

SDSR 2015, Brexit and Future UK Defence Acquisition – Issues and Challenges

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Introduction

On 23rd June 2016, the British electorate voted to leave the European Union (EU)¹, in what can only be described as a surprise result that has sent shockwaves through not only the British political establishment but across both Europe and the world. As far as UK defence acquisition was concerned, a strategic environment that was already in a state of dynamic flux due to the publication of a new National Security Strategy (NSS) and Strategic Defence and Security Review (SDSR) in late 2015, was made even more complex by the referendum result and what that could mean for the UK's international relations.

While the full impact of the Brexit vote is unlikely to be understood for some time to come – especially as the UK has yet to officially declare its intention to leave under Article 50 of the Lisbon Treaty – this article will look at some of issues and challenges that now face UK defence acquisition, in light of recent political events.

The UK Defence Context

The new SDSR was published in November 2015² only a few months after the election and it became quickly apparent that while much of the preparatory work had been completed, there had been little strategic direction from ministers, who were focused on the election and not the SDSR. Unfortunately, this could prove to be an ongoing issue, with the UK Parliament now subject to fixed five-year terms³ and coincidentally, five-yearly defence reviews. This lack of strategic direction has been exacerbated by firstly, the disruption caused to normal government business by the EU referendum campaign and secondly, as a consequence of the result, the resignation of the Prime Minister David Cameron, a leadership contest within the Conservative Party and selection of a new Prime Minister (Theresa May) as well as the formation of a new cabinet which has had to address the urgent question of negotiating our exit from the EU.

With regard to the UK's broader defence relationship with Europe, it has always seen NATO as the bedrock upon which that relationship rests. In most cases, joint defence acquisition has taken place on an ad hoc basis, through either bilateral (such as with France on the Sepecat Jaguar) or multilateral (such as the Panavia Tornado and the Eurofighter Typhoon) arrangements, away from organisations such as the European Defence Agency (EDA) or OCCAR – notable exceptions being the A400-M transport aircraft and Principle Anti-Air Missile System (PAAMS), as well as potentially, Boxer.⁴ Although there have been opportunities for the UK to increase its participation and even assume more of a leadership role with the resultant increase in opportunities for UK industry, the UK has seen these organisations as having a greater benefit to smaller countries and something of a bureaucratic roadblock as far as acquisition cycle times are concerned. For example, in October 2012, the UK

Government announced it was reviewing its membership of the European Defence Agency (EDA), which didn't rule out the UK's complete withdrawal. Other issues, such as the creation of an EU 'Army' have been strongly opposed by the UK, as having the potential to undermine NATO and a duplication of effort with the potential to push the USA away from Europe. Hence, in defence policy terms at least, the UK has not been in favour of greater European integration.⁵

Issues and Challenges

While there are many issues and challenges facing the MOD and armed forces as a result of the decision to leave the EU, covering them all is beyond the scope of this paper. It will however discuss the challenges faced by the MOD as regards the defence budget, EU regulation and those surrounding the UK's political relationships.

Budget

One consequence of the Brexit vote has been the fall in the value of Sterling with regard to foreign currencies. For example, on the day of the referendum, the exchange rate (Pound Sterling to US Dollar) was £1 to \$1.4893.⁶ Immediately after the result became clear, the value of the Pound plummeted, and despite several attempts at rallying, stood at £1 to \$1.2422 towards the end of November, a drop of 17%.⁷ It would appear that this instability in the exchange rate is likely to continue, with the most informal and unintentional statements by ministers involved having an impact.⁸ Even before the referendum, the MOD was struggling to make efficiency savings to keep the Equipment and Support Plan affordable, including the planned renewal of the nuclear deterrent. What complicates matters is that according to US State Department figures (for the years 2002 to 2012), the UK has an established demand for importing defence equipment from the USA. The figures include significant equipment purchases (such as C-17 aircraft and Predator Unmanned Aerial Vehicles (UAVs)) but also spares related to US equipment operated by the UK Armed Forces. The figures also show that in general, the UK imports more than France and Germany combined and more than Saudi Arabia.⁹

Furthermore, the UK has plans to buy a number of 'off-the-shelf' products from the USA, including additional Apache helicopters, nine P-8 Orion Maritime Patrol Aircraft (MPA), 138 F-35B aircraft and twenty next-generation Protector UAVs, all of which will add to the yearly demand for defence imports from the USA in terms of spares. Given the deterioration in the value of the Pound against the US Dollar, this must represent a major financial challenge for the MOD. It is a situation not helped by the weakening of the Pound against the Euro (which dropped 11% - down from 1.3091¹⁰ to 1.1683¹¹ over the same period) and where, for example, the British Army plans to acquire 589 Ajax vehicles for £3.5 billion, the majority of the costs of which, are in Euros. However, if the contract was signed in Sterling, then this will be a problem for General Dynamics, rather than the UK Government. Even if the companies involved had bought extra spares and components in the lead up to the referendum, and the UK Government bought dollars in advance, these programmes will be running over decades, and it would be optimistic for the MOD to set up contracts on the assumption that the Pound will recover to its pre-referendum level.¹²

Economic growth forecasts following the referendum have been rare until recently, but in his autumn statement, the Chancellor stated that the Office of Budget Responsibility (OBR) expects the UK economy to grow by 1.4% in 2017 (down from 2.2%) and 1.7% (down from 2.1%) in 2018.¹³ Therefore, a defence budget based on 2% of GDP will not grow significantly for at least the next couple of years. As such, the referendum has thrown the SDSR 2015 into some disarray.¹⁴ If this decrease in the value of Sterling is sustained at the current level, the cost of the UK's defence exports will rise by at least £700 million per annum, as firstly, the amount of money spent on defence imports is unlikely to fall, given the continuing costs of supporting in-service equipment and secondly, the UK's commitment to purchase additional equipment such as the F-35B. "With a defence budget of slightly more than £35 billion, the £700-million shortfall amounts to a 2 per cent cut of the purchasing power of Britain's defence budget, and a much larger cut in the purchasing power of the equipment and support budgets."¹⁵ Clearly, the implications for UK defence acquisition of the devaluation of the pound are complex and will only become clearer with time – such a devaluation makes UK exports that much cheaper, but it also increases the cost of any imported raw materials or components.

Regulation

One significant issue related to our membership of the EU has been EU Directive 2009/81/EC (The Defence Procurement Directive)¹⁶, which requires the acquisition of defence equipment above a certain threshold to be competed across the entire EU. Although there are exemptions to this directive, covered under TFEU (Treaty on the Functioning of the European Union) Article 346¹⁷, such exemptions are becoming harder to justify under national security terms. The UK Defence Industry (and the Ministry of Defence (MOD)) sees this directive as at best, a delay in the procurement process, and at worst, a barrier to UK industry winning defence work. It could also be seen as a constraint on the UK's 'freedom of action' as a sovereign state. Whatever the result of the Brexit negotiations, if the UK chooses to remain within the European Free Trade Area, it will have to accept some of the constraints this imposes, such as Directive 2009/81/EC.¹⁸

The opportunity that arises from the ability of the UK Government to determine its own procurement frameworks is enhanced by the similar ability to adjust other EU legislative, for example in the environment and safety sectors, to better suit the UK's industry – all to be determined, at least initially, as part of the 'Great Repeal Bill'.¹⁹

Political Relationships

More difficult to quantify is the impact Brexit will have on political relationships, both domestic and foreign. With the majority of voters in Scotland (along with Northern Ireland and Gibraltar) voting to remain within the EU²⁰, there is an increased possibility that the Scottish National Party (SNP) will push for a second independence referendum, if its political demands vis-à-vis the EU are not met. If successful, this could have all the potential impacts that were envisaged before the 2014 referendum²¹, especially with regard to Type 26 Frigate construction and the Faslane submarine base²², compounded with the strategic investment the Government have identified for Scottish defence infrastructure, both from the relocation of capability within Scotland but also the relocation from the rest of the

defence estate to Scotland.²³ Externally, the willingness of other European states to continue their collaboration with the UK under ad-hoc bilateral or multinational programmes, once the UK has left the EU, could be open to question. For example, Slovakia holds the (rotating) EU Presidency until 31 December 2016 (after which it passes to Malta) and its Prime Minister, Robert Fico, has led the calls to make the UK's exit from the EU as difficult as possible.²⁴ This is likely to increase division within the EU as those states who want to 'punish' the UK clash with those who wish reconciliation.²⁵

However, Brexit is unlikely to affect the Franco-British relationship, as this was cemented by the Lancaster House treaties in 2010, which included a nuclear cooperation agreement, thereby limiting it to just the UK and France and both countries are committed to a number of defence projects, such as light anti-ship missiles and FCAS (Future Combat Air System). Even after leaving the EU, the UK "remains for the foreseeable future, France's most credible and reliable partner in the realm of defence on the European continent. The two countries share similar interests, which Brexit cannot affect", so it is important that France remains in the 'reconcile' camp.²⁶ It will certainly limit the UK's access to EU research funding. It has been argued that the strength of the UK economy as a whole, as well as its research base and defence industry, means that the UK will remain an attractive partner for other European states in terms of defence acquisition, however, this view is a subjective one and given the UK's exit from the EU is still years away, one cannot know for sure what will happen.²⁷ What will be important for the UK is how it uses the Brexit decision to recast its role in the world and redefine its identity within an international context, forging new relationships with other countries, prime candidates being Africa and Asia²⁸, the Commonwealth and the Overseas Territories.²⁹ Such an adjustment will also require the UK to decide just what sort of foreign, defence and security policies it wants and what sort of capabilities it requires to fulfil such a role.³⁰

Conclusion

The curse "may you live in interesting times"³¹ seems to be especially active at the moment, with the UK electorate voting to leave the EU, and the election of Donald Trump to the US Presidency. For UK defence acquisition, this means there is a great deal of uncertainty in the short-to-medium term, with a whole range of issues and challenges needed to be taken account of, two of which have been highlighted in this paper. Both have the potential to have an impact on how the MOD operates and how it generates UK military capability. Only time will tell as to the true impact and consequences of Brexit.

¹ By a margin of 1,269,501 votes – Leave attained 17,410,742 votes or 51.9% of the total, while Remain received 16,141,241 votes or 48.1% of the total. See The Electoral Commission. (2016) *EU Referendum Results* webpage, located at <http://www.electoralcommission.org.uk/find-information-by-subject/elections-and-referendums/past-elections-and-referendums/eu-referendum/electorate-and-count-information>, as of 17 November 2016.

² HM Government. (2015) *National Security Strategy and Strategic Defence Review 2015: A Secure and Prosperous United Kingdom*, CM9161, November 2015, located at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/555607/2015_Strategic_Defence_and_Security_Review.pdf, as of 17 November 2016.

³ Kelly, R. and White, I. (2016) *Fixed-Term Parliaments Act 2011*, Commons Briefing Paper SN06111, 24 June 2016, located at <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06111>, as of 17 November 2016.

⁴ See OCCAR. (2016) *OCCAR Programmes*, located at <http://www.occar.int/programmes>, as of 18 November 2016; Haynes Deborah, 'Army set to buy £3bn fleet from German firms' in *The Times*, 15 October 2015, p. 8.

⁵ House of Lords. (2012) 'European Defence Agency', *Lords Hansard*, 23 October 2012, Column 131, located at <http://www.publications.parliament.uk/pa/ld201213/ldhansrd/text/121023-0001.htm#12102351000392>, as of 18 November 2016; Young, S. (2016) *The United Kingdom's 2015 Strategic Defence and Security Review – Economic, Procurement and Brexit Implications*, Conference Paper: 11th Defence and Security Economics Workshop, 3-4 November 2016, Carleton University, Ottawa.

⁶ Exchangerates.org.uk. (2016) *British Pound to US Dollar (GBP USD) for 23 June 2016(23/06/2016)* webpage, located at http://www.exchangerates.org.uk/GBP-USD-23_06_2016-exchange-rate-history.html, as of 23 November 2016.

⁷ Exchangerates.org.uk. (2016) *British Pound to US Dollar (GBP USD) for 22 November 2016(22/11/2016)* webpage, located at http://www.exchangerates.org.uk/GBP-USD-22_11_2016-exchange-rate-history.html, as of 23 November 2016.

⁸ BBC News. (2016) *David Davis: UK may pay for access to EU single market*, webpage, 1 December 2016, located at <http://www.bbc.co.uk/news/uk-politics-38168942> as of 02 December 2016.

⁹ Taylor, T. (2016) *Brexit and UK Defence: Put the Equipment Plan on Hold?*, Brexit Briefing, RUSI, 6 July 2016, located at <https://rusi.org/commentary/brexit-and-uk-defence-put-equipment-plan-hold>, as of 22 November 2016.

¹⁰ Exchangerates.org.uk. (2016) *British Pound to Euro (GBP EUR) for 23 June 2016 (23/06/2016)* webpage, located at http://www.exchangerates.org.uk/GBP-EUR-23_06_2016-exchange-rate-history.html, as of 23 November 2016.

¹¹ Exchangerates.org.uk. (2016) *British Pound to Euro (GBP EUR) for 22 November 2016 (22/11/2016)* webpage, located at http://www.exchangerates.org.uk/GBP-EUR-22_11_2016-exchange-rate-history.html, as of 23 November 2016.

¹² *Ibid.*

¹³ Reuben, A. (2016) 'Autumn Statement: Big Increase in Borrowing Predicted', *BBC News* website, located at <http://www.bbc.co.uk/news/business-38078881>, as of 23 November 2016.

¹⁴ *Op Cit.* Taylor, 2016.

¹⁵ Taylor, T. (2016a) *The Ministry of Defence's Post-Brexit Spending Power: Assumptions, Numbers, Calculations and Implications*, Brexit Briefing, RUSI, 12 August 2016, located at <https://rusi.org/commentary/MoD-post-brexit-spending-power-assumptions-numbers-calculations-and>, as of 22 November 2016.

¹⁶ See European Union. (2009) Directive 2009/81/EC, 20 August 2009 located at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/35921/directive200981ec.pdf, as of 18 November 2016.

¹⁷ Formerly this was TEC (Treaty of the European Community) Article 296 and refers to the list of equipment contained in European Council. (1958) *Council Decision 255/58*, 15 April 1958, located at <http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2014538%202008%20REV%204>, as of 18 November 2016.

¹⁸ *Op Cit.* Young, 2016.

¹⁹ Caird, J. S. (2016) *Legislating for Brexit: the Great Repeal Bill*, London: House of Commons Library, 21 November 2016, available at <http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7793> as of 02 December 2016.

²⁰ *Op Cit.* The Electoral Commission, 2016.

²¹ Mullish, J. (2014) 'The Impact of Scottish Independence on Trident and the UK's Defence Industry', *DefenceIQ* website, 9 September 2014, located at <http://www.defenceiq.com/naval-and-maritime-defence/articles/the-impact-of-scottish-independence-on-trident-and>, as of 23 November 2016; Editorial. (2014) 'Scotland Independence Referendum: What a yes Vote Would Mean – The Experts' View', *The Independent* website, 16 September 2014, located at <http://www.independent.co.uk/news/uk/scottish-independence/scotland-independence-what-a-yes-vote-would-mean-the-experts-view-9736841.html>, as of 23 November 2016.

²² *Op Cit.* Taylor, 2016.

²³ Ministry of Defence. (2016) *A Better Defence Estate*, November 2016, located at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/565858/20161107_MOD_Better_Defence_Estate_FINAL.pdf as of 02 December 2016.

²⁴ Eyal, J. (2016) *Slovakia, the Visegrad Group and Brexit: Charity Should Begin at Home*, Brexit Briefing, RUSI, 7 October 2016, located at <https://rusi.org/commentary/slovakia-visegrad-group-and-brexit-charity-should-begin-home>, as of 24 November 2016.

²⁵ Razoux, P. (2016) *BREXIT: Strategic Consequences – A View from France*, Brexit Briefing, RUSI, 13 July 2016, located at <https://rusi.org/commentary/brexit-strategic-consequences-%E2%80%93-view-france>, as of 24 November 2016.

²⁶ *Ibid.*

²⁷ *Op Cit.* Young, 2016.

²⁸ Pantucci, R. (2016) *Brexit: A Case for British Recalibration in Relation to Asia and Africa*, Brexit Briefing, RUSI, 1 July 2016, located at <https://rusi.org/commentary/brexit-case-british-recalibration-relation-asia-and-africa>, as of 24 November 2016.

²⁹ Benwell, M. and Pinkerton, A. (2016) 'Brexit and the British Overseas Territories', *RUSI Journal*, Vol. 161, No. 4 (August 2016), pp. 8-14.

³⁰ Hemmings, J. (2016) *What Kind of Foreign Policy and Security Posture Should a Post-Brexit Britain Adopt?*, Brexit Briefing, RUSI, 4 July 2016, located at

³¹ This was once thought to be an approximate translation of an old Chinese curse, but it now thought to have originated with Joseph Chamberlain, father of Sir Austen and Neville Chamberlain. See https://en.wikipedia.org/wiki/May_you_live_in_interesting_times.



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