

# Defence Sector Report

1. This is a report for the House of Commons Committee on Exiting the European Union following the motion passed at the Opposition Day debate on 1 November, which called on the Government to provide the Committee with impact assessments arising from the sectoral analysis it has conducted with regards to the list of 58 sectors referred to in the answer of 26 June 2017 to Question 239.
2. As the Government has already made clear, it is not the case that 58 sectoral impact assessments exist. The Government's sectoral analysis is a wide mix of qualitative and quantitative analysis contained in a range of documents developed at different times since the referendum. This report brings together information about the sector in a way that is accessible and informative. Some reports aggregate some sectors in order to either avoid repetition of information or because of the strong interlinkages between some of these sectors.
3. This report covers: a description of the sector, the current EU regulatory regime, existing frameworks for how trade is facilitated between countries in this sector, and sector views. It does not contain commercially-, market- or negotiation-sensitive information.

## Description of sector

### *The defence sector*

4. The defence industry is of high strategic and political importance and critical to maintaining the UK's national security, providing battle-winning capabilities to UK Armed Forces. The existence of an indigenous defence industry able to counter emerging national security threats as a national endeavour and the export of advanced weapons systems constitutes an effective foreign-policy lever and an important element of both the UK's hard and soft power.
5. In 2016, the UK's defence industry turnover was £23 billion and the sector directly employed an estimated 142,000 people.<sup>1</sup> It makes a major contribution to the economy through the protection it provides the UK, by investing in apprentices (4,300 in 2016),<sup>2</sup> creating and sustaining high-skilled jobs across the UK, and exporting equipment and services around the world. In 2016, the UK defence industry won £5.9 billion of global export business.<sup>3</sup>
6. The defence sector can be broadly divided into four sub-sectors:
  - The defence aerospace sub-sector (including missiles) is broadly speaking the most internationally focused with significant ongoing collaborations with predominantly European (eg, Typhoon) but some US partners (eg, F35). As

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<sup>1</sup> 'Industry Facts and Figures 2017: A guide to the UK's Aerospace, Defence, Security and Space Sectors', ADS

<sup>2</sup> 'Industry Facts and Figures 2017: A guide to the UK's Aerospace, Defence, Security and Space Sectors', ADS

<sup>3</sup> 'UK defence and security export statistics for 2016', DIT, October 2017

well as equipping the UK Armed Forces, the sector has a strong export performance reflecting internationally competitive product offerings. Key UK products and related support services include fighter and trainer aircraft, helicopters, large aircraft wings, missiles and jet engines. This sector is closely related to the civil aerospace sector with many companies involved in both. Defence aerospace has a significant footprint in the South West (helicopters and engines) and North West (combat aircraft).

- The maritime sub-sector is largely a national endeavour to equip the Royal Navy. Key products are nuclear submarines, complex warships, amphibious, support and simpler patrol vessels. Accordingly the naval sector is clustered around complex warship building on the Clyde, nuclear propulsion in Derby and submarine construction in Barrow. Commercial shipbuilding is also seen on the Tyne, and in Birkenhead.
  - The land sub-sector has undergone a high degree of rationalisation. There is a requirement to support and upgrade a large number of defence equipment systems currently in-service, which is done through enterprises of all scales. Aside from support, key products include light armoured vehicles, armour, weapons and munitions. There is some overlap in the component supply chain with adjacent civil sectors, including automotive.
  - The intelligent systems sub-sector overlaps with the aerospace, maritime and land sub-sectors and wider adjacent civil sectors including space, security and cyber. Accordingly this is the most varied sector encompassing cyber, data processing, autonomous systems, surveillance, communications and high grade cryptography products. The UK is a technology leader in many fields in what is – particularly in combination with the security sector – an area of significant and increasing export success. The sector encompasses established primes and small and medium-sized enterprises distributed across the UK.
7. The Government is a key supporter of the defence sector, including the promotion of defence exports and through initiatives such as the Defence Growth Partnership, which encourages a more competitive and internationally focused defence sector.
8. In accordance with North Atlantic Treaty Organisation (NATO) guidelines,<sup>4</sup> the UK's defence spending amounts to at least 2 per cent of its gross domestic product. In the Strategic Defence and Security Review 2015 (SDSR), the government committed to spending £178 billion on equipment and equipment support in the ten years from SDSR 2015.

### ***Defence industry rationalisation***

9. The UK defence sector has undergone significant rationalisation. The largest UK supplier in the defence sector is now BAE Systems; it receives approximately 15 per cent of the total Ministry of Defence (MOD) procurement spend.<sup>5</sup> Globally, the defence industry has also undergone significant rationalisation and consolidation with

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<sup>4</sup> [Funding NATO](#), North Atlantic Treaty Organisation, June 2017

<sup>5</sup> [Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017'](#), Ministry of Defence, September 2017.

the emergence of dominant multinational companies. Some of these retain UK headquarters and likewise overseas-based multinationals have a significant UK presence.

10. In some sub-sectors there are now only single UK-based suppliers, which reduces the prospect of domestic competition. The situation in maritime is partly dependent on previous MOD partnering arrangements with industry; this is something that is being addressed through the recently published National Shipbuilding Strategy. In land equipment and intelligent systems there is more competition.

### **Market structure**

11. There are a small number of large firms who each hold a substantial percentage of the overall market share in the defence sector. BAE Systems has roughly five times the defence revenue of the next largest, Rolls Royce, although Rolls Royce non-defence revenue brings it near equivalent size. BAE Systems is the largest defence company in Europe, and the third-largest in the world.<sup>6</sup>
12. Often for particular defence products and services there are only single UK suppliers.<sup>7</sup> Single Source Procurement has implications for competition, value for money and private investment in research and development (R&D). The MOD's approach to single source procurement is explained at Annex A.
13. The defence sector is R&D intensive. R&D expenditure in the UK for defence purposes was £1.8 billion in 2015,<sup>8</sup> and contains a number of highly innovative companies across the supply chain. These overlap with adjacent maritime, civil aerospace, space and security sectors. While the sector retains a defence core, the sector as a whole is increasingly integrated with the civil sector, not least as cutting-edge technologies, such as cyber and autonomous systems, are increasingly developed first in the civil sector.
14. The European Commission noted this trend in the EU Funding for Dual Use guide,<sup>9</sup> which stated 'the relationship between the civil and defence worlds is intensifying and the dividing lines between them are becoming increasingly blurred. The armed forces and defence industry's dependence on technologies with a civilian origin is increasing as is the tendency of the latter to diversify into civil markets.'

### **Defence industry supply chains**

15. Defence supply chains of multinational and large defence companies can be long, complex and international. Alongside the dominant prime equipment manufacturers and service providers sits a diverse supply chain with an important mid-tier and small

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<sup>6</sup> ['SIPRI Arms Industry Database'](#), Stockholm International Peace Research Institute.

<sup>7</sup> Directive 2009/81/EC requires the MOD (on behalf of the UK) to annually report its procurement activity conducted under the Directive to the European Commission. In 2015, 67 per cent of procurements by number and 15 per cent by value of defence procurement contracts placed under the directive was single source. This was 86 contracts, worth £1.6 billion – although 2015 figures were skewed by one high-value contract. Previous years' values can be seen in the [DSPCR Five Year Review](#).

<sup>8</sup> [ONS UK gross domestic expenditure on research and development: 2015](#) Section 8. Comprises £1.2 billion Government funding, £0.4 billion from the business sector and £0.2 billion from overseas.

<sup>9</sup> ['EU funding for dual use: a guide for regions and SMEs'](#), European Commission, October 2014.

and medium-sized enterprises (SME) element. UK defence companies may therefore import significant amounts of materials and subsystems, as well as exporting significant amounts of subsystems and finished goods.

16. ADS Group's (ADS)<sup>10</sup> Industry Intelligence Survey 2016 also found that 66 per cent of defence companies in the UK organised their production solely within the UK in the last three years. Overall, 65 per cent of UK defence industry's supply chain is located in the UK, 15 per cent in Europe and nine per cent in North America. There is minimal supply chain presence in Latin America, the Middle East, Africa and Asia.<sup>11</sup>

### ***Defence industry's dependency on the MOD***

17. Overall, UK defence firms are quite dependant on MOD spending but generally this has declined over recent years, or remained relatively constant, as a proportion of their global revenues. For the majority of MOD's top suppliers, MOD sales account for less than ten per cent of their global revenue, although Babcock, BAE Systems and Serco received 37 per cent, 21 per cent and 12 per cent of their annual revenue from MOD in 2016/17, respectively.<sup>12</sup> This reflects the consolidation and internationalisation of the global defence industry.

### ***The MOD approach to defence procurement***

18. The MOD's approach to defence procurement is described in the National Security through Technology White Paper of 2012.<sup>13</sup> This places an emphasis on securing best value for money for the taxpayer through the use of open global competition. The MOD uses single-source procurement to source equipment from UK suppliers where it can be justified on national security grounds.
19. In broad terms, the UK generally buys defence materiel either direct from UK-based suppliers, who may or not be subsidiaries of international companies; direct from the US Government through the Foreign Military Sales process; or via international collaborative programmes that are explained at Annex B. Data on MOD defence industry imports is not currently collated. The US is the most significant international supplier of equipment for the MOD, with plans to acquire new Apache helicopters, P8 patrol planes and F35 fighters.
20. While there is little in the way of direct procurement from EU suppliers in the EU nations with a large national defence industry, cross-border EU trade is more complex and likely to be undercounted as much of it is undertaken as part of collaborative programmes. In addition, foreign investment in the defence sector means there is likely to be significant cross-border trade indirectly through parent companies and affiliates, subcontractors, consortia and wholesalers/distributors.

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<sup>10</sup> The ADS Group is a trade organisation representing the aerospace, defence, and security industries in the UK.

<sup>11</sup> 'UK Defence Outlook 2016' (page 12), ADS.

<sup>12</sup> 'Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017', Ministry of Defence, September 2017.

<sup>13</sup> The MOD is refreshing its industry policy this year.

21. In 2015, the MOD placed 1,639 contracts for goods, works and service valued at £14.2 billion.<sup>14</sup> In addition to defence materiel, the MOD is also a significant customer for a wide variety of dual-use and civil goods, works and services ranging from clothing to training simulators, from construction of buildings to provision of staff, from medical and veterinary supplies to international freight and distribution, and from food and drinks to fuel and lubricants.
22. Defence infrastructure is the main non-materiel procurement carried out by the MOD – see Annex C for further details. Many of these non-materiel procurements are for dual use and civil goods, and works and services that are captured by the Public Contracts Regulations 2015.

### ***Devolved areas of responsibility***

23. The Scotland Act 1998, Schedule 5, Part 1, paragraph 9 states that the defence of the realm is a reserved matter. The Concordat between the Scottish Ministers and the Secretary of State for Defence sets out an illustrative list of matters thought likely to be included within the reservation. That includes the activities of the Secretary of State for Defence and the MOD for the purposes of the armed forces and the defence of the realm, which would cover the MOD's procurement activity.

### ***MOD defence expenditure***

24. In 2015/16, the MOD spent around £18.7 billion with UK industry, an average of £290 for each person living in the UK.<sup>15</sup>
25. The proportion of MOD spending with its current top-10 suppliers has increased from approximately 39 per cent in 2007/08 to around 41 per cent in 2016/17.<sup>16</sup>
26. In 2016/17, MOD direct spend with SMEs was at least £707 million with nearly 6,000 different suppliers. The MOD placed at least 440 new contracts with SMEs, with a collective value of around £523 million.<sup>17</sup>
27. In 2016/17, around 54 per cent by value<sup>18</sup> of new MOD contracts (for which data are available) were placed competitively. Among the top-ten suppliers the level of competitive contracting varied between one per cent and 91 per cent.<sup>19</sup>

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<sup>14</sup> 'Defence and Security Public Contracts Regulations 2011 Five Year Statutory Review' (tables 1 and 2), Ministry of Defence, December 2016. Note, the number and values of the contract awards for framework agreements awarded by MOD are included in the figure but, to avoid double counting, not the individual call off contracts under those frameworks. The value of contract awards also includes payments to foreign government and international organisations that are not directly attributable to an individual contract award.

<sup>15</sup> 'MOD Regional Expenditure with UK Industry and Commerce and Supported Employment 2015/16', Ministry of Defence, August 2017.

<sup>16</sup> 'Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017', Ministry of Defence, September 2017.

<sup>17</sup> 'Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017', Ministry of Defence, September 2017. In January 2017 D&B resumed SME assessments with around 3,350 new suppliers, in the 2015/16 dataset, identified as SMEs. However no new assessments have been received for the 2016/17 dataset and over 7,000 suppliers, receiving just over £4 billion in 2016/17, have not had their SME status assessed. The 2016/17 figures are marked as provisional in case a further D&B assessment of the not assessed suppliers is received. At the moment however these figures should be considered as minimums especially when comparing across years.

<sup>18</sup> 'Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017' page 5, figure 2.

## **Labour in the defence sector**

28. The Office for National Statistics (ONS) produce estimates of gross value added (GVA) for each industry sector but this does not readily map to the defence sector. GVA is roughly the contribution made to overall national gross domestic product (GDP).<sup>20</sup>
29. ADS has estimated that the defence sector made a £8.7 billion contribution to GVA in 2016.<sup>21</sup> The sector is export, research and skills-intensive. There were £5.9 billion of export orders in 2016.<sup>22</sup> Of the 142,000 people that ADS estimates were directly employed by the UK defence industry, 21 per cent by job function were in research, design and engineering.<sup>23</sup>
30. The UK defence industry has capital intensity (net capital stock as percentage of turnover) of 36 per cent, higher than the motor vehicle and steel industries, and the economy as a whole.<sup>24</sup>
31. There is significant regional employment with defence suppliers spread across the UK. These include shipbuilding and maritime services in the South West and Scotland, combat aircraft in the North West, submarines in Cumbria and aerospace in the Midlands.
32. MOD expenditure with UK industry and commerce supports one in every 200 jobs in the UK.<sup>25</sup>
33. There is some reliance on access to labour, particularly in the maritime sector where there is a shortage of UK workers, which is addressed with labour from the rest of the EU, although for manufacture and support of classified pieces of equipment or services, employment may be limited to UK nationals. Companies regularly rotate individuals around their EU operations for their personal development. There is also a demographic challenge with the workforce ageing and a desire to get more women into the sector.
34. UK defence industry has relatively low exposure to the EU labour market, however, the sector labour market is exposed to certain skill shortages such as science, technology, engineering and mathematics, and cyber.
35. Short-term travel for maintenance and support is important for most of the major defence firms. Services and repairs often require movement of staff (short-term) and

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<sup>19</sup> [Finance & Economics Annual Bulletin Trade, Industry & Contracts 2017'](#) (figure 2), Ministry of Defence, September 2017.

<sup>20</sup> Unlike GDP, GVA is not adjusted for taxes and subsidies.

<sup>21</sup> [UK defence outlook 2016](#), page 9, ADS.

<sup>22</sup> [UK defence and security export statistics for 2016'](#), DIT, October 2017.

<sup>23</sup> UK defence outlook 2016, page 9, ADS. <https://www.adsgroup.org.uk/wp-content/uploads/sites/21/2017/09/DefenceOutlook2017-WebRes.pdf>

<sup>24</sup> [The economic case for investing in the UK defence industry'](#), Oxford Economics, August 2009.

<sup>25</sup> [MOD Regional Expenditure with UK Industry and Commerce and Supported Employment 2015/16'](#), Ministry of Defence, August 2017. FTE employment is referred to as 'jobs' for brevity.

procurement of parts at short notice. A number of firms currently provide maintenance and support to EU countries from the UK.

### **Research and development in the defence sector**

36. The defence sector is a high R&D and capital-intensity sector. The UK government's funding of defence R&D in 2015 was unchanged from 2014 at £1.2 billion.<sup>26</sup> The proportion of UK total defence funding by the government sector also remained unchanged from 68 per cent in 2014. The UK business sector provided £0.4 billion (23 per cent) of funding and an additional £0.2 billion (nine per cent) came from overseas. Of particular note, business R&D expenditure in the civil sector grew by 81 per cent in constant prices since 1990, but business expenditure on R&D in the defence sector decreased by 50 per cent over the same period.<sup>27</sup>

### **Foreign investment in the defence sector**

37. Historically, the UK has operated one of the most open major defence markets. Coupled with the Government's support to defence exports and close political and military ties with key export markets, including the Gulf, this has resulted in significant inward investment from overseas-based defence suppliers.
38. The UK is committed to maintaining and improving its global competitiveness, in an increasingly competitive market. A number of large overseas-based defence companies (primarily US and European) have a significant UK presence, often through acquisition of UK companies.
39. UK defence industry has higher capital intensity than the motor vehicle and steel industries and the economy as a whole. Therefore, further investment in capital will be needed by the sector to maintain the UK's comparative advantage with respect to international competitors such as the US in the aerospace sector.

### **Defence export market**

40. The global defence export market experiences peaks and troughs in response to fluctuations in defence spending levels, threat perception and national requirements. However, the UK's position as one of the world's most successful defence exporters, averaging second place in the global rankings on a rolling ten-year basis (2006–15),<sup>28</sup> makes the UK consistently Europe's leading defence exporter over the period.
41. UK Trade and Investment Defence and Security Organisation (UKTI DSO) estimates UK defence export orders over the period 2007 to 2016 as US\$120 billion.<sup>29</sup> In 2016, the UK defence exports were £5.9 billion with a nine per cent share of the global export market. Total export orders placed UK as the fifth-largest defence exporter. Aerospace accounted for 70 per cent, land for 13 per cent and sea for 17 per cent of 2016 UK defence exports.<sup>30</sup>

<sup>26</sup> <https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/articles/migrationandthelabourmarketuk/2016#main-points>.

<sup>27</sup> 'UK gross domestic expenditure on research and development: 2015' (section 8), ONS, March 2017.

<sup>28</sup> 'UK defence and security export statistics for 2016' (slides), DIT, October 2017.

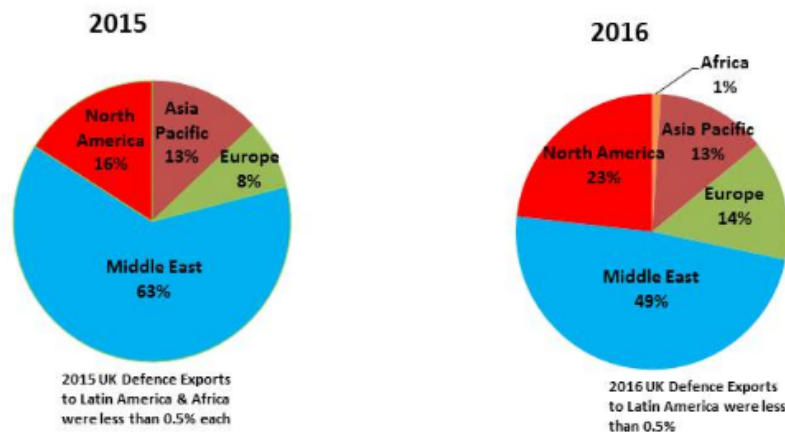
<sup>29</sup> 'DIT DSO UK export statistics for 2016: tables' (chart 2), DIT, October 2017.

<sup>30</sup> 'DIT DSO UK export statistics for 2016: tables' (chart 9), DIT, October 2017.

42. By number of orders, the UK's most important markets for defence and security exports were the Middle East, North America and Asia–Pacific. The Middle East accounted for 49 per cent whereas Europe accounted for 14 per cent in 2016.<sup>31</sup>

## Estimated total UK defence exports (based on orders / contracts signed) by region 2015 and 2016

**Chart 7: Estimated Total UK Defence Exports (Based on Orders/Contracts Signed) by Region 2015 & 2016**



Source: DIT DSO

43. During the past ten years, the UK has won significant defence orders, including Oman (offshore patrol vessels (OPV), Hawk & Typhoon aircraft), Saudi Arabia and India (Hawk aircraft), Norway and South Korea (helicopters), France (Trent 700 engines), Brazil (OPVs), Republic of Ireland (OPVs), USA (bridging) and Estonia (mine hunters).
44. By sector, aerospace accounted for 63 per cent of all defence export orders globally in 2015. This is amplified at domestic level, where the UK remains heavily dependent (around 85 per cent by value) on air sector exports, including platforms, equipment and support.<sup>32</sup> As a leader in air sector technology and capability, this is evidence of the UK exploiting its industrial expertise. This strength will be vital to securing the high-value export opportunities in growth markets where securing air superiority is, and will remain a key priority for nearly all nations. Links to and cross over with the aerospace sector are important for future growth.
45. As mentioned above, there is likely to be significant cross-border trade indirectly through parent companies and affiliates, subcontractors, consortia and wholesalers/distributors. In addition, cross-border trade through international collaborative programmes tends to be apportioned on the basis of work-share

<sup>31</sup> [DIT DSO UK export statistics for 2016: tables'](#) (chart 7), DIT, October 2017.

<sup>32</sup> [DIT DSO UK export statistics for 2016: tables'](#) (chart 8), DIT, October 2017.



between the procuring nations; so for example, all Typhoon aircraft are part made in UK, Spain, Italy and Germany. Similarly the A400M transport aircraft is manufactured by Airbus largely in Germany, France, Spain and the UK. While Gripen and F35 are seen as Swedish and US products, around 30 per cent<sup>33</sup> and 15 per cent<sup>34</sup> respectively by value of their components are UK supplied.

46. This more complex picture might help explain the results of ADS's Industry Intelligence Survey 2016. It found that Europe continues to be the dominant export location for UK defence industry with 81 per cent of defence companies that responded exporting to Europe. In comparison, 57 per cent of respondents were exporting to North America and 44 per cent to the Middle East.<sup>35</sup>

### ***EU funding of the defence sector***

47. Defence is largely excluded from EU funding programmes, such as Horizon 2020 and European Structural Funds, so EU funding in this sector is small and largely associated with civil- and dual-use-focused activities, which may have a spillover effect into defence.
48. The MOD has also recently received funding under the Single European Skies initiative to fund certain Air Traffic Control upgrades, at €10 million.
49. The European Defence Action Plan considered how the EU can do more to develop the European Defence Industrial and Technological Base. A 'Preparatory Action on Defence Research' initiative was launched this year, in which the UK is participating, and this is likely to become a permanent part of the EU research programme from 2021 onwards. The European Defence Industrial Development Programme is also being developed, which will support cooperation between European nations on the development of military capability.
50. The EU does not fund defence acquisition programmes.

### ***Strategic Defence and Security Review (SDSR), international by design and industrial policy refresh***

51. While SDSR 2015 restated the Government's commitment to the key principles of the UK's approach to defence procurement described in the National Security through Technology White Paper, it committed to refresh defence industrial policy to help UK industry to grow and compete successfully. SDSR described how defence policy and plans would become international by design. This recognises the importance of strengthening the UK's relationship with key allies and the role of collaborative programmes where we have the right technology, skills and industrial capabilities and where we can reduce costs and share technology to mutual benefit. While the timescale for refreshing defence industrial policy is still to be confirmed, it will tie into the wider UK Industrial Strategy, and the National Shipbuilding Strategy, published in 2017. The refreshed defence industrial policy will build further on the

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<sup>33</sup> ['Written Evidence from Saab to the Defence Committee'](#), House of Commons, April 2012.

<sup>34</sup> 'Built in the UK, Delivered to the World', F-35.

<sup>35</sup> ['UK Defence Outlook 2016'](#), ADS.

recently announced Defence Innovation Initiative and the policy of international by design, explaining how these apply to defence procurement and industrial policy.

## The current EU regulatory regime

### *The DSD and DSPCR*

52. The Defence and Security Directive (DSD) is the main EU legislation in the field of defence and security, with the purpose of:
- creating a level playing field for these sectors – that means opening up non-exempt UK requirements to EU suppliers as well as allowing defence and security suppliers established in one EU Member State to bid for business opportunities in all EU Member States on an equal footing; and
  - reducing EU Member States' reliance on the Article 346 exemption.
53. The DSD applies to the award of defence and security contracts by the public sector (central government, security agencies and the wider public sector such as police authorities), bodies governed by public law, and to utilities (both public sector and private sector) operating in the energy, water, transport and postal services sectors. The vast majority of procurement expenditure and activity is, however, carried out by the MOD. In 2015, the MOD procured £10.6 billion of goods, works and services under the DSD, which represented 75 per cent of the value of all its requirements. In addition, £9 billion of MOD procurement was subject to open competition for all suppliers in the EU.<sup>36</sup>
54. The DSD does not generally regulate businesses that tender for public contracts except where such businesses fall within the definition of a body governed by public law in the Directive. The other exception to the general rule is the optional subcontracting regulations that are not used in practice. Businesses are affected, as the procedural rules specify the processes and requirements that must be applied in inviting businesses to tender for public procurement contracts. The DSD also sets out remedies for suppliers, explaining when, and how, procurement decisions may be challenged when there has been an alleged breach of the rules.
55. The DSD was transposed into UK legislation by the Defence and Security Public Contracts Regulations 2011 (DSPCR). The DSPCR applies to the award of certain contracts in the fields of defence and security throughout England, Scotland, Wales and Northern Ireland where the procurement procedures began on or after 21 August 2011. It governs the contract award procedures for (subject to certain exclusions):
- the supply of military equipment or sensitive equipment, including any parts, components or sub-assemblies of military equipment;
  - works, goods and services directly related to the above equipment; and

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<sup>36</sup> ['Defence and Security Public Contracts Regulations 2011 Five Year Statutory Review'](#) (tables 2 and 4), Ministry of Defence, December 2016.

- works and services for specifically military purposes or sensitive work or works and sensitive services.

56. The DSPCR requires competitive procurement except in limited circumstance that must be properly justified (eg, where exclusive rights or technical reasons mean that only one supplier can do the work.). It also sets out the regulatory framework for conducting contract awards procedures that is better suited to the complexity of the defence and security sectors than the general rules for public procurement, although it is not best commercial practice, in particular:

- the default procedures are the restricted procedure and negotiated with prior publication of contract notice that can be used without restriction. This gives procurers the flexibility to negotiate with suppliers in detail all or any features of complex procurements. The competitive dialogue procedure can also be used for particularly complex contracts where the default procedures are not sufficient;
- rules for selection and award criteria have been drawn more widely to reflect defence and security issues;
- specific provisions on security of information are included, which ensure that sensitive information will remain protected against unauthorised access;
- special clauses on security of supply provide contracting authorities/entities with greater certainty that equipment, works or services can be delivered, in particular in times of crisis or armed conflict; and
- special rules on sub-contracting make it possible for contracting authorities/entities to require competitive procurements for sub-contractors on an EU-wide basis, potentially improving market access for SMEs and thus complementing the Small Business Act for Europe objectives.

### ***The future of EU regulations in the defence sector***

57. The European Commission has issued a report to the European Parliament and Council that sets out the main findings of their review on the effectiveness, efficiency, relevance and coherence of the DSD.<sup>37</sup> Their statistics on the number of contracts awarded and their value in € million under the DSD show clear upward trend from €22 million (£20 million) in 2011 to €19.2 billion (£17.2 billion) in 2015.<sup>38</sup>

58. The value of all contracts placed under the DSD was €30.9 billion (£27.6 billion) from 2011 to 2015. The report concludes that EU Member States use of the DSD from 2011 to 2015 was uneven. The UK accounted for 57 per cent of all contract awards, by value, under the DSD from 2011 to 2015. Of the other Member States, the next greatest contributors to the EDEM by value were France (16 per cent), Poland (6.5 per cent), Germany (5.5 per cent), and Italy (3.5 per cent). Cyprus, Greece, Ireland,

<sup>37</sup> Report from the Commission to the European Parliament and the Council on the implementation of Directive 2009/81/EC on public procurement in the fields of defence and security, to comply with Article 73(2) of that Directive.

<sup>38</sup> ['Evaluation of Directive 2009/81/EC on public procurement in the fields of defence and security'](#) (figure 7) Commission Staff Working Document, European Commission, November 2016.

Malta, Luxembourg and Spain have not published any contract award notices under the DSD.<sup>39</sup>

59. The report concludes that the DSD is fit for purpose and broadly on track to meet its objectives, more than doubling the value of defence and security procurements subject to fair and open competition in the EU. However, only ten per cent of contracts, by value, are awarded to foreign suppliers.<sup>40</sup> The shortfall in meeting the objectives is put down to the short period of time since all EU Member States transposed the DSD. The Commission will focus on ensuring the effective implementation of the DSD, which requires a stable legal framework.
60. UK statistics show that total defence exports over the period 2007 to 2016 were US\$120 billion. Over this period the estimated total of UK defence exports to Europe was ten per cent.<sup>41</sup> However, the amount of business generated by the right of market access under the DSD is a small part of total UK defence exports. The European Commission's statistics in their report show that contracts awarded to UK industry under the DSD by the EU27 MODs in the same period were just €168 million.<sup>42</sup>

### ***Intra-EU transfers of defence-related products***

61. Directive 2009/43/EC provides the regulatory regime within the EU for transfers between Member States of defence products listed in the EU Common Military List (EUCML). It also regulates transit between EU Member States but does not extend to exports to third countries. Directive 2009/43/EC was transposed into UK secondary legislation as an amendment to Export Control Order 2008) under the Export Control Act 2002.
62. The main purpose of Directive 2009/43/EC is to introduce simplified licensing rules and procedures on the intra-community transfer of defence-related products between EU Member States and to provide some safeguards to support these arrangements. The Directive covers, among other things, complete items of military equipment, sub-systems, components, spare parts and technologies within the EUCML.
63. The Directive does not do away with the need for an export licence for defence products, but is intended to significantly reduce the number of individual export licences for transfers with the EU, by establishing new 'general licences' which would, for example, cover defence exports of specific listed defence items within one EU Member State to the armed forces of other EU Member States and so called EU certified companies. There are further general licences in place to facilitate other export scenarios, for example to help with demonstration, exhibition and repair.

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<sup>39</sup> 'Evaluation of Directive 2009/81/EC on public procurement in the fields of defence and security' (table 7) Commission Staff Working Document, European Commission, November 2016, table 10, pages 38–39.

<sup>40</sup> 'Evaluation of Directive 2009/81/EC on public procurement in the fields of defence and security' Commission Staff Working Document, European Commission, November 2016.

<sup>41</sup> 'DIT DSO UK export statistics for 2016: tables' (chart 6), DIT, October 2017.

<sup>42</sup> ['Evaluation of Directive 2009/81/EC on public procurement in the fields of defence and security'](#) (table 53) Commission Staff Working Document, European Commission, November 2016.

64. That said, so far the benefits have been minimal. Most nations continue to use individual export licences for much of their activity while the list of items of the general licences is usually minimal and there are few certified companies. The Commission has initiated action over greater publicity over the opportunities the Directive offers and to encourage a more consistent general list of items and conditions used on two of the general licences to achieve a minimum level of harmonisation across the EU.
65. The introduction of Directive 2009/43/EC has made minimal impact on the UK's export licensing arrangements. There were few implications for UK export control system when the Directive came into force, as it allowed the UK to operate an export control system very close to its previous national arrangements.
66. The benefits of Directive 2009/43/EC for UK defence industry arise from imports to the UK. Individual export licensing systems prevailed across the EU. Directive 2009/43/EC forced EU Member States to introduce simplified licensing arrangements. There has, as stated above, been a rather patchy implementation across EU Member States of the Directive and the benefits have not been fully realised.
67. While UK defence industry can make effective use of simplified licensing arrangements in the UK to export to other EU Member States, they are not receiving reciprocal benefit when receiving defence goods from the part of their supply chain located in the rest of the EU. Since the regime is only mandated for intra-EU license activity, exports to countries outside the EU would remain a national decision. The UK does have in place simplified licences covering third-country destinations of the least sensitivity. For destinations and goods of greater sensitivity, individual export licence arrangements are necessary, increasing administration costs.
68. In relation to intra-EU Transfers of Defence-Related Products, security exemptions within Article XXI of the World Trade Organisation (WTO) General Agreement on Tariffs and Trade would permit national rules for defence exports to be applied on security grounds.
69. Whilst the WTO General Agreement on Trade in Services (GATS) may conceivably be more relevant to defence, it is unlikely to have a huge impact on the defence sector for the following reasons:
- GATS only applies to services and does not apply to barriers to goods (eg, tariffs/discriminatory internal taxation on defence goods).
  - GATS does not apply to "services supplied in the exercise of governmental authority" (Art I (3)). In many WTO members, a significant proportion of defence services will fall into this category, as they will be supplied directly by the state, using public money and there will be no private market for such services.
  - Generally, GATS does not apply to government procurement (Art XIII), which is likely to be the largest consumer of private defence services.

- GATS contains a specific national security exception, which allows each WTO member to take “any action which it considers necessary for the protection of its essential security interests:...(i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment” (Art XIVbis(1)(b)(i)). Given the deference usually applied in the context of the national security exception, WTO members have considerable flexibility in the context of defence.

### **Council Regulation (EC) No 150/2003: import duties**

70. Council Regulation (EC) No 150/2003 of 21 January 2003 suspends import duties on certain weapons and military equipment from around the world, procured by Member State authorities. Duty is suspended on such goods subject to the application of EU customs systems such as inward processing relief and military end-use certificates.
71. The MOD holds all data for MOD imports (provided monthly from Her Majesty’s Revenue and Customs declarations database) and has a legal obligation to declare all goods arrivals in the UK (including MOD-owned goods).
72. The MOD also moves a considerable amount of “owned” equipment (eg, equipment already in service with the armed forces) around the world (for operations, exercises, repairs, etc) much of which requires customs declarations on export/import under current the EU regulation. No other UK Government department exports and re-imports owned goods to the extent that the MOD does.

### **EU competition law**

#### *Mergers and acquisitions*

73. The European Commission has extensively applied the merger-control rules to the defence sector in the EU with the aim of guaranteeing effective competition control, and contributing to an improved functioning of the market for defence.
74. The main competition law provisions are Article 101 of the Treaty on the Functioning of the European Union (TFEU) that prohibits all agreements between undertakings, decisions by associations of undertakings, and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction, or distortion of competition within the EU and Article 102 prohibits abusive business conduct by an undertaking where that undertaking has a dominant position in a given market within the EU. However, the MOD and other EU Member States still have the right under Article 346 TFEU to ensure any decision on a merger and acquisition that affects national security is taken by national authorities in the UK.
75. The UK has its own competition provisions modelled on Article 101 and Article 102. These are set out in the Competition Act 1998. The “Chapter I prohibition” in the Act reflects Article 101 and prohibits agreements, decisions by associations of undertakings and concerted practices that have as their object or effect the restriction of competition. The “Chapter II prohibition” reflects Article 102 and prohibits the abuse of a dominant position. There is no equivalent to Article 346 in the Competition

Act 1998 so, currently, any national security exemption requires a Public Policy Exclusion Order to be made under the Act.

76. The Enterprise Act 2016 allows the Government to use statutory undertakings (in addition to any special shares and contractual undertakings) to place certain obligations on a company (albeit there are limited number of defence suppliers), which include prior approval before winding-up or dissolution and/or the disposal or destruction of strategic assets; restrictions on foreign ownership; and approval of the appointment or removal of any director.
77. In addition, the MOD operates and maintains a List-X database that records all contractors or subcontractors that have access to data classified at "secret" or above. To qualify for List-X status the contractor is bound by certain conditions, again including ownership and control, which provides a level of assurance towards protecting sensitive assets and data.

#### *State aid*

78. In the past, the European Commission's primary concern when assessing state aid measures in the defence sector was to avoid spillover effects that could impact on the civil sector. However, the Commission Communication of July 2013 highlighted that EU Member States seeking to rely on Article 346 in the context of state aid must demonstrate that the measures that they take fulfil the same necessity and proportionality conditions set out in the case law for procurement. Therefore, if an EU Member State intends to rely on Article 346, it must be able to demonstrate that the concrete measures in the military sector are necessary and proportionate for the protection of their essential security interests and that they do not go beyond what is strictly necessary for that purpose. The burden of proof that these conditions are fulfilled lies upon EU Member States.
79. EU Member States have an obligation, under the TFEU, to notify to the Commission all state aid measures, including aid in the pure military sector. They may only derogate from that obligation if they can prove that non-notification is necessary for reasons of essential security interests under Article 346 TFEU.

#### *Intellectual property rights*

80. The UK patent law provisions on defence and security derive from UK national law, not from EU law. Specifically, the Patents Act 1977 (Section 22 for security and Sections 55 to 59 in relation to the Crown user rights that allow us to use third-party owned patents for defence purposes).
81. A patent offers protection in a specific country. However, it is generally possible to obtain patent protection in up to 38 states at once (including all EU Member States) by filing with the European Patent Office, which is wholly separate from the EU.
82. The Intellectual Property Rights Directive 2004/48/EC requires all EU countries to apply effective, dissuasive, and proportionate remedies and penalties against those engaged in counterfeiting and piracy, and aims to create a level playing field for right holders in the EU. It means that all EU countries will have a similar set of measures available for right holders to defend their intellectual property rights.

## **EU environmental law**

83. The main environmental rules UK defence industry must comply with are set out below.

### *Registration, Evaluation, Authorisation and restriction of Chemical Substances (REACH) Regulation (EC) No 1907/2006*

84. Chemicals produced in or imported by the EU are subject to the EU REACH 1907/2006/EC (Registration, Evaluation, Authorisation of Chemicals) Regulation. REACH is a Single Market measure that addresses the production and use of chemical substances, and their potential impacts on both human health and the environment.
85. REACH primarily puts the responsibility on manufacturers and importers of chemicals and other substances covered by REACH, with a focus on identifying risk and applying appropriate risk management measures. Further duties affect downstream sector users of chemicals. Authorities (Member States or the European Chemicals Agency, which manages REACH on behalf of the Commission/EU) can initiate additional EU-wide regulatory controls on the most dangerous chemicals.

### *Waste Electrical and Electronic Equipment (WEEE) Directive 2012/19/EU*

86. WEEE aims to reduce the impacts of electrical and electronic equipment (EEE) on the environment during their life and when they become waste. WEEE does not apply to equipment intended solely for a military purpose. It does apply to dual-use and civil equipment that is used for a military purpose but not produced solely for that purpose.
87. WEEE places the obligation on the producer of equipment that falls within the scope of the regulation to finance its recovery, but the UK regulation does provide an option which allows both parties to negotiate on how to allocate the financing responsibility for disposal of EEE in its original configuration.

### *Restriction of Hazardous Substances (RoHS) Directive 2002/95/EC*

88. The Restriction of the Use of Certain Hazardous Substances (RoHS) in Electrical and Electronic Equipment Directive (2011/65/EU) aims to prevent hazardous substances from entering the production process and thereby keep them out of the waste stream. There is no defence exemption in the RoHS Directive.
89. The RoHS Directive takes its scope from the WEEE Directive, only EEE that falls within the Schedules to the WEEE Directive will fall under the RoHS Directive. The Directive places severe restrictions on the use of lead, cadmium, polybrominated biphenyls, hexavalent chromium and polybrominated diphenyl ethers in new EEE.

### *F-Gas and Ozone Regulation (EC) No.842/2006*

90. Regulation (EC) No.842/2006 limits the use of certain fluorinated greenhouse gases (F-Gases). The objective is to contain, prevent and thereby reduce the emissions of F-Gases covered by the Kyoto Protocol.



### ***Other legal requirements***

91. The defence sector crosses into a number of adjacent sectors including maritime, civil aerospace space and security. Rules and requirements relevant to those sectors are also relevant to defence.
92. In addition, MOD procurements for dual-use and civil goods, works and services are captured by the Public Contracts Regulations (PCR) 2015 (unless below threshold and/or exempt).
93. There is also a large amount of general legislation derived from EU law such as the Transfer of Undertakings (Protection of Employment) Regulations 2006, the Workplace (Health, Safety and Welfare) Regulations 1992 and the Data Protection Act 1998 (which implements the Data Protection Directive in the UK) which also has an impact on the defence sector.

### **Existing frameworks for how trade is facilitated between countries in this sector**

94. The arrangements described in this section are examples of existing arrangements between countries. They should not be taken to represent the options being considered by the Government for the future economic relationship between the UK and the EU. The Government has been clear that it is seeking pragmatic and innovative solutions to issues related to the future deep and special partnership that we want with the EU.

### ***Defence procurement***

95. Aside from the EU regulations described above, the WTO sets rules for public procurement contained in the Agreement on Government Procurement (GPA). The GPA is a plurilateral agreement between many of the major economies, including the United States, Canada, the EU and Japan, that aims to mutually open government procurement markets among its parties. The UK is currently a member of the GPA through its membership of the EU. The Government is taking steps to ensure the UK remains a party to the GPA when the UK withdraws from the EU.
96. In 2015, MOD placed 192 civil and dual-use contracts valued at £946 million under the PCR 2015.<sup>43</sup> As these contracts were also covered by the UK's GPA obligations, the MOD was obliged to open these contract awards to bidders from GPA parties. Although, it is likely that the MOD would have allowed them to bid for policy reasons.
97. Contracts relating to arms, munitions and war material awarded by contracting authorities/entities operating in the field of defence are excluded from the scope of the GPA. Other contracts covered by the DSD are also exempt from the application of the GPA by virtue of Article III.

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<sup>43</sup> Defence and Security Public Contracts Regulations 2011 Five Year Statutory Review' (tables 1 and 2), Ministry of Defence, December 2016.

98. Article III of the WTO GPA means that in the specific context of defence and security markets, EU Member States retain the power to decide whether their contracting authority/entity may allow economic operators from third countries to participate in contract award procedures. Recital 18 of the DSD provides that Member States should take that decision on grounds of value for money, recognising the need for a globally competitive European Defence Technological and Industrial Base, the importance of open and fair markets and the obtaining of mutual benefits. The UK and most EU Member States therefore do allow bidders from third countries (principally, from US defence industry) to participate in their procurement.

### ***Impact of defence relationships on market access***

99. Often defence procurement is seen as an important strand in building defence relationships, with most procurement choices dependent on a combination of cost, capability, local industrial participation and political alliance. These relationships with the UK's defence partners result in market access for UK defence industry. For example, in collaborative programmes such as Typhoon and A400M, the UK is a valuable partner because of its spending power, technological capabilities and operational experience. Within the context of SDSR's "international by design" concept, the UK would also look to encourage greater acquisition cooperation with its key partners.

### ***The Letter of Intent***

100. The UK has signed the Letter of Intent Framework Agreement,<sup>44</sup> which is a treaty to facilitate industrial restructuring in Europe with France, Germany, Italy, Spain and Sweden. It also provides a forum where the UK can discuss the issues of market access and the problems facing defence industry with its main defence industrial partners in the EU. It also contains provisions to facilitate cooperative armaments projects amongst the partner nations.

### ***OCCAR***

101. The UK is also a member of Organisation Conjointe de Coopération en matière d'Armement (OCCAR), which is an intergovernmental organisation which facilitates and manages cooperative armament programmes between the nations of Belgium, France, Germany, Italy, Spain, and UK.

### ***Treaties and MOUs***

102. Competence to negotiate trade deals on defence and security procurement remains with Member States. The UK has entered into a series of treaties and memoranda of understanding (MOUs) with defence partners in that set commercial arrangements that require the MOD to use transparent and equitable procurement processes in order to secure varying degrees of market access with the partner nation.

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<sup>44</sup> <https://www.gov.uk/guidance/letter-of-intent-restructuring-the-european-defence-industry>

103. The UK and France signed a Defence and Security Cooperation Treaty at Lancaster House in 2010. The purpose of this treaty was, inter alia, to develop industrial and technological cooperation and mutual access to each other's defence markets. The Treaty includes the obligation that 'each Party undertakes not to hinder legitimate access to its markets and to its Government contracts in the field of defence and security' subject to any rights and obligations under the EU. It also commits the Parties to develop and to preserve key industrial capabilities and technologies, and to those ends, work to minimise unnecessary regulatory hindrance.
104. The UK has also signed MOUs with defence partners that have commitments on market access, one of the most important being the UK/US Reciprocal Defence Procurement MOU, which has implementing procedures on contracting. The MOU requires full and equitable consideration of bids from the UK and US.
105. The MOD has signed many similar types of MOUs with other countries that contain commitments on market access, equipment co-operation and/or industrial cooperation, including MOUs with Australia, Austria, Bahrain, Canada, Croatia, Denmark, Estonia, Finland, India, Italy, Jordan, Kuwait, Latvia, Malaysia, Netherlands, New Zealand, Norway, Qatar, Slovakia, Spain, Sweden, Switzerland, Turkey, and United Arab Emirates.

#### ***Defence and civil standards***

106. While defence specific standards are generated either nationally or by NATO, the EU has an important role in civil standards, which also apply to defence.
107. The UK's membership of CEN (the European Committee for Standardisation) and CENELEC (the European Committee for Electrotechnical Standardisation) allows the UK to help shape voluntary standards at the European level. These can reduce barriers for industry by avoiding conflicting national standards and providing one route to demonstrate compliance with requirements in EU law. CEN/CENELEC specifically provides platforms for the development of European Standards and other technical specifications. These are recognised by the EU as European standards bodies but have a wider membership including European Economic Area countries and Turkey.
108. The MOD's standards policy is to use civil standards where practicable and military standards only where necessary. This supports the principles of open procurement set out in the National Security through Technology White Paper. Specific defence standards have their foundations in equivalent national civil standards.

#### ***The European Aviation Safety Agency (EASA) Regulation***

109. EASA regulations specifically exclude Military Aircraft and this competence is delegated to the European Defence Agency (EDA). Maintaining alignment between military standards of airworthiness in Europe requires close cooperation between member states, the EDA and EASA.

110. EASA was created in 2003 and reached full competency in 2008 through the introduction of Regulation 216/2008 which sets out common safety rules and objectives for civil aviation in Europe. EASA has competence (either full or shared) over:

- initial, additional and continuing airworthiness certificates of aircraft and products;
- air crew and flight limits;
- air operations;
- third-country operator authorisations that certify compliance with safety requirements for foreign aircraft;
- prohibiting unsafe airlines;
- safety oversight in air traffic management and air navigation services;
- air traffic controller licences and certificates;
- airspace and airborne collision avoidance; and
- administrative procedures related to aerodromes.

111. EASA prepares draft rules for consideration and adoption by the European Commission. Member States' National Aviation Authorities (NAAs) then implement the adopted rules with monitoring from the Agency. The UK's NAA is the Civil Aviation Authority (CAA). EASA also has a number of executive tasks, for example the initial airworthiness certification of new and modified products (eg, specific models of aircraft and engines) and the certification of organisations based in third countries.

112. The system is underpinned by the set of common safety rules which are designed for uniform application across the EU. Those rules apply both to the air transport industry, individuals, organisations and products and to the NAAs themselves.

113. As a member of the EU, the UK is represented at the EASA Committee, which is the EU comitology<sup>45</sup> committee on aviation safety, and has a seat on the EASA Management Board, which is the Agency's management body.

***Devolved areas of responsibility and issues relating to Gibraltar, the Crown Dependencies or Overseas Territories.***

114. The Scottish Government has recognised that all defence and sensitive security procurement under DSPCR is a reserved matter.

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<sup>45</sup> Comitology refers to a set of procedures through which EU countries control how the European Commission implements EU law.

115. The Government of Gibraltar introduced its Procurement (Defence and Security Public Contracts) Regulations 2012 (LN. 2012/088) on 21 June 2012 pursuant to the DSD. It applies to procurement of the same, goods works and services as covered by DSPCR by the contracting authorities established in Gibraltar including specifically the Royal Gibraltar Police and Fire Brigade.

***Intra-EU transfers of defence-related products***

116. Export controls are not a devolved matter within the UK.
117. The DSD does apply to Gibraltar but not to the Overseas Territories and Crown Dependencies.

**Sector views**

[This information was provided by the Government to the Committee, but the Committee has decided not to publish this section]

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## Annex A

### *Single source procurement*

1. For some projects it is only possible for the MOD to pursue single-source procurement with a particular defence contractor.
2. The MOD has also decided to adopt a single-source approach even where there is more than one potential defence contractor either because of strong value for money reasons, such as where additional goods, works or services not included in the original contract are being procured, or where there is a policy of maintaining a national strategic capability to protect our essential interests of security.
3. Part 2 of the Defence Reform Act (DRA) 2014 addresses the oligopolistic nature of the market by creating a domestic statutory framework governing Single Source Procurement. This replaced the earlier, voluntary framework known as the Yellow Book. It also created an independent non-departmental public body, the Single Source Regulations Office (SSRO), to oversee the framework for non-competitive procurement. It makes provision for a civil compliance regime and creates a criminal offence for the unauthorised disclosure of sensitive commercial information. The reforms aimed to achieve significant savings for the MOD.
4. The DRA covers the MOD's qualifying single-source contracts that are not subject to a legal obligation to be advertised and competed under the UK Regulations that implement EU Directives. The DRA was enacted in response to the recommendations of Lord Currie's review in 2011, which found that the previous voluntary framework for MOD single-source pricing was no longer fit for purpose. Lord Currie recommended much stronger protections against mispricing and stronger obligations on contractors to provide open book and transparency to the MOD, allowing the department much closer oversight of contractor costs.
5. The DRA enables the agreement of a contract price that is fair and reasonable to both parties. There is a strong compliance and governance regime; protections for both parties against excess profit or loss; and rights to appeal to the SSRO on a range of issues. In certain circumstances, the SSRO may make a legally binding determination on matters related to pricing but only on issues which are referred to it by either the department or the supplier. The MOD expects in the years ahead the new statutory framework will deliver cost savings compared to old, voluntary arrangements.

## Annex B

### *International collaborative procurement*

1. International collaborative programmes are delivered either through international bodies created specifically to deliver international capabilities, by one of the nation's taking the lead for the programme or by each nation procuring its share. Thus Typhoon is procured by NATO Eurofighter and Tornado Management Agency (NETMA), on behalf of UK, Germany, Italy and Spain. NETMA is a NATO body, governed only by those who procure the aircraft. Similarly the A400M transport and refuelling aircraft is procured by OCCAR, on behalf of UK, France, Germany, Spain, Turkey and Belgium.
2. OCCAR is an international procurement organisation based in Bonn and established by UK, France, Germany and Italy; later joined by Spain and Belgium. While OCCAR aspires to be the European procurement agency of choice, and has an administrative arrangement with the EU and EDA, it remains a separate intergovernmental body.
3. Most others collaborative programmes are delivered by a leading nation establishing a Joint Programme Office eg, Joint Strike Fighter (US), Meteor (UK on behalf of five others) or by sharing the burden, some of the UK–French collaborative programmes.
4. The MOD currently can sign international collaborative defence agreements that can waive VAT providing certain conditions are met. Removal of this waiver has the potential to create affordability issues on programmes.

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## Annex C

### *Defence infrastructure*

1. The MOD's Defence Infrastructure Organisation (DIO) supports UK armed forces by building, maintaining, servicing and disposing of the infrastructure needed to support defence.
2. At 31 March 2015, the MOD's defence estate related assets were valued at £31 billion.<sup>46</sup> This comprises:
  - Rural estate – 380,000 hectares. This provides various facilities for training such as driving military vehicles, infantry manoeuvres and areas for artillery firing.
  - Built estate – 75,000 hectares. This comprises naval bases, barracks, airfields and defence facilities in the UK and overseas. The built estate contains 815 listed buildings and over 700 scheduled monuments.
3. DIO is currently developing and procuring contracts to deliver hard and soft facilities management and construction projects for the UK defence estate under two main areas:
  - next generation estate contracts – hard facilities management and construction projects; and
  - project Hestia – soft facilities management.
4. In addition, DIO routinely undertakes a wider range of smaller procurement initiatives covering the UK and overseas estate, through a mix of stand-alone, private finance initiative and Crown Commercial Service arrangements.
5. The future suite of DIO contracts is estimated to be worth between £500 million to £600 million per year and more than £5 billion over ten years.<sup>47</sup>

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<sup>46</sup> 'A short guide to the Ministry of Defence', National Audit Office, July 2015

<sup>47</sup> 'A short guide to the Ministry of Defence', National Audit Office, July 2015



## Annex D

### Supplementary Statistics

- Table 1 and 2 below show the number and value of MOD bespoke contracts subject to EU Procurement Directives or exempt from or below their financial thresholds from 2011 to 2015 from the published national review of the DSPCR 2011<sup>48</sup>

	EU Defence Directive	EU Public Procurement Directive	Exempt	Below Threshold	Total
2011	4	525	518	3,537	4,584
2012	122	348	276	2,533	3,279
2013	195	265	169	1,626	2,255
2014	258	268	135	1,200	1,861
2015	259	192	153	1,035	1,639
2016	174	NYK	157	NYK	NYK

Table 1: Number of MOD Contracts Awards and Other Procurements

	EU Defence Directive	EU Public Procurement Directive	Exempt	Below Threshold	Total
2011	2	1,757	6,138	110	8,008
2012	422	2,661	3,457	128	6,666
2013	2,161	1,795	1,821	116	5,893
2014	4,101	3,191	1,873	101	9,266
2015	10,598	946	2,511	94	14,150
2016	4,674	NYK	2,048	NYK	NYK

Table 2: Value of MOD Contract Awards and other Procurements (£M)

<sup>48</sup> The figures differ from our official statistics on expenditure, as they show the value of multi-year contract in the year that the contract was placed, and per EU practice are in calendar years and do not include call-off contracts under framework agreements to avoid double-counting with the framework.