked at, is that you can see it as a criticism of the privatisation process, because the company itself—Capita—comes in for some criticism. But you can also see it as a reflection of the fact that, when the defence budget is pressed, not enough



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money tends to go to infrastructure to keep it up properly, because it is the poor relation. Those are two rather different points, but I think all of us are a bit sceptical about the money. I would have thought the estate was valued already in the MoD's accounts at current use. I do not know how the value of the estate that is being sold at current use matches up with what they plan to sell it for.

Q127 Mrs Moon: I will leave aside the question about whether Capita has a proven record in doing anything well. You talked about the impact on procurement of the fall in the price of the pound. The Ministry of Defence always tells us that they future-proof, that they are aware of fluctuations in the currency market and are able to protect against that. Do any of you have any evidence of how successful they are at that? Has that ever been examined, or is it just another MoD assertion that cannot be proved?

Professor Taylor: When I asked about this issue, I was told that the MoD had hedged—I think the Minister said for the short term, but in private he told me precisely how long it is. It is not long enough to cover anywhere near the major purchases that are in mind. I do not think anybody anticipated—if the MoD had in its risk register and its equipment plan a sense that the pound might drop in value by 17%, I would be impressed, but I rather doubt it. It is a major challenge for them. I suspect that what is going on is a good deal of reprogramming, so that purchases are spread out over a longer period, but as we know, that tends to push up the price of things.

Q128 Douglas Chapman: A few of you mentioned the equipment plan in your responses. In terms of what affects the deliverability of that, is it the increased cost that Dr Chin referred to? Is it the over-optimistic approach to costings for new projects, or is it the £700 million black hole that Professor Taylor talks about in his paper on the currency? Is one of those things—A, B or C—the most risky part of the way the Government have gone about this, or is it D, which is all those things put together plus an unrealistic approach to how we plan longer term for defence spending?

Dr Chin: I would go for option D. It is a combination of all of the above, but that is, in essence, a cop-out. I imagine you would prefer us to identify what we think will be the principal existential threat to this programme.

Professor Dorman: I would add a fourth one, which I should have mentioned. If you look at the defence estate report, in making the sales of the assets they assume they are going to sell, they are going to have to move a whole series of units. The report also identifies that they have not actually got the cash to move the units. It is predicated on making sales of assets by moving people out of different bases, but they do not have the money to move them. They will have to find the money to move them, to make the money they're going to save.

Professor Uttley: I agree with the point about all of the above. It is also noteworthy that the focus has been very much on the acquisition costs, but we have to factor in the equipment support elements of that. An area



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where, as I understand it, there could be a risk is in not just the initial up-front acquisition but the liabilities for through-life support of those programmes that make up the plan.

Dr Chin: If you were looking at this, you probably would break it down into temporal risks and hazards. The most immediate focus is on the currency and the devaluation of the pound. That might recover, depending on how the fortunes of the British economy and the world economy play out over the next two years. In the same sense that we have seen a currency crisis, we might see a reverse of that, as we did in the 1980s, when a lot of the financial predictions that the MoD based its defence planning on proved to be fortuitous, in that the value of the pound rose quite considerably, and that helped.

In the longer term, it is going to boil down to the issue of how well you manage the equipment programme. I suppose that touches on the reforms introduced by both Levene and Gray and how well those play out. I assume you will want to talk about those later.

Chair: That is the next question, actually.

Dr Chin: We will move on to that then. In the longer term, over the life cycle of the programme itself—it comes back to the point that Matt has raised about the life-cycle costs of each of these particular programmes and how those play out. I know the MoD has made a great effort to try to take these issues into consideration, but I do not know how successful it has been. It has been an aspiration going back over decades that procurement should factor this whole idea of life-cycle costs into the acquisition cost, but I do not have any evidence to show how good or bad the MoD has been in terms of forecasting the actual costs of the programmes as they roll out and go into service and then out of service.

Professor Taylor: I would stress that a lot of the programmes where UK industry is involved are pretty mature, and they are not suffering from unscheduled cost increases to a problematic degree. In the past five years, the Government have taken out some of the risk of unscheduled cost increases by buying off-the-shelf equipment, mainly from the United States. That equipment is subject to the same intergenerational cost increases that have marked previous things. Norman Augustine, who came up with the original law about intergenerational cost increases, was interviewed recently and emphasised that his law was still in force. Into that safe procurement-cost area of buying off the shelf, as it were, we have to factor in the foreign currency issue and the fact that we do not yet have a contract price for the F-35s, the P-8s or the Apaches; we will pay that which the Americans ask us to pay. But we do have to recognise that the Government tried to avoid some risk in acquisition by buying developed items off the shelf.

Q129 **Chair:** Before we come to Levene and Bernard Gray, can I ask a quick question? Dr Chin, I think you made this point: how super-efficient can one make an organisation when one is constantly being told that billions will be taken out in successive years?

Dr Chin: I think it was Professor Dorman who made that observation.

Chair: Professor Dorman, right. Are any of you aware of any studies that have been done that have actually analysed what the MoD claims in the past to have carried out by way of efficiency savings and assessed whether they were efficiency savings or cuts? If you have not, I feel the prospect of a good PhD thesis coming on.

Professor Uttley: Not recently. There are studies that exist. They have tended to focus on exemplar cases or present averages or aggregated statistics, with little description of the underlying method or source. These are studies that do not relate directly to weapons acquisition; they relate to forms of outsourcing and so on. I am aware of those studies; others may have other observations.

Professor Dorman: The only one I have is on the personnel side, but it is probably indicative. You may remember that during the 2010 election there was a debate about the top-heaviness of the Armed Forces. I seem to remember that, in the 2010 SDSR, there was a promise to cull the generals by 25%. The MoD is hiding its figures even more than it ever has done, but looking at a number of parliamentary answers, it would seem that senior officers continue to increase as a proportion of the Armed Forces. That exponential upwards line is still there. If we take hierarchies as efficiency, we are not doing very well.

Q130 **Chair:** It might be worth while both for this Committee and defence academics to start looking not so much at what they say they will do in terms of efficiency savings, but at what they claim they did in the past and whether those really were efficiency savings or really cuts in capacity, as you suggested earlier.

Professor Taylor: To understand efficiency, you have to understand inputs and outputs. Outputs from the Ministry of Defence evolve—or the claimed outputs—and it is very difficult at the Defence Ministry level. I know that there are studies and numbers on some of the outsourcing with regard to equipment support. The NAO has commented on metrics for availability and so on, and repair times that have followed from contracting for availability. They are the particular studies I am aware of. However, often, when the Government have made claims about efficiency savings that they are going to make, by the time you come to measure, the inputs and outputs have changed, so it is very difficult to pin it down.

Q131 **Mr Spellar:** Would you say that the Gray and Levene reforms have improved the defence acquisition system?

Dr Chin: I think, on paper, yes—especially Bernard Gray and what he said about the problems being experienced within acquisition. The sorts of issues that he raised are long-established and well known, but the approach he adopted and the solutions put forward about how you deal with over-optimism, in particular, in the procurement process offer one option. I am not entirely certain about Levene.



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I would impose two huge caveats on any comment about the success or failure of the reforms. First, you need to think about how much worse it would be if you did not have these reforms—that is something we need to take on board. Weapons acquisition, as you know, has not done very well by its own standard, but when you compare it with other forms of economic activity, it is actually not that bad.

The other point I would make is that it is too soon to form a concrete judgment on success or failure. The RAMs say it takes between eight and 10 years before you can measure the effects of a set of reforms in acquisition to determine whether those reforms have actually worked. As Professor Trevor Taylor has highlighted, what makes things more complicated is the fact that the goalposts often shift and move over that time. A weapons programme lasts 20 or 30 years, so it will outlast the Government who initiated the reform, the people serving in the Armed Forces and the civil servants responsible for the delivery of those reforms and their implementation. So in a sense, it all becomes very muddled.

From my perspective, I think one of the biggest problems with regard to acquisition—again, it is an old problem—is the fact that it is so slow. It takes decades to procure kit. Think about the world we live in today and the way in which technological change is taking place—its tempo and breadth—and the way technologies are beginning to form synergies between each another. Look, for example, at synthetic biology, where we see computers and biology being mixed and integrated in interesting and new ways. All these things are producing a much faster cycle of change, which, in many senses, makes the procurement process look antiquated and completely outdated. Something needs to be done to speed up the procurement process so that you end up with something that is more agile and can react more quickly to what is coming towards us.

In that sense, I do not think Levene or Gray necessarily give you an answer to that question, but in terms of providing accountability and dealing with the problems of over-optimism, it kind of ticks the boxes—at least from what little I have seen of it so far. But as I said, I think the evidence will only come to fruition as we see programmes go through.

Professor Uttley: I agree with Dr Chin's point about where we are in the cycle. It is probably too early to evaluate this fully. I suppose the answer to your question is, "Compared to what? How much better are we?" There is evidence of improvement, as we have seen through the NAO reports. Those of us who have looked at this sort of area for a long period of time tend to notice a cycle in which there is a degree of optimism about acquisition reform and an assumption that we have finally gripped the problem, bounded it and come up with the silver bullet that will resolve it.

I take you back to the reforms undertaken by the then Sir Peter Levene. As we saw the introduction of competitive tendering, there were huge amounts of enthusiasm about smart procurement and smart acquisition. Those were good ideas but, for a range of factors, they were not fully delivered.



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The question is: what constitutes success in this area? Is it absolute parsimony, with no cost overruns, no delays, et cetera? Or do we need to look at these reforms relative to the situation that preceded their implementation?

Q132 **Mr Spellar:** But industry is improving its processes every day—compare car plants now with the car plants of 20 years ago—and that spreads all the way through. Back to the question: has the defence acquisition system actually improved? If so, to a marginal extent, to a considerable extent or to a significant extent?

Professor Taylor: I am rather sceptical about many of the conventional wisdom aspects of defence acquisition. Many of the problems we have with cost overruns, and so on, do not lie in the procurement body. The procurement body is very important, and it is important that people do a committed and honest job, but even before all this began the evidence was that 80% of smaller projects in DE&S came through on time and on budget. Most of the problems lie with the requirements and the way in which people define or specify them. There are pressures on people to come up with low numbers because that makes it more likely to be approved, and so on. The system is better now than it was, but perhaps that is because in some cases we are getting slightly more realistic about requirements.

To a certain extent, I have a bit of a fear that, rather than being incentivised to be over-optimistic, DE&S has now been set up to be pessimistic. If there is such huge pressure on it to deliver projects on time and on budget, the obvious thing to do—going to the private sector—is to do what the airlines and the railways do, which is always to come up with a padded timetable that does not give the speed that some of us would like.

If we want to look further, the clearest area for optimism in acquisition is probably in complex weapons, where you don't have competition and where you have a very close relationship between the Ministry of Defence and a group of companies. For at least the last five or six years, and perhaps going back 10 years, we have had the delivery of weapons that do what it says on the tin, that do what they are supposed to do, for the price and at the time that they were supposed to come in at. The model looks best in that area of complex weapons at the minute, rather than anything else.

Dr Chin: The other thing, looking at variables, is that changes to specifications used to be a huge problem in acquisition, and it was one that both defence contractors and the customer got well. You put in a very low price, but you would know that at some point the military would come back and say, "We need to change the requirement," and at that point you would load on your costs and inflate the price of the contract so that you made a profit. That was something that Lord Weinstock of GEC told me was rampant within the defence industries.



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Gray and Levene dealt with that on paper by controlling the requirements or preventing them from changing. Again, if you look at this historically, it has been a process, an activity, that successive Governments and civil servants have tried to control, deter and stop, but they have been confronted by "We have to make a change on the grounds that this weapons system will become obsolete in addressing the threat that we need it to address" or, "We need to make sure that its lifespan will last the full 50 years that we planned. As a result, we need to make changes." It is very difficult in those circumstances not to permit the change to go through. Looking at the latest NAO Report, one of the areas of good news it focuses on is that it appears that that activity is under control at the moment. That is a tick in the box for the process, its reforms and what it has generated in terms of positive outputs.

Chair: We have got about three quarters of an hour scheduled for the remainder of the session. With four people on the panel, it is not the case that everyone should feel that that they should all answer every question. We shall try to make our questions a little more succinct so that we cover the waterfront in the time available.

Q133 **Jack Lopresti:** I will try to be succinct. It seems to me that you said that it is too early to see whether the new and emerging defence acquisition model will actually deliver the equipment programme. Looking at DE&S in particular, which is due to be match-fit by 2017, are there any major risks to that actually happening?

Dr Chin: Major risks of?

Q134 **Jack Lopresti:** Major risks to DE&S being what has been described as match-fit by 2017.

Dr Chin: To be honest, I don't know.

Professor Taylor: In the strategic plan of the DE&S there is a definition of match-fit. Match-fit always strikes me as a phrase that is striking but meaningless.

Q135 **Jack Lopresti:** I am not sure whether that is very reassuring.

Professor Taylor: Well, it rolls off the tongue and we kind of understand it. There are serious efforts now underway to manage better, to put career structures in place in DE&S. It is improving steadily as an organisation. That is due to the people in it. It is about improving the commitment of people and their background knowledge.

I am a bit concerned that we have moved away a little bit from emphasising teamwork to emphasising individual silo knowledge. I am relatively confident that the DE&S is improving. I don't think that will make a big deal difference to how acquisition works, if you like, because if you get the requirements wrong, if you choose not to place great emphasis on through-life costs, you are going to get the problems of affordability and overruns coming up again.



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Professor Dorman: The other challenge to match-fit is that, as DE&S is improving, we know that in the background there are civil service cutbacks in numbers. How that is going to play out in how DE&S emerges is not clear. Where all those people are going to come from is interesting.

Professor Taylor: I looked at the numbers for DE&S and would like the chance to check before it goes into the evidence. About 40% of DE&S spending on staff is with outside contractors and about 60% on its own people.

Q136 **Jack Lopresti:** Okay. Looking at small and medium-sized enterprises, what challenges do they have in maintaining or increasing their role in the defence procurement process? If you were a small SME and looking to increase your capacity and get involved in the national procurement process, what specific challenges do you think you would have?

Professor Taylor: I think there are two. Defence is an area of integrated activity, which means that when you introduce one small component you have to make it fit into everything else. For SMEs that means how their systems are going to fit into the bigger picture of defence. That often means that they have to work with the larger companies that control the big architecture. They need relationships. Emphasising that we want more work for SMEs means that there has to be more integration work for that being fed in. How do we make that work?

The second thing is just understanding the whole Government procurement challenge. Many people believe that what marks off defence businesses in the UK and the US is their core competence. Their core competence is often about winning Government contracts, knowing how to lobby, how to prepare bids, how to keep their accounts so that they suit the Government and that whole process. The Government is not necessarily the easiest customer for an SME. It has a lot of regulations that need to be followed. Those two parts are there. The Government are very keen to capture the technological innovation that SMEs can offer, but that has to be developed and fitted into the bigger picture—it doesn't just automatically appear there.

Q137 **Chair:** Let me just make sure I have understood this correctly. We have got two processes going on: we've got a transformation programme for DE&S and we've got the reforms to the acquisition system for equipment, which largely focus on the decision of Levene to give front-line commands much greater control over procurement decisions. Presumably, as the front-line commands are taking more control over procurement decisions, there is less for DE&S to do, so we would be expecting them to be transforming and contracting. Would you say, for example, that there is still a role for DE&S, given that so much more is now being done by the front-line commands? If so, what is it?

Professor Taylor: I think we have to break down the functions a little bit more precisely. Military requirements are a function of what the problems are in the outside world and what the military have to deal with on the one hand, and on the other hand they are to do with what the private sector



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industry can offer, in terms of technology and equipment that enables and helps the military to meet those things. There is a whole question about who talks to industry; who is the expert on what technology can offer? The military are obviously expert on what they need and what the problems are that they are likely to deal with, but they are not necessarily expert on what technology can offer. That is where DE&S and its technical and commercial staff should be playing a role.

Q138 Chair: Am I understanding correctly? The military now have the control of the budget for their service to a considerable extent where acquisition is concerned, so they will still be needing to be liaising constantly with DE&S, in terms of the interface with industry and Government and so forth, but they will be taking the budgetary decisions, rather than those decisions being taken centrally. Is that the essence of the change?

Professor Taylor: Well, there are two elements. The single service is responsible for their budget, and that means they have to pay for the equipment, and they have to work out how they are going to pay for the support. Support is a slightly bigger chunk than for new equipment. They are responsible for making the decisions but, if you like, the DE&S recommendation is perhaps related to if you're running a competition and what contractor you should have, or a decision about procurement strategy. However, the decision about whether or not you go ahead with a new armoured vehicle or not is a military choice. They have to manage that money, and that is a critical problem for the three services, because they have got to make sure they can pay for everything that is needed with the money that is there. So far, the jury is out on that question. There are some issues about whether the Navy has got enough for its manpower. The Army has some very complicated things to do, because it has such a range of equipment and the support costs all have individual lines. You outlined the basic position.

Q139 Chair: Okay. I don't want to wander at all from equipment acquisition, but there are some functions, are there not, that have remained central to DE&S? For example, decisions to do with service accommodation? On the defence estate, decisions are taken centrally rather than in the individual services. Is that right?

Professor Dorman: Historically, the defence estate was with the services. Let's face it: for the past 50 years, all three services have neglected the defence estate. That's why there is a whole history of shoddy accommodation, because basically, when it came to services running their own budgets, it was people and kit that they prioritised and not accommodation. That was the case for 30 or 40 years and it just got run down. You saw the centralisation of the defence estate, and the assumption is that we have to do something about the defence estate—if we leave it with the services, they will carrying on neglecting it. So, there has been a whole centralisation of the defence estate and, actually, the services were deemed to not be that good at running the defence estate.

Q140 Chair: So the argument is that the services will be better at acquiring the equipment that they will need, particularly as they are going to have to

fight with it?

Professor Dorman: Yes.

Q141 **Chair:** Whereas, when it comes to the defence estate, it is better that that responsibility be taken more centrally.

Professor Dorman: That was the argument until Levene came in. Levene has now shifted part of the defence estate back to the services. The historical record is that different services are terrible at looking after the defence estate, and if you centralise it, you can protect the upgrades to service accommodation. We are now shifting it back to the commands. When we say the services, it is the three front-line commands, but it is also the joint force command and the central side of things. The three services have not got entirely the bits that are deemed to be their services—the three commands have got their own bits—but the defence estate has gone back.

Q142 **Chair:** It does seem to be a bit of a permanent merry-go-round with these allocations and reallocations of roles in cycles, doesn't it?

Professor Dorman: As I say, it goes back to one of your questions about efficiency and how you measure how management changes go through, as Dr Chin and Professor Taylor highlighted. You are looking at eight to 12 years to start to evaluate how successful they are, but the history of defence reforms is that they occur much more frequently. By the time you get to the point of being able to measure how successful one reform was, you are into the next set of reforms, which generally unpick the previous ones.

Professor Uttley: Arguably, it also points to a particular division of labour that comes out of the analysis of the problems that existed before the new system. The assumption is that making the services more accountable for their acquisition makes them less likely to engage in the sort of tactics that they were accused of engaging in in the previous regime, namely entryism and those sorts of things. It seems to be an attempt to increase the incentives for the services to engage in sensible forward planning and detailed analysis of the true cost of the equipment they intend to buy, rather than a system where there was an incentive built in for them to compete against each other for a finite budget by underestimating costs and so on, as per the Gray report. Some key questions in all of this are whether that assumption is correct and whether entryism could or does exist. These are questions that I cannot answer myself, but they are the sorts of things that I would argue we should be looking out for as things unfold.

Q143 **Chair:** Let's move on to the question of a defence industrial strategy. We had one under Lord Drayson years ago, famously. Do we need a new one as part of the wider new industrial strategy that the Government has announced? If we do need a new defence industrial strategy, what should it include and to what extent does the defence growth partnership help to meet these needs?



Dr Chin: I think you already know my view on the defence industrial base from the last session. What I would say is that I remember a senior civil servant talking to me many years ago about when he was in the Ministry of Defence in the 1960s. He said that they wrote out a list of all the capabilities that they thought they needed as key to security of the UK. He went back and looked at that list 10 years later and it was completely and utterly wrong. He concluded at that point that the idea of having any kind of industrial strategy, especially in the realm of defence, was going to be hugely problematic and would probably not work. As a result, he decided that it was probably best just to rely on the free market to determine the size of your defence industrial base.

That problem remains an acute one today. What capabilities do you believe you need to secure the United Kingdom, in terms of the physical safety of the country itself? That is not clear to me at the moment, and I do not necessarily think it is clear to many people. BAE will clearly have a view; it will say it believes you need to make sure you invest in the particular capabilities that suit its particular needs. But if you look at the way in which technology is changing, as I said earlier—for example, if you look at the Global Strategic Trends or Future Operating Environment programmes produced by DCDC—the technologies identified as quantum changes in terms of revolutionising warfare and the security paradigm in which we live are not necessarily those technologies that we would normally associate with the defence industrial base. I do not really see any evidence or engagement with those capabilities.

Perhaps that is because these capabilities are going to come from small and medium-sized enterprises for these niche skill sets, which would explain why the current Government is emphasising the importance of SMEs to its acquisition programme. Ultimately I think the technology horizon itself is in such a state of flux at the moment that there is a good chance that you will bet on the wrong horse and end up preserving capability that proves to be irrelevant or obsolete.

Q144 **Chair:** But to some extent there is bound to be a mismatch if threats are unpredictable, which they are, and defence systems are complex, which they are. Even if you adopt a piecemeal approach and say, “We’ll react to events as they occur,” it will take such a long time to design and create a new system that the threat picture will have changed by the time even your ad hoc response to the previous threat has become a reality.

Dr Chin: I am not saying you should have an ad hoc response. Going back to the statement I made earlier, what you need is a procurement system that is quicker, more agile and more adaptable. I am not suggesting I know the answer to that question in terms of how you create such a process, but I think that should be the aspiration ultimately.

Q145 **Mr Spellar:** That is not inconsistent with having an industrial strategy—

Dr Chin: No.

Mr Spellar: —and of the major industrial countries in NAO, can you tell us any that does not have its own defence industrial strategy?

Dr Chin: No, I wouldn't argue with that at all. France, the United States, Italy and Germany all have their own versions.

Q146 **Mr Spellar:** So why is a theoretical free market preferable if the logical consequence of that, if the other parties all have an industrial strategy, is that inevitably you will end up buying off the shelf from them and stripping out your own capability?

Dr Chin: That is a possibility, yes. I admit that.

Mr Spellar: It's a racing certainty.

Dr Chin: But you are addressing a different question, aren't you? There, we are talking about access to supply and competition, and whether that is a good or a bad thing. The issue of the defence industrial base and the capabilities you want to preserve is a separate although related question. Ultimately in looking at this, the problem with industrial strategies and the fact that everyone is doing the same thing doesn't necessarily mean it is the right thing. If you look at history, there are many examples of states having done the same thing in practice, and having all made exactly the same mistakes. Success is usually the state that can be innovative and adaptive. A good example is Prussia in the 19th century and the reforms and initiatives it undertook.

Q147 **Mr Spellar:** I think it built up an industrial capacity as part of that.

Dr Chin: Yes, it did, and I agree that under mass industrialised warfare you need that. I'm not suggesting you shouldn't have it; I'm simply saying you need to think very carefully about the capabilities you want to invest in. I'm not saying, "No, don't have an industrial strategy". It is about having the right industrial strategy.

Q148 **Chair:** I want to bring in Professor Uttley, but I mentioned the defence growth partnership and if anyone has any observations on that, I would be grateful.

Professor Uttley: Apparently we do have a defence industrial strategy because we are on the verge of refreshing it. I suspect that if the Government were here they would say they have a strategy. As we know, it is based on an open procurement default setting whereby policy is to look for the best available equipment through competition, off the shelf, from global marketplaces, with some caveats relating to technology advantage in the ability to operate freely and to upgrade the technologies we have. This is predicated on a particular view of value for money, headline cost, lead time and system performance based on the notion of lower risk, off-the-shelf purchases or the benefits that can be accrued or derived through competition.

A point I would make is about the definition of value for money that is being employed when thinking about acquisition. I think I am about to echo some of the points Professor Taylor made in his written submission about how you define value. It seems to me, having looked at the available evidence, that there is certainly some mileage in looking at the net economic and security benefits of different acquisition options in

terms, to put it crudely, of where the defence pound goes: the economic and employment multipliers that are derived from investing in suitable onshore alternatives, fiscal revenues, strategic influence that can be derived through exporting national defence goods and so on and so forth.

Therefore, rather than talking about a list of capabilities, I will make a more general point about the definition of value for money that could be applied in this area. A definition that is cognisant of employment, industrial and economic implications of what we are really talking about, which is huge amounts of Government expenditure in a sector in which Governments are the only legitimate purchasers and exporters.

Professor Taylor: I would start from a policy position and ask what UK overall policy is. A phrase in the last SDSR is, prominently, "strong, influential, global". If you say your policy direction is to be "strong, influential, global", that carries certain implications. If you said your policy aspiration was to be manipulable, dependent and things like that, that would carry implications, but we are saying something very different here: "strong, influential, global".

The reality we need to recognise is that what happens on military operations and what can happen on military operations is significantly a function of the supplies of parts and services, just as it is with the manufacturing industry and the car industry, as we have mentioned. If you do not have the supplies of parts and so on, you cannot make the automobiles. Without the supplies, the Ministry of Defence cannot make defence capability. What is possible on military operations also depends on a rather more subtle point about operators understanding how equipment actually works and therefore what the limits are on how you can use it, the parameters of it.

Once you take those stances that we want to be "strong, influential, global", that implies that you have a significant amount of domestic reliance on sources of supply. If we did not want to be "strong, influential, global", we would not have to worry about that. That is just a policy stance the Government have taken.

It is that type of thinking that lies behind a quotation I put in my written submission to you from Frank Kendall, when he said "Industry is...part of our force structure". He was speaking as a prominent defence official in the most powerful military country in the world. We say that industry is not part of our force structure because we have got some magic way of avoiding it. For me, this is the start. I would then go on to accept that deciding what we need to do and precisely what that priority should be is a difficult process. None of us are in this because we think there are easy answers.

As far as the defence support group is concerned, what we can see—

Chair: I am sorry. Is that what we mean by the defence growth partnership?

Professor Taylor: Defence growth partnership, sorry.

The defence growth partnership reflects—let's call it schizophrenia: the division in the Ministry of Defence in that some people recognise the logic of what I am talking about and realise we need to support and build our domestic sources of supply. That is reflected in things like the submarine, shipbuilding and complex weapons. Whether it is apparent in areas such as surveillance and communications, which are very important—it's not there. And other people want to be able to buy from the world market because they want the maximum freedom possible. The defence growth partnership has got everything except a significant amount of money and a previous position the Government are willing to accept that they would look to UK suppliers wherever possible.

Professor Uttley: That takes us on to the issue of Government support to exports, against the back of the prosperity agenda. The focus of the defence growth partnership on improving export opportunities is only part of the equation. The other part, as Professor Taylor has said, is generating the onshore capabilities that facilitate the achievement of export orders.

Q149 **Mrs Moon:** Thank you for introducing the things I wanted to raise with you. You could not have given a better introduction if you had tried.

We are buying the F-35B, the P-8A and the Apache from the Americans, not from open-source contracting but from Government-to-Government sales, which are more secretive than any other form. Are there any benefits to the UK defence industry?

Professor Taylor: Well, there are UK benefits that are pretty well publicised with the F-35 in terms of the work that BAE Systems and others do on the back of the airplane. With the other two cases, you had the evidence last week. I was in here to hear Boeing. I think we make part of the airplane—for the 737 I think it is, for the P-8.

The quick answer to your question with regard to the P-8 and the Apache is no, not for production; the in-service phase is another matter. Quite what in-service work will be done on the Apache and what intellectual property and control we will have over the Apache, I don't know.

Q150 **Mrs Moon:** Indeed. Thank you. Do you see expertise across the British defence industry being reduced by these purchase decisions?

Professor Uttley: I suppose the way we would look at this is that the nature and scope of the activities of onshore defence contractors is ultimately driven by the order book. Reductions in volume and type of business will inevitably over the short, medium or longer term, impact on the qualified scientists and engineers that they employ. That is a general point.

In terms of the specific impacts from these choices on specific onshore firms, I could not give an answer. The question is probably more appropriate when there is an acquisition option where an onshore firm is competing against an import alternative, where these issues could be



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measured and evaluated. This is a slightly different category where the Government has chosen to employ its principle of open procurement by securing this deal through the foreign military sales arrangement.

It does lead to a broader point about the quantity and quality of information we actually have about Britain's onshore defence industries, the full implications and economic effects of a decision to import through a foreign military sales alternative—in fact the volume of imports within the UK equipment plan and so on. Those of us who have attempted to look at this issue have encountered a difficulty in that these statistics are not routinely collected anymore. They were collected some time ago. The Ministry of Defence made the decision to stop collecting these statistics, partly because they were expensive to acquire, but also because of their view that this data should not in any way influence procurement choices because they related to employment and things that were not directly related to the security of supply and military capability.

Q151 Mr Spellar: Who made that decision?

Professor Uttley: It was around about 2008 or 2009—I am getting to that age where my decades start to merge. It preceded the coalition Government, briefly.

Professor Taylor: Our capacity in armoured vehicles has practically disappeared. If you look to the future and are interested in, say, the next helicopter project—we have a helicopter sector, we have a fixed-wing sector—what is going to be the next fixed-wing project? Well, there is the unmanned project, Taranis, sitting in BAE Systems, but in aerospace it looks much more problematic than it does in the naval sector or the weapons sector. But there is a question with the weapons sector and the other sub-systems firms—radar, electronics companies. How confident can they be that they can get their product on to foreign platforms? That is a political and economic issue. The quick answer to the question is yes, if you don't get orders, the business disappears, and at the minute there are not the major projects in the pipeline. That has implications not just for the top level but for the people lower down.

Q152 Mrs Moon: Should there be a commitment to protecting certain sovereign capabilities? Are we at the point of risking a hollowing out of our personal sovereign capability and defence capability?

Professor Taylor: The second is certainly true. The defence industrial capability in the UK is reducing because of decisions that have been made. It is almost inevitable. Precisely what sovereign capabilities need to be retained is a tricky one, but that has to be assessed in the light of what part you see collaboration playing. In the last 40 years, collaboration has had a major role in helping the UK to keep substantive capabilities by collaborating on a roughly equal basis with European states. That collaboration has been problematic, but it has been very important in keeping our industrial capabilities together.

How that collaboration will fare in the future, especially in the light of Brexit, is an open question. I would say that the real issue is how we use



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collaboration to keep the capabilities we want. Basically, we have sovereign control over collaborative projects that go into service. We do not have the same degree of sovereign control over things that we buy off the shelf from overseas.

Q153 Mrs Moon: Can I talk to you about value for money? The excellent RUSI paper about the defence pound was one of those ones that I have never got out of my head. It suggested that basically every time we buy abroad, we lose 28% of potential income from national insurance and taxation. The paper suggested that if we spent a third of the budget on foreign military sales, we could lose over £1 billion in received income to the Treasury. Given that we do not know what the cost of some of these platforms are, how will we be able to assess the damage and the additional cost of the platforms we are buying? How else are we going to protect British jobs and the British defence industry, if it is not by looking at value for money?

Professor Taylor: The paper we did was slightly mischievous. It came about because a Government Minister at the time said that the Ministry of Defence should make a contribution to reducing the deficit.

Mrs Moon: Indeed.

Professor Taylor: And we said that the deficit is a function of expenditure and revenue. Therefore, we looked at what the Ministry of Defence is doing to revenue, and did the calculations. It is not necessarily an entirely legitimate proposition in European procurement terms but we hoped that, while we were in the EU, we would have an opportunity to sell to Europeans, as well as them selling to us. The calculation is an elephant sat on that table. We all know it is there but nobody wants to take any notice of it. The volume of imports that we now have is significantly more than when we wrote the paper.

Q154 Mrs Moon: That has not gone unnoticed.

Professor Taylor: Matthew said that the figures are not collected by the British Government, but the State Department does publish the value of military list licences that are issued to the UK. They publish a figure, and I expect the Committee is familiar with it. I think that the last one is up to 2012, but of course it has not gone down. We are talking about \$8 billion to \$10 billion a year. Some of that is re-exported in British products, so we are making an estimate or guesstimate of how much we are importing. It is probably about £6 billion a year, or something like that. Let's take 30%, because I can do the maths easier. That is a chunk of money that is contributing to somebody else's economy. We are getting the benefit of the very advanced systems, but it is a contribution to somebody else's economy.

Q155 Mr Spellar: To what extent do you think that has led to the reduction in the value of our defence exports, from something like £9.8 billion in 2013 down to £7.7 billion in 2015? What other factors might there be?



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Professor Uttley: The factors at work there are the, if you like, lumpiness of export orders—the export figures are distorted by a small number of high-value exports. I have to confess that I have not looked at the relationship between what we have just been discussing and export orders gained, but I think that there we are more looking at a consequence of what is in the pipeline, rather than a direct relationship between the two.

Q156 **Mr Spellar:** But other countries have been maintaining or even increasing their exports over that period, have they not?

Professor Dorman: They have, and they have been more successful. It is interesting. Looking at some of the really big programmes—Tornado sales to Saudi Arabia, Eurofighter Typhoon sales to Saudi Arabia, India sales, Rafale, at that point—the UK has not been quite so successful in its sales in recent years. One of the big questions for the UK industry is, what is the next generation of equipment and is it going to sell, or is this the last generation of equipment? If it is the last generation of equipment, because actually we are doing a lot of our programmes as a junior partner—the F-35 sales overseas is going to be what the US sells, and the UK takes a proportion—unless we have a whole series of platforms and things you can sell, long-term sales are going down. That is where we are at the moment. The question is, what is the next generation of things that are going to sell? We have not sold a destroyer, frigate or a submarine since the '70s. I think the last two new ones we sold—we are good at selling old ships to people—

Q157 **Mr Spellar:** Is that because we have overspecified for our vessels?

Professor Dorman: It is interesting. We did that, even back in the '80s. I remember the Upholder class conventional submarines were much bigger than the Royal Navy wanted because we were going to sell them overseas; as it was, we gave them to the Canadians for £1. Type 23 frigates were upgraded because we were going to sell them overseas. The question mark is about what people actually want to buy from us.

Q158 **Mr Spellar:** Why do you think that is?

Professor Dorman: Partly overspecification. It is also about the fact people want to buy stuff that goes into service in the UK; the GB brand is important.

Professor Uttley: Perhaps what you might be alluding to—or maybe my mind is wandering unduly—in relation to your question, is that if there is evidence of an unwillingness by the UK Government to purchase onshore defence equipment, it seems to me, intuitively at least, that it is less likely to be exportable and less likely to be attractive to potential recipient states. In other words, if the technology is not good enough for the UK's Armed Forces, why should we buy it? Talking about that relationship between onshore defence industrial activity and exports, it seems to me that you would expect to see a decline in exports if the UK Government are buying less British kit.



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Professor Taylor: The UK is a big exporter but perhaps, as we heard last week, it is because we are too dependent on Saudi Arabia as a single customer. We are a major exporter, but it is a reality that although people have talked about putting exportability into requirements for a long time, the military have never really been interested and it has never really happened.

Q159 **Mr Spellar:** Can we just briefly look at the question of imports, which obviously, with the change in the currency, are going to become relatively more expensive? Do you have any views on the impact of those on existing foreign contracts? Also, slightly related to that, what are your views about any impact of leaving the EU on our defence industry and our relations with European defence companies?

Professor Uttley: May I deal with your second, first? Without wishing to walk through a minefield here, Brexit means Brexit but we don't really know what Brexit really means yet. I think that is probably a reasonable summary of where we are. The first point we need to make about this sort of area is that most of the procurement side of things is handled on an intergovernmental basis, through collaborative ventures and so on, rather than through institutions of the European Union; so we see the Letter of Intent states, and so on. There are also, as we know, safeguards in the Lisbon treaty, article 346, that give member states a degree of sovereignty over their acquisition. So the extension of the single European market rules across the EU in the defence sector has been more limited.

What does it mean at this juncture? Certainly, as I understand it, the majority of our defence procurement law is derived from EU directives transposed into British law. So we have a legal framework for defence procurement that coincides with EU law. We could possibly talk about two different scenarios, I suppose, very briefly, in terms of what might happen with Brexit. We can envisage a least disruptive to business as usual kind of scenario—a sort of Norway-type model, or a variant of that, whereby we would expect the UK to pay into the EU to have access to the single European market for procurement; but it would suffer a democratic deficit in the way that Norway does, and we would trade in that way.

The hard Brexit, as it has been referred to, raises a range of interesting questions. The first is whether we will see more turbulence in our domestic procurement legislation. To put it crudely, it would be possible for the British Government to pick and choose bits of legislation. So, on some of the points we have been making about defence industrial policy, Governments might have more latitude than they currently have. What that might mean for the defence industries? In all probability major foreign defence contractors may well look to relocate to continental Europe to preserve access to their supply chains. So there are lots of potential outcomes that probably differ on a Brexit scenario-by-Brexit scenario basis; and I am sure that they will keep you, and those who analyse this, very occupied for some time.

Chair: We need to move on, because we have two more questioners, with two questions each, and about 10 minutes.



Q160 Douglas Chapman: Moving on to research and development, the Government have put aside 1.2% of the defence budget for investment in science and technology. Is that sufficient to grow that sector and be a player?

Professor Taylor: It is very good to have a floor. Whether that floor is sufficient depends, I think, on wider research and technology activities within the economy as a whole, because defence is going to be using more and more research that is generated in the wider commercial, civil sector. It is significantly less than it was, if you like, in the mid-'90s. It is about the same in cash terms, I think, as it was in the mid-'90s. Whether it is enough—it is good to have a floor. The concern, I think, that is reflected in our comments is that research is one thing, but development and putting it into projects are another. How that money will feed into development projects that then come into service, so that research gets used, is a source of concern. If we do not have projects, what the research is doing is turning us into a slightly more expert customer that will be better able to judge what other people are offering us, because we will understand technology better; but we will not be using that technology directly ourselves.

Dr Chin: That is the primary function of the DSDL—to allow the MoD to act as an informed customer when looking at these technologies; so you could argue from that perspective it does what it needs to. The MoD's remit probably does not go beyond that in terms of looking at planting seed corn, and spin-off into the wider civilian economy. I think, as Professor Taylor has highlighted, in the world in which we live today there are more efficient ways of generating R&D, and many of those ideas are coming out of the civilian sector and then spinning into defence, rather than the other way round. So the balance of power, I think, is shifting in a very pronounced way. You could argue that the reduction in defence science and technology is actually a good thing. Historically, we have always accused defence of crowding out research generally and consuming resources that could be better used in other areas of economic development.

Q161 Douglas Chapman: As a follow-up to that, there has also been an announcement about the defence innovation initiative. I think that there is £800 million over 10 years. Is that sufficient to keep the industry at the forefront of all these new technologies and, in relation to competitors, are we behind or in front of the curve? If we are behind, how can we mitigate that?

Professor Taylor: I think you're talking about the defence technology initiative, which is £800 million over 10 years—£80 million a year.

Douglas Chapman: Yes.

Professor Taylor: That is a significant reflection of the American third offset strategy in their technology initiative. The UK is sending a message that yes, we really want to be supporting what you are doing and following that gain. As far as I understand, £80 million a year is not new money; it



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is coming out of the 1.2%. It is a lot of money on the front of a newspaper, but it is not a lot of money in defence. It is a sensible thing to do, but maybe the UK has an unstated strategy that what we are aiming to do is develop enough niche technologies, so that we can get a good deal from the United States on the things that they are manufacturing. That has not been articulated, but it may be what is being pursued.

Professor Dorman: Two things. One is that I think there have been some studies that show that most of the technology R&D investment comes through in about 25 years' time. Basically, as we have been running it down since about the 1990s, we are in a position—which leads to my second point—where the UK is going to have to start thinking about engaging its Armed Forces when it may not have technological advantage. It is also interesting to see, when you look at potential rivals—China and Russia—that they have put a lot into R&D. So one of the things our Armed Forces will have to start thinking about—unfortunately they will have to start thinking about operating in a world in which they no longer have technological advantage, which is something they have assumed since the second world war.

Q162 **Jim Shannon:** As for some of the concerns that the SSRO have, they have said they would like to have more powers to examine every single contract—many of us think likewise, by the way—rather than just those referred to by industry and the MoD. Can we get your views on that? Do you think that they should be able to have the power to examine every single source contract?

Professor Uttley: It is anomalous that we have a regime that imposes regulations on domestically-sourced equipment. Those strictures do not apply to foreign military sales because foreign military sales are an exemption. I would make a number of points about SSRO. It seems to me and, I think, many others, that the sort of reforms we have seen have reduced the potential for adverse selection of moral hazard, which we know has been a problem in weapons acquisition. It is possible to debate and discuss some aspects of profit formulae and those sorts of things, but it seems to me that the biggest issue is around the uneven application of SSRO for significant areas of procurement that are conducted through single sourcing, and that is the foreign military sales.

Professor Taylor: I never quite understood the domain in which it operates, because a sole source competition is not necessarily a cost-plus competition. So if a cost has been agreed for a good or a service, then that will have been done by the commercial staff in DE&S. So is the SSRO then to look back at what the DE&S agreed and try and change it if it is a sole source cost-plus contract—they are relatively rare these days?

There are two issues with the SSRO. What are the allowable costs the company can make on the Government? That would apply, it seems to me, only to cost-plus contracts, because if it is a fixed-cost contract, how the company chooses to spend its money is by and large the company's business. So what are the allowable expenses? One thing is that there are probably some allowable expenses—some practices—in the commercial



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commercial world that are not allowed in the commercial Government world. The other question is what the profit rate should be. The appropriate profit rate for a contract depends on a range of things rather than just one, and it's a question of how those things should be weighted: the degree of risk, the performance and so on. The Americans have moved much more towards contracts where there is a set cost with an incentive fee, so the better you perform, the higher the profit you make.

I have never quite understood the precise domain in which the SSRO operates. I can see that if I was sitting in the SSRO, I might feel a bit frustrated that I can't get a bigger role, and I also have to show that I am paying my way.

Professor Uttley: It would be interesting to know the percentage profit that the contractors are realising through the imports, through the foreign military sales system, and to compare that with the profits subsumed under the SSRO estimates. It would be interesting if the foreign military sales profits were higher, given that they are lower-risk ventures.

Professor Taylor: I think the evidence is fairly clear that the profits, the margins, made by American defence companies are bigger than the margins made by British defence companies and continental defence companies.

Q163 **Jim Shannon:** The Government are obviously keen to get value for money. The SSRO's approach seems to be to get value for money as well. At least that is the interpretation that one would have of it. But if you were able to change the way the SSRO worked or its powers, what would you like to see?

Professor Taylor: It's an interesting question. I always feel there are some questions that we should get paid for answering.

If the SSRO focused on some cost-plus contracts, did some objective analysis, did not have to worry about justifying its own existence and did some modest work that we could see was very thorough, that would be a good start—and would raise some of the difficulties, rather than its trying to branch out into a much wider world, which I think many of us feel is impracticable. I think we would struggle to get the kind of information that is wanted from foreign defence contractors full stop, but trying it get through from an FMS sale is impossible.

Q164 **Chair:** May I conclude, then? On the SSRO, okay, I understand the difficulties with them getting the information that they might want to have in relation to foreign military sales, but they keep complaining that they are not even getting the number of cases referred to them that they would like to see from UK military contracts. You talk about their needing to justify their existence, but surely if they cannot get the work referred to them and cannot have the power to demand that cases be referred to them, it is going to be very difficult for them to function at all, is it not? Finally—and this is the question—do you think that a watchdog like the SSRO could ever function properly unless it was outside the body, namely



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the MoD, that it was supposed to be subjecting to intense scrutiny?

Professor Taylor: I don't know in detail what they have been refused or what they—

Chair: Well, they are always complaining that they get a tiny number of these qualifying defence contracts referred to them, and so far they have lost two chairmen to resignation, which is two out of two, I believe, so they are obviously not a happy organisation, and one suspects that that is because they are not really independent of the body that they are supposed to be scrutinising. I wondered whether any of you agree with that.

Professor Taylor: I think the logic is that they should be outside, but the logic might also be that they have a Government-wide remit. Why restrict this to the Ministry of Defence?

Q165 **Chair:** Because the Ministry of Defence is why they were set up—to try to avoid the taxpayer being ripped off by companies that are able to outmanoeuvre civil servants who are not very skilled in negotiating deals.

Professor Taylor: We have to go back to fixed-price and cost-plus contracts. The logic that you raise with regard to cost-plus contracts might be valid, but the logic that you raise with regard to fixed-price contracts would suggest that perhaps the SSRO has greater expertise than the DE&S in negotiating what the fixed price should be. As you well know, the Ministry of Defence is not the only body that deals with Government. If you say there is a role for the SSRO with cost-plus contracts across Government, then fine.

Q166 **Chair:** Yes, but let's start somewhere. Our concern is that in the sphere of defence there are these hugely expensive contracts, and there isn't a proper market because many of these things come from single sources. We are not suggesting that this body should be involved in negotiating the deals, but surely, like any scrutiny body—including, dare I say it, this Committee—they ought not to have power other than deterrent power that is such that, if bad deals are negotiated, they will then be able to launch effective criticism after the event. That should encourage people to negotiate better deals.

I am not disputing whether it might one day be a nice thing to have a body of this sort operating across Government, although I suppose the National Audit Office does a lot of good work in that respect; I am just asking very simply about this one that has been set up because there is a particularly acute problem in the defence sphere. Can it ever work successfully as a scrutineer unless it is outside the Department it is supposed to be scrutinising? That is a fairly straightforward question.

Professor Uttley: Presumably there would be an assumption that by having part of the Ministry of Defence looking at profits on cost-plus contracts, that would be in the Ministry of Defence's interests in terms of its management of its resources. There is a certain logic that says that the more efficiently the MoD can secure these contracts, the better for the Ministry of Defence and therefore for the taxpayer. There is an argument



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that there ought to be incentives in place and that the MoD itself ought to be looking to get a better deal. The point about whether it is separate and can carry a bigger stick is arguably a jurisdictional question. It is conceivable.

Q167 **Chair:** I just wondered whether any of you had a view on whether it would be able to be more effective if it were independent of the MoD. It is a very straightforward question.

Professor Uttley: It seems to me that if the MoD has incentives to reduce the potential for unreasonable profits on its contracts, the MoD should seek to secure that. Were there to be an external body that then reviewed that—

Q168 **Chair:** Well, you'd think they would, but the fact is that we have a long history of highly expensive MoD contracts that have not been regarded as successful, which is why this body was set up in the first place. I fear this will have to be the last comment, Professor Taylor.

Professor Taylor: I'm not sure—it would be a good question to ask DE&S—how many cost-plus contracts have been concluded in the past three or four years. I am not convinced about simple cost-plus contracts. I suspect there have been other contracts with target costs, but those are relatively rare these days.

Chair: We'll have to leave it at that. Thank you all very much, gentlemen. The session is concluded.