



House of Commons
Scottish Affairs Committee

The Referendum on Separation for Scotland: Separation shuts shipyards

Seventh Report of Session 2012–13



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Report, together with formal minutes

*Ordered by the House of Commons
to be printed 16 January 2013*

The Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)).

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Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at www.parliament.uk/scotaffcom. A list of Reports of the Committee in the present parliament is at the back of this volume.

The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee are Eliot Wilson (Clerk), Duma Langton (Inquiry Manager), Gabrielle Hill (Senior Committee Assistant) and Ravi Abhayaratne (Committee Support Assistant).

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Summary

Shipbuilding in Scotland will face two starkly different choices at the referendum.

Clyde Shipyards – Govan and Scotstoun

- within the UK the Clyde will become the main British centre of excellence for naval surface ships, with the order for the complete run of Type-26 vessels, plus any export work, guaranteeing its future well into the next decade.

The Clyde yards will then be the sole supplier of complex naval ships to the Royal Navy. The Clyde yards will have both security and prosperity by remaining within the United Kingdom.

- Separate from the United Kingdom, the Clyde will not be eligible for UK-restricted orders and will have little prospect of winning export work. The needs of any Scottish Navy will be insufficient to maintain capacity and any attempts to switch into a short run of submarine building will be horrendously expensive.

Outside the UK, the shipyards are doomed.

Rosyth

- In the UK, Rosyth will get carrier refit work over 50 years.
- Outside the UK, there will be no UK naval work and any separate Scottish Navy has been promised to Faslane, to fill part of the hole which will be left by the departure of the entire Royal Navy submarine fleet and vessels presently stationed there.

The impact of a delayed decision

A huge difficulty is caused by the delay in holding the Referendum. We believe the Ministry of Defence will not place an order for the type-26 new Royal Navy frigates until the constitutional position is clear. The Clyde yards will run out of work while the Scottish Government procrastinate.

Delaying the referendum until after the anniversary of Bannockburn in the hope of political gain, but it places thousands of jobs in jeopardy.

Shipbuilding and ship servicing is the clearest example we have yet seen of the stark choice to be faced in the forthcoming referendum:

- orders from the Royal Navy and prosperity by remaining within the UK.
- collapse and closure with Separation.

Given the gloomy future for the Clyde and Rosyth under Separation we believe the Scottish Government now must clarify exactly what alternatives it intends to put in place to safeguard the jobs of the thousands of workers involved in this industry and these local economies.

1 Introduction

1. In October 2011, we launched two lines of inquiry into the Referendum on Separation for Scotland. We have published several Reports so far related to the first area of inquiry: on the mechanics and process of the referendum itself.¹ The second area of inquiry addresses the key substantive issues that the voters of Scotland would need more information on to be able to make an informed choice in any referendum. In our *Unanswered Questions* Report, we identified six areas on which we would seek evidence: the likely currency; Scotland's relationship with the EU; pensions and social security; economics; citizenship and immigration; and defence.²

2. This Report is part of the wider second inquiry into key substantive issues. We have taken evidence on many aspects of defence issues in Scotland and how separation might affect both the defence industry and those who currently serve in the British Army, Royal Navy, and Royal Air Force. We published our Report on the implications of separation for Trident on 25 October 2012,³ and we anticipate producing more Reports on separation and defence-related issues.

3. The UK no longer builds merchant ships on any significant scale, but it does build ships for the Royal Navy, and parts of Scotland have an important social and cultural association with shipbuilding. As part of the UK defence industry, the shipyards in Scotland contribute to the Armed Forces of the UK. We decided to explore how shipbuilding, and its associated industries, might be affected if Scotland became a separate country. We visited several MoD sites and defence employers in Scotland to talk to them about the implications for their activity if Scotland left the UK. This included BAE Systems, Govan and the Aircraft Carrier Alliance at Rosyth. We would like to thank all those who assisted our visits.

2 Shipbuilding in Scotland

4. There are three major shipyards currently operating in Scotland: Govan and Scotstoun in Glasgow, and Rosyth in Fife, all of which rely on military contracts for their workload.⁴ Rosyth is the centre of activity for the Aircraft Carrier Alliance—a joint venture between Babcock Marine, BAE Systems, the Ministry of Defence and Thales—currently building two Queen Elizabeth Class aircraft carriers for the Royal Navy. The yard at Rosyth sustains over 1,000 jobs. Govan and Scotstoun are operated by BAE Naval Maritime and employ

1 Eighth Report of Session 2010-12, *The Referendum on Separation for Scotland: Do you agree this is a biased question?*, HC 1492; Second Report of Session 2012-13, *The Referendum on Separation for Scotland: making the process legal*, HC 542; Third Report of Session 2012-13, *The Referendum on Separation for Scotland: a multi-option question*, HC 543; Sixth Report of Session 2012-13, *The Referendum on Separation for Scotland: The proposed section 30—Order Can a player also be the referee?* HC 863.

2 Sixth Report of Session 2010-12, *The Referendum on Separation for Scotland: Unanswered Questions*, HC 1806

3 Fourth Report of Session 2012-13, *The Referendum on Separation for Scotland: Terminating Trident—Days or Decades?*, HC 676

4 Q 115

near 2,800 people.⁵ The Govan and Scotstoun yards have built seven warships since 2004,⁶ including six Type 45 destroyers for the Royal Navy. The final one—HMS Duncan—started sea trials in 2012. BAE staff based at Scotstoun are designing the forthcoming Type 26 frigate.

5. The Queen Elizabeth aircraft carriers, the largest surface ships ever constructed for the UK,⁷ have involved shipyards across the UK in building sectional blocks for the carriers. The blocks have been transported by barge from yards in Glasgow, Liverpool, Devon, Tyneside and Portsmouth, to be assembled in a specially constructed dock at Rosyth. The Govan yard received considerable investment in advance and has achieved the largest share of block construction.⁸ Research by the University of Strathclyde's Fraser of Allander Institute in 2009 suggested the UK warship building supported 15,000 jobs across the wider supply chain and contributed £600 million a year.⁹

Why the UK builds its own warships

6. The UK never willingly builds warships outside the UK. Peter Luff MP, the then Minister responsible for procurement in the Ministry of Defence, told us that the UK had not built a warship outside the UK for 200 years except in times of crisis:

We built warships during the Second World War outside these shores. They were not complex warships but simple things like the so-called Landing Ship, Tanks, which were the brainchild of Winston Churchill—a thousand of them were built in the United States of America to enable amphibious attacks on the D-Day beaches, for example—and we built some 200 or 300 wooden minesweepers around the world during the Second World War in bizarre places like Tel Aviv, Bombay, Cochin, Singapore, Burma and Canada; so we have built ships [...] but as to complex warships, I honestly think the answer is not for a couple of hundred years.¹⁰

7. This was reiterated by Philip Dunne MP, the new Minister for Defence Equipment, Support and Technology, who said “Other than during the world wars, we have never placed an order for a warship outside the United Kingdom.”¹¹

8. The principle reason the UK builds warships at home is that it wants to be able to maintain the ability to do so without having to rely on any other nation. Ian Godden, Chairman of Farnborough International, told us that building a complex warship is comparable to hi-tech construction projects “like the Olympic Village or a new railway line

5 BAE Systems employs 4,000 people in Portsmouth, 1,500 on shipbuilding; and over 4,000 people in Barrow, Cumbria, on submarines.

6 Scotland Office, *Scotland and Defence*, March 2010

7 *Aircraft carrier: A mind boggling building job*, 7 April 2011, bbc.co.uk, HMS Queen Elizabeth is expected to begin sea trials in 2017. www.aircraftcarrieralliance.co.uk

8 *Solving the UK's shipyard and skills conundrum*, Jane's Defence Weekly, April 2012

9 *Solving the UK's shipyard and skills conundrum*, Jane's Defence Weekly, April 2012

10 Q 420

11 Q 2016

or airport.”¹² so maintaining the capability to build these warships means retaining the particular skills. This was recognised in the 2005 Defence Industrial Strategy:

The build of warships extends beyond the simplistic view of steelwork and its assembly, incorporating an amalgamation of skills, facilities, technologies and knowledge. In particular, it is the high complexity, value added aspects of ship build and platform integration that must be maintained under UK sovereignty.¹³

[...] This was necessary to enable the UK to mount military operations from the UK base, and it is not effective to develop advanced, high-value skills needed for specialist hull construction or complex assembly tasks each time.¹⁴

9. Scotland has these skills. Importantly, complex warships, such as the Type 45 destroyers or the Queen Elizabeth Class aircraft carriers, are built in the UK because some of the technology involved is militarily sensitive. The Ministry of Defence is, understandably, careful as to who has access to, and knowledge of, the weapons systems on its warships, and keeping such information secret enables the UK to retain military effectiveness. Furthermore, building such warships in the UK contributes to the economy and the wider supply chain and the Treasury benefits from the tax revenue.¹⁵

EU rules on open competition and Article 346

10. In general, EU law, under the Treaty on the Functioning of the European Union (TFEU), prohibits action that interferes with open competition across the EU. Signatory countries are required to advertise major contracts and open them to competition across the EU. There are several exceptions, chief of which is the use of Article 346 of the TFEU when a member state decides it is necessary to protect national security interests.¹⁶ Peter Luff MP, the then Minister of State in the Ministry of Defence responsible for procurement, quoted Article 346 to the Committee and explained how it was applied:

Article 346 [...] of the Treaty on the Functioning of the European Union, known as article 296 in previous treaties, makes it very clear, and I quote, that “any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes”. In other words, where we think our security depends on this, the Commission does allow us to procure within the United Kingdom.¹⁷

12 Q 1951

13 Ministry of Defence, Defence Industrial Strategy, CM 6697, December 2005, B2.21-B2.25

14 Ibid., B2.24

15 RUSI, *The Destination of the Defence Pound*, January 2012

16 Ministry of Defence, February 2012, *National Security Through Technology: Technology, Equipment, and Support for UK Defence and Security*, Cm 8278

17 Q 380

He explained how the UK Government decided when to exempt defence procurement using Article 346:

The test that we apply as a country is a test of operational advantage and freedom of action. We believe in our ability to maintain an operational advantage and a competitive edge over our enemy. We want to do it ourselves and we want to guarantee that we can actually maintain that action and not depend on foreign countries to maintain that action.¹⁸

11. Les Mosco, Director Commercial, Defence Equipment and Support, said that the UK Government does not have to make an application for an exemption under Article 346; it defines its own security requirements and awards the contract as it sees fit:

We satisfy ourselves internally in the MoD that the requirements of 346 are met, under the kind of circumstances described in the European procurement regulations that define when you can and cannot use 346. If we think it is a 346 case, we satisfy ourselves of that internally and then proceed.¹⁹

12. So, at the moment, if the UK uses Article 346, it can favour companies within the UK—including Scotland, England, Wales and Northern Ireland. The award of such contracts is open to challenge from another member state, but Mr Mosco could not recall any situation where the UK had been challenged when it had decided to use Article 346.²⁰

How does this apply to shipbuilding?

13. The next big order from the Ministry of Defence is for the Type 26 frigate, also known as the Global Combat Ship. The Type 26 frigates are to replace the Type 23 frigates, which are the current core of the Royal Navy front-line fleet, carrying out a range of tasks such as counter-terrorism, anti-piracy, safeguarding trade routes, and responding to humanitarian and security issues around the world.²¹ The Strategic Defence and Security Review proposed there would be 13 Type 26 frigates.²² They are planned to be built at a rate of one ship a year with the first one coming into service around 2020.²³ The first five are to be basic frigates and the next eight will have additional anti-submarine capability. Each frigate is expected to cost £250–£350 million.²⁴

14. The Type 26 frigate contract represents the final part of the Terms of Business Agreement between BAE Systems and the MoD.²⁵ (We discuss the TOBA more fully below.) Duncan McPhee, Unite Shop Steward, BAE Systems, Scotstoun, gave evidence to

18 Q 380

19 Q 2041

20 Q 2041

21 www.royalnavy.mod.uk/The-Fleet/Ships/Frigates

22 Q 2012

23 Britain's Future Frigates: Type 26 & 27 Global Combat Ships, Defence Industry Daily, 9 September 2012

24 Naval Technology, Type 26 Global Combat Ship (GCS) Programme, United Kingdom, www.naval.technology.com

25 Q 2017

the Committee following a meeting between the shipbuilding unions and Peter Luff MP, Minister responsible for procurement at the MoD. Mr McPhee said:

The specific question that was asked to get the UK Government's position on this was, "In an independent Scotland will we be allowed to tender for the contracts?" It was made quite clear that we would not because we will be a foreign country. I believe that under article 346, if they [the MoD] were considering placing that order in a foreign country, it would have to be opened up EU-wide and possibly worldwide. [...] That, to me, would mean that, unless an independent Scottish Government could provide equivalent-type orders, we would be greatly reduced or completely finished as a shipbuilding industry.²⁶

Mr Luff subsequently explained to the Committee what he had told the unions:

When we come to build the new Type 26 frigate—the Global Combat Ship—we will have to apply for an exemption under article 346 to enable us to build it within the United Kingdom without contracting it. That means that, if Scotland is separate, we cannot build it in Scotland.²⁷

The new Minister with responsibility for procurement, Mr Philip Dunne MP, reiterated this to the Committee:

Other than during the world wars, we have never placed an order for a warship outside the United Kingdom. It is not our intention to do so with the Type 26.²⁸

15. And as Professor Malcolm Chalmers, Royal United Services Institute, told us:

If Scotland were to become independent before decisions had been made about where to build new Type 26 frigates, for example, I do not understand what political make-up could in those circumstances make the UK Government place those orders in Scottish yards if there were, as there are, alternative places to build them in England.²⁹

16. If, for whatever reason, the UK chose not to apply Article 346 to the Type 26 contract, then it would have to make the contract available through open competition. If this was the case, and if Scotland was a separate country, then Scotland would have to compete internationally.³⁰ Indeed, witnesses said there would be no advantage to the UK for it to offer the contract to Scotland exclusively, without an open tender, if Scotland was outside the UK. It would open itself to challenge from someone else in the EU, and as Professor Trevor Taylor, Royal United Services Institute, pointed out to us: "Why not compete it? If you are not going to give national preference, you might as well compete it."³¹

26 Q 113

27 Q 384. See also Q 113

28 Q 2016

29 Q 219

30 Qq 389-396

31 Qq 1949-1950

17. Putting out such a contract to international tender has a precedent. The Ministry of Defence put the initial contract to build the Military Afloat Reach and Sustainability fleet—commonly known as MARS tankers—out to international tender in 2007. The programme originally consisted of six tankers and five support and logistical vessels.³² Crucially, the Ministry of Defence took the decision to open the contract to competition as it did not classify the MARS tankers as warships. The contract, with a value of £596 million, was awarded to Daewoo Shipbuilding and Marine Engineering in South Korea.³³

18. The UK has consistently built its own warships. It wants to retain the capability to design, build and maintain such warships in this country, keep the skills and industry to do so, maintain freedom of action over its own navy, and because of the sensitivities around some of the equipment involved.

19. EU law requires major procurement contracts to be offered for open competition. Member states can use various exemptions to place contracts with preferred suppliers. One such exemption, Article 346, allows countries to exempt defence procurement on the grounds of national security. The UK has consistently excluded the construction of complex warships from open competition using Article 346. If Scotland was a separate country, then the Ministry of Defence could not use Article 346 to favour shipyards in Scotland because they would no longer be within the UK.

20. In those instances in which the Ministry of Defence has decided not to exempt contracts on the grounds of national security, it has then been obliged to offer the contract for tender internationally. In such a situation, any shipyards in Scotland would have no preferential status and would have to bid for the contract on the same basis as other international yards.

The Terms of Business Agreement

21. The previous Government's Defence Industrial Strategy, 2005, set out that it was necessary to retain the capability to build warships in the UK because of the need to "develop and support military capability throughout its life; and the ability to mount operations from the UK base."³⁴ This need to retain that capability, so the UK was not reliant on anyone else for warships, contributed to the Ministry of Defence developing the Terms of Business Agreement, or TOBA, with BAE Systems. As Vice Admiral Andrew Mathews, Chief of Materiel (Fleet), Defence Equipment and Support, put it:

The purpose of the deal was to get them [BAE] to a place where we had an affordable shipbuilding industry, high performing and benchmarked across world class, that delivered us the future warships that we wanted without getting that loss of capability. That was the purpose of the deal.³⁵

32 HC Deb 7 January 2013, Col 49W. Scottish Affairs Committee, Sixth Report of session 2007-08, Employment and Skills for the Defence Industry in Scotland, HC 305

33 Q 405

34 Ministry of Defence, Defence Industrial Strategy, CM 6697, December 2005, B2.21-B2.25

35 Q 2022

22. The TOBA guarantees BAE a minimum level of surface ship build and support activity from 2009 to 2024 worth £230 million each year.³⁶ In return, BAE has to retain the capability to design and build complex warships within the United Kingdom—the TOBA is with BAE Systems, not just BAE and the Scottish yards. The need for this commitment, as Professor Taylor, said, came out of the experience leading up to building the Astute Class submarines, “where we left too big a gap and allowed a skill run-down to occur in Barrow”, and the realisation that a work force needs to have continuous work to keep a satisfactory skill base.³⁷ BAE found that it could not interchange the skills between surface ships and submarine yards. Dr John Louth, Royal United Services Institute, told us:

There is quite a strong evidence base that BAE Systems could not just raid surface competencies and skills because they were not a neat enough fit. They had to have time to develop, plan and refresh the skills and competence base for the Astute programme. Indeed, much of the cost overruns and the delays with Astute were in some ways associated with the regeneration of that skills base.³⁸

23. So, in trying not to repeat these mistakes, the TOBA was introduced to manage the workforce and skill requirements for the three surface ship programmes (Type 45 destroyers, Queen Elizabeth Class aircraft carriers, and the Type 26 frigates), and was based on the understanding that the workforce size would vary because, as Mr Dunne said: “you don’t need as many people to build a frigate as you do an aircraft carrier”.³⁹ Vice Admiral Mathews, explained the numbers involved:

When we let the terms of business agreement with what was then BVT, which was a joint venture between BAE Systems and Vosper Thornycroft, the deal was predicated on the fact that we were building the Type 45 destroyers, so around 2,000 people would be employed in shipbuilding. We were then going to go up to between 5,000 and 5,500 employed in shipbuilding during the carrier phase, and then come down to the Type 26 frigate, which would employ about 1,500 people.⁴⁰

24. The TOBA would require BAE Systems to manage the workforce reduction from over 5,000 to 1,500 for the Type 26 frigate build, but without the loss of skills that occurred with Astute. In effect BAE would come down to “the equivalent overhead of one complex warship building yard”.⁴¹ The Royal Navy, with the budget available to it, cannot provide work for all the yards currently at BAE’s disposal—Govan, Scotstoun and Portsmouth.⁴²

25. The issue is not just one of reducing the size of the workforce, but also the time between the carrier build phase finishing and the Type 26 build phase starting. The workforce for the carrier programme steeply tails off after 2015 but the Type 26 frigate is still in the design stage, with the main gate decision, “currently” scheduled for “the middle

36 PAC, The Major Projects Report 2010, Supplementary written evidence from the Ministry of Defence, February 2011

37 Q 1951

38 Q 1968

39 Q 2015

40 Q 2022

41 Q 2022

42 Q 1951

of the decade”.⁴³ Professor Taylor told us that dealing with the combination of a fluctuating workforce and a period between major contracts has created a problem for BAE and the MoD:

It seems fairly self-evident that there is overcapacity in the UK as a whole for shipbuilding. There is a very clear programme of work with a gap in it that includes the Carrier and then the F26 [Type 26]. The decision, which seems to be both a political and programme decision, is where that new ship will be essentially manufactured. There is a choice of three plants and two sites: the Clyde and Portsmouth.⁴⁴

The timing of the Type 26 decision and the TOBA

26. The conversation between BAE and the MoD, and the timing of the decision as to where the Type 26 would be built is important, as Dr John Louth pointed out:

The programmatic problem is that the people concerned with the design and development of the F26 [Type 26] are, at some time in the very near future, going to have to have some kind of certainty around where it is going to be constructed. Unfortunately, these sorts of programmes have to take into account location of manufacture and fit because the facilities aren’t identical. That could complicate the programmatic considerations.⁴⁵

Mr Dunne made it clear that it was for BAE to propose how to manage this:

In relation to the flow between the carrier cessation of build and the commencement of the Type 26, we anticipate there will be a gap. The company is working on how to best manage that, and we are leaving it to the company to come forward with proposals. We will consider those proposals and we will then be in a position to respond and move forward.⁴⁶

27. BAE has been considering how to manage the problem, and it commissioned LEK Consulting to research how it might best use the three yards while balancing the needs of the TOBA. Reports in the media suggest that BAE favour Govan and Scotstoun over Portsmouth. Indeed, most of the Type 23 frigates were built in the Scotstoun yard when it was known as Yarrow Shipbuilders.⁴⁷ The Clyde yards have already received considerable investment in plant and facilities over the last ten years, whereas Portsmouth would require “several tens of millions of investment” to enable the consolidation of a Type 26 vessel, and lacked some of the skills to manage the whole of the Type 26 programme.⁴⁸ These are encouraging reports, and given what we have heard about the need to retain capability within the UK, we remain concerned that one of the options open to BAE Systems would

43 HC Deb 22 Oct 2012, col 686

44 Q 1941

45 Q 1954

46 Q 2015

47 www.royalnavy.mod.uk/The-Fleet/Ships/Frigates

48 *Solving the UK's shipyard and skills conundrum*, Jane's Defence Weekly, April 2012

be to close the shipyards on the Clyde and keep Portsmouth open, as there is no risk of Portsmouth leaving the UK in the foreseeable future.

28. If the Type 26 build contract is given to the Clyde yards, then the assumption is that Portsmouth's capability to build warships would be run down. This would leave the UK unable to rely upon an English yard to build a warship without considerable investment and re-skilling.

29. One way to reduce impact of the gap and keep the workforce occupied would be to order the construction of smaller ships that did not require substantial investment in either Scotland or England—to maintain the 'drum beat' of work. There is the possibility of a £150 million contract to build two Offshore Patrol Vessels (OPVs) in Portsmouth to fill the post Carrier gap and help maintain the numbers and skills employed in shipbuilding in Britain,⁴⁹ and we understand the proposal was being discussed but had not been accepted.⁵⁰ A similar contract could be placed in the Clyde yards. It was also suggested to us that the workforce could diversify and use their engineering capability in other ways that could keep the skills in Scotland.⁵¹ This may provide alternative employment in the long term, but without firm proposals it is not clear how many jobs might be created and how quickly those who currently build ships would be able to retrain and successfully find alternative employment.

The timing of the Type 26 decision, the gap and the referendum

30. The proposed statutory timetable for the referendum requires it to be held before the end of 2014. At the moment, the Type 26 main gate decision is due in "the middle of the decade". This further complicates the dilemma as to where to build the Type 26, as Professor Taylor, told us:

It seems that the political and programmatic decision is entwined with the referendum. It seems very difficult to decouple the two. [...] One thing we do know is that the UK has to rationalise its shipbuilding. It must make a decision on where it will anchor tomorrow's shipbuilding.⁵²

Dr Louth observed that a scenario where a contract had been signed to build the Type 26 frigates in Scotland, and then Scotland became a separate country would create: "a number of hoops that perhaps we have never really had to jump through before".⁵³ Philip Dunne said that these complications were not influencing the Type 26 timetable:

The date of the referendum is not influencing the date of the placing of the contract for the Type 26. That is being determined by the maturity of the design, and that is

49 HC Deb, 22 October 2012, Col 686

50 Q 1952

51 Q 1951

52 Q 1941

53 Q 1943

being driven by the defence operational requirements, not the political requirements of the Scottish Government.⁵⁴

While he said his personal view was “the shorter the period to the referendum, the better”, he was adamant that the decision was separate from the referendum timetable.⁵⁵ It was for the BAE come forward with proposals, at which time the MoD “will consider at that time how those proposals fit in with our plans.” Furthermore:

One of the considerations at that time, depending on whether we have or have not had the referendum and which way it goes, will be the consequences in the event of a change in circumstance of the Scottish yards, in the event that that is where the company proposes to build the ships.⁵⁶

Legal implications, contracts and options

31. This timescale raises the question of the legal implications if a decision is taken to build the Type 26 frigate in Scotland before the referendum date. As we explained earlier, the UK does not build its warships outside the UK and we have been told that it would use Article 346 to exempt the Type 26 build from open competition. If it had already taken the decision to build the Type 26 on the Clyde, and then Scotland became a separate country, the TOBA would remain, and the sovereign state whose capital is London would still want the capacity to design, build and support warships.⁵⁷ Scotland would no longer be in the UK and:

Clearly, in the event of separation, that will be a new factor that we will have to take into account. We will be looking at all MoD contracts at that point that are in existence and all those that are in the planning phase, and we will decide what to do about them.⁵⁸

32. When asked whether the Type 26 contract could have a clause defining where the build must take place, including being moved to stay within the UK, Mr Dunne replied:

There are a great many conditionalities within that. We have to take these things a step at a time. Sitting here today in December 2012, we are not in a position to be able to predict precisely when we will have those contractual negotiations and therefore what the terms of those clauses will be.⁵⁹

33. The MoD would consider whether contracts should be terminated and the work relocated back to the residual UK,⁶⁰ or whether it was prudent to continue some contracts until they were due to end as “it may then be inefficient to remove them.”⁶¹ It would be

54 Q 2018

55 Q 2021

56 Q 2032

57 Q 1942

58 Q 2026

59 Q 2032

60 Q 2028

61 Q 2026

standard practice to include break clauses in contracts, and we are confident that the MoD would include clauses in such large contracts as for building warships. But this would still incur costs, and the concern remains as to how expensive it would be for the Ministry of Defence to withdraw its business from Scotland.

34. Mr Dunne said that a consideration would be “the capability and the security sensitivity of each contract.”⁶² And he made it clear that the decision as to how to proceed with some contracts could entail some costs, and that these costs would be factored into the separation negotiations:

As to those contracts that are in progress at that point, it would be a matter for negotiation with an independent Scottish Government as to what would happen to those contracts, the financial implications, who would bear them and where completion would take place.⁶³

35. He conceded that, if a contract had already been signed, that the best value deal might include continuing to build the Type 26 on the Clyde even if Scotland was outside the UK.⁶⁴ These considerations argue against a decision on the Type 26 build being made before the referendum date, but there is a cost associated with that “delay” that would be very visible as it would extend the gap without work that the TOBA was designed to avoid.⁶⁵ Similarly, there would be a cost to allocating the contract to the Clyde and then having to terminate it.

36. It would appear that holding the referendum, and importantly the timing of the referendum, is becoming more relevant for the defence industry. Ian Godden said the big defence companies had been thinking about the impact of separation for about a year.⁶⁶ Professor Taylor said it would be good practice for companies to carry out risk assessments and look how they might mitigate those risks, and if a company was prudent they would be aware of separation and would be doing some scenario planning.⁶⁷ Dr Louth said that it was unrealistic to think they would be doing otherwise.⁶⁸

37. We are confident that the MoD, despite what it say in public, has been doing the same and, as a result, we find it inconceivable that it would make a decision on the Type 26 frigate build before the referendum outcome is known, because the consequences of a yes vote in the referendum are too complicated and expensive.

38. The Type 26 frigate will be built in either Scotland, on the Clyde, or in England at Portsmouth. The decision as to where the Type 26 will be built will be announced in ‘the middle of the decade’. The referendum is to be held before the end of 2014. If a decision was made before the referendum date and the contract was awarded to the shipyards on the Clyde, and thereafter Scotland became a separate country, there would be considerable

62 Q 2026

63 Q 2028

64 Q 2024

65 Q 1955

66 Q 1890

67 Q 1895

68 Q 1891

consequent legal and contractual difficulties for the UK. The Ministry of Defence has said that, in the event of separation, it would reassess all its relevant contracts. There would be enormous pressure, because of security considerations, for the Type 26 build to be relocated to remain within the UK. However, this would entail considerable financial costs and these would be factored into the separation negotiations. The lower risk alternative, to give Portsmouth the contract, would incur extra investment costs and the relocation of skilled staff (the design team are in Scotstoun), which would increase the cost of the Type 26.

39. Essentially, the timing of the referendum is driving decisions for the shipbuilding industry for the wrong reasons, and this is not good news for Scotland. A gap is emerging between the construction phase of the Carrier programme ending and the construction phase of the Type 26 frigate starting. However, the announcement which, though likely to be held in October 2014, could go as late as December 2014.

40. We are convinced that the MoD will not award the Type 26 contract until after the outcome of the referendum is known. If the result is a ‘No’ vote, we believe that the work will be carried out on the Clyde, whereas a ‘Yes’ vote will result in the work being carried out in Portsmouth. The sooner the referendum takes place, the sooner the decision will be made and the sooner there will be an end to the uncertainty.

3 Refit and maintenance— Rosyth

41. The Ministry of Defence also awards contracts for the refit and maintenance of its warships. For example, HMS Portland, one of the Type 23 frigates, recently spent 50 weeks being refitted in Fife by Babcock at a cost of £27 million.⁶⁹ Such refitting work is very important to Rosyth. Raymond Duguid, from Unite, Rosyth, told the Committee:

Refit and ship repair is our core work; that is the bedrock on which we can build business, so we need that. [...] The only person we do refitting and repair for at the moment is the Royal Navy.⁷⁰

Mr Duguid said the skills and facilities at Rosyth are not aimed towards refitting merchant vessels but rather Rosyth maintains “high-end, high-technology combative ships.”⁷¹

42. Peter Luff said the Ministry of Defence would apply the same rules for refit as for ship construction, namely:

We often focus on the construction of a particular platform or asset. Through-life maintenance and support are often of a greater value to the economy. We would not be able to maintain complex warships in a country where we could not guarantee our

69 HMS Portland home to Plymouth after £27 million refit, 18 December 2012, www.royalnavy.mod.uk

70 Qq 120-122

71 Q 125

freedom of action. It is as though Scotland would disqualify itself from the maintenance of ships.⁷²

He continued:

I do not see how we could maintain an aircraft carrier in a separate Scotland.⁷³

43. The next such contract to be awarded is for the two Queen Elizabeth Class carriers, could be as much as the construction costs and provide work for fifty years.⁷⁴ (The construction costs are now estimated at over £6.2 billion.⁷⁵) The size and complexity of the carriers would necessitate different elements of the support package requiring different facilities. For example, the carrier would need to be rearmed from a munitions depot that has a jetty with a licence to handle munitions.⁷⁶ Part of the maintenance cycle would require a dry dock, but Portsmouth does not have a suitable dry dock for a 65,000–tonne carrier, that facility would have to be found in England or abroad.⁷⁷ The most expensive part of the support package is in supporting the combat systems and the technology associated with a complex warship,⁷⁸ and Mr Dunne told us that “Security will clearly play a part” in the decision around support to the carriers.⁷⁹

Timing of the carrier support decision

44. The Royal Navy is currently going through an assessment of the ‘support package’ for the carriers, with the decision where the carriers will be maintained being made “in about two years time”.⁸⁰ Vice-Admiral Mathews explained that the decision might be staggered:

It will probably be a transitional first phase, where we will let an initial support phase, to understand the real requirements for supporting this new and very large carrier. So we will have the first ship at sea; we will sustain that through an initial transition phase; and then we will go into a much longer-term support contract thereafter, as the second ship comes into service. That is the sort of concept that we are looking at.⁸¹

45. Mr Dunne said that the decision would be primarily driven by value for money criteria but that “Security will clearly play a part.” At the same time he denied that the date of the referendum was influencing the decision as to where the carrier support and maintenance would take place:

72 Q 391

73 Q 392

74 Q 2034

75 NAO Report, *Carrier Strike*, HC 1092, 7 July 2011

76 There are two in Scotland that would be suitable: Glen Douglas in Argyll and Crombie in Fife.

77 Cammel Laird in Liverpool was given to us as an example. Qq 2034—36

78 Q 2035

79 Q 2036

80 Q 2034

81 Q 2034

The best I can say in helping to address your concern is that by the time we come to be supporting these vessels post the referendum, it would undoubtedly add to the uncertainty if Scotland were an independent country because they would be treated like other independent countries that are partners and allies if we were looking at a docking site external to the UK. They would not be able to benefit from our current position, which is that we would wish to do so within the UK.⁸²

46. At the moment, there are facilities in Scotland that are well placed to carry out the support work for the Queen Elizabeth Class carriers, and if successful, could guarantee work spread over fifty years. The same rules around limiting contracts to build warships within the UK on national security grounds also apply to aspects of the contract for refit and maintenance, where the UK would wish to preserve its freedom of action. The decision as to the support contract for the carriers similarly appears to be subject to the same uncertainty as that for the Type 26 frigates brought about by the referendum.

4 Options for the Scottish yards

A future Scottish Navy

47. The complex warships built for the Royal Navy have many roles and are involved in operations across the globe in support of the United Kingdom's foreign and defence policy. The Royal Navy has recently been in action off the coast of Libya, helped civilians out of Lebanon when war broke out in 2006 and delivered aid to Haiti following the 2010 earthquake.⁸³ On 4 September 2012, one Type 42 destroyer, two Type 45 destroyer and five Type 23 frigates were on operations for the Royal Navy.⁸⁴

48. The foreign, security and defence policy motion agreed at the SNP October 2012 conference recognised that Scotland would have responsibility to defend its extensive coastline and islands, important under-sea and offshore infrastructure, with neighbours share a responsibility towards the North Sea and north Atlantic, and that:

Scotland will require military capabilities to fulfil these responsibilities.

In addition, it said that their proposed armed forces would include:

deployable capabilities for United Nations sanctioned missions and support of humanitarian, peacekeeping and peace-making 'Petersburg Tasks'.⁸⁵

82 Q 2036

83 www.royalnavy.mod.uk

84 HC Deb 7 Sep 2012 Col 454W

85 The Petersburg tasks were set out in the Petersburg Declaration adopted at the Ministerial Council of the Western European Union (WEU) in June 1992. www.europa.eu

49. In evidence we heard that the priorities for a Scottish navy would probably be fishery protection, defending the North Sea assets, and sea denial.⁸⁶ In order to carry out these activities, the SNP motion said:

The Scottish defence and peacekeeping forces will initially be equipped with Scotland's share of current assets including ocean going vessels

[...] A Scottish defence industrial strategy and procurement plan will fill UK capability gaps in Scotland, addressing the lack of new frigates, conventional submarines and maritime patrol aircraft.⁸⁷

50. This is relevant for the future of the Scottish shipyards. The total UK defence budget is £34 billion. The total value of the Type 45 destroyer programme alone is near £6.6 billion.⁸⁸ At the moment, the UK spends about 2.2% of its GDP on defence. The average for NATO, excluding high spending UK and France, is around 1.4%. If a separate Scotland spent about 1.4% of its GDP on defence, it would have a budget, depending on the accounting of oil revenues, of somewhere between £1.7 billion to £2.1 billion per annum.⁸⁹ The SNP defence and security motion said that a separate Scotland led by the SNP would commit to an annual defence and security budget of £2.5 billion. A proportion of this would be available to be spent on a navy—the model of proposed Scottish armed forces by Stuart Crawford and Richard Marsh suggested a navy that cost around £650 million.⁹⁰ For comparison, the unit cost of producing a single Type 45 destroyer is £651 million,⁹¹ and the operating costs for the first two Type 45 destroyers, in 2011-2012, was £101 million.⁹²

51. Evidence to this Committee has suggested that, on a reasonable division of assets, Scotland might expect to acquire two frigates and a number of other small vessels from its share of the Royal Navy. The Crawford and Marsh model suggested that Scotland could negotiate for a couple of frigates and a number of offshore patrol vessels and mine counter measure ships.⁹³ In comparison, the Danish Navy has seven frigates and a number of different smaller vessels, the Norwegian Navy has five frigates and a number of smaller vessels, and Ireland has eight large patrol boats.⁹⁴

52. If Scotland inherited assets from the Royal Navy that matched its needs, then it would not have to build warships. If the division of assets did not meet Scotland's needs, then a separate Scotland would need to acquire additional vessels, which could include building them,⁹⁵ and thus provide work for Scottish yards. It is unclear how the Scottish Government would ensure that the Scottish yards could be occupied from day one. Neither

86 Q 273, Q 281, Q 565

87 Resolution to SNP conference: Foreign Security and Defence Policy Update. www.moraysnp.org

88 Scottish Affairs Committee, *The Implications for Scotland of both the Strategic Defence and Security Review and the Comprehensive Spending Review*, 7 February 2012, HC 580-II, Session 2010-2012, Q 137

89 Q 158

90 Stuart Crawford and Richard Marsh, A' The Blue Bonnets, RUSI, October 2012

91 HC Deb 21 November 2012, col 497W

92 HC Deb 24 October 2012, col 879W

93 Stuart Crawford and Richard Marsh, A' The Blue Bonnets, RUSI, October 2012

94 Written evidence from Dr Phillips O'Brien, HC 139-II, session 2012-13

95 Q 286

is it clear what level of commitment they would offer that would address the issues identified by the TOBA and ensure the ‘drum beat’ of work continued at a steady rate. If the Scottish yards were to build less complex ships, then we are unclear if the level of work would stop those who build complex warships, like those designing the Type 26, from moving to Portsmouth.

53. Like the Royal Navy, a future Scottish navy would need to maintain and provide support to its ships. This work could not occupy both Faslane and Rosyth, because it would be on a much smaller scale of activity. We understand the Scottish Government has made a decision, in principle, that as much work as possible would be allocated to Faslane. This would nowhere near fill the gap created by the departure of the entire fleet of Royal Navy submarines and surface vessels currently based at Faslane. The maintenance cycle would also have to be considered when assessing the availability of warships to contribute to overseas engagements or humanitarian missions. Stuart Crawford’s model of a future Scottish defence force consisted of two frigates that would “allow a Scottish Government to contribute to joint military exercises or operations.”⁹⁶

54. The SNP October motion also said that Scotland would become a member of NATO on its own terms, which included the removal of all nuclear weapons from Scottish soil and the right to take part only in UN sanctioned operations. If it was not allowed to be a member of NATO on these terms, then Scotland would “work with NATO as a member of the Partnership for Peace programme like Sweden, Finland, Austria and Ireland.”⁹⁷ We are unsure how many frigates a separate Scottish navy would need so that it could carry out a conventional domestic security role, an overseas engagement and undergo maintenance or even training exercises.

55. We remain unconvinced that the likely size of any future separate Scottish defence procurement budget would be large enough to buy any of the complex warships currently built in Scotland, nor would they have, on the evidence we have seen, a use for such warships.

56. The UK Government, through the TOBA, committed to three ship building programmes: the Type 45 destroyers, the Queen Elizabeth Class aircraft carriers, and the Type 26 frigates. The first two have benefitted Scottish shipbuilding and the third has the potential to provide work for well over a decade to come. We are aware of the scale of the potential work available if Scotland remained in the Union.

57. A separate Scotland might inherit assets from the Royal Navy. Inherited assets might meet the needs of the Scottish navy, in which case it would not appear to need to build any new ships. If inherited assets did not meet the needs of a possible Scottish navy, then it would be helpful to know what warships the Scottish Government have identified they would need and might wish to have built in Scotland.

58. We urge the Scottish Government to recognise that the Royal Navy is the major customer for the Clyde shipyards but will only remain so if Scotland is part of the United Kingdom. The Scottish Government should now set out how it proposes, in the

96 Q 454

97 Resolution to SNP conference: Foreign Security and Defence Policy Update. www.moraysnp.org

event of separation, to match the level of work provided by the Royal Navy. The workforces in Govan, Scotstoun and Rosyth need to know their futures as soon as possible.

Submarines

59. The foreign, security and defence policy motion agreed at the SNP October conference said it does not want Scotland to “host nuclear weapons” and wants to see the “speediest safe transition of the nuclear fleet” from Faslane. At the same time as enforcing the removal of nuclear-powered submarines that are currently, or going to be, based at Faslane, a:

Scottish defence industrial strategy and procurement plan will fill UK capability gaps in Scotland, addressing the lack of new frigates, conventional submarines and maritime patrol aircraft.⁹⁸

60. The UK’s nuclear submarine fleet does not just provide the platform for launching the Trident missile. The fleet has a variety of roles: defending British territorial waters, reconnaissance, shadowing and escorting other Royal Navy vessels, surveillance of enemy submarines and ships, and importantly to take part in covert, and overt, operations: HMS Triumph, a Trafalgar Class submarine, was recently deployed in Operation Ellamy off the coast of Libya in 2012.⁹⁹

61. The SNP proposal mentions the need to defend its coastline and islands, under-sea and offshore infrastructure and, with allies, contribute to safeguarding the North Sea and north Atlantic. Some witnesses were unsure if a separate Scotland would need submarines, and it would clearly depend on its defence policy. Professor Trevor Taylor said:

The first thing for me would be that whether or not an independent Scotland needed conventional submarines at all would be a function of the defence policy, which is yet to be written. It is the defence policy that would have to come first rather than a solution.¹⁰⁰

And Professor Chalmers said:

You would have to think about what the shape of a Scottish Navy would be. Like Norway, it might like to have a couple of submarines.¹⁰¹

62. Dr Phillips O’Brien, University of Glasgow, looked at four comparable countries, Norway, Denmark, New Zealand and Ireland. Only Norway has a fleet of submarines—six Ula Class diesel electric submarines—and these had been built as a joint exercise between Norway and Germany.¹⁰² Notably the Norwegian submarines were assembled in Germany.¹⁰³

98 Resolution to SNP conference: Foreign Security and Defence Policy Update. www.moraysnp.org

99 www.royalnavy.org.uk

100 Q 1966

101 Q 272

102 Written evidence from Dr Phillips O’Brien, HC 139-II, session 2012–13

103 Ula Class submarines, Norway. www.naval-technology.com

To buy or to build

63. The UK only has nuclear-powered submarines, so if a separate Scotland intended to have conventional submarines, then it could not inherit them from the Royal Navy.¹⁰⁴ Similarly, there are no British yards that build conventional submarines.¹⁰⁵ If so, then the Scottish defence and industrial strategy and procurement plan would have to either buy them or build them. It is possible to buy second-hand or off-the-shelf submarines, the only model of a possible Scottish defence force that we are aware of, from Stuart Crawford and Richard Marsh, did not include submarines in the short to medium term, principally on cost grounds, but they agreed that: “In the longer term, Scotland might wish to consider off-the-shelf purchase of conventionally-powered and armed submarines of the type built by Germany or Sweden.”¹⁰⁶ Importantly, for the purposes of this Report, that would not provide work for the shipyards on the Clyde.

64. If Scotland was to build submarines, then it could happen two ways: the first would be to develop the ability to design, develop and build submarines. This would involve significant technological and financial risk considering the lack of experience in Scotland in submarine construction, and as a result it is very difficult to estimate the costs of developing the ability to design and build.¹⁰⁷

65. Alternatively, Scotland could enter into an agreement with another European country and arrange licensed assembly of an established design in its own shipyard. Francis Tusa said DCNS in France or ThyssenKrupp Marine Systems in Germany offered this service:

They would take engineers and workers from Govan to those yards to show them how they are built. [...] If you look at DCNS, they are building submarines with and for the Brazilian Navy where precisely this practice happens. The first one/two get built in France and the rest are built in country, and they do technology transfer.¹⁰⁸

66. Even so, several witnesses told us that the cost of building submarines would be prohibitively expensive for Scotland. Ian Godden said:

It would probably be the most expensive submarine in the world. [...] We have a problem with six submarines keeping the drum beat going over time. You need to be buying six. You are just postponing the problem if you don't have a drum beat continuing. You need at least six submarines to order to keep the drum beat over a period of time; otherwise, the fixed costs of both design and manufacture of a one-off or two things are enormous.¹⁰⁹

Dr Louth said that:

104 Qq 561-564, Qq 271-272

105 Q 276

106 Stuart Crawford and Richard Marsh, A' The Blue Bonnets, RUSI, October 2012. See also Q 564

107 Written evidence from Professor Trevor Taylor HC 139-II, Session 2012-13. See also Q 1977

108 Qq 276-277

109 Qq 1058-1960

A back-of-a-fag-packet analysis would probably give through-life costs greater than the whole of your GDP for a couple of years or an independent Scotland's GDP for a couple of years. In terms of proportion of GDP per annum, you would probably be on a par with the United States rather than NATO averages of 1.5%.¹¹⁰

The United States spend 4.9% of their GDP on defence.¹¹¹

67. Dr Louth said that if a separate Scotland wanted submarines, then “intuitively its defence budget is not £2 billion.”¹¹² Professor Taylor calculated that, given an assumption of a defence budget between £1.7-£2.1 billion, and if Scotland followed the broad European average for the proportion of its defence budget spent on new equipment—about 16%—then this would mean an annual equipment spend of between £272-£336 million—equivalent to about one submarine. For comparison, four of the joint French/Spanish Scorpene submarines are being exported to Brazil, with the first one built in France/Spain, then the next three were built in Brazil. These cost around £336 million each. The Russians exported six Kilo/Project 636 Class submarines to Vietnam, which were all built in Russia and cost around £208 million each.¹¹³

Skills required to build submarines

68. Submarine building requires very specialist skills that differ from those for shipbuilding. When we visited the shipyard in Govan, one of the trades union representatives told us, “When we on the Clyde tried to build submarines they floated, when the people in Barrow tried to build ships they sink.” And Ian Godden told us: “You build a submarine in-out and you build a ship out-in. Basically, the fundamentals are very different.”¹¹⁴ BAE found out that, during the development of Astute, the skilled workforce who worked on surface ships could not simply move into submarine construction.

69. So, assuming the experienced workforce on the Clyde did not relocate to England with the ship contracts, the workers on the Clyde would have to learn the necessary skills. Francis Tusa pointed out that this would involve a steep learning curve for the Scottish yards:

It is different from building a surface warship. The minimum number you have to do is four. Below that the economies of scale are insane, because there are not any. If you were building four, the first one would almost certainly come out of either the TKMS yard in Germany or the DCNS yard in France. They would take engineers and workers from Govan to those yards to show them how they are built.¹¹⁵

70. Professor Taylor pointed to the difficult experience of Australia in attempting to design and build its Collins Class submarines. The Australian Government announced its intention to build submarines in its 1981-82 budget; construction began in 1989, with the

110 Q 1966

111 IISS, *The Military Balance*, 2012

112 Q 1957

113 Written evidence from Professor Trevor Taylor HC 139-II, Session 2012-13.

114 Q 1962

115 Q 277

intention of the first submarine to be commissioned into service in 1995. The exercise encountered problems at each stage of development, during sea trials and continuing when it had entered service. The first Collins submarine was finally approved as operational in 2000.¹¹⁶

71. Francis Tusa estimated that, based on shipyards where submarines are built in Europe, the workforce required to build a four-boat fleet of conventional submarines in Scotland would peak between 500 and 600 during construction, and would then fall to around 100 and 150 for long term service support.¹¹⁷ (This would compare to the current workforce of 2,800 on the Clyde and 1,000 at Rosyth.) The Kockums yard in Sweden employed 300-400, and the Navantia yard in Spain employed 400-600 at its construction peak, but this later reduced to 200-300.

72. Whichever method Scotland chose to acquire submarines, it is questionable as to how quickly it could acquire the capability, and it is certainly inconceivable that the work to build submarines would start in time to catch the tail off after the carriers build finished. If Scotland chose submarines, it would need to be part of a considered defence strategy, as Dr Louth told us:

It is very dangerous—I would even say foolhardy—to disconnect defence industrial policy from notions of purposefulness and defence capabilities. If we have defence industrial policy running defence policy because it is jobs-based rather than capability-based, that is pretty dysfunctional and very unusual given the responsive nature of sovereign states.¹¹⁸

73. A separate Scotland could decide it needed conventional submarines. The UK does not have any conventional submarines so it could not inherit any from the Royal Navy. Scotland could build its own submarines from scratch, after developing the skills to design and build from the start, or it could buy a pre-existing design under licence to build a proportion in Scotland. Either method would be prohibitively expensive. Any investment in buying diesel electric submarines would reduce the resources available to invest in other capabilities.

74. The shipbuilding workforce in Scotland does not currently have the specialist skills needed to build submarines. Acquiring those skills would be a lengthy and costly process, and might create 500-600 jobs during construction and at best sustain 150 jobs over the long term.

Exports

75. After he had met with the Ministry of Defence Ministers in May 2012, Kenny Jordan, Confederation of Shipbuilding Unions, asked what the Scottish Government would do to

¹¹⁶ Parliament of Australia, Research Paper 4, 2001-02, Procuring Change: How Kockums was Selected for the Collins Class Submarine.

¹¹⁷ Written evidence from Francis Tusa, HC 139-II, Session 2012-13. The BAE Systems yard at Barrow, which builds nuclear submarines for the Royal Navy, employs 4,700 people

¹¹⁸ Q 1975

replace Royal Navy contracts.¹¹⁹ There have been suggestions that the Scottish yards could remain open because the skills base in Scotland would generate sufficient export orders.¹²⁰

76. Scottish shipbuilding's strength is in building complex warships, including innovative design and the latest technology. (The defence industry in Scotland is generally high technology.¹²¹) The result is a very capable warship, but also a highly expensive warship and this restricts the potential number of foreign buyers—BAE did not find any export buyers for the Type 45 destroyers. A separate Scotland would find itself in a competitive market against other shipbuilders from Germany, Netherlands, Spain, China and South Korea.¹²²

77. In the past, the UK has built and exported ships to countries including Brazil, Trinidad and Tobago and Brunei,¹²³ and the Portsmouth yard is currently building offshore patrol vessels for Oman.¹²⁴ The bulk of these contracts have been for smaller less sophisticated types of ship, which means they require a smaller scale of production, and, as Francis Tusa pointed out, the workforce required to build an OPVs is a small percentage of that required for the Type 45.¹²⁵ The last order for ships of a significant size, that were entirely built in Scotland, were two frigates for the Malaysian navy in 2001-02.¹²⁶

78. Several countries, including Australia, Brazil, Canada, India, Malaysia, New Zealand and Turkey, have all expressed some interest in the Type 26, but only Brazil appears to be pursuing this and on condition that it builds the ships under licence in its own yards.¹²⁷ Indeed, most of the recent export successes from BAE have been for design only or involved technology transfer so the work takes place in the buying country shipyards.¹²⁸ And if a separate Scotland wanted to build the Type 26 frigate for export, it would have to do so with the agreement of, and on licence from, BAE Systems and the Ministry of Defence. The UK is the second largest defence exporter in the world,¹²⁹ and part of that is because of the products' association with the Military of Defence. As Professor Taylor told us:

Even export orders that are ostensibly for foreign customers actually came about because of a Ministry of Defence commitment to that piece of equipment.¹³⁰

79. There is a range of questions about what kinds of warship a separate Scotland might try to build and export, particularly if its own navy is limited in size and is not able to

119 Independence 'would decimate Scottish shipbuilding', Defence News, 17 May 2012

120 Independence 'would decimate Scottish shipbuilding', Defence News, 17 May 2012

121 Q 1880

122 Britain's Future Frigates: Type 26 & 27 Global Combat Ships, Defence Industry Daily, 9 September 2012

123 Shipyards on the slipway, BBC Scotland, 25 November 2012

124 HC Debs, 22 October 2012, col 686

125 Q 290

126 Written evidence from BAE Systems, HC 139-II, Session 2012-13

127 Shipyards on the slipway, BBC Scotland, 25 November 2012. See also Process Begins to Equip Royal Navy's Type 26 Frigate, Defence News, 23 August 2012, Britain's Future Frigates: Type 26 & 27 Global Combat Ships, Defence Industry Daily, 9 September 2012

128 Written evidence from BAE Systems, HC 139-II, Session 2012-13

129 Q 416

130 Q 1897

match the combat effectiveness of the Royal Navy. There is a huge question mark over the viability of the Scottish yards in a separate Scotland.

Shared procurement with the UK

80. The foreign, security and defence policy motion agreed at the SNP October conference said that “Joint procurement will be pursued with the rest of the UK and other allies”.¹³¹ The UK currently takes part in several joint procurement exercises, Typhoon being an obvious example. Indeed, it is a growing theme within NATO for countries to share defence procurement where it benefits all parties. It is an obvious way of pooling resources where defence budgets are reduced. However, we are not aware of the UK building a warship as part of a joint procurement exercise. The nearest example would be the relationship with the USA around nuclear submarines, or the modifications to the Queen Elizabeth Class aircraft carriers to accommodate the take-off requirements of future jointly procured fast jets.¹³²

81. It would represent a considerable departure from established practice for the Ministry of Defence to enter into joint procurement of a new warship that specifically involved the construction phase outside of the UK. The UK has said that where it enters into such arrangements, it does so with those nations who closely share its foreign and defence policies.¹³³ Yet one of the SNP’s stated policies is explicitly not to have the same foreign and defence policies as the UK. For example, the First Minister, Alex Salmond MSP, has said:

The great argument in favour of having a Scottish Defence Force is two-fold—one, you wouldn't have to have the biggest concentration of nuclear weapons in Western Europe situated in Scotland, which many people support the removal, and secondly of course, we'd have the right to decide whether or not to participate in international engagements.”¹³⁴

And as Professor Chalmers told us:

If an independent Scottish Government were to insist on the Trident submarines being removed rapidly without the UK Government having anywhere to put them, that would create a very bad atmosphere between Scotland and the UK, and indeed between Scotland and the wider international community. It is one thing accepting a re-division of territories, which very few other countries in NATO would sympathise with at all,¹³⁵ but quite another if it was seen to be taking a radically different foreign policy course, and that is what rapid expulsion would be.¹³⁶

131 Resolution to SNP conference: Foreign Security and Defence Policy Update. www.moraysnp.org

132 This change of course on aircraft carriers is essential, Daily Telegraph, 10 May 2012

133 Ministry of Defence, February 2012, National Security Through Technology: Technology, Equipment, and Support for UK Defence and Security, Cm 8278

134 BBC Scotland, Scottish independence: Salmond details Scottish Defence Force plan, 19 January 2012, <http://www.bbc.co.uk/news/uk-scotland-scotland-politics-16636329>

135 Note by witness: Very few other countries in NATO would sympathise at all with a re-division of territories but they would reluctantly accept it.

136 Q 165

82. At the same time, while recognising the shipbuilding skills in Scottish yards, there are other shipyards in the UK, and, if forced to do so, BAE Systems could build the warships that the UK needs in yards in England.

83. A separate Scotland could be expected to develop its own foreign and defence policies. The SNP is explicitly committed to developing a divergent foreign and defence policy, including the eviction of Trident at great expense and inconvenience for the UK and its NATO allies, and the establishment of different criteria for involvement in overseas deployments. This is hardly the best way to persuade the UK to enter into any joint procurement.

Conclusions and recommendations

Shipbuilding in Scotland

1. The UK has consistently built its own warships. It wants to retain the capability to design, build and maintain such warships in this country, keep the skills and industry to do so, maintain freedom of action over its own navy, and because of the sensitivities around some of the equipment involved. (Paragraph 18)
2. EU law requires major procurement contracts to be offered for open competition. Member states can use various exemptions to place contracts with preferred suppliers. One such exemption, Article 346, allows countries to exempt defence procurement on the grounds of national security. The UK has consistently excluded the construction of complex warships from open competition using Article 346. If Scotland was a separate country, then the Ministry of Defence could not use Article 346 to favour shipyards in Scotland because they would no longer be within the UK. (Paragraph 19)
3. In those instances in which the Ministry of Defence has decided not to exempt contracts on the grounds of national security, it has then been obliged to offer the contract for tender internationally. In such a situation, any shipyards in Scotland would have no preferential status and would have to bid for the contract on the same basis as other international yards. (Paragraph 20)
4. We are convinced that the MoD will not award the Type 26 contract until after the outcome of the referendum is known. If the result is a 'No' vote, we believe that the work will be carried out on the Clyde, whereas a 'Yes' vote will result in the work being carried out in Portsmouth. The sooner the referendum takes place, the sooner the decision will be made and the sooner there will be an end to the uncertainty. (Paragraph 40)

Refit and maintenance - Rosyth

5. At the moment, there are facilities in Scotland that are well placed to carry out the support work for the Queen Elizabeth Class carriers, and if successful, could guarantee work spread over fifty years. The same rules around limiting contracts to build warships within the UK on national security grounds also apply to aspects of the contract for refit and maintenance, where the UK would wish to preserve its freedom of action. The decision as to the support contract for the carriers similarly appears to be subject to the same uncertainty as that for the Type 26 frigates brought about by the referendum. (Paragraph 46)

Options for the Scottish yards

6. We remain unconvinced that the likely size of any future separate Scottish defence procurement budget would be large enough to buy any of the complex warships currently built in Scotland, nor would they have, on the evidence we have seen, a use for such warships. (Paragraph 55)

7. The UK Government, through the TOBA, committed to three ship building programmes: the Type 45 destroyers, the Queen Elizabeth Class aircraft carriers, and the Type 26 frigates. The first two have benefitted Scottish shipbuilding and the third has the potential to provide work for well over a decade to come. We are aware of the scale of the potential work available if Scotland remained in the Union. (Paragraph 56)
8. A separate Scotland might inherit assets from the Royal Navy. Inherited assets might meet the needs of the Scottish navy, in which case it would not appear to need to build any new ships. If inherited assets did not meet the needs of a possible Scottish navy, then it would be helpful to know what warships the Scottish Government have identified they would need and might wish to have built in Scotland. (Paragraph 57)
9. We urge the Scottish Government to recognise that the Royal Navy is the major customer for the Clyde shipyards but will only remain so if Scotland is part of the United Kingdom. The Scottish Government should now set out how it proposes, in the event of separation, to match the level of work provided by the Royal Navy. The workforces in Govan, Scotstoun and Rosyth need to know their futures as soon as possible. (Paragraph 58)

Submarines

10. A separate Scotland could decide it needed conventional submarines. The UK does not have any conventional submarines so it could not inherit any from the Royal Navy. Scotland could build its own submarines from scratch, after developing the skills to design and build from the start, or it could buy a pre-existing design under licence to build a proportion in Scotland. Either method would be prohibitively expensive. Any investment in buying diesel electric submarines would reduce the resources available to invest in other capabilities. (Paragraph 73)
11. The shipbuilding workforce in Scotland does not currently have the specialist skills needed to build submarines. Acquiring those skills would be a lengthy and costly process, and might create 500-600 jobs during construction and at best sustain 150 jobs over the long term. (Paragraph 74)

Exports

12. There is a range of questions about what kinds of warship a separate Scotland might try to build and export, particularly if its own navy is limited in size and is not able to match the combat effectiveness of the Royal Navy. There is a huge question mark over the viability of the Scottish yards in a separate Scotland. (Paragraph 79)

Shared procurement with the UK

13. A separate Scotland could be expected to develop its own foreign and defence policies. The SNP is explicitly committed to developing a divergent foreign and defence policy, including the eviction of Trident at great expense and inconvenience for the UK and its NATO allies, and the establishment of different criteria for involvement in overseas deployments. This is hardly the best way to persuade the UK to enter into any joint procurement. (Paragraph 83)

Formal Minutes

Wednesday 16 January 2013

Members present:

Mr Ian Davidson, in the Chair

Jim McGovern
Iain McKenzie
Pamela Nash

Simon Reeve
Mr Alan Reid
Lindsay Roy

Draft Report (*The Referendum on separation for Scotland: Separation shuts shipyards*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 83 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Seventh Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Tuesday 22 January at 2.00 pm]

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–12

First Report	Postal Services in Scotland	HC 669 (HC 884)
Second Report	Video Games Industry in Scotland	HC 500 (Cm 8067)
Third Report	UK Border Agency and Glasgow City Council	HC 733
Fourth Report	The Scotland Bill	HC 775
Fifth Report	Student Immigration System in Scotland	HC 912 (Cm 8192)
Sixth Report	The Referendum on Separation for Scotland: Unanswered Questions	HC 1806
Seventh Report	The Crown Estate in Scotland	HC 1117
Eighth Report	The Referendum on Separation for Scotland: Do you agree this is a biased question?	HC 1942

Session 2012–13

First Report	A Robust Grid for 21 st Century Scotland	HC 499
Second Report	The Referendum on Separation for Scotland: making the process legal	HC 542
Third Report	The Referendum on Separation for Scotland: a multi-option question?	HC 543
Fourth Report	The Referendum on Separation for Scotland: Terminating Trident—Days or Decades?	HC 676 (HC 861)
Fifth Report	The Future of HM Coastguard in Scotland	HC 583
Sixth Report	The Referendum on Separation for Scotland: The proposed section 30 Order—Can a player also be the referee?	HC 863