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Ministry
of Defence

PERMANENT SECRETARY



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08 February 2023

Rt Hon Tobias Ellwood
Chair of Defence Committee
Sent electronically

Dear Chair,

MINISTRY OF DEFENCE (MOD) MAIN ESTIMATES AND MEMORANDUM FOR 2022/23

As we prepare for Supplementary Estimates, I am conscious that I owe you a response to points you previously raised on the MOD's Main Estimates and memorandum for 2022/23. I apologise for my excessive delay in replying.

Administration Costs

You asked about administration costs and how they tie in with the then Civil Service 2025 (CS2025) exercise. It is worth noting that our administration budget includes civilian personnel, service personnel and other costs and services, so is not a directly relevant baseline for this. It was set in the 2020 Spending Review, and therefore does not include any assumptions about the impact of CS2025.

The Prime Minister has decided against top-down targets for Civil Service headcount reductions and government departments are instead being asked to identify further efficiencies and savings to live within budgets. In Defence we look at workforce requirements and potential efficiencies through a whole force lens, seeking the optimum mix between regular and reserve service personnel, civil servants and contractors. The different terms and conditions between service personnel and civil servants – and therefore costs of employment – means that reductions in workforce cost can lead to increases in the permanent civil service headcount.

The OBR assessment of inflation and energy costs.

We have taken prudent action to limit our exposure to inflation risk. This includes contracts where we have capped risk, with forward purchases of foreign exchange and fuel hedge swap contracts. We do face a particular challenge on our contract spend as we expect to see price increases driven by rising input costs for our suppliers although to an extent our commercial mechanisms protect us from this in the short-term. The situation is volatile and inflation forecasts are changing regularly, but we continue to manage the

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programme dynamically, having already brought forward spend opportunities where those de-risk future cost or delivery.

Personnel Costs

When we compare the department's total personnel costs (which include those within the administration cost regime) between Supplementary Estimates for FY 21/22 and those planned for FY 22/23 in Main Estimates, the increase is 0.7% (0.8% for the military and 0.6% for civilians). These costs exclude personnel in the department's arm's length bodies including DE&S, which are reported in separate lines in the Estimates. The FY 22/23 Main Estimate costs for personnel were calculated prior to the agreed pay awards for this financial year, therefore costs will increase in line with the net additional costs of the implemented pay awards. Official Statistics show that the number of Full Time Trade Trained Regular Armed Forces personnel at April 22 was 136,820 and based on current in-year forecasts, we expect this to reduce modestly by April 2023. MOD Civilian FTE in April 2022, excluding DE&S staff to align with the financial analysis above, was 48,690¹ and based on current in-year forecasts, we expect little change (-0.1%).

Depreciation

As noted in the Memorandum, the depreciation budget has increased by 6% as a direct consequence of the implementation of IFRS16 where Right of Use Assets (effectively leases) are now held on the Departmental Statement of Financial Position. The Estimates Memorandum highlighted the net increase of £412m for IFRS16, which included an increase of £550m for depreciation and a reduction of £138m for decreases in spend in relation to Operating Leases now being treated as Finance Leases following adoption of the new accounting standard. The impact of bringing existing property leases, including remeasurement of lease liabilities for Annington Homes, has had the greatest impact on the depreciation budget. Of the £550m increase for depreciation, £370m relate to existing property leases, which includes £171m of depreciation due to Annington Homes leases.

Infrastructure costs

I wrote to Dame Meg Hillier MP, Chair of the Public Accounts Committee on 19 July 2021 following the Public Accounts Committee hearing on 28 June 2021 to clarify the status of the 30% disposal target by 2040. This confirmed that the original target, to reduce the built estate by 30%, was a top-down assumption set out in the 2015 SDSR that was not based on detailed plans. This is no longer appropriate and is not being pursued by the Department. Instead, following the 2020 Spending Review, and the publication of the Defence Command Paper, Defence has a clear plan for modernising its capabilities and reducing the size of the estate over the next few years, without being percentage led.

There will be running cost savings associated with any disposal that reduces the size of the estate and these are forecast into plans such as those behind the delivery of the Defence Estate Optimisation (DEO) Portfolio. It should, however, be noted alongside this that DEO is at its core an investment portfolio to deliver modern, greener and more sustainable infrastructure facilities aligned to the evolving military capability needs of the

¹ Rounded to the nearest 10, and excludes c.10,350 DE&S staff.

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Armed Forces. The portfolio is investing £5.1Bn in infrastructure in addition to other planned infrastructure budgets, to deliver a fit for purpose estate. All running cost and life cycle avoidance costs that are being delivered are tracked and forecast into estate management plans.

Budget Exchange

To clarify the activity on Budget Exchange, the Department returned £488m to HMT under Budget Exchange at the Supplementary Estimate in FY21/22. The Department has requested £236m of the £488m for 22/23. The remainder of the budget exchange will be drawn down in subsequent years, namely £104m for FY23/24 and £148m in FY24/25 to reflect the revised profile of spend. Figures for 22/23 onwards are due to be revised in the Supplementary Estimates.

Major Programmes

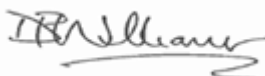
The memorandum includes a link to the Government Major Projects Portfolio, which provides details of all major programmes. This is complemented by the Equipment Plan, which is updated and published on an annual basis, which also provides details of all the major projects being undertaken by the Department. This ensures that what the Department releases into the public domain remains both appropriate and consistent.

Foreign Exchange Forward Purchasing Programme

Finally, I would like to cover the Department's approach to Foreign Exchange (FOREX), which was raised at the Select Committee hearing on NATO with the Secretary of State on 2 November 2022. The Department continues to monitor the currency markets and has built appropriate levels of contingency and risk to protect our budget from short term volatility. This includes the use of forward purchase arrangements, via the Bank of England, to reduce foreign exchange risk and exposure to changes in prices by progressively securing prices on each years forecast. More recently, foreign exchange rates have fluctuated due to the wider impact of inflation, interest rates and market volatility, and we will continue to review the risk to our Equipment Plan.

Given that I have answered a question to the Defence Secretary, I am also placing a copy of this letter in the Library of the House.

Yours sincerely,



DAVID WILLIAMS