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Mid-Term Blues?
Defence and the 2013 Spending Review

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Executive Summary

In December's Autumn Statement, the government announced further reductions in defence spending for 2013/14 and 2014/15. These, in turn, have reduced the baseline from which future budgets will be calculated.

The government has made clear that the next Spending Review, due to be completed by June 2013, will operate on the principle that 'departmental resource budgets will continue on the same trajectory as over the period of the Spending Review 2010.' This implies a reduction in the 2015/16 defence budget of around £1.1 billion compared with the level planned before the Autumn Statement.

On reasonable assumptions, the Ministry of Defence may need to find around £11 billion in savings over the next decade as a result of the decisions taken in Autumn Statement 2012 and in Spending Review 2013.

New Treasury assumptions on inflation will increase pressure for further savings, even if the government maintains the commitment to real-terms growth in defence spending after 2015/16.

If the cuts announced in the 2013 Spending Review are nearer the pessimistic level of expectations, some may argue the case for a 'mini-SDSR', making further capability cuts beyond those made in 2010. Yet holding such a review in the latter half of an electoral term, while still retaining the commitment to a further post-election SDSR in mid-2015, would create its own uncertainties. As a result, the government's strong preference is likely to be agreement on further efficiency savings. The deeper the reductions announced in the Spending Review, the less credible that this option will appear.

The Ministry of Defence could also face a very difficult 2015 Spending Review, especially if the country's wider fiscal position remains as difficult as is now projected.

From 2016/17, the MoD will face a sharp rise in annual spending on the new class of nuclear missile submarines, a level of spending which will then be sustained through to the late 2020s. In contrast, procurement spending on combat air, air support, helicopters and surface ships is due to fall significantly. In order to fund increased successor spending up to 2025/26, while maintaining investment in new conventional capabilities, it may be necessary to extend the government's commitment to annual real increases in equipment spending (a commitment that currently expires in 2020/21).

Defence and the 2013 Spending Review

Introduction

The Ministry of Defence is now about half way through the restructuring and reductions made necessary as a result of the 2010 Comprehensive Spending Review and the accompanying Strategic Defence and Security Review (SDSR).

The coalition government inherited a large over-commitment in the forward defence budget, which meant that the capability cuts announced in the 2010 SDSR were much more severe than would otherwise have been required in order to reduce annual defence spending by 7.5 per cent. As a result of the efforts made since then, Defence Secretary Philip Hammond was able to announce, in May 2012, that 'the black hole in the defence budget has finally been eliminated and the budget is now in balance'.[1]

Recent developments, however, suggest that further difficult decisions may soon need to be taken. The Treasury's 2012 Autumn Statement has announced further reductions in defence spending over the next two years, over and above those planned in the SDSR. These, in turn, have reduced the baseline budget from which budgets after 2014/15 will now be calculated. The Equipment Plan, published in January 2013, has raised new questions as to whether the MoD will have to make significant cuts in non-equipment spending in order to afford its ambitious programme for new procurement. The next Treasury spending review, due to take place in the first half of 2013, is widely expected to lead to further reductions in the budget for 2015/16. Finally, looking further forward, the MoD could also face a very difficult 2015 Spending Review, especially if the country's wider fiscal position remains as difficult as is now projected.

Present Misery: The 2010 Spending Review and the SDSR

The 2010 spending review announced a 7.5 per cent reduction in real defence spending between 2010/11 and 2014/15, as the MoD's contribution to wider plans for meeting the government's target of sharply reducing the budget deficit, which had reached 11.2 per cent of GDP in 2009/10.[2] As a consequence, the MoD has had to make significant reductions in front-line capabilities for all three services. It is in the middle of a difficult programme of large-scale redundancies, for both service and civilian personnel. It has had to accept important capability gaps (for example, in carrier strike and maritime patrol) in order to preserve resources for investment in the future.

When these decisions were made, it was hoped that four years of austerity would be enough for the government to meet its wider budget reduction targets. With Treasury agreement, the MoD therefore based its plans for the latter part of the 2010s on the assumption that it could look forward to real (albeit modest) increases in its budget. It therefore drew up its ten-year plans on the twin assumptions of: first, no further reductions in total spending (in real terms) after 2014/15; and second, an equipment budget that rises by 1 per cent per annum in real terms 'after 2015' through to 2020/21.[3]

Autumn Gloom: The 2012 Autumn Statement

These assumptions now appear under threat. With the economy failing to return to sustainable growth, the government believes that its programme of public spending austerity will now have to extend for a further two years. Accordingly, the recent Autumn Statement, published in December, announced a programme of additional departmental spending cuts for the last two years of this spending review period (2013/14 and 2014/15). It also made clear that further reductions in spending would be required in 2015/16 and 2016/17. The Treasury has now begun negotiating detailed spending reductions for 2015/16, and this process is scheduled for completion during the first half of 2013.

As in the 2010 spending review, the MoD's share of the required 2015/16 savings in the 2013 review may not be finally decided until a relatively late stage of the process. Yet the early omens, from a MoD point of view, are worrying. As part of the government's efforts to promote economic recovery, the Autumn Statement announced expenditure of an additional £5.5 billion on capital spending. In order to help finance this investment, however, the Autumn Statement announced cuts of £3.4 billion in departmental resource budgets.

Spending on health and schools has been excluded from the cuts made for this purpose.[4] Some further cuts in welfare have been made, but the decision to protect state pensions and other age-related benefits has meant that total spending on transfer payments ('Resource AME') will continue to grow in real terms over these two years.[5]

As in the 2010 spending review, this selective 'ringfencing' has left non-protected departments bearing a greater share of the proposed cuts. As the largest such department, the MoD has taken the biggest share, in absolute terms, of the £3.4 billion reduction in departmental resource spending announced for 2013/14 and 2014/15 in the 2012 Autumn Statement.[6]

First, the Autumn Statement made **a 1 per cent** (or £245 million) cut **in the MoD's 2013/14 resource budget**. It now appears that the MoD will significantly under-spend its 2012/13 budget, and the Treasury has agreed that this under-spend in 2012/13 can be carried forward into the subsequent year. This small cut in the 2013/14 allocation should therefore not present much of a problem for the MoD's budget managers.

Second, the Autumn Statement announced a **reduction of 2 per cent** (£490 million) in the MoD**'s 2014/15 resource budget**. This reduction will bring the budget down to an estimated £23.98 billion, from the £24.75 billion announced in the 2010 Spending Review and the £24.47 billion announced in the 2011 Autumn Statement.[7] As a result, **over the four-year period of the 2010 Spending Review, the MoD is now set to reduce its core resource budget by 9.6 per cent in real terms.**[8] Because the size of the reduction in the capital Department Expenditure Limit (DEL) has remained unchanged since the SDSR, **total MoD DEL spending (excluding spending on operations) is now due to fall by 8.8 per cent in real terms** over the same period. If planned savings as a result of the withdrawal from Afghanistan are also taken into account, total defence spending is now due to fall by around 15 per cent in real terms over these four years.[9]

The reduced 2014/15 allocation will now be used by the Treasury as the baseline for setting the MoD's budgets for 2015/16 and beyond. Therefore, even if this year's spending review makes no further reductions in these budgets, the MoD will still need to make a total saving of around £5 billion between 2015/16 and 2024/25, compared with its previous plans.

Flexible Targets

The MoD enters the 2013 spending review as one of a small number of departments (DfID is another) for whom ministers have been willing to give spending commitments (in relation to both the equipment budget and the budget as a whole) beyond 2014/15. However, some uncertainty remains as to the exact meaning of these commitments, which could prove important in determining the outcome of the review.

In relation to the government's commitment to raising the equipment budget by 1 per cent per annum in real terms 'from 2015', the main uncertainty concerns the starting year. Paragraph 3 of the government's Defence Equipment Plan, published in January 2013, states that the current equipment budget 'reflects the commitment, announced in July 2011, to 1% real terms growth each year from *2014/15* to 2020/21 in the funding available for equipment [emphasis added]'.[10]

In paragraph 9 on the following page of the document, by contrast, it estimates that the programme 'is affordable on the basis of the agreement with the Treasury to a 1% increase above inflation in the Equipment Programme budget from *2015/16* through to 2020/21 [emphasis added]'.

Separately, Prime Minister David Cameron also made a commitment in relation to the defence budget as a whole when, in launching the 2010 SDSR, he stated that, 'My own strong view is that this structure [the plans set out in the SDSR] will require year-on-year, real terms growth in the defence budget in the years beyond 2015.'[11]

In remarks made during a January 2013 visit to Algeria, the prime minister made clear that he stood by this commitment. Despite these remarks, the government subsequently made clear that this commitment on the total budget would not take effect until after 2015/16.[12] As such, the commitment should be seen primarily as a clarification of how the Conservative Party, if it were to gain an absolute majority in the next general election, would conduct the next Strategic Defence and Security Review.

The 2013 Spending Review

The 2013 spending review is due to conclude in the first half of 2013. The Autumn Statement has already set out the broad framework for the review, including the overall spending totals for both 2015/16 and 2016/17. The Treasury is now working to agree a detailed allocation to departments for 2015/16, the financial year of the next general election.

There are indications that defence, along with some other, relatively smaller, departments, will be the main focus of savings efforts. Such a concern is consistent with newspaper reports that the Cabinet meeting on 22 January saw 'strong push back' against the Treasury's recommendation that these areas – including spending on police, justice, culture, energy and science, as well as defence – should be reduced disproportionately. Senior ministers (including Defence Secretary Philip Hammond, Home Secretary Theresa May and Business Secretary Vince Cable) voiced their concern that their departments would, once again, have to take the brunt of cuts in departmental spending.[13]

This alliance of 'non-ringfenced' departments suggests that the Treasury still stands by the commitments made in the Autumn Statement last year. Not only did this announce that the government would seek further savings in total departmental spending for 2015/16; it also made clear that, in allocating these further savings to departments, it would operate on the principle that 'departmental resource budgets will continue on the same trajectory as over the period of the Spending Review 2010 ... spending on health, schools and ODA will be protected from further reductions.'[14]

The 'trajectory' of the MoD resource budget for the four years between 2010/11 and 2014/15 (excluding operational expenditure) is due to be a reduction of 9.6 per cent in real terms: an average reduction of 2.5 per cent per annum. **If this trajectory were extended into 2015/16, it would imply a further £600 million cut in the 2015/16 resource budget. Taken together with the £490 million in the 2014/15 baseline from which this cut will be calculated, the consequence would be a reduction in the 2015/16 resource budget of around £1.1 billion compared to the level planned before the Autumn Statement.**

The Treasury will likely argue that, if it is to meet its overall target for reducing government spending, it cannot exempt the MoD, now the largest non-ringfenced department, from making a contribution. Were the MoD to be exempt, it would leave other government services – including the police, prisons, courts, the Foreign Office and local social services – faced with even tougher cuts than already envisaged. Alternatively, further reductions would have to be made by revisiting some currently protected areas of spending, such as health, schools, state pensions and overseas aid.

The MoD, for its part, will contend that it should not be treated on par with other non-ringfenced departments. This would be consistent with the 2010 spending review, as a result of which the MoD fared better than most other non-ringfenced departments, but not as well as those (such as the NHS and DfID) that were fully protected.

The 2012 Equipment Plan

In order to further reassure Parliament and the public that it has balanced the MoD's books, the government also undertook efforts to be more transparent in relation to its forward equipment spending plans, and to allow the National Audit Office to examine the details of these plans. Accordingly, a summary of the Equipment Plan, together with an accompanying National Audit Office assessment, was published on 30 January 2013.[15]

In combination, these two documents constitute a major step forward, providing detailed information that will be invaluable in supporting outside scrutiny of MoD plans. Due to be published on an annual basis, they should

– like the well-established, annual Major Projects Report – become an important focus for future debate on defence planning. If the MoD takes intelligent advantage of their existence, moreover, it can use them for encouraging continued improvement in its own planning processes.

The Equipment Plan reports that the ten-year equipment budget (starting in 2012/13) is projected to cost a total of £159.4 billion, of which £73.1 billion will be for the procurement of new equipment and £86.3 billion for the support of existing equipment. The new procurement total includes £4.8 billion held as a central contingency reserve, together with a total of £8 billion of 'available unallocated headroom', which 'will be allocated to projects not yet in the committed core programme only at the point when they need to be committed in order to be delivered on time, and only in accordance with the military assessment of priority at the time'.[16] The central contingency reserve is based on an assessment by the MoD's Cost Assurance and Analysis Services (CAAS) team, which estimated the potential understatement of new equipment project costs at £4.4 billion.[17]

Taking these unallocated and contingency elements into account, spending on new equipment is due to rise from £6,222 million (approximately £6.2 billion) in 2014/15 to £9,289 million (approximately £9.3 billion) in 2021/22: an increase of 49 per cent. Spending on the equipment support budget is due to rise by 17 per cent over the same period, with total equipment spending due to rise by 31 per cent.[18]

The Inflation Squeeze

In drawing up these figures, the MoD has used a projected inflation rate of 2.7 per cent per annum. On this basis, the total equipment budget is due to grow by an average of 1.2 per cent per annum in real terms over these seven years: only a little above the 1 per cent annual real growth commitment made in 2010 in order to allow the fulfilment of the procurement commitments made in the SDSR. New equipment spending (including 'unallocated headroom') is projected to rise at an average of 3.1 per cent per annum in real terms over these seven years. In contrast, support spending is due to fall by an average of around 0.5 per cent per annum.

Since the current Equipment Plan was drawn up in May 2012, however, the Treasury has begun to use new estimates of future (GDP deflator) inflation rates. The Autumn Statement, on which the current spending review will be constructed, assumes an annual inflation rate of only 2.0 per cent from 2014/15 onwards.[19] If the Treasury insists that the MoD should use this new inflation rate in drawing up its plans for 2015/16, it could ask for a further £230 million in savings (including £137 million in the non-equipment budget), while still staying on track to increase the overall budget in real terms after 2014/15.

The 2015/16 Non-Equipment and Resource Budgets

If this new inflation adjustment is included in the equation, and even before any further reductions are ordered as a result of the 2013 spending review, the MoD could see its 2015/16 non-equipment budget reduced as shown in Table 1.

Some proportion of these projected cuts in the non-equipment budget might be avoided if it were possible to reschedule the equipment budget for 2015/16 into later years. The likely savings of such postponements, however, might well be partially offset by the rescheduling of some equipment spending from previous years. The MoD non-equipment budget would, as a result, have to be cut significantly in real terms in 2015/16 in order to finance a growing equipment budget. In this scenario, the MoD might still be able to meet its target for increasing the equipment budget by more than 1 per cent. It might even move further up the pecking order of government spending priorities, preserving its total budget in real terms (as has been promised to the health and education sectors). Even so, it would still have to make difficult savings in its non-equipment budget in order to reallocate resources into its programme of growing equipment spending.

Table 1: An Illustrative Scenario for the Reduction in the Non-Equipment Budget, 2015/16 (£ million).

Non-equipment budget 2014/15 (after Autumn Statement)	18,620[20]
Current plan for non-equipment budget 2015/16	19,626[21]
Reduction as a result of new (Autumn Statement) 2014/15 baseline	-490[22]
Reduction as a result of new inflation adjustment	-137[23]
Reduction as a result of reallocation to equipment budget	-717[24]
Revised plan for non-equipment budget 2015/16	18,282
Total reduction in 2015/16 non-equipment budget from PR12 plans	**-1,344 (-6.8%)**
Total non-equipment reduction, in real terms, compared to 2014/15	**-696 (-3.7%)**
Reduction in resource budget, in real terms, compared to 2014/15	**-688 (-2.8%)**

The non-equipment budget is not the same as the resource budget, which includes equipment support costs but excludes non-equipment capital costs. Adjusting for these factors, **the scenario outlined in Table 1 would lead to a real reduction in the 2015/16 MoD resource budget of around 2.8 per cent.[25] This is close to the 2.5% real cut which, as previously estimated, would be consistent with continuing the resource budget's spending review 2010 trajectory.**

Where to Look for Savings in the 2015/16 Resource Budget

It therefore appears that the MoD may need to make cuts in its 2015/16 resource budget in order to fund its growing equipment programme, even if the Treasury agrees to allow its total budget to grow somewhat in real terms.

If significant real savings in the resource budget are required, where might economies be possible? The resource budget is made up of three main parts. Around 40 per cent is spent on staff costs (for both service and civilian personnel) and a further 35 per cent is spent on equipment support. The remaining 25 per cent is spent on other costs: primarily, the upkeep of the defence estate, as well as fuel and transport. Efforts to reduce the resource budget are likely to consider all three categories.

One possible way to make significant savings might be to re-examine the current assumptions on the future growth of **personnel pay**. Reductions in projected pay increases have already helped prevent the much deeper capability reductions that would have been needed if the pay of MoD personnel (civilian and personnel) had continued to rise at its historic rate of 1.7 per cent per annum above general inflation. In such a scenario, and in the absence of compensating cuts in the equipment or support budgets, service personnel numbers would have had to fall to around 130,000, compared to the current, and still very challenging, target of 145,000.

The freezing of pay (except for the lowest paid) for 2011/12 and 2012/13, followed by the 1 per cent ceiling on pay increases for 2013/14 and 2014/15, has thus saved the MoD from significantly greater pain over this period. An extension of such pay restraint into 2015/16 could make a significant further contribution to savings targets. For example, if the MoD is currently assuming 3.7 per cent annual growth in personnel pay (2.7 per cent inflation plus 1 per cent), a continuation of the 1 per cent cap for an additional year could save around £300 million from the 2015/16 budget.

Whether such an assumption is plausible depends in part on broader labour market trends. A further decline in UK real earnings, both in the public and private sectors, is certainly a possibility if the UK economy fails to recover its pre-crisis growth rates. Were the economy to enter into another 'lost decade', this could feed through into average earnings, just as it has done over the last five years. Alternatively, if the wider economy returns to robust rates of growth, it could become progressively more difficult to recruit good quality applicants to the armed forces, or indeed MoD civilian positions, without spending more money on pay.

In any case, the MoD cannot make an assumption on further reductions in the real pay of its own employees, except in the context of a wider policy of public sector pay restraint for 2015/16. It remains to be seen whether the government is prepared to adopt such an approach in the coming spending review.

The MoD might be asked to examine the possibility of further reductions in **service personnel numbers**. Yet the political sensitivity of such reductions has been heightened by the need to conduct successive redundancy programmes even as the armed forces are engaged in difficult operations abroad, especially in Afghanistan. The MoD is also aware that it is still barely half way through its programme of SDSR-dictated personnel reductions. The regular armed forces have been reduced since the SDSR: from 178,000 in April 2010 to 165,000 in December 2012. However, the pace of reductions is now accelerating, with a further reduction of 20,000 (14,500 of which would be from the army) still required to meet the planned 2015 level of 145,000.[26] Announcing a significant, further reduction in this target might pose considerable political and logistical challenges.

Civilian personnel numbers arouse less political sensitivity, and might be a target for some further economies. Yet the number of civilian personnel has already fallen more sharply, from 83,000 in April 2010 to 65,000 in October 2012; and these figures are due to fall below 60,000 by 2015.[27] Moreover, because the budget for civilian personnel is relatively small, reductions in this area will only be able to make a relatively modest contribution to meeting any savings target.

The MoD is also likely to be asked to look at its growing expenditure on **equipment support** (which now accounts for a third of the resource budget) as a possible source for savings. While the total defence budget is due to fall in real terms by 7.8 per cent between 2012/13 and 2014/15, planned equipment support spending is due to rise by 5.6 per cent. These numbers suggest that equipment support spending has been relatively unaffected by the rationalisations and reductions set in motion by the SDSR.[28] Given this contrast, there will be questions as to whether support spending has yet to be subjected to the same degree of scrutiny given to front-line capabilities. The MoD appears to have accepted this case for enhanced scrutiny. The National Audit Office recently reported that 'in preparing the Equipment Plan 2012 to 2022 the Department has focused on increasing the robustness of its procurement costings, and has yet to apply the same level of challenge and review to the support costs element, although it plans to do so for the Equipment Plan 2013.'[29]

Finally, savings in the resource budget might be achieved by reducing **spending on estate maintenance, transport and fuel**. These basic operating expenditures have often been a source of short-term savings in the past. However, ill-considered cuts can often have a disproportionate effect on operational readiness, and can sometimes lead to additional long-term costs.

A fall in international fuel prices would provide welcome relief, but cannot be counted upon to deliver savings three years from now.

Table 2: The Equipment Procurement Plan (£ million).

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Equipment procurement	5,811	6,159	6,222	7,277	6,789	7,093	7,581	8,223	8,702	9,289
2012/13 prices	5,811	6,038	5,980	6,857	6,272	6,424	6,732	7,159	7,427	7,773
% change in real terms		4%	-1%	15%	-8%	2%	5%	6%	4%	5%
Average annual % change in real terms (from 2014/15)										3.8%

Rapid Growth in the Equipment Budget

Compared to the resource budget, spending on new equipment is set to rise rather sharply until the end of the decade. As Table 2 shows, procurement spending is due to rise over the last two years of the 2010 spending review period, even as the resource budget is being cut. This trend is set to continue throughout the ten-year Equipment Plan period. Current plans show significant year-to-year variation, although much of this may change in practice. From 2014/15 onwards, however, the procurement budget is projected to grow at an average rate of 3.8 per cent per annum in real terms.

Although there is likely to be some slippage in this timetable, as indeed has already been the case in 2012/13, it is difficult for the MoD to anticipate when this will occur. Most of the procurement budget for 2015/16 and 2016/17 is already contractually committed, or closely tied to clear policy commitments. As the MoD knows from recent experience, moreover, attempts to slow down procurement plans in order to balance the budget are usually counterproductive, with companies being forced to charge extra for the costs of capacity underutilisation.

Any significant attempt to shift the procurement programme 'to the right' would create a further difficulty. From 2016/17 onwards, the MoD will be faced with a sharp rise in annual spending on its successor deterrent programme. Submarine and deterrent procurement spending is due to rise from around £1.1 billion in 2012/13 to around £2.4 billion in 2021/22.[30] This level is due to rise further, as successor submarine production gathers pace, and is likely to sustain this level through to the end of the 2020s. In contrast, procurement spending on combat air, air support, helicopters and surface ships is due to fall significantly after 2015/16. As a consequence, the MoD wants to ensure that its largest ongoing procurement projects – most notably, aircraft carriers, the Lightning II (Joint Strike Fighter), air transport and refuelling aircraft, and new

Chinook and Wildcat helicopters – will be near completion before successor deterrent spending begins to approach peak levels.[31]

Table 3: Projected Equipment Procurement Budget by Sector, 2021/22.

Sector	£ million	% of total core equipment programme	% of total equipment programme
Submarines and deterrent	2,400	35	26
Land equipment	1,200	18	13
Ships	900	13	10
Weapons	900	13	10
Combat air	600	9	6
Air support	250	4	3
Helicopters	250	4	3
ISS	200	3	2
ISTAR	100	1	1
Total core procurement	6,800	100	
Unallocated and contingency	2,500		27
Total procurement	**9,300**		**100**

Source: Ministry of Defence, 'The Defence Equipment Plan 2012', pp. 7–17. Estimates for projected spending by sector are for the 'core' equipment programme, which includes contractual commitments, the nuclear deterrent, and projects for which there is a policy commitment or which have been publicly announced. Projected 'unallocated' and 'contingency' will increasingly be allocated to sectors over time.

In order to fund increased successor programme spending up until 2025/26, while maintaining investment in new conventional capabilities, it may be necessary to extend the government's commitment to annual real increases in equipment spending (a commitment currently set to expire in 2020/21). This will be an important issue for the 2015 SDSR and associated spending review. If no such commitment is made, the result will be a sustained squeeze on conventional force modernisation.

A sustained increase in the defence budget as a whole may also be needed if force structures and numerical capabilities are to be maintained at 2015 levels through to 2025. The last three years have seen an unusually low level of growth in the unit costs of defence capability, primarily because of the pay restraint in place since 2010. Nevertheless, sooner or later, average national earnings are likely to begin rising again, requiring the MoD to follow suit in order to maintain pay comparability. MoD pressure to avoid further cuts in conventional numerical capabilities, however, will have to compete with pressures for additional resources to be released for other public services which, like defence, have suffered since 2010.

The 2015 Spending Review: Further Reductions?

Because of the 2015 election, and the unwillingness of the Conservative and Liberal Democrat parties to agree plans for subsequent years, this year's spending review will only agree departmental budgets for one year, 2015/16. It will be up to the 2015 spending review to agree on MoD budgets for 2016/17 and beyond (up to 2019/20 or 2020/21). This decision will in turn provide the budgetary framework for, while also being informed by, the 2015 SDSR.

Much could happen between the 2013 and 2015 spending reviews, both in the wider economy and in the external security environment. The shape of the 2015 spending review might also be shaped by the political composition of the government that comes to office after the next election. It is therefore too early to predict what decisions might be taken on future defence budgets after 2015/16.

Yet, some indication of what these decisions might be (at least under a continued coalition government) can be gleaned from the 2012 Autumn Statement. This makes clear that the government believes that further reductions in government spending in 2016/17, comparable to those made in previous years, will be needed to meet its deficit reduction targets. Unless the priority given to defence compared with other elements of government were to change, therefore, the MoD could find itself facing further cutbacks. On these assumptions, the 2015 spending review could well lead to a further 2.5 per cent reduction in the MoD's 2016/17 resource budget, similar to the projected reduction for 2015/16.

The 2015 spending review and SDSR may also make decisions on the MoD budget up until 2019/20 or 2020/21, while also setting provisional planning assumptions to last through 2025/26. By this stage, the scale of economies required for funding peak spending on the successor deterrent programme will have become more evident. Current equipment plans allow for a sharp increase in army equipment spending during the decade after the Afghanistan withdrawal. However, this is only made possible, while also funding the successor deterrent, by assuming that significant real growth in the equipment budget, well above 1 per cent per annum, will continue through 2025. Without a substantial growth in the total defence budget, such an increase could only be secured by significant cuts in other areas, such as service personnel numbers. A return to real wage growth, as discussed above, could only intensify this trade-off.

Implications
The recent Autumn Statement, published in December, announced significant reductions in defence spending for 2013/14 and 2014/15, bringing the total reduction in the defence budget for the current spending review period to 8.8 per cent in real terms. The 2013 spending review, due in the first half of this year, could see further reductions in defence spending for 2015/16 and beyond.

The MoD does not face a problem comparable in magnitude to the 'Black Hole' that it faced as a result of the 2010 spending review, when ministers had to respond to a funding gap of around £74 billion over ten years.[32] Nevertheless, should the 2013 spending review leads to further defence spending cuts, the extent of the prospective gap between planned capabilities and available resources could still be considerable. On reasonable assumptions, the MoD may need to find around £11 billion in savings over the next ten years as a result of the decisions taken in Autumn Statement 2012 and the 2013 Spending Review.[33] If the 2015 spending review makes a further 2.5 per cent cut in the MoD resource budget (as could be the result of the cut in departmental spending proposed in Autumn Statement 2012), the requirement for ten-year savings could increase to around £17 billion.[34]

The Treasury's reduction in the assumed levels of GDP deflator inflation, used in calculating how much cash spending will be needed to meet any 'real-terms' targets, could create further pressures for cost reductions on both the equipment and non-equipment budgets . It would mean, for example, that planned total equipment spending for 2021/22 could be reduced from £18.8 billion to £17.7 billion, while still meeting the target of annual 1 per cent per annum real growth after 2014/15.

If the defence cuts announced in the 2013 spending review are nearer to the pessimistic level of expectations, some may argue the case for a 'mini-SDSR', revisiting the capability plans made in 2010 in order to bring the defence plans back into balance with the reduced budget. Such a review would show that the government was prepared to take the hard decisions that are necessary in order to prevent a return to the over-programming that blighted defence planning until recently.

Yet holding such a review in the latter half of an electoral term, while still retaining the commitment to a further post-election SDSR in mid-2015, would create its own uncertainties. It could, moreover, risk refocusing attention on the successor deterrent programme, a subject on which there is no prospect of the Conservatives and Liberal Democrats agreeing before the next general election.

As a result, the government's strong preference is likely to be agreement on a programme of further efficiency savings, over and above those already in pipeline, the results of which could then be further analysed in the run-up to the 2015 SDSR. The deeper the reductions announced in the 2013 spending review, however, the less credible that this option will appear.

In principle, the government could decide to carry a notional funding gap into next election, on the basis that its two constituent parties had different views on what the future path of defence spending should be. Yet such an approach would only be plausible if one of the parties – presumably the Conservatives – was willing to promise significant additional resources for defence. It is far from clear that they would be willing to do so, given the wider context of spending cuts in other areas. For the main driver for the defence cuts that have taken place since 2010, and promise to continue until 2016/17 and perhaps beyond, is the difficulty of achieving deficit reduction in a national economy that continues to underperform. The best hope for a return to growth in the defence budget, therefore, is that the UK economy will one day recover from its current doldrums.

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Notes and References

1. *Hansard*, HC Debates, 14 May 2012.
2. HM Treasury, 'Autumn Statement 2012', December 2012, p. 21.
3. Defence Secretary Philip Hammond recently confirmed 'the planning assumption agreed with the Treasury of a 1 per cent per annum real increase in the equipment and support budget from 2015'. *Hansard*, HC Debates, 14 May 2012.
4. Reduced GDP growth has allowed the Department for International Development's (DfID) resource budgets to be cut by £250 million in 2013/14 and £430 million in 2014/15, whilst maintaining the commitment to spend 0.7 per cent of GNI on official development assistance. Even so, DfID is still due to receive a real-terms resource budget increase of 23 per cent over the four years of the spending review. HM Treasury, 'Autumn Statement 2012', p. 58.

5. Even after the measures to reduce working-age benefits announced in the Autumn Statement, which are due to result in £1.8 billion of savings in 2014/15, total Resource AME (Additionally Managed Expenditure) is still projected to rise by 1.5 per cent in real terms between 2012/13 and 2014/15. This takes account of the transfer of £7 billion from Local Government Resource DEL to Resource DEL in 2014/15. HM Treasury, 'Autumn Statement 2012', p. 60.
6. HM Treasury, 'Autumn Statement 2012', p. 58.
7. The 2011 spending review had previously announced a reduction in the MoD budget, in order to reflect savings made from the extension of public pay restraint for two more years. HM Treasury, 'Autumn Statement 2011', November 2011, p. 46. See also HM Treasury, 'Public Expenditure Statistical Analyses 2012', July 2012, p. 21.
8. Using the 2010 spending review baseline for 2010/11 of £24.3 billion in Resource DEL, and the GDP deflators published in Autumn Statement 2012.
9. This assumes that total operational spending in 2014/15 will be around £2 billion, which allows for withdrawal and other costs in Afghanistan. This is the amount that the Treasury retains in its 'Special Reserve' for 2014/15.
10. Ministry of Defence (MoD), 'The Defence Equipment Plan 2012', January 2013.
11. *Hansard*, 'Strategic Defence and Security Review', HC Debates, 19 October 2010, col. 799.
12. Jim Pickard and Hannah Kuchler, 'Downing Street Rows Back on MoD "Ringfence"', *Financial Times*, 31 January 2013.
13. George Parker, Kiran Stacey and Sarah O'Connor, 'Osborne Faces Cabinet Revolt over Cuts', *Financial Times*, 22 January 2013.
14. HM Treasury, 'Autumn Statement 2012', p. 61. The possibility of a cut in defence spending was confirmed when the prime minister was reported to have said he remained committed to his 'own strong view' that the defence budget should increase in real terms 'in the years beyond 2015'. Government spokesmen subsequently clarified that this referred to the path of the defence budget after 2015/16, and that the non-equipment budget for 2015/16 was not exempt from examination. Pickard and Kuchler, 'Downing Street Rows Back on MoD "Ringfence"'.
15. MoD, 'The Defence Equipment Plan 2012'.
16. *Hansard*, HC Debates, 14 May 2012.
17. The NAO reports a CAAS estimate of project cost understatement totalling £12.5 billion over ten years. National Audit Office (NAO), 'Ministry of Defence: Equipment Plan 2012–2022', report by the comptroller and auditor general, HC 886, January 2013, p. 30. The MoD maintains, however, that this estimate was derived from the Equipment Plan as defined in June 2011. Since that time, individual project budgets have been reviewed and, in some cases, adjusted to include greater levels of risk provision at the project level. MoD, 'Update to Planning Round 2012', January 2013.
18. NAO, 'Ministry of Defence: Equipment Plan 2012–2022', pp. 7, 24.
19. HM Treasury, 'Autumn Statement 2012', p. 86.
20. NAO, 'Ministry of Defence: Equipment Plan 2012–2022', p. 7.
21. *Ibid*.
22. From HM Treasury, 'Autumn Statement 2012'.
23. As a result of reduction in GDP deflator inflation from 2.7 to 2.0 per cent.
24. This is the difference between the currently projected 2015/16 equipment budget of £15,542 million (approximately £15.5 billion) and that required to maintain 1 per cent annual real growth – £14,825 million (approximately £14.8 billion).
25. This assumes that non-equipment capital spending for 2015/16 falls by the same proportion as other non-equipment spending.
26. Defence Analytical Services Agency, 'UK Armed Forces: Monthly Personnel Report', December 2012. The chief of the General Staff, General Sir Peter Wall, has confirmed

that the reduction to a regular army of 82,000 will be completed 'by 2015': see MoD, 'Redundancy Announcement', 22 January 2013.

27. Defence Analytical Services Agency, 'Quarterly Civilian Personnel Report', November 2012.
28. NAO, 'Ministry of Defence: Equipment Plan 2012–2022', p. 7.
29. *Ibid.*, p. 5.
30. MoD, 'The Defence Equipment Plan 2012', p. 16.
31. *Ibid.*, pp. 9–17.
32. For further discussion, see Malcolm Chalmers, 'Looking into the Black Hole: Is the Defence Budget Crisis Really Over?', RUSI Briefing Paper, September 2011.
33. This takes into account the cuts in the 2014/15 and 2015/16 budgets discussed above. It also assumes that, after 2015/16, the total defence budget increases by 0.4 per cent in real terms annually. It compares this scenario with the PR12 budget projection summarised in NAO, 'Ministry of Defence: Equipment Plan 2012–2022', p. 7.
34. This takes into account the cuts in the 2014/15 and 2015/16 budgets discussed above. It also assumes that, after 2016/17, the total defence budget increases by 0.4 per cent in real terms annually. It compares this scenario with the PR12 budget projection included in *ibid.*, p. 7.

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