



House of Commons
Defence Committee

**Shifting the goalposts?
Defence expenditure
and the 2% pledge:
Government Response
to the Committee's
Second Report of
Session 2015–16**

First Special Report of Session 2016–17

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The Defence Committee

The Defence Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Ministry of Defence and its associated public bodies

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Publication

Committee reports are published on the [Committee's website](#) and in print by Order of the House. Evidence relating to this report is published on the relevant [inquiry page](#) of the Committee's website.

Committee staff

The current staff of the Committee are James Davies (Clerk), Dr Anna Dickson (Second Clerk), Dr Megan Edwards, Ian Thomson, Eleanor Scarnell, Claire Cozens, and John Curtis (Committee Specialists), David Nicholas (Senior Committee Assistant), Carolyn Bowes, and David Gardener (Committee Assistants).

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First Special Report

The Defence Committee published its Second Report of Session 2015–16, entitled *Shifting the goalposts? Defence expenditure and the 2% pledge* HC 494 on 21 April 2016. The Government's response was received on 21 June 2016 and is appended to this report.

Appendix: Government Response

The Government welcomes the House of Commons Defence Committee's inquiry into our commitment to spend 2% of Gross Domestic Product (GDP) on defence.

The Government acknowledges the detailed work undertaken by the Committee, and its recognition that we remain fully committed to meeting our commitment to spend 2% of GDP on defence over the course of this Parliament. We have the largest defence budget in the EU, the second largest in NATO, and the fifth largest in the world. On top of this, defence spending is set to increase by £5 billion by 2020–21, clearly demonstrating that new money is being made available for defence. Our commitment to spend 2% of GDP on defence and security every year of this decade confirms that defence remains a priority for this Government.

We also welcome the Committee's recognition that our accounting methods fall firmly within NATO's own guidelines. As all NATO members are assessed using the same guidelines, we complete our return using NATO's metrics so that our spending can be compared accurately with that of our Allies. There is no foundation to the suggestion that this amounts to 'creative accounting'.

The Committee's findings are highlighted in bold, with the Government's response in plain text. For ease of reference, paragraph numbering follows that in the "Conclusions and Recommendations" section of the Committee's Report.

The UK's commitment to 2%

1. We welcome the Government's commitment not to fall below the NATO recommended minimum of spending 2% of GDP on defence each year for the rest of the current Parliament. This sends an important message to all the UK's partners and potential adversaries. We recognise, nevertheless, that meeting the minimum—at a lower proportion of GDP than ever before—does not mean that defence is adequately resourced, following decades of successive cuts in expenditure. We also note that the NATO minimum would not have been fulfilled if UK accounting practices had not been modified, albeit in ways permitted by NATO guidelines. (Paragraph 11)

We welcome the Committee's recognition of the importance of the Government's commitment to spend at least 2% of GDP on Defence over the course of this Parliament. This pledge will ensure that we invest sufficiently to deliver effective military capability both now and in the future. It will allow us to implement the commitments made in the 2015 Strategic Defence and Security Review (SDSR 15), including new capabilities such

as nine new maritime patrol aircraft for surveillance, two new Army strike brigades and an additional F-35 Lightning II squadron. It also sends a clear message to our Allies, encouraging them to maintain robust levels of defence spending.

As the Committee notes, our reports to NATO are in full accordance with NATO's guidelines, which allows the level of UK defence spending to be compared on an equal basis to that of our NATO Allies.

The settlement for Defence at the 2015 Spending Review (SR 15) was extremely positive, and as the Committee notes in its report, the Chancellor's announcement of a real terms increase in the Ministry of Defence budget by 0.5% each year, as well as access to the new Joint Security Fund, represents a significant step. In addition, we will continue to accurately capture all spending that contributes to the defence of the UK.

2. We would like further clarity regarding the nature of operational funding from the Treasury Reserve. That the MoD has been unable to provide a robust data set identifying which years included costs of operations in its calculation of UK defence expenditure submitted to NATO is a concern to the Committee; we invite the MoD to do so. (Paragraph 12)

It is entirely appropriate to include operational funding from the HM Treasury Special Reserve in the calculation of UK defence spending. In principle, the Department is funded to deliver forces to the 'start line' with additional costs thereafter being met by the HM Treasury Special Reserve. Without access to the HM Treasury Special Reserve to fund additional operational costs we would be severely constrained in our ability to carry out military operations.

UK policy is to include the net additional cost of operations in our defence spending figures submitted to NATO. The House of Commons briefing paper SN00113 published in 2009, which contains analysis of historical defence expenditure, states that 'international comparisons of defence expenditure based on the NATO definition include all spending on military forces, military aid to other nations, military pensions, host government expenses for NATO tenant forces, NATO infrastructure and civilian staff costs; but excludes spending on paramilitary forces.' According to this definition operational funding would have been included in our defence spending returns to NATO as the normal course of action over previous years, as it is part of all spending on military forces. However, this cannot be verified as it is MOD policy for financial records to be retained for seven years only, as is legally required.

The Committee's report highlights that Tony Blair stated that defence spending from 1997–2007 remained roughly constant at around 2.5% of GDP over the decade if the additional cost of military operations in Iraq and Afghanistan was included. NATO records of UK defence spending over this period fit very closely with this statement, which strongly suggests that the net additional cost of operations was included in our spending returns to NATO throughout this time:

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
UK defence expenditure as % of GDP	2.7	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.5	2.4	2.5

Figures from NATO Information on Defence Expenditure available at: http://www.nato.int/cps/en/natohq/topics_49198.htm

The Committee's report has also highlighted the sudden increase in defence spending as a percentage of GDP from 2007–8 to 2008–09 as potential evidence of the MOD shifting the goalposts of defence expenditure. This is incorrect. A sharp drop in UK GDP took place as the economy entered recession in 2008–09. The consequence of this was that the calculation of spending indicated it as a larger share of GDP.

When measured in budgetary terms, NATO figures show that there was no sudden change in overall UK defence spending, which rose from £34.4Bn in 2007–08 to £37.1Bn 2008–09. This £2.7Bn increase in defence spending in 2008–09 is similar to the £2.3Bn increase in defence spending from 2006–07 to 2007–08. The net additional cost of operations was also very similar in each of these years, at £2.9Bn in 2007–08 and £3.0Bn in 2008–09. It is clear when analysing defence spending in budgetary terms that there was no sudden increase in real terms defence spending, and that MOD did not therefore “shift the goalposts.”

What constitutes “2%”?

3. In the tabulated percentage breakdown of defence expenditures in 2010 and 2015 provided by the MoD, the new inclusions of the 2015 accounting strategy are difficult to identify. The only way that the MoD can refute claims of ‘creative accounting’ is to outline, clearly and unambiguously, what the new inclusions are, how much (both in GBP and as a percentage of the total defence expenditure) they constitute, and from which Department each was funded previously. We recommend that the MoD to provide this information, in a clear and unambiguous manner. (Paragraph 25)

The Government does not accept the Committee's claim that creative accounting has been employed in our Defence spending calculation. It is NATO that determines the definitions for categorising UK defence spending, not the UK. NATO's aim is to capture total Government spending on defence, not just what is spent from the core defence budgets. All NATO members are assessed using these same guidelines, so that members' defence spending can be assessed on a comparable basis. The Committee has acknowledged that we are acting in full accordance with NATO guidelines, and that this provides a basis from which to measure and compare spending among NATO Allies.

In line with NATO guidelines, we include all government spending that contributes to defence in our overall defence spending figures. In addition to the core defence budget provided by HM Treasury, our 2015–16 data return includes:

- income generated by MOD;
- elements of the Government's cyber security spending;
- elements of the Conflict, Security, and Stability Fund relating to peacekeeping activities undertaken by the MOD;

- net additional cost of operations funded by the HM Treasury Special Reserve;
- war pensions;
- MOD civil service pensions.

4. While the MoD may legitimately include the costs of operations, funded by HMT, as part of the NATO 2% calculations, the Committee is surprised to see no breakdown of those figures for 2010, when significant operations continued in Afghanistan and the programme of Urgent Operational Requirements was still delivering. We recommend accordingly that the MOD separate the costs of operations for each of the two tables pertaining to 2010 and 2015. (Paragraph 26)

A breakdown of total defence expenditure in 2010–11 and 2015–16, including the additional cost of operations funded by the HM Treasury Special Reserve, are displayed in the tables below. The total defence expenditure figures in the tables include the additional cost of operations. Spending is broken down into similar categories to those requested by NATO.

Defence and operational expenditure: 2015–16¹

2015–16 Defence Expenditure—as reported in NATO Data				
	Total Defence	Operations	Total Defence	Operations
	£M	£M	% of Defence Spend	% of Defence Spend
TOTAL DEFENCE EXPENDITURE as reported	39,019	434	100.0	1.1
- of which:				
Equipment and R&D	9,130	53	23.4	0.1
Personnel	14,866	38	38.1	0.1
Infrastructure	1,014		2.6	0.0
Other	14,008	343	35.9	0.9
Others:				
Ammunition and explosives	155	3	0.4	0.0
Petroleum Products	493	28	1.3	0.1
Other equipment and supplies	6,497	144	16.6	0.4
Rents	1,168	3	3.0	0.0
R&D (not dedicated to major equipment)	400	1	1.0	0.0
Property Management	1,891	28	4.8	0.1
IT and Comms	1,306	17	3.3	0.0
Utilities	340	2	0.9	0.0

¹ 2015/16 figures are based on Estimates.

2015–16 Defence Expenditure—as reported in NATO Data				
Transportation and Movement	571	11	1.5	0.0
Professional Fees	746	2	1.9	0.0
External Education and Training	241	8	0.6	0.0
Other Costs	201	94	0.5	0.2
Total Other Expenditures	14,008	343	35.9	0.9

Defence and operational expenditure 2010–11²

2010–11 Defence Expenditures—as reported in NATO Data				
	Total Defence	Operations	Total Defence	Operations
	£M	£M	% of Defence Spend	% of Defence Spend
TOTAL DEFENCE EXPENDITURE as reported	39,053	3,638	100.0	9.3
- of which:				
Equipment and R&D	9,529	631	24.5	1.6
Personnel	13,942	250	35.7	0.6
Infrastructure	625	373	1.6	1.0
Other	14,957	2,384	38.3	6.1
Others:				
Ammunition and explosives	379	161	1.0	0.4
Petroleum Products	633	168	1.6	0.4
Other equipment and supplies	6,372	840	16.3	2.1
Rents	970	5	2.5	0.0
R&D (not dedicated to major equipment)	347	36	0.9	0.1
Property Management	1,625	218	4.2	0.6
IT and Comms	1,557	127	4.0	0.3
Utilities	334	8	0.9	0.0
Transportation and Movement	856	307	2.2	0.8
Professional Fees	373	30	1.0	0.1
External Education and Training	205	31	0.5	0.1
Other Costs	1,307	454	3.3	1.2
Total Other Expenditures	14,957.3	2,384	38.3	6.1

² 2010/11 figures are based on the 2010/11 Annual Report and Accounts

5. As training is an essential ingredient in the provision of military capability, the Committee is surprised to see no costs associated with individual and collective training in either the 2010 or 2015 breakdown of expenditure. The MoD is again asked to break-out these costs for each period and into the future, in order that the Committee may assess the relative expenditures on equipment, personnel and training. (Paragraph 27)

The Ministry of Defence undertakes a wide range of training activity; including phase 1 and phase 2 training for new recruits, complex joint exercises with other nations, and specialist training for specific trades and skills requirements, such as nuclear engineering. The costs for all of these activities encompass nearly all of the Defence Lines of Development and cannot be broken out without incurring disproportionate cost. In addition to this, NATO defence spending returns do not require individual and collective training costs to be identified and therefore this information is not available in the format requested. However, we recognise that an increased understanding of training costs would be beneficial, and the Army and RAF are already working on developing a better understanding of the costs of training.

In 2015–16 initial or basic phase 1 training was delivered to 9,200 Army recruits by the Recruit Training Group or the Royal Military Academy Sandhurst. Phase 2 training, which is received at the beginning of a soldier's career, was delivered to 6,500 personnel. Phase 3 training, undertaken throughout a career and often linked to progression or the development of additional specialist skills was delivered to over 48,000 Army personnel. In addition to this, 18,000 Army personnel undertook higher level collective training last year, which forges teams of increasing size, complexity, and capability. All soldiers and officers will also need to maintain a high standard of physical fitness throughout their career. As such, physical training will always be accorded a high priority with sport and adventurous training playing invaluable supporting roles, and over 30,000 Army personnel undertook some form of adventure training last year.

The Royal Navy provide new entry courses at the Britannia Royal Naval College (BRNC) for Navy Officers, HMS Raleigh for Ratings and the Commando Training Centre (CTC) at Lympstone for Royal Marine Officers and Marines. The target annual figures for initial or basic phase 1 training are 2,500 at Raleigh, 600 Officers at BRNC, and 950 Officers and Marines at CTC. Approximately 720 personnel are currently undergoing new entry training, with 320 at Raleigh, 200 at BRNC, and 150 at CTC. Initial or basic phase 1 training was delivered to 3,500 Navy recruits last year, and phase 2 and Phase 3 Training was delivered to over 29,000 Navy personnel.

Last year the RAF delivered initial or basic phase 1 training to 1850 airmen at the Recruit Training School and 328 at RAF College Cranwell. Phase 2 training, including technical and flying training was delivered to 1530 airmen and 328 officers at various locations. In addition phase 3 training was delivered at all RAF sites in many forms.

6. Whilst the Government's revised accounting strategy to achieve defence expenditure at 2% of GDP conforms to NATO guidelines, it incorporates items—such as more than £1 billion in war pensions and MoD civilian pensions—not previously included in the defence budget. We believe that this 'redefinition' of defence expenditure undermines, to some extent, the credibility of the Government's assertion that the 2% figure represents a significant increase in defence expenditure. We therefore

recommend that the MoD provide its own calculation of what UK defence expenditure would currently be without the new inclusions contained within the 2015 return to NATO, i.e., if the 2010 accounting strategy were employed. (Paragraph 28)

The UK updates its approach to calculating defence spending to ensure that it is categorising defence spending fully in accordance with NATO guidelines, by capturing all spending contributing to the defence of the United Kingdom. The nature of defence spending changes over time, and it would be a misrepresentation of current defence spending to provide figures based on out-dated reporting procedures. For example, since 2010 the additional cost of operations has decreased significantly, while cyber security has become increasingly important. In addition to this, revisions to the measurement of GDP have resulted in an increase of approximately 4% in UK GDP. The updated process for reporting defence spending therefore gives a far more accurate representation of total UK defence expenditure, and it is entirely appropriate to report current spending in this manner.

7. It has been argued that the NATO 2% minimum has been achieved as much by moving the goalposts as by the introduction of new money. If the MoD is to disprove the assertion that its 2% figure is substantially dependent on ‘creative accounting’, it must set out in detail the exact proportion of the 2% that constitutes ‘new money’. (Paragraph 37)

When defence spending will increase by £5 billion over this Parliament it is evident that there is significant new funding which is being made available to defence. This includes access to up to £1.5 billion a year for the Armed Forces and the Security and Intelligence Agencies from the Joint Security Fund.

The headline defence spending figures for 2014–15 and 2015–16 are displayed below. NATO will publish defence spending estimate figures for 2016–17 for all member states. NATO member states’ defence spending figures in previous years can be accessed at http://www.nato.int/cps/en/natohq/topics_49198.htm.

£BN	2014–15	2015–16
Total defence spending	39.9	39.0
Defence spending as % of GDP	2.20%	2.07%

8. The 2% NATO minimum will be met this year, in part, by the inclusion of one-off items of expenditure. Given the fact that those items cannot be counted as expenditure in future years, we expect the MoD also to set out clearly how the commitment to spend 2% of GDP on defence expenditure over the lifetime of the current Parliament will be met. (Paragraph 38)

In addition to its core funding settlement, the MOD also receives funding to cover the net additional cost of operations; that is, costs incurred by the Department which would not otherwise have been incurred. This type of funding is met by the HM Treasury Special Reserve and is made available through the issuance of specific limits of liability rather than a delegated budget. Special Reserve funding has been used principally for counter-Daesh operations in Iraq and Syria (Op SHADER), as well as continuing operations in Afghanistan (Op TORAL) and Baltic area policing through NATO.

In addition to this other items of defence expenditure (e.g. as outlined in our response to recommendation 3) will be included, in line with NATO guidelines. This will mean that the UK defence spending figure remains above 2% of GDP over the course of the current Parliament.

9. The additional funding of security through the newly created Joint Security Fund has the potential to help sustain defence spending at 2% of GDP. The MoD cannot, however, guarantee specific levels of financing from the JSF, as it is subject to its bids for funds being successful. Successful bids to the JSF from other Departments will lower its potential contribution to defence expenditure. Should significant funds be awarded to other Departments, we would wish the MoD to provide reassurance against their being “re-badged” as defence expenditure at a later date, as a ‘quick fix’ to address future shortfalls in the accounting of the 2% commitment. (Paragraph 42)

The Spending Review published in November 2015 indicated how £3.5bn from the Joint Security Fund would be allocated over the spending review period between MOD, the SIA and the Special Reserve. Allocations have been decided for the departments and are now included in their respective baselines. We will continue to ensure that we follow all NATO guidelines for calculating defence spending.

10. The Joint Security Fund is advertised by the Government as being worth £1.5 billion per annum by 2020. This does not clarify how much, in total, will be available in each specific year up to that date. The MoD should state when we will know how much, in total, the Joint Security Fund will be worth in each year until the end of the current Parliament. (Paragraph 43)

It was announced in the spending review that the Ministry of Defence will be able to spend £2.1Bn of the £3.5Bn Joint Security Fund over the rest of this Parliament. The allocations made to departments from the Joint Security Fund have now been included in the relevant departmental spending baselines.

11. The defence budget includes expenditure of 2.9% (£1 billion) and 1.2% (£0.4 billion) on Research and Development and Science and Technology respectively. In the light of increasing demands to be able to counter multi-dimensional (also known as asymmetric, hybrid or ambiguous) warfare, such as cyber and information operations, we wish to see evidence of how such expenditure is sufficient to address the fundamental research and development requirements now facing the UK. (Paragraph 49)

The Government recognised in the SDSR 15 that globalisation and technological advances bring unparalleled opportunities to the UK and to people around the world. The UK increasingly relies on networked technology in all areas of society, business and government, and this has brought significant benefits. Advances in medical technology, genetic engineering, biotechnology, materials science, big data and robotics hold huge potential for our security and prosperity. But such technology will also become available to more state and non-state actors, including terrorists, organised crime groups and cyber criminals. Thus the National Security Risk Assessment 2015 concludes that the threats faced by the UK have increased in scale, diversity and complexity since 2010.

Therefore we continue to dedicate 1.2% of the growing defence budget to science and technology over this Parliament. This is the centralised research budget, under the Department's Chief Scientific Adviser, and represents investment in new technologies that

have the potential to disrupt our adversaries, including cutting-edge research through the MOD's Defence Science and Technology Laboratory, working closely with industry and academia.

But to secure operational advantage and control our costs into the future, we need to recognise and respond quickly to transformative ideas and technologies. These will come from outside the traditional national security field, as well as from our allies and in response to our adversaries. We are creating a new, cross-government Emerging Technology and Innovation Analysis Cell, with close links to the private sector and academia to ensure that we identify these opportunities. We are also establishing a defence and security accelerator for government to help the private sector, allies and academia turn ideas into innovative equipment and services faster for national security users. We have established a £165 million Defence and Cyber Innovation Fund, but we also are exploring different forms of financing to unlock greater private sector investment in defence innovation, as part of the Defence Growth Partnership.

12. The MoD must outline what the impacts would be if skilled employees are lost due to the increased disparity between public and private sector pay, and how these will be mitigated and afforded within the budget. (Paragraph 53)

Recruiting, retaining and developing the right people is a top priority for Defence. To achieve this we apply the Whole Force Approach, aiming to deliver a balanced force structure of Regular and Reserve personnel, civilians and contractors, optimised to meet Defence's requirements. The Services, responsible for generating capability, have manpower plans to grow the necessary people with the right skills to man equipment and deliver those capabilities.

The Department recognises that there are some areas where the number of appropriately skilled staff is a challenge, and a number of long and short-term measures are being taken to mitigate the impact. These measures include: financial retention incentives; targeted financial incentives on recruitment for specialist areas; and development of an 'Enterprise Approach', working with the wider Defence Industry to better share experience and best practice, and to tackle challenges including career management, manning, and access to key skills.

As set out in SDSR 15, the Department has also identified a number of long-term plans to ensure that the Service offer better reflects the aspirations and expectations of our Service personnel and potential new recruits. Central to this is modernising the offer for those who choose to serve in the Armed Forces. To meet this requirement MOD will deliver:

- A Flexible Engagements System that will reflect the realities of modern life by enabling Regular Service personnel to vary their work commitment, between full time and part time, and alter their liability for operational deployments to support changing personal circumstances, whilst also providing Reservists with improved opportunities to be employed in higher commitment jobs.
- A Future Accommodation Model that will improve choice, including helping more Service personnel live in the private sector and own homes.

- A New Offer for New Joiners. This is a new reward package for future recruits that will enable the recruitment and retention of sufficient, capable and motivated Service personnel into the future.
- A more diverse workforce and inclusive working environment. We are committed to developing an inclusive working environment, and building Armed Forces that are diverse and fully representative of the UK workforce. A Defence Diversity and Inclusion Programme (DDIP) has been established, which is driving change in leadership and culture; recruitment; retention and progression.

Following SDSR 15 the Department needs to achieve a 30% reduction in civilians by 2020, whilst making transformative changes to the structure, skills and employment of our civilian workforce. We are developing a MOD Civilian Workforce Strategy for 2020 and beyond, and a Business Improvement Review was set up in January 2016 to explore opportunities for improving the efficiency and effectiveness of Defence support activities. Some of the key actions we have taken to support the strategic management of our civilian workforce include:

- Developing Civilian Work Force Plans to help identify current and future resourcing issues, specifically critical skills gaps, which will inform Pay and Skills Strategies.
- Improving our line management capability to support and develop all staff;
- Expanding the number of apprenticeship programmes offered to develop both the existing workforce and our future talent pipeline;
- Exploring the option to evolve the separate civilian and military HR IT systems with a single Whole Force system supporting wider Defence capability.

13. The MoD must also justify how an annual public sector pay award cap of 1% until 2019–20 will be sufficient to avoid pressure on the budget from pay. It may prove difficult to maintain this stance in relation to wider economic pressures. (Paragraph 54)

There is a balance between pay and jobs in many public services, and pay restraint is one of the many difficult choices the Government has had to make to help put the UK's public finances back on track. The Office for Budgetary Responsibility (OBR) estimates that this policy will protect 200,000 public sector jobs. At a time when further spending reductions are required to finish the job of fixing the public finances, a pay award policy makes a significant contribution in protecting jobs and the quality of public services. Overall, public sector pay remains, on average, comparable to private sector pay and public sector defined benefit pensions are amongst the best available. HM Treasury analysis, as well as independent studies, show public sector pay at a premium for most of the last Parliament, and a significant continued premium when pensions are taken into account.

The MOD like all other Public Sector organisations will continue to work in accordance with HM Treasury published guidance and ensure that future pay offers will be fair and recognise the needs of the business. To support this, the Department is developing a pay and reward strategy for its civilian staff that is aligned to the changing work-force and targets remuneration to areas where it is difficult to recruit and retain people with those skills that are essential to delivering Defence outputs.

With regards to military pay, MOD will be continuing to take annual recommendations from the independent Armed Forces' Pay Review Body. As announced as part of SDSR 15 the Department is also developing a new Armed Forces offer for new joiners. This will better meet the expectations of future recruits and improve recruitment and retention of key skills by developing the most efficient method for targeting reward for Service personnel.

We will work closely with our allies and partners, many of whom are pursuing similar innovation initiatives, and invest in joint research programmes. The US are pursuing their Third Offset Strategy, which aims to retain their military advantage into the future, and France has important military technology programmes, especially in aerospace, maritime, and space capabilities. We are working with our key allies, including the US and France, to share our approaches and to deliver our future technology co-operation making best use of our respective innovations strategies.

14. A detailed explanation is required regarding how the £11.2 billion in 'efficiency savings', publicised in the 2015 SDSR, will be achieved. Whilst we welcome the announcement that any efficiency savings will be reinvested in "national security priorities", it is less clear whether this will result in the savings being added to the defence budget specifically. We recommend that the MoD should provide the Committee with regular updates on the extent to which the identified savings are being realised and whether those savings are being reinvested, in full, in defence. (Paragraph 55)

As detailed in the Spending Review and Autumn Statement 2015, the department has agreed to deliver £9.2 billion of efficiency and reform savings over the life of this Parliament. £7.2 billion will be delivered through a number of efficiency measures, including military and civilian pay restraint, significant reductions to the civilian headcount, and reductions in travel expenditure and professional fees. A further £2 billion will be delivered through the reprioritisation of existing funding. Additionally, £2.1 billion will be made available to the MOD from the Joint Security Fund. In total, this will provide the department with around £11 billion-worth of spending power over the life of this Parliament, which will be directly reinvested in full into the defence budget to enable investment in new capabilities, innovation, and the defence estate.

The "£11 billion of savings from MOD, the security and intelligence agencies and cross-government counter-terrorism spending" identified in SDSR 15, and noted by the Committee, is a separate figure, albeit of the same value. It comprises the aforementioned £9.2 billion efficiency reform savings within the MOD, £1.3 billion from the security and intelligence agencies, and £400m from cross-government counter-terrorism spending. As outlined above, the £9.2 billion of efficiency reform savings will be directly re-invested in defence. The remaining £1.7 billion from the security and intelligence agencies and cross-government counter-terrorism spending will be re-invested into capabilities to protect our national security, but will not necessarily be re-invested in defence specifically.

The department is currently focusing on implementing the challenging efficiency programme outlined in the 2015 Spending Review, and would welcome the opportunity to update the Committee on delivery progress as appropriate.

UK Defence expenditure and the 2% pledge

15. The 2% minimum figure has value as a political statement in reinforcing the UK's commitment to defence both domestically and internationally. It also serves as a barometer against which to measure and compare defence expenditure amongst NATO Allies. However, achieving a pre-determined threshold for defence expenditure does not automatically deliver the ability to protect ourselves or our Allies against the varied threats to NATO and UK defence and security. The 2% pledge, while necessary, may not be sufficient. We believe that the focus should not be merely on a headline figure, but on whether this expenditure can possibly provide a sound defence for the UK. (Paragraph 73)

We welcome the committee's conclusion. The Defence Investment Pledge (DIP), agreed at the September 2014 NATO summit held in Wales, gave a strong statement of our commitment to common defence and security and to tackling NATO's key capability shortfalls. The Pledge was influential in galvanising our NATO allies to meet the NATO guideline to spend 2% of GDP on defence, with the NATO Secretary General stating that the UK commitment was "a great example of leadership within the alliance." Both Poland and Estonia have met the guideline since the summit, and several other members have also set out plans to increase defence spending in future years with both Latvia and Lithuania increasing spending to above 1% of GDP in 2015.

But the Pledge is not only about spending 2% of GDP on defence. NATO can only retain its operational edge and technological advantage through investing in Defence innovation, which is why the DIP also includes the guideline that all allies should spend 20% of their Defence budgets on major equipment and research. We have historically been one of the few allies to invest at least 20% of our budget in major equipment, and are proud to have met this again this year.

The Pledge is important, but we agree that there should be a range of measures to assess capability. For this reason, in addition to the 2% and 20% figures, the Wales summit committed Allies to an annual review of progress against the pledge. These metrics address each country's percentage contribution of Air, Land and Maritime assets to NATO operations, with a focus on deployability and sustainability. This is in addition to the bi-annual review of allies' Military capability and plans against NATO's minimum capability requirements, which is part of the NATO Defence Planning Process. NATO allies are therefore measured and scrutinised on a range of measures on a regular basis.

SDSR 15 has set the MOD's strategic context and deliverables for the life of this Parliament. Through the Annual Budget Cycle and associated capability audits the Department reprioritises the forward Defence Programme to ensure that it will be able to meet the full range of its commitments within the budgets set in the 2015 Spending Review.

16. Despite the UK's high ranking, relative to other NATO members, UK defence expenditure has fallen far too low in our national priorities. The world today is at its most dangerous and unstable since the end of the Cold War. While 2% is arguably a useful metric by which to measure the sufficiency of the UK commitment to NATO, it does not solely determine whether our total expenditure on defence is sufficient, given that the UK has significant additional commitments such as our defence of the Falkland Islands. Some of the costs of these UK commitments are additional to

the NATO requirement, and therefore constitute an additional requirement for UK defence expenditure. Until and unless the MoD quantifies the net additional costs of the UK's commitments beyond NATO, we cannot be confident that 2% is enough, whether in political or capability terms. We remain to be convinced that the current financial settlement is sufficient to rectify the decline of defence as a national priority. (Paragraph 74)

The UK has the second largest Defence budget in NATO, the largest in the European Union, and the fifth largest in the world. We are increasing investment in our security and intelligence agencies and in counter-terrorism. We are one of the only countries to meet the NATO guideline to spend 2% of GDP on defence and meet the Organisation for Economic Co-operation and Development (OECD) guideline to spend 0.7% of Gross National Income (GNI) on Official Development Assistance (ODA). Defence spending is set to increase by £5 billion by 2020–21, a clear demonstration that defence remains a national priority.

The NATO 2% defence spending guideline captures all defence spending, not only that which contributes directly to NATO commitments. However, with a few exceptions, we declare all of our forces and capabilities as available to NATO. It is not a straightforward task to divide defence spending into spending on our NATO obligations and spending on our additional requirements, such as the defence of the Falkland Islands. While the force elements committed to the Falkland Islands and other national tasks do not directly contribute to our NATO commitments, the capabilities that the UK can offer to NATO are developed and improved in these environments and tasks. Our ability to deploy and sustain military capabilities at strategic distance from the UK contributes to the conventional deterrence those force elements provide when committed to NATO tasks. The costs associated with these tasks therefore contribute to our ability to meet our NATO commitments.

The analysis of threats and hazards contained in the National Security Strategy (NSS) and SDSR 15 are the product of extensive collaboration across Whitehall. Prior to the Review, the central national security departments developed policy baseline papers which included analysis of how national security challenges within their departmental responsibility could develop. A series of Joint Intelligence Committee papers were commissioned specifically to support the SDSR and the National Security Risk Assessment (NSRA) was refreshed. This work within government was complemented by extensive consultation across the wider defence and security policy community, including think tanks and academia, and with key Allies and partners. Together, this work represents a high degree of consensus around the growing scale, diversity and complexity of threats to the UK and its interests.

Four particular challenges will drive UK security priorities for the coming decade: the increasing threat posed by terrorism and extremism instability; the resurgence of state-based threats; the evolving threat from technology, especially in the cyber domain; and the wider erosion of the rules based international order. Given the aggregate challenge of these risks the Government has chosen to prioritise defence and security spending alongside very difficult decisions in other areas of public spending. The link between threats and the designation of funding emerges very clearly from the NSS and SDSR. For instance, the SDSR directs £2.5 billion of additional funding towards the UK's intelligence agencies and a doubling of planned investment in Special Forces equipment to counter the growing threat from terrorism. The SDSR re-affirms the UK's commitment to the NATO

target to spend 2% of GDP on defence to underpin delivery of a high end war fighting force which presents a credible deterrent in the face of resurgent state based threats. £1.9 billion of funding for cyber will protect the UK from attack and advance its offensive cyber capabilities in the face of a greater number of more capable online adversaries.

UK defence: what can we afford?

17. Our inquiry has highlighted concerns regarding the adequacy of 2% as an acceptable level of defence expenditure in the UK. As a result, the Government must be clear that 2% is a minimum—not a target—and be prepared to increase defence expenditure further, in order to reflect the increasing threats faced by both the UK and our Allies. (Paragraph 85)

The Defence Investment Pledge, agreed in Wales, clearly states that all Allies committed to spending “a minimum of 2% of their Gross Domestic Product (GDP) on defence” within a decade—by 2024.

The UK is fully committed to honouring the Defence Investment Pledge. SDSR 15 further outlined our plans to spend at least 2% of our GDP on defence in every year of this Parliament, guaranteeing a real increase in the defence budget every year of this Parliament, and creating a Joint Security Fund which will grow to £1.5 billion by the end of this Parliament.

The Government has chosen to prioritise defence and security at a time of pressure on public spending. The commitment to spend 2% of GDP on defence came after a thorough examination of threats and risks, after which the Government decided on an appropriate level of funding. This will be reviewed in 5 years alongside a new risk assessment and NSS/SDSR.

18. The minimum of 2% can be considered sufficient only if all major defence deficiencies are met. We welcome the Government's commitment in the 2015 SDSR to fill key capability gaps, such as re-acquiring maritime patrol aircraft. We wish, nevertheless, to be reassured about the provisions planned to ensure success of future projects. Should, for instance, the 'concept study' to investigate the potential for a new class of lighter, flexible general purpose frigate be unsuccessful, we wish to be informed at the earliest opportunity of the MoD's contingency plans to deliver the extra ships to satisfy the total originally promised. Similarly, we wish to see future provisions planned for equipping the new strike brigades with the new Ajax armoured vehicle variant. (Paragraph 90)

The Government recognises the importance of meeting the commitments set out in SDSR 15 and the challenges of successfully procuring the right equipment to meet our needs. Both the general purpose frigate and the Ajax armoured vehicle projects are subject to close scrutiny within the Department to ensure that they meet our capability requirements, are coherent with related projects, are affordable, and provide good value for money. We will keep the Committee informed of progress with these projects as they develop.

To ensure departmental delivery of the various SDSR commitments the Chancellor of the Duchy of Lancaster will Chair a new National Security Council (NSC) sub-committee: NSC (SDSR Implementation). The Cabinet Office will produce an annual update to Parliament on progress in delivering SDSR commitments across all departments.

19. The MoD must provide evidence that, should a disparity arise between procurement aspirations and affordability within the threshold expenditure of 2% of GDP, finances will be available to mitigate this which will not be removed from another part of the budget to which they have already been committed. (Paragraph 100)

The MOD manages the financing of our procurement through a process incorporating both longer term financial planning and more flexible in-year financial management. Should issues arise with the affordability of defence procurement aspirations this will be managed according to the situation and circumstances. It is expected that the Department will be eligible to make use of the enduring Special Reserve for any large scale or enduring military operation requirements endorsed by the National Security Council (NSC) in the future.

20. It has been suggested that maintaining a Regular Army of 82,000 personnel, and a combined number of 700 extra personnel for the Royal Air Force and Royal Navy, may not be enough reliably to operate the equipment promised in the 2015 SDSR. The MoD, therefore, needs to provide robust justification for the personnel numbers deemed sufficient for each of the Armed Forces. (Paragraph 101)

SDSR 15 set out a clear vision of our National Security Strategy over the next five years, including our commitment to maintain the size of the regular Armed Forces.

Army

To meet the demands of Joint Force 2025, and the force driving policy in Defence Strategic Direction, the Army has begun a major modernisation agenda as announced in SDSR 15 which builds upon the foundations of Army 2020. The first step is the refinement of the Army's structure to incorporate demand for future Responsive and Fixed Force tasks, manpower obligations to other Services, and the requirement to man, train, equip and sustain an effective and resilient force. Initial findings suggest that an integrated Army of 112,000 personnel is sufficient to deliver the Army's contribution to Joint Force 2025.

Royal Navy

SDSR 15 committed to growing the size of the Royal Navy to 30,600 in 2025, with an increase of 400 personnel, representing an uplift of 1,600 over the SDSR 10 position. With this uplift in numbers and through an on-going process of internal reprioritisation and efficiency, the Navy will have sufficient manpower to crew both aircraft carriers and the Successor submarines.

The Royal Navy, like many employers in the UK's maritime and wider engineering sector, is facing a significant challenge in retaining technical expertise. While in manning balance, overall strength is subject to a number of specific shortfalls at certain levels. To address this, the Royal Navy is implementing a wide range of financial, non-financial and organisational initiatives.

Royal Air Force

The trained Strength of RAF Regular personnel will increase to a baseline of 31,750 by 2020. This increase will go some way to providing the manpower required to meet the new and extended capabilities agreed in the SDSR 15. However, the RAF will need to identify further reductions and rebalancing to achieve commitments, and Whole Force solutions will be key to this succeeding.

To support manpower requirements the RAF is engaging in targeted recruitment increases, along with a range of retention measures. Recruiting forecasts are positive in most specialisations, with improved performance in the current recruiting year, particularly in Science, Technology, Engineering and Mathematics (STEM) qualified candidates.

21. The Government's decisions to rectify some major UK defence equipment deficiencies are most welcome. What is unclear, however, is whether the proposed strength in manpower and expertise is adequate to utilise such new capabilities effectively. We wish to see evidence of how the UK will afford, within the budget, training programmes that are sufficient to address this and not depleted by efficiency savings. It is imperative that training and personnel numbers do not suffer to the point where they render us in possession of a so-called Hollow Force: 'exquisite' equipment that cannot be maximised to its full potential. (Paragraph 102)

We welcome the Committee's recognition that we are investing in our equipment, with the Government set to spend £178 billion on equipment and support over the next decade. However, we acknowledge the importance of ensuring that we have adequate training and personnel numbers to deliver capabilities effectively. Service training pipelines are gauged to cope with the demands of Initial and Trade Training, and to deliver the required number of recruits qualified to join the deployable Armed Forces. In addition, training solutions for new equipment should be funded as part of the Main Gate acceptance criteria. Taken together, these actions should avoid "hollow capabilities".

The Services are also taking a number of steps to enhance training programmes.

Army

The Army is making greater use of simulation training, and improving its ability to replicate the operating environment. Training is also being enhanced through greater provision of overseas training exercises. In addition, the Army also conducts around 90 overseas exercises a year. These overseas exercises seek to address the growing demand to be 'interoperable by design' with our partners, supporting our ability to operate in collaboration with our allies. For example, we have developed a number of exercises with the United States as we seek to identify and close interoperability gaps.

Royal Navy

The Royal Navy has made significant progress in implementing a comprehensive programme to improve training, career opportunities and personal requirement training. The introduction of Engineering Training Ships and Adaptive Force Escorts is an important component of this programme to increase training capacity, and they are now incorporated into the rolling generation and deployment of our Frigate and Destroyer

force. Personnel will be carefully redistributed across the support area to ensure that the optimum balance is maintained between training for the future and supporting current activity.

This programme has sufficient funding in the budget to enable full manning, provision of spares and logistics support, and appropriate training necessary for the new ships, aircraft and equipment being delivered to the Royal Navy. For example, comprehensive training programmes, including embedding personnel with the US and French Navies, ensure that skills are retained and developed in support of the Queen Elizabeth Class aircraft carriers coming into service.

Royal Air Force

The RAF delivers extensive technical training, with the Defence College of Technical Training (DCTT) training engineers and technicians from all three Services. To meet future challenges DCTT is optimising delivery of technical training, for example through increasing utilisation of modern learning techniques and technology. In addition, to address a capability gap in operating Maritime Patrol Aircraft (MPA) the RAF has placed approximately 30 personnel with Allied fixed wing MPA forces. This 'Seedcorn Initiative' has resulted in a cadre of personnel with viable skills that will grow and regenerate capability once the new MPA are available.

21 June 2016