Rapporteur Report

The Economics of National Defence in an Age of Austerity

Meeting No. 2: The Defence Industrial Strategy:
What Future for Industry?

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Following on from the initial workshop in May, which focused on the UK defence strategy after the Strategic Defence and Security Review (SDSR), this series continues to explore ‘The Economics of National Defence in an Age of Austerity’. This workshop, entitled ‘The Defence Industrial Strategy – What Future for Industry?’, was held ahead of the release of the UK Government’s White Paper on ‘Equipment, Support and Technology for UK Defence and Security’, and looked at the future of the UK defence industry and whether the Defence Industrial Strategy can respond adequately to the challenges facing the indigenous industrial base. Discussion, which was held under Chatham House Rule, also centred on investment in the workforce, and what current investment trends could mean in the future.

Introduction

The fiscal crisis that has enveloped the UK has hit many sectors hard, and the defence industry has been subjected to some harsh realities. However, the UK faces numerous and complex threats to national security and new defence strategies must be considered in this age of austerity. The Government’s publication of the National Security Strategy (NSS) and the Strategic Defence and Security Review (SDSR) in October 2010 introduced a new era in the evolution of the UK’s Defence Industrial Strategy. Ahead of the publication of the White Paper on ‘Equipment, Support and Technology for UK Defence and Security’, this roundtable event looked at the future of the UK defence industry. It was noted that direct UK defence employment is expected to drop to 80,000 by 2015 as a result of the decisions taken in the SDSR, and this discussion sought to find ways in which the efficiency of the UK defence industry can be improved. This report reviews the key issues that arose out of the two sessions of the roundtable discussion entitled ‘The UK Industrial Base – Indigenous or International?’ and ‘Defence Industry Workforce and Jobs – Investing for Tomorrow?’
International relations: The defence industry and the wider world

With the economic climate facing the UK, the issue of export led recovery could not be more appropriate for the UK defence industry. Not only must it be focused on existing domestic markets, but there must also be a conscious effort to expand international trading networks. It was suggested that defence and security acquisition must be shaped with exports in mind, and the upcoming Defence Industrial Strategy (DIS) White Paper should display evidence of active support for exportable production. During the discussion there were calls from both policy-makers and industry representatives for the government to get a grip on where vital national interests lie regardless of international pressures, and to proudly showcase UK products in order to successfully export them. In relation to exports, distinction was drawn between the UK adopting an overly protectionist position and the adherence to basic national sovereign requirements, but there was consensus within the discussion that national interests are critical to defence procurement planning.

It was noted that the UK’s defence and security presence remains one of the largest in the world, ranking 2nd in defence exports and 5th in security exports. Participants suggested that the main question to focus on is ‘how can we do more for less money?’ With the defence budget facing further cuts, some argued that the primary goal should be the development of a coherent strategy to maximise procurement efficiency. Others suggested a stronger focus on creating revenue based on an exportable and broad product range. One view that drew criticism was the attitude that the UK can buy ‘off the shelf’ to increase capability. This was seen as a short term solution which will further damage the UK skills base and employment capacity. It was argued that reliance on buying ‘off the shelf’ does not take full advantage of the exceptionally open and liberal UK defence market, which attracts foreign companies who create jobs. Participants debated the merits of the Ministry of Defence (MoD) attempts to retain capabilities and production lines through ‘subsidising jobs’, as some argued that maintaining onshore manufacturing is unrealistic and expensive. The extent to which the government has fully understood the best ways to regenerate defence capability was questioned, with some participants arguing that the MoD should be focusing on procurement capability rather than buying off the shelf.

There was debate over whether the UK should produce superior equipment in order to achieve export dominance. With 90% of UK exports classed as ‘superior kit’, it was argued that if the UK does not maintain its stature as an advanced equipment exporter then the industry risks becoming a commodity exporter. This may cause the UK to lose a critical element that has driven the industry forward. The primary question that arose from this discussion was ‘to what extent is what we procure popular’? The point was raised that any country that can afford to purchase expensive, top of the range equipment is likely to be able to manufacture it within its own industry. Therefore, should the UK focus more on the equipment that is needed, not just wanted? It was also argued that the UK is developing equipment that has excessive (and expensive) capability even for the needs of the UK. In this regard, some participants suggested that it is the responsibility of industry to direct the MoD on suitable production for both domestic and international requirements.
Indigenous relations: Transparency between UK Government and industry

A recurrent theme within the discussion was the concept of transparency between government and the defence industry. There was agreement between those in industry that only through greater clarity from government could the issues of procurement and UK defence capability be addressed. It was suggested that the MoD frequently changes its requirements of industry, which causes waste and inefficiency. Participants acknowledged that the government policy has become more transparent, but argued that this policy is not translating into procurement programmes. There were calls for transparency to be institutionalised in order to encourage more realistic requirements.

The Green Paper sought to bring together the strands of defence and security, however participants argued that national security is far less transparent than defence and is obscuring government policy for industry. The dynamics behind the defence and security linkage were questioned in light of the fact that substantial UK defence procurement has been carried out under Article 346 of the Lisbon Treaty, which allows governmental non-disclosure of supply information in the essential interests of national security. As the industry needs to react rapidly to customer requirements, it was suggested that indigenous relations could be undermined by the government treatment of this Article.

Upon reflection of the impact of the recession on the transparency between government and industry, it was suggested that only with fiscal stability will transparency become standardised. Participants suggested that the primary concern is to cut spending on procurement over-commitments by being more selective and taking a realistic stance on the defence capabilities that are required. The 2009 Gray Report was also considered alongside the 2010 Strategy Review, and it was suggested that accountability and transparency regarding defence equipment acquisition must be present at the highest levels of government as they are integral to delivering improvements further down.

Indigenous relations: Working with small and medium enterprises

Discussion of the role that Small and Medium Enterprises (SMEs) play within the defence industry began with the acknowledgement of the ingenuity and innovation that is produced from many enterprises. It was emphasised that in the current economic climate there will probably be increasing movements by the MoD away from UK industry, and the importance of SMEs as a critical tool in creating the vision of UK defence must not be forgotten. There was debate, however, over the nature of the relationship between SMEs and the defence primes. It was suggested that large companies play a vital role in helping SMEs to exploit their potential, as there is no structure in government to deal effectively with a myriad of commercial relationships with SMEs. It was noted that the standards and compliance structures that were currently in place made it increasingly difficult for SMEs to do business with the MoD. The centralising of defence was seen to create further difficulties for SMEs. However, some participants argued that all SME contracts are done ultimately via the defence primes, and there is a priority for the government to ensure security of
defence supplies. Other participants criticised both the government and defence primes for adhering to this system, and suggested that the industry give additional support to partnerships between UK SMEs and foreign countries.

**Regenerating industry: Science and technology transfer**

Participants were keen to discuss the merits of improved science and technology within the defence and security industry. The discussion led to a consensus that the UK must capitalise on the vast US investment in modernising UK defence, as it was acknowledged that the UK benefits disproportionately from technology transfer with its transatlantic partner. There was debate over where UK resources in technology development were best placed. A strong argument surfaced that the limited science and technology resources in the UK should be directed into niche capabilities and sovereign needs. The example of nuclear warhead technology was used to demonstrate the importance of developing niche areas that must be domestically based. There were calls for the White Paper to identify these niche ideas and to exploit the US relationship to make sure that limited resources are not squandered on unnecessary investment. However, with heavy cuts to defence expenditure, there were suggestions that the UK could be perceived by the international market as a less attractive place in which to invest.

The need to manufacture open systems was regarded as important if the UK is to maximise its trade opportunities. The transfer of science and technology between countries in order to manufacture products was seen as a creative way of exporting UK defence. It was noted that the mood in Europe seems to be for a more open market which will increase opportunities for UK defence and security products. However, the concept of ‘off the shelf’ procurement was approached with some reservation, as it was suggested that the UK should be careful about adopting new buying principles with capabilities that are globally available. Another point of contention centred on the question ‘should the UK be concerned where technology goes once it is sold’? Participants debated the most appropriate balancing point between robust economic growth and provision of national security.

**In need of a strategy? Coherence between defence and security**

The inclusion of security for the first time within the remit of a Strategy Review was perceived with more scepticism than it had been during the previous roundtable discussion in May. Although some participants suggested that the convergence of requirements will assist with producing a much needed strategy for the defence industry, there was a general consensus that the defence market is far more mature and transparent than the security market.

Rather than focusing on a honing a security and defence strategy, it was suggested that fostering an industrial climate without a strategy could suit the UK market better. In a direct comparison with the US, it was noted that in the UK, a dialogue between the defence sector and policymakers is promoted less. There was discussion of the merits of finding greater coherence through military,
industry and political discourse, rather than adhering to a fixed strategy. The merits of new government architecture in line with a new strategy, such as the National Security Council, were questioned as participants considered whether another level of policymaking may create more opacity.

Participants acknowledged the wide ranging threats that the National Security Risk assessment presents, and the need to have some future initiative. Opinion leant more favourably towards an increase in dialogue between those parties concerned than a government directive on how the defence industry must move forward.

**Conclusion**

As the UK defence industry remains under pressure as a result of the recession, many questions remain for industry, policy-makers and the UK MoD, with the primary concern revolving around the future of the defence industry. This roundtable discussion addressed the multitude of challenges and opportunities that have surfaced in this age of austerity. It also outlined some of the problems that the UK defence industry is facing. At a time when quick solutions are politically attractive, reflection on past mistakes may be a useful way to finding a viable and sustainable direction for the defence industry. Regarding indigenous defence capabilities, participants cited transparency as a prominent issue to be address, with the paramount need to build a culture in which industry and Government can work together in the national interest. The importance of cementing a firm hold within the international market was also highlighted as key to the renewal of the UK defence industry. Furthermore, creating not just a strategy but a climate by which to further the success of the defence industry is vital. One of the most salient points that surfaced during the discussion was related to exporting products. The UK Government and defence industry must discuss and clarify a stance regarding defence exports and technology transfer, as international markets appear to be one of the clearest avenues for growth and prosperity for the UK government and the defence industry.