



House of Commons
Scottish Affairs Committee

The Referendum on Separation for Scotland: How would Separation affect jobs in the Scottish defence industry?

Eighth Report of Session 2012–13

Report, together with formal minutes

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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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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).

Contacts

All correspondence should be addressed to the Clerk of the Scottish Affairs Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 6123; the Committee's email address is scotaffcom@parliament.uk

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Summary

The defence industry is very important to the Scottish economy, providing more than 15,000 jobs and contributing between £ 1.8 billion–£2 billion annually to the Scottish economy. The impact of separation upon the Scottish defence industry will be substantial and distinctively negative. We have been unable to identify any defence supplier or product which will benefit from separation and a large number which will suffer.

Those firms or subsidiaries dependent on British Army, RAF or Royal Navy orders under Article 346 of the European Union Treaties (which allow the UK to reserve certain orders to national suppliers) will lose such work, which will be transferred to other parts of the UK. We also recognise that the market offered to defence suppliers in a separate Scotland will be negligible in size compared to that of the United Kingdom as a whole and the joint projects in which it participates.

A separate Scotland, particularly one which has deported the Royal Navy's submarine force and potentially enforced unilateral nuclear disarmament upon the United Kingdom will not necessarily be seen as a reliable ally or as a trusted partner, NATO or others, for collaboration in those large international projects which are the main routes to market for many Scottish defence products.

Similarly a future separate Scotland's access to secret technology owned elsewhere is unlikely to be automatic. Even if access for US and other nuclear forces to Scottish sea, land and air is allowed on a "don't ask, don't tell" basis, there will not necessarily be the maximum security clearance necessary to allow export to, or collaboration with, US or other suppliers or purchasers.

A separate Scotland is unlikely to be able to fund the level of research and development necessary to maintain Scottish companies at the cutting edge of technology, thus they will soon degenerate to commodity suppliers which will face international competition.

The defence industry in Scotland is designed to meet the needs of its main customer—the Ministry of Defence. A separate Scotland would operate on a much smaller budget and need very different equipment. It is essential that the Scottish Government spells out, as quickly as possible, its intentions for procurement and research budgets, and foreign and defence policies.

Many thousands of people in defence jobs in Scotland need to be told, before the referendum, of their prospects for future employment.

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 the inquiry: the mechanics and process of the referendum itself.¹ The second area is a series of inquiries examining key substantive issues. This Report is the third looking at the implications of separation upon defence in Scotland,² and is focussed on how separation would affect the current defence industry in Scotland.

Economy and jobs

2. The defence industry is very important to the Scottish economy. Ian Godden, Chairman of Farnborough International, told the Committee that although the UK is the sixth biggest economy in the world, its defence industry is the second biggest, above France and Germany, and that “Defence as such is a very significant part of our heritage and industrial base, of which Scotland plays a key part.”³

3. Estimated annual sales for the defence industry in Scotland are between £1.8 billion and £2 billion, with Scotland benefitting from growth in both the UK and international markets. The defence industry supports “probably north of 15,000 jobs” throughout Scotland,⁴ with wages around a third higher than the Scottish national average.⁵ The Ministry of Defence (MoD) itself employs around 18,000 Service personnel and civilians in Scotland, in sites covering 30 out of 32 local authorities throughout Scotland, and has over 700 direct contracts in Scotland.⁶ The MoD, as a buyer of equipment and services, is very important to the Scottish defence industry. Between 50% and 80% of defence work in Scotland is directly dependent upon the MoD contracts, and in the opinion of Professor Taylor, Royal United Services Institute (RUSI), the figure would, “certainly be nearer the 80% than the 50%”.⁷ In addition, there are a percentage of export sales made on the strength of the product being sold to the MoD or to allies, particularly the US.⁸

4. Those jobs and contracts are in a range of businesses, including a high proportion of manufacturing and traditional engineering such as shipbuilding,⁹ but “the guts of the most

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 Fourth Report of Session 2012-13, *The Referendum on Separation for Scotland: Terminating Trident—Days or Decades?*, HC 676; Seventh Report of Session 2012-13, *The Referendum on Separation for Scotland: Separation shuts shipyards*, HC 892

3 Q 225, Q 1879. See also, A Question of Independence, Defending an independent Scotland, Scotsman Conference, 15 May 2012

4 Q 1879

5 Sixth Report of Session 2007-08, *Employment and Skills for the Defence Industry in Scotland*, HC 305

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

7 Qq 1897-1898

8 Q 1899

9 HC (2012-13) 892

of the defence industry is very high technology”, including research, design and manufacturing in airborne radar, optronics, and electronics design and manufacture.¹⁰ The supply chain is important as contracts will have sub-contracts for components or maintenance services that benefit smaller businesses. We were told that there are more Small and Medium sized Enterprises (SMEs) in the UK defence industry than in the industries of France, Germany, Italy, Spain and Sweden combined.¹¹ During the course of this inquiry we visited several of the major firms, including Selex Galileo in Edinburgh, Raytheon in Glenrothes, Vector Aerospace in Perth, Chemring in Ardeer, DM Beith in Ayrshire, the Aircraft Carrier Alliance in Rosyth, BAE Systems and Thales in Glasgow. We would like to thank all those who made our visits possible and welcomed the Committee.

5. We have used the term UK to describe the current UK (including England, Wales, Northern Ireland and Scotland). In February 2013, the UK Government published a paper, *Scotland analysis: Devolution and the implications of Scottish independence*,¹² in which it said that, in the event of Scotland leaving the Union, the remainder of the UK would be the continuing state and still be called the UK. In the hypothetical situation where the people of Scotland voted to leave the Union, we describe the two resulting states as ‘the UK’ (consisting of England, Wales and Northern Ireland) and ‘a separate Scotland’. Where it is necessary to make the position clear, we sometimes use the term ‘a future UK’.

10 Q 1880

11 Q 1919

12 *Scotland Analysis: Devolution and the implications of Scottish Independence*, Cm 8554, February 2013; Qq 2542-2547

2 Defence procurement and domestic industry

Budget

6. In 2012, the total UK defence budget was around £39 billion,¹³ or about 2.7% of GDP. Although this was planned to fall to about 2.2% of GDP in 2015,¹⁴ agreed funding for defence over the period 2011-12 to 2014-15 remains over £33 billion per year.¹⁵ A separate Scotland would not match the defence spending of the UK in total or in terms of a proportion of GDP. Professor Malcolm Chalmers, Research Director, UK Defence Policy at RUSI, suggested that if Scotland spent the NATO average of 1.4% of its GDP on defence then it would have a budget of between £1.7 billion and £2.1 billion per annum.¹⁶ Dr John Louth, Director, Defence, Industries and Society Programme, RUSI, agreed with this figure and said:

If it is right that an independent Scotland will come in roughly on NATO average of percentage of GDP, then, as we have said, the annual budget for an independent Scotland is about £2.1 billion. That is significantly smaller than Denmark, Belgium and roughly half of Norway's at the extreme. That is not that attractive in terms of the league table of defence spending of independent nation states. Scotland has to be cognisant of that.¹⁷

1.4% of GDP in Norway gives an annual defence budget of near £4 billion, and in Denmark of nearly £3 billion.¹⁸

7. A model of a possible Scottish military, developed by Stuart Crawford and Richard Marsh, had an estimated budget of around £1.8 billion, or about 1.3% of Scotland's GDP.¹⁹ Most of the estimates we have seen so far suggest Scotland would have an annual budget of between £1.7 billion and £2.5 billion, considerably less than that of the UK.²⁰ The SNP has proposed an annual defence and security budget of £2.5 billion.²¹

8. The estimates we have seen appear to be for a steady state budget. The Crawford and Marsh model accommodated transitional costs—how to get from the current situation to a self-sufficient functioning new country—by spreading the cost of any new equipment over

13 Ministry of Defence Annual Report and Accounts 2011-2012, HC 62

14 Malcolm Chalmers, *The End of an 'Auld Sang' Defence in an independent Scotland*, RUSI, April 2012

15 Written evidence from the Ministry of Defence to the Defence Committee, Session 2012-13, *Defence implications of possible Scottish independence*, HC 483, para 44

16 Q 158

17 Q 2007

18 Malcolm Chalmers, *The End of an 'Auld Sang' Defence in an independent Scotland*, RUSI, April 2012

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

20 Francis Tusa estimated £2.5 bn or less, Chalmers estimated £1.7-£2.1 bn. Crawford & Marsh estimated £1.8 bn.

21 SNP Foreign, Security and Defence Policy update, October 2012

a period of time or by expecting them to be catered for in the division of assets.²² Conversely, Professor Chalmers said the transitional costs of setting up a new state would be high and this, coupled with the initial competition for resources, would put a lot of pressure on a new separate Scottish defence budget. At the same time it may not be possible for Scotland to get what it needs in the division of assets, because it could not be sure that what it could negotiate from the UK would match what it would want for its armed forces.²³ We do not believe that Scotland would necessarily overcome these transitional costs in the division of assets.

Procurement budget

9. The total amount the UK spends on purchasing equipment, the procurement budget, is between £16 billion and £18 billion (over 40% of the total budget).²⁴ This includes everything the Armed Forces buy, from warships to night vision goggles. Francis Tusa, editor of *Defence Analysis*, said different countries spend varying proportions of their defence budget on procurement: in Belgium it is as low as 18%, Norway 20%, Sweden 22%, and in Denmark as high as 34%.²⁵ Dr Louth said that if Scotland spent between 25% and 40% on procurement, out of a defence budget of around £2 billion per year, then the sum available to buy equipment would be at most about £1 billion, a figure that was “not a significant prize for companies to pursue”.²⁶ The result would be that the Ministry of Defence equivalent in a separate Scotland would have a much smaller amount of money to spend on any equipment it needed, such as warships or night vision goggles. Similarly, Professor Chalmers said:

If you had a Scottish defence budget of about £2 billion a year and it spent 40% of that on new equipment and equipment maintenance, which is quite high, you would be talking about £800 million a year. A lot of that would be small-scale suppliers and so on. I think quite a bit would be buying things from overseas.²⁷

10. To put this £800 million to £1 billion into context, in 2011 the MoD placed a £1 billion contract for 14 Chinook helicopters, at a cost of £71 million each.²⁸ An individual Type 45 Destroyer, the last of which has just finished being built on the Clyde, costs £1 billion.²⁹ A Typhoon jet plane costs about £126 million (and that is to buy, not to actually fly on a daily basis).³⁰ An Orion P-3 marine patrol aircraft costs about £24 million. The MoD bought 300 Foxhound Light Protected Patrol Vehicles, to replace Land Rovers in Afghanistan, at a cost of £270 million. (This also demonstrates the economies of scale—the order for 300 worked

22 Qq 2370-2378

23 Malcolm Chalmers. *The End of an 'Auld Sang' Defence in an independent Scotland*, RUSI, April 2012

24 *Ibid.* and Q 2046

25 *Defence Analysis*, *Scottish Independence: The Defence Equation For The Sake of Auld Lang Syne (Revisited) ...?* February 2012

26 Q 1907

27 Q 225

28 RAF to get 14 Chinooks, 22 August 2011. www.defencemanagement.com

29 www.royalnavy.mod.uk/The-Fleet/Ships/Destroyers/Type-45-Destroyers

30 Committee of Public Accounts, Thirtieth Report of Session 2010-12, *Management of the Typhoon Project*, HC 860, See also Qq 2008-2010 [A single F-16 costs about £100 million.]

out at cost a per-unit of around £900,000. A more recent order for 25 vehicles was £30 million, or at a cost of £1.2 million per vehicle.)³¹

11. Several witnesses told us that the defence industry tends to be located in countries that spend a greater proportion of their GDP on defence because they want to have access to the higher spending markets. When we asked our witnesses about this relationship, Francis Tusa returned the question: “is the Belgian defence industry the size of the French defence industry? No, it is not. Why? Belgians spend very little on defence.”³² Dr Louth agreed:

It seems to me that there is a very strong correlation between the size of the nation’s defence budget and the size, scale, capability and capacity of its defence industrial base.³³

And Francis Tusa said:

You need to look at the examples of companies like Thales, which is international. They move their facilities to where the money is. In the case of air defence, they closed down all of their French facilities and moved them to the UK because that was where the budget was for their particular niche.

This could happen quite quickly:

It is a lot easier to flex factory demand within the defence industry than you would think. The idea that that could take decades before a move is wrong. If you ended up with an independent Scottish defence force with limited capabilities, and low-tech capabilities at that, those facilities will be within Britain within months—end of. It goes where the money is, pure and simple.³⁴

Professor Chalmers broadly agreed, but thought it might take “a little longer than Francis says”, and he added:

The companies will make commercial judgments about whether or not to relocate. They will look at existing contracts and what signals they are being given by their paymasters in Washington, London or elsewhere. They will also look at their employees and whether they are prepared to relocate across the border. I do not think everything will leave on day one, but the trend will be pretty clear. Why should the UK Government in this scenario support jobs in Scotland in the defence area unless it is clearly more cost-effective to buy from those suppliers?³⁵

Funding for Research and Technology

12. We were told that the amount a country spends on research and technology was an important indicator of government support for the defence industry. Such investment is

31 Army orders 25 more Foxhound vehicles, 24 August 2012, www.defencemanagement.com

32 Q 214

33 Q 1926

34 Q 214

35 Q 215

provided an incentive to industry and higher education to develop and improve new equipment. Just as a large procurement budget is an attraction to the defence industry so is the amount spent on research. Countries that spend a small proportion of their defence budget on research and development tend to have a small domestic defence industry. Vice Admiral Mathews, Chief of Materiel (Fleet), Defence Equipment and Support, said there was a correlation between the manufacture of advanced defence equipment and the amount a country spends on defence research and development.³⁶ This is highly relevant because of the high tech nature of much of the industry in Scotland. Mr Philip Dunne MP, Minister for Defence Equipment Support and Technology, Ministry of Defence, said the MoD currently spent about £1.5 billion on research and development, approximately £400 million of which was on science and technology,³⁷ and:

We do not direct our science and technology budget outside the UK. I am not going to give an absolute commitment to that because there are quite a number of examples of collaborative projects with other nations. We are working with Australia, India and France on some of our S and T spend, but I am not aware [...] of any individual projects that are placed with no UK involvement.³⁸

13. One of the places we visited, Selex in Edinburgh, had benefitted from research funding from the MoD. In turn they have invested in the local university, the research provided post-graduate research opportunities, high wage employment, and apprenticeships to school leavers who wanted to work in a high tech industry. If the UK currently funds such research in Scotland as part of an international defence programme, then in the event of separation, we believe the MoD would move that research to stay within the UK. If the research opportunities moved south, then the workforce working on these programmes would have to consider whether to follow.³⁹

14. Ian Godden said that when the UK Government previously reduced its investment in Research and Technology by 23% to £400 million, the international defence companies asked him: “Is this a place to invest for the future?” Mr Godden added it was important that a future Scottish Government was aware of the signal the research budget would send to the industry:

For me, unless somebody has thought through what the spend is of this new nation in the future in research and technology and signalling and whether it is growing, shrinking or whatever it is, and the universities associated with it have collectively decided, “This is a policy that we are going to invest in this industry”—that is a political decision. It is not an industrial decision, but, to me, that is the biggest signal.⁴⁰

36 Q 2064

37 Q 2060

38 Q 2065

39 Qq 233-235

40 Q 1996

And he said that unless a separate Scottish Government: “is committed to significant and sustained investment where companies believe they are going to get expertise out of Scottish universities, I agree with you. It will not be perceived as the place to go.”⁴¹

15. Estimates of the size a research budget in a separate Scotland ranged from £20 million to £30 million,⁴² with which Scotland could choose to fund research where it wanted, or not. Professor Taylor said that many smaller countries spent nothing on defence research and over 90% of the research carried out in Europe was done by the UK, France and Germany.⁴³

Implications of a smaller budget

16. It has been argued that Scotland does not receive its ‘fair share’ in UK defence spending and that the MoD spends less in Scotland than the amount sent to the MoD from Scottish tax payers. This does presume that it is possible to trace where the MoD spends its money with any accuracy. Professor Ron Smith, Department of Economics, Birkbeck College, said:

The whole system is so interdependent that it is very hard to track down regionally. Some of it you can. We do not know whether the £2.5 billion will be more or less than is spent in Scotland at the moment; there is real uncertainty about it.⁴⁴

17. And a considerable amount of MoD spending is on assets that operate abroad, such as the overseas bases in Germany, so the same argument could be applied for much of the UK.⁴⁵

18. The contribution from Scottish taxpayers also contributes to the collective defence of alliances that the UK is part of, such as NATO. In return the UK benefits from the security protection offered by NATO. The contribution of Scottish taxpayers goes towards the security and protection of the whole of the UK,⁴⁶ so it funds the warships that might be called up from a port in England to keep an eye on Russian warships seeking shelter off the Scottish coast,⁴⁷ and the Typhoons based in Scotland that police the skies of Northern Europe as part of the NATO Quick Reaction Alert force.⁴⁸ As a result, it is very difficult, and not particularly helpful, to try to identify what proportion of each pound spent is dedicated to the protection of Aberdeen or Aberystwyth.

19. The defence industry in Scotland contributes to this defence of the whole UK and the level of spending on the domestic defence industry enhances the self sufficiency of the UK

41 Q 1938

42 Q 214 and Q 1939

43 Q 1934

44 Q 2175

45 Q 2357

46 Q 2176

47 Seven Russian warships remain near the Moray Firth, 15 December 2011 www.bbc.co.uk/

48 www.raf.mod.uk/rafleuchars/aboutus/whywearehere.cfm

to defend itself. Philip Dunne MP, Minister for Defence Equipment Support and Technology, Ministry of Defence, told the Committee:

The security umbrella that is provided through the whole-UK spend and commitment to defence is very much more substantial than would be available to an independent Scotland.⁴⁹

20. The Ministry of Defence chooses, for a variety of reasons, to spend its money within the UK, and Scotland benefits from this. Professor Taylor, RUSI, told us:

A relatively safe assumption is that almost all Scottish defence business rests either directly or in a fairly close relationship with work from the Ministry of Defence.⁵⁰

21. For example, every Royal Navy submarine since 1917 has been fitted with a periscope from Thales or their previous incarnation as Barr and Stroud. Without MoD contracts, some of which are very large, a defence supplier in Scotland would be faced with much smaller individual major contracts and a much smaller general domestic market. A smaller budget and reduced spending power would mean reduced economies of scale too: fewer helmets would be bought so more would have to be paid per helmet (or boots, water bottle, lorry, helicopter, etc.).

22. The defence industry in the UK, and by definition Scotland, makes weapons for the UK military to use. It also tests some of these in Scotland at Cape Wrath and Benbecula. These are expensive items that would probably be beyond the budget of an independent Scotland:

In addition, there is work on the F-35, Paveway bombs and things of this nature, but, for most of the other projects, they are equipping things one cannot imagine Scotland buying. I cannot imagine Scotland buying F-35 aircraft, for example.⁵¹

23. The industry in Scotland also makes a wide variety of smaller components. Thales provides optical equipment for armoured vehicles used by the British Army. Chemring makes the charge that fires the ejector seat for the F-35.⁵² Ian Godden pointed out that Scotland would not automatically lose all the business it currently gains from being part of the UK.⁵³ What the MoD would still be able to buy from Scotland would be low-tech items which are not considered security sensitive, but these are the same items that are widely available and generally sourced from countries with lower production costs.⁵⁴ Francis Tusa said:

“Oh, the EU has said it will be trans-border procurement.” I am sure it will be for bootlaces and bottled water, but for the key systems there is the political resonance of security of supply and very simple things like, again, size of budget.⁵⁵

49 Q 2046

50 Q 1897

51 Q 215

52 www.chemring.co.uk

53 Q 1926

54 Q 242

55 Q 214

24. Other witnesses shared this view that some cross-border procurement would remain. Professor Taylor said:

I would feel fairly confident in saying that there would not be an increase in orders from London north of the border. My suggestion is that it would be a diminished number.⁵⁶

25. The population of Scotland is 8.5% of the United Kingdom. A budget of £2.5 billion would represent 6.5% of the UK defence budget. A procurement budget of £1 billion would represent about 6% of the UK defence procurement budget. This is before costs associated with intelligence and the transition period are taken into account. A defence industry in a separate Scotland would have a substantially smaller domestic market.

26. The budget for research in the defence sector is an important indicator of intent. At the moment, the UK research budget is £400 million where estimates of a future research and development budget for Scotland vary between £20 million and £30 million. The high-tech nature of the defence industry in Scotland means it would be sensitive to changes in the level of investment in research. The reduction in research opportunities would be a factor in determining whether defence industries remained in Scotland. It would also affect the amount of research funding for universities in Scotland. We urge the Scottish Government to provide more information on their commitment to funding defence-related research after separation.

What this would mean for the Scottish defence industry

27. The MoD is under domestic pressure to invest in and support jobs in the UK while at the same time securing value for money for the UK tax payer.⁵⁷ If the UK needs a Frigate, and it can build one in the UK, then it does. This keeps jobs and money in the UK economy and the Treasury gets a fair proportion of it back in tax. Vice Admiral Mathews told us that if Scotland became a separate country, the MoD would reassess what was sourced in Scotland, compare it to what the MoD could produce elsewhere in the UK, and ask the question “Well, do we want to transfer this business?”⁵⁸

28. Philip Dunne explained what the MoD would take into account while reassessing current MoD contracts in Scotland:

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. In some cases, that might involve withdrawing the contract, which would have some cost implications for the MOD that would then be factored into any separation discussions, and we might conclude for some that it is acceptable for the contract to continue until termination for those bits that are already under way,

56 Q 1901

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

58 Q 2044

because it may then be inefficient to remove them. However, it will depend on the capability and the security sensitivity of each contract.⁵⁹

Mr Dunne made it clear that the cost of any change to current contracts would be part of 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.⁶⁰

29. In such circumstances it is difficult to imagine that the UK would place any new major contracts in a separate Scotland.⁶¹ Some contracts might remain, but many would be withdrawn and it is worth pointing out that almost all of the firms we visited, such as Vector, Thales, Selex and BAE Systems have other facilities elsewhere in the UK. DM Beith is one of the MoD sites we visited in Ayrshire. On the surface, it is one of 11 munitions stores spread across the UK, but DM Beith also carries out maintenance and upgrade work on complex US-UK weapons, including those used by the submarine fleet operating out of Faslane. If the fleet leaves, then the weapons leave and the work at Beith goes too. The Minister told us that this work could be moved south.⁶²

30. Similarly, Vector Aerospace carries out maintenance on parts for Chinook helicopters and Tornado jets. It is unclear whether a separate Scotland would have such aircraft and on what scale, and whether that would provide an equivalent amount of work to replace that lost if the MoD withdrew.⁶³ Vector has sites in Hampshire.

31. The MoD has said to us that the contract for the sensitive work on radar equipment that is currently carried out at Selex is an example of a contract they would look at and want to keep within the UK. Thales design and manufacture a range of electronic and optronics equipment for the MoD and export, and are very much associated with the latest defence technology. They contribute to a whole range of MoD assets, such as the Foxhound patrol vehicles. We believe that such research and work would move to somewhere in England.

32. In the event of separation, the Ministry of Defence would reassess its current contracts in Scotland and, as appropriate, withdraw the work to within the UK. The Ministry of Defence has said that the cost of severing contracts as a result of separation would be factored into any separation negotiations.

33. We cannot see a situation where a future UK Government would sign a new contract for defence work in a separate Scotland, unless it was one for which there was an international open competition and Scotland provided better value for a readily available product.

59 Q 2026. See also Q 2044

60 Q 2028

61 Q 219

62 Q 2042

63 Qq 704-705

34. The defence industry that is currently in Scotland is within the UK and is largely attuned to provide equipment and supplies required by the UK. As much as 80% of defence sales in Scotland are directly to the Ministry of Defence. Separation would remove the single biggest customer, and one with the fourth largest defence budget in the world.

35. There is a strong correlation between the size of a country's defence budget and the location of major defence employers. There are several factors that impact upon industrial location, but size of the domestic budget is one of the most persuasive. The defence industries, and particularly the high-tech sector, tend to locate in countries that have high defence budgets, invest in research and technology, and buy sophisticated equipment, often intended for high intensity operations.

3 Operational advantage and security of supply

36. There is often a close relationship between governments and the defence industry. This relationship is not just determined by price. There is an element of history as to why certain industries are based where, and this in turn may affect the availability of traditional skills and capabilities. But the development of new technology in an international industry is very important. Countries want to access equipment that provides a technological advantage over enemies, and they want to ensure unconstrained access to that equipment. The UK is no different. While the MoD has said that “Wherever possible, we will seek to fulfil the UK’s defence and security requirements through open competition in the domestic and global market”,⁶⁴ it also recognises that defence procurement is different because of the desire to maintain an operational advantage over adversaries, and the need to maintain freedom of action. As Peter Luff MP, then Minister for defence equipment, support and technology, told us:

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.⁶⁵

And that means making sure the capability is nationally produced.

Operational advantage

37. Operational advantage means possessing something that increases success in combat and reduces the risk of danger to UK personnel and equipment. The UK Defence white paper said:

A key issue is our ability to assure the operation of critical sub-systems, which will often include the design and operation of complex electronic hardware and the associated controlling software. This may require us to request assurances relating to processes and components used in the manufacture of such sub-systems, as well as their subsequent operation and support through-life. Without these assurances we would be unable to judge the level of operational risk or take appropriate action to mitigate certain threats. Similarly, the ability to understand a system as a whole and to be able to modify or upgrade it through systems integration can be essential to the performance of the system and to our ability to react to the changing and evolving threat environment.⁶⁶

38. The UK has: “a sophisticated demand for high-value products that have to stand up to active service”⁶⁷ In addition to containing reliable systems and components, the MoD

64 *National Security Through Technology*. Cm 8278, February 2012

65 Qq 380-381

66 *National Security Through Technology*. Cm 8278, February 2012, para 61

67 *Ibid.*,

wants to be able to receive upgrades as necessary over the lifetime of the product and, importantly, ensure security of supply when its Armed Forces are on operations. While minor or common components can be sourced internationally at market price, purposely-designed ones tend to be sourced along national grounds.⁶⁸

39. The need for assured security of supply was explained by Professor Taylor who told us that: “unexpected military operations are becoming the order of the day”, that operations of any scale involve mobilisation of any industry on which a country relies, and:

Therefore, an assurance of an agile and supportive supplier who was ready to go the extra mile for you has become a feature of defence in a way that it wasn’t during the cold war. [...] I do not know if it is a big variable or a large variable—it depends on the cost—but people are going to look at assurance of supply and that should be, as I say, part of the equation.⁶⁹

He gave the example of Operation ELLAMY in Libya, when several British companies went out of their way to ensure the UK Armed Forces had what they needed. Any UK Government would want similar assurances of “flexible, timely, agile and sometimes off-contract support from any of its suppliers.”⁷⁰

Article 346

40. Under Article 346 of the Treaty on the Functioning of the European Union, individual states can, if they wish to limit procurement to domestic suppliers, derogate from the Treaty requirements to procure through open EU wide competition in the interests of national security.⁷¹ There is no application process; the MoD satisfies itself that the requirements of Article 346 are met and carries on. It would be for another state to challenge the decision. Les Mosco, Director Commercial, Defence, Equipment and Support, said he could not recall an instance where the MoD had asserted an exemption under Article 346 and it had been challenged.⁷² At the moment, Scotland benefits from this because it is in the UK. If Scotland left the UK, then invoking Article 346 would exclude Scotland.⁷³ Mr Luff explained:

Where we wish to maintain our operational freedom of action we would apply the article 346 exemption, yes. That would mean we could not buy from Scotland. We could not buy from an independent or separate Scotland.⁷⁴

41. If the UK wants to open the order out beyond the UK, then it must put it out to open competition and, as Mr Luff told us, “we would be obliged to compete the contract internationally. We could not favour Scotland, England or Northern Ireland.”⁷⁵

68 Qq 1917-1923

69 Qq 1979-1980

70 Q 1979, Q 1924. See also RUSI, *The Defence Industrial Base—A Critical Component of Military Capability*, June 2012

71 *National Security Through Technology*, Cm 8278, February 2012, para 73-74

72 Q 2041

73 We explained how this would affect the shipbuilding industry in Scotland in HC (2012-13) 892

74 Qq 380-381

42. This has been shown in Scottish shipbuilding. In our previous Report, entitled *Separation Shuts Shipyards*, we highlighted how the Royal Navy has consistently retained the capability to design, build and maintain its warships within the UK for reasons of national security. To do so, it consistently excluded the construction of complex warships from open competition using Article 346. If Scotland was a separate country, then the Royal Navy would then not place orders in Scottish shipyards because that would be outside the UK.⁷⁶

43. For reasons to do with operational advantage and maintaining security of supply, the UK will seek to place defence contracts within the UK. Such operational advantage is often related to high-tech equipment developed through expensive research. The UK protects such assets by closely guarding the design and production process. The UK also wants to guarantee that, when needed, it can secure the equipment it needs. To do so, it commonly chooses to place certain contracts within the UK. This would exclude a separate Scotland, unless an agreement between the two countries could be negotiated.

44. EU law requires major procurement contracts to be offered for open competition. Individual states can use various exemptions to place contracts with domestic suppliers. One such exemption, Article 346, allows countries to exempt defence procurement on the grounds of national security, and has consistently been used by the MoD where it wishes to keep defence programmes within the United Kingdom.

45. If the Ministry of Defence did not protect defence contracts domestically, then any such offer would be subject to rules on open competition and Scottish firms would have to enter international competition without favour.

75 Qq 380-381

76 HC (2012-13) 892

4 Regulation and official secrets

46. The defence industry is strictly controlled. As Dr Louth said, “Defence is a hugely regulated market. If things have the capacity to kill people, then they need to be properly licensed.”⁷⁷ At the same time the industry is international, which forces governments to find ways of operating together, to allow sales across borders and to enter into joint working. They do this by developing regulatory regimes that, where it is in the interests of both parties, are mutually recognised.

Regulation and export controls

47. The defence industry is regulated by government in several different ways. Dr Louth described the infrastructure associated with national security as “an enormous bureaucracy”⁷⁸ designed to enable defence companies to operate with classified information, clearance arrangements for individuals and companies, and export controls. Any such framework in a separate Scotland would require legislation setting out clearly the rules under which a separate Scottish regime would operate. Other NATO countries would be unwilling to enter into defence procurement with Scotland unless such a framework was in place and functioning satisfactorily. Professor Taylor said it was unlikely “that goodwill would take you very far” until the Scottish Government had put that legislation in place.⁷⁹ In the first instance it would need to make clear how companies would operate across the border with the UK. Otherwise, as Professor Chalmers asked:

In the specific area of defence, having export control regulations that are easy for companies to relate to will be very important, because an independent Scotland would have to have a separate set of export control regulations. Would that regulate exports between different parts of the old United Kingdom? Would you have to have an export licence to send a pump from Scotland to another subsidiary in England?⁸⁰

48. Professor Chalmers also explained that the procedure would not be a case of Scotland inheriting the current structure and civil servants:

It is not simply a case of transferring units from one authority to another; it is putting into place a whole system of government, and export control is something that would have to be done right. If you got it wrong, you might tip the balance in terms of location. Companies do not want disruption.⁸¹

77 Q 1992

78 Q 1982

79 Q 1882

80 Q 236

81 Q 238

Security vetting in the defence industry

49. The MoD limits the number of people who have access to confidential information. Companies which are successful in winning MoD contracts have their staff and premises vetted by the MoD and any necessary security arrangements put in place, before they receive protectively-marked material. If successful, they gain what is called List X status.⁸² Les Mosco, Defence Equipment and Support, expressed doubt as to how this would operate in a separate Scotland:

The UK Government accreditation system would presumably not apply in Scotland. There would have to be a Government-to-Government agreement as to how that is to work in the future, and that might mean that the existing List X status no longer applied and the facilities would have to be reviewed again. It would all depend on the terms of the Government-to-Government agreement as to how List X approvals would happen in the future. [...] It would have to be negotiated and sorted out, case by case.⁸³

It would be in Scotland's interests to reach an agreement with the UK that List X approvals of companies operating in Scotland would operate in the future—most of the facilities we visited were List X sites. There is however no guarantee that an agreement would be in place at the date of separation.

50. Philip Dunne MP, reiterated the difficulty of allowing contracts with security sensitivities outside the UK:

The position in the event of an independent Scotland is that there would be some projects that we would wish to maintain with UK eyes only construction. Undoubtedly, some of the activities and projects that take place in Scotland—I am thinking in particular of some of the sensitive radar equipment procurement—we would be most unlikely to seek to procure outside a UK eyes only environment.⁸⁴

51. The UK has bilateral arrangements with international partners to mutually recognise their security measures that might allow the UK to allow sensitive work to take place abroad. In the event of separation, these would have to be renegotiated and Mr Dunne told us that: “Scottish participation in any of those agreements would be something for the Scottish Government to seek to secure.”⁸⁵ Ian Godden stressed the importance of this:

They [Scotland] would have to set up a whole series of dialogues with other nation states because, in my mind, this would trigger a very significant difference.⁸⁶

It would be important that Scotland developed the bureaucracy necessary to enable it to manage the range of international relations that the UK currently has, including requirements for security vetting.

82 Qq 2049-2052. See also *National Security Through Technology*: Cm 8278. February 2012.

83 Q 2049-2052

84 Q 2037

85 Q 2053

86 Q 1983

52. The regulation of any defence industry seeking to operate beyond its national borders is complex and requires extensive protracted negotiation. A separate Scotland could not rely on existing arrangements continuing with the UK Government, or provided through the UK Government with other countries.

Regulation and the US

53. Ian Godden stressed that international defence relationships had to exist on three levels: governmental, military and industrial. At the moment, the UK has such a multi-level relationship with the US. For example it is the only Level 1 partner with the US on the Joint Strike Fighter (F-35) programme.⁸⁷ The US has export control laws relating to the distribution of technology designed to limit access to sensitive information, notably the International Traffic in Arms Regulations (ITAR) and, at the moment, UK firms benefit from exemptions to ITAR.⁸⁸ Mr Dunne described how the UK benefited from the relationship with the US:

In relation to the US, we have a specific bilateral co-operation treaty and it is fair to say that the British MOD is a substantial beneficiary under those arrangements, which cover procurement and capability. Quantifying that is not easy, but it ranges across intelligence through to the deterrent programme—clearly a major beneficiary of that relationship—to operational exercises, joint training and operations in Afghanistan at the moment both under NATO and with the US national forces. It would be fair to say that it is a significant relationship, and one from which, again, there can be no certainty that Scotland would be able to benefit.⁸⁹

Several witnesses said they did not think the US would not allow the same privileges to Scotland as they do the UK. Professor Taylor said:

The Americans are extremely sensitive about the protection of their intellectual property. From the point of view of the regulatory risk of a new Government, that is a relatively visible thing.⁹⁰

Mr Godden agreed and said he did not know how quickly the legal framework for a Scottish security regulatory regime could be put in place but:

I know that the relationship that goes alongside that is equally important and would need to be absolutely in place immediately with places like the USA; otherwise we will potentially lose business and certainly our capability to do some of the existing contracts that we are currently involved in.

He continued:

Without the relationship—military, industrial and political—with the USA, I worry that Scotland might be barred immediately from certain things it is currently doing.⁹¹

87 www.jsf.org.uk/JSF-and-the-UK/Overview.aspx

88 See www.gov.uk/exporting-military-goods-to-the-united-states

89 Q 2053

90 Q 1882. See also Q 1982

And gave the example of Selex Galileo in Edinburgh:

[The] Triple X ratings down at Crewe Toll in Selex would be re-examined instantly by the US. There may be 25 or 30 people suddenly barred from doing any more work by the US on x programme, which is a joint UK-US programme. It gets down to that level of granularity and detail.⁹²

The resolution of issues around a Scottish regulatory and security system would be very important for Raytheon in Glenrothes, who make components that go into weapons such as the Tomahawk missile, and whose trade is predominantly with the US.⁹³

54. The SNP has made it clear that it wishes to have a foreign and defence policy that diverges from that of the UK,⁹⁴ but it would have to develop and establish that policy while at the same time persuading the US that the changes were not really substantial and would not harm American interests. Ian Godden noted that it took Australia many years to persuade the US to enter into a bilateral relationship with them, and that building such relationships takes time:

The US is very suspicious about anything new and it would take it, I am guessing, two or three years to get comfortable with the people it is even dealing with.⁹⁵

55. The UK currently enjoys a highly privileged defence relationship with the US. Scotland could certainly not presume to inherit this relationship. First, it would have to set up a regulatory regime for its defence industry, including the ability to security vet personnel, and have it in operation on the first day after the UK regulations stopped. Secondly, the United States would be nervous of a new state and would want to understand the defence policy of a separate Scotland before being persuaded that it could do business with companies in Scotland. These relationships can take time to build.

91 Qq 1982 - 1983

92 Q 1983

93 Qq 1993-1994

94 Qq 1991-1995. See also HC (2012-13) 676

95 Qq 1982-1983

5 Uncertainty and the transition

56. The companies we visited raised questions around the business and regulatory climate that would exist in Scotland if it became a separate country, and questions have been asked about the status of both current and future MoD contracts.⁹⁶ When our inquiry began, Professor Sir Hew Strachan commented on how “politically silent the defence industries have been” and said he had “expected them to say rather more than they have, but they have not.”⁹⁷ We have found that many companies are still unwilling to comment in public but will do so in private. The broader business community in Scotland has started to raise concerns about the uncertainty that the referendum is generating. CBI Scotland published a list of issues it would like addressed in the forthcoming Scottish Government white paper on the referendum, which said:

In addition, what assessment has the Scottish Government made of the effect of independence on the prospects of and employment in the defence-related industries which supply equipment to the UK or other NATO allies?⁹⁸

57. This is additional to the general question of whether the tax and regulatory regime in Scotland would be more or less attractive than that offered in the UK. Although each firm will monitor risk and develop methods to anticipate events in order to plan for any period of uncertainty, some clarity is needed for them to be able to make decisions around investing or relocating.⁹⁹ Mr Godden said

businesses could probably cope with uncertainty over a one, two or three-year period, but beyond that they will start investing elsewhere.¹⁰⁰

58. And while larger corporations like Finmeccanica, Thales and BAE Systems are better able to manage longer periods of political uncertainty—they can invest in different countries and develop several customers—this helps the corporation but does not necessarily help Scotland if the investment is switched to another country. Mr Godden also said smaller businesses are less resilient:

For the smaller companies it is very difficult because they have shorter term contracts. They have shorter term horizons. [...] They are the ones that usually suffer from uncertainty. Although the balance sheets of most of the defence companies have been okay in this last recession, they are the ones that have struggled the most because they don’t have access to finance the bridge any uncertainty of timing and contracts, and they typically will have to diversify.¹⁰¹

96 Q 1884

97 Q 217. See also Francis Tusa, *Defence Analysis*, Volume 10, Issue 1, January 2007

98 CBI Scotland, *The Scottish Government’s Independence White Paper—issues that business would like it to address*, December 2012

99 Qq 1894-1895

100 Q 1882

101 *Ibid.*,

59. Furthermore, Dr Louth said simply because the defence industry has developed ways to manage uncertainty did not mean it would necessarily welcome it.¹⁰² Of course, the industry has to deal with the uncertainty that comes along with every electoral cycle and the risk that a change in government can bring about a change in defence policy.¹⁰³ However, the degree of change that might come about by Scotland becoming a separate country would be of a different magnitude than the usual political upheaval, as Professor Taylor said:

A question such as Scottish separation, I would imagine, would clearly rank as a significant risk to defence companies that operate in Scotland because the political context in which they operate would be changing so drastically.

And he noted that: “a yes vote would probably raise more questions than a no vote”.¹⁰⁴

60. Mr Dunne said that the Ministry of Defence had concerns around what would happen if Scotland voted to leave the Union:

which would inevitably introduce a great deal of uncertainty into the whole procurement process for the MoD in a residual UK, and about whether Scottish companies would be able to be given the favourable treatment that they are at the moment.¹⁰⁵

61. Several witnesses said that the uncertainty would halt investment decisions. Dr Louth said that there would be nervousness around making significant capital investment “with all the hanging questions associated with a yes vote than otherwise.”¹⁰⁶ Scottish Engineering said:

Concerns have been directly related to this organisation by members across all sectors as to the uncertainty around the potential question of forthcoming Independence. Where organisations are either owned by a foreign parent or, as is the case with many, operate throughout the UK, there is reluctance to commit to either basic investment or substantial capital projects, due to the aforementioned uncertainty.¹⁰⁷

And Ian Godden said:

The big question on uncertainty is where you put your investment in technology, people and skills. If there is long-term uncertainty about a particular market—meaning more than a few years—then they will tend to invest where they have some certainty. That means where the policy, the growth and the contracts are clear.¹⁰⁸

102 Q 1881

103 Q 1884

104 Q 1881

105 Q 2019

106 Q 1886

107 Scottish Engineering, HC 139-II, Ev 310

108 Q 1882

62. This emphasises the importance of providing information about the future defence policy, enabling industry to know what is required of it, and to what extent a separate Scotland would want to be different from the UK. Mr Godden said:

The most important thing to give certainty is for the parties in this debate to state their defence policy for Scotland and then the industrialists can get a bit of certainty about what is likely to happen.¹⁰⁹

63. Similarly, it is not possible to know how international governments and business will react towards Scotland, which would be important considering the likely need to develop exports.¹¹⁰ In addition to concerns around what the defence policy might be, we also heard concerns about how the transition from the current situation to a separate Scotland would take place. Professor Taylor said:

I do not understand but would not underestimate the difficulties of the transition process. [...] I simply do not know how the transition process would work. That really opens up the possibility that, in a way, firms based in Scotland might cease to be eligible and cease to have access to the technology that they currently get. I do not know the answer to that.¹¹¹

Active defence industrial policy and supporting Scottish industry

64. The defence industry tends to be located where there is a demand from the national Government and appropriate opportunities for export. The MoD White Paper, *National Security Through Technology*, said:

We recognise that many of the large companies that supply the UK are now transnational in outlook and therefore have choices about where they invest. We will ensure that the UK continues to provide a unique environment for industry in the defence and security sectors.¹¹²

65. In the event of a yes vote, a separate Scotland would have a smaller defence budget than the UK, and the future Scottish Defence Force would be unlikely to buy most of what the Scottish defence industry currently provides. A separate Scotland would have to develop an industrial strategy to attract investment and stop the defence industry drifting to countries with bigger budgets.¹¹³ Mr Godden explained:

Without active industrial intervention [...] a defence industry in a country will naturally decline. It requires positive industrial policy rather than no policy. With no policy, it will get sucked into both larger countries and people that spend more. If the defence industry is to be protected or encouraged, then an active industrial policy is required.¹¹⁴

109 Q 1996

110 Q 1884

111 Q 1926

112 *National Security Through Technology*, Cm 8278, February 2012, para 21

113 Qq 1926-1931

114 Q 1996

66. Such a strategy could build on Scotland's strengths, its skills base and traditional industries, such as engineering. A separate Scotland could actively support the current defence industry to diversify into other areas,¹¹⁵ and some of the defence technologies produced in Scotland do have a dual use.¹¹⁶ Professor Taylor told us, however, that many defence companies had found diversification to be difficult for two reasons: firstly, defence tends to be about manufacturing highly sophisticated products in small numbers whereas civilian manufacturing is aimed at less sophisticated products in large numbers; and secondly, defence businesses' marketing operations are often aimed at one customer, or very few customers. In the end, many of those who tried to diversify chose to sell their defence arms to a defence specialist.¹¹⁷ Some of the firms we spoke to were not against diversification and reducing their reliance on the MoD, but they questioned how quickly, and to what extent, new industries would pick up the slack to replace the defence contracts.

67. The UK is currently the second biggest exporter of defence equipment in the world, with access to markets partly based on the UK's position in the world and its established relationships with other countries. Professor Chalmers said that it would be important for Scotland to develop an industrial policy designed to gain access to such markets as: "It would have to be much more export-oriented than it is now to survive in anything like its present form."¹¹⁸ This reinforces the importance of having such policies in place to support the industry as soon as possible if, for some of the reasons outlined earlier, the Ministry of Defence withdraws its custom.¹¹⁹

68. It is inevitable that the defence industry in a separate Scotland would be different from the current one. A future Scottish military would not want to buy most of what the defence industry in Scotland currently provides for the UK. There is no guarantee that the UK and others would place the same level of orders. A separate Scotland would have to develop an industrial policy that would assist the industry to adapt to provide for the domestic market, generate products for export, and diversify into products for civilian use.

Joint procurement

69. One way to compensate for the consequent loss of MoD spending could be for Scotland to enter into joint-procurement initiatives with other countries. In this way it might enable it to afford new equipment, gain economies of scale or equipment that it otherwise could not afford, and ensure interoperability with allies. The UK does this with potential partners "whose defence and security posture is closest to our own or where we have shared interests."¹²⁰

115 Q 1906

116 Q 236

117 Q 1906

118 Qq 214-215

119 Q 236

120 *National Security Through Technology*. Cm 8278, February 2012, para 82

70. Many large defence procurement schemes are international,¹²¹ for example Typhoon is shared between the UK, Spain, Italy and Germany.¹²² Each country entered the programme to secure work for their domestic industry and also to gain a military asset with the latest technology. In the case of Typhoon, the UK is responsible for the front of the aircraft. Suppliers who wanted any of the contracts to be part of the UK section of the aircraft took part in “competition with Government agreement”.¹²³ Scotland would not inherit the UK's share of Typhoon. It would have to find a joint procurement programme it wanted to be part of, negotiate how many units of the finished product it would buy and what contribution it would offer to the construction. As part of this, a separate Scotland would need to develop how it wanted to deal with other countries. Ian Godden said:

This debate about what is going to happen between England and Scotland is not at a big enough level because the USA, France and Germany have to be brought into this thinking. My attitude is that, if Scotland can decide what its attitude to Germany, France and the USA is, as well as England, then we might have a decent industrial defence perspective about how to run that.¹²⁴

71. These countries are entering into joint procurement arrangements whereby their domestic industry would contribute to the production of an asset they would themselves procure. It is unsurprising that there is a correlation between countries which co-operate militarily and whose defence industries co-operate. Dr Louth used the Anglo-French experience in Libya as an example.¹²⁵ The willingness of other countries to engage in joint procurement with a separate Scotland would be seen in close relation to how a new Scottish military might co-operate with those who it is seeking to do business with.

72. The joint procurement programmes in which the UK currently takes part include detailed agreement on the share of work allocated to the UK defence industry. The Ministry of Defence might expect that share of work to remain within the UK, if necessary transferring it from Scotland so that it stayed in the UK. Multi-national companies would want to locate where they knew, with some certainty, that they could benefit from any such joint procurement programme.

73. If a separate Scotland wanted to establish any future joint procurement programmes, then these would be for Scotland to seek to negotiate. Such programmes are agreed most commonly between countries which cooperate militarily, and where military as well as financial benefits can be gained from joint procurement.

121 Q 1900, Q 2038

122 Q 1912

123 Q 1917

124 Q 1996

125 Q 1983

6 Conclusion

Foreign relations and Trident

74. A separate Scotland would have to demonstrate that it shares the same defence and security posture, and interests, as the UK for its defence industrial base to benefit from a relationship with the UK. The issue of whether Scotland is a member of NATO is a good example.¹²⁶ We are aware that asserting a different foreign policy is one of the motivations for separation, for example so Scotland could deploy its armed forces overseas on different terms to that of the UK. This raises the question as to how different Scotland would want to be while maintaining nothing has changed, and what it would mean in practice. For example, would a Scottish Government refuse to allow military exports from a firm in Scotland if the item being exported was to be used in what the Scottish Government termed an illegal war, or an action of which it disapproved? This is a very real concern—the Belgians refused to sell the UK ammunition during the Falklands War.¹²⁷ The SNP has expressed differences on foreign interventions before. Mr Salmond called the NATO bombing of Serbia in 1999 “an act of dubious legality, but above all one of unpardonable folly.”¹²⁸ Similarly the First Minister has repeatedly said they would not have supported the war in Iraq.¹²⁹ It would be very difficult for the UK to work with a separate Scotland if it could not rely upon security of supply.

75. All of our witnesses have said that the removal of Trident would complicate any negotiations and the extent to which the MoD would withdraw from Scotland. Removing Trident would incur a huge financial cost and risk the UK losing its nuclear deterrent.¹³⁰ Membership of NATO cannot be assumed. Professor Chalmers summarised how he thought other NATO countries would react to the eviction of Trident:

It is one thing accepting a re-division of territories, which very few other countries in NATO would sympathise with at all, but quite another if it was seen to be taking a radically different foreign policy course, and that is what rapid expulsion would be.¹³¹

76. The policy of Scotland to the nuclear weapons currently based in Scotland would impact upon UK-Scottish relations. It would also impact upon US-Scotland relations.¹³² New Zealand adopted an anti-nuclear stance in the 1980s and was frozen out by the US for nearly 25 years.¹³³ Scotland would need to reassure the US that its defence policy was not against US interests.¹³⁴ Ian Godden said:

126 Q 172

127 The Guardian, *Belgium PM strives to mend fences at No 10*, 1 December 1999

128 BBC, *NATO bombing ‘unpardonable folly’*, 29 March 1999

129 The Daily Telegraph, *Alex Salmond: Labour MSPs responsible for Iraq war deaths*, 20 March 2013

130 Q 1901

131 Q 165

132 The Economist, *Interviewing Alex Salmond, the man who wants to break up Britain*, 12 January 2012; Holyrood Magazine, *War of Words*, 22 October 2012

133 www.fas.org/ See also Q 1395

134 Q 1988

It reinforces my point that the relationship with the US for Scotland on defence policy is rather crucial. Although it is an interim solution, they will get extremely nervous—even in an interim solution—understanding what the defence policy is and what the attitude is to this new Government.¹³⁵

77. The SNP have said they would ban nuclear weapons from Scotland, while operating a “don’t ask, don’t tell” policy on foreign vessels visiting Scottish ports and waters. It would appear that in these circumstances, Scotland would allow a US vessel carrying nuclear weapons into a Scottish port, because they would not ask. There is a contradiction in evicting UK nuclear weapons from the Clyde while accommodating visiting vessels carrying nuclear weapons from the US or other nations.

78. One of the most important ways that Scotland can contribute to the collective defence offered by NATO is to allow Trident to remain on the Clyde. We would urge the Scottish Government to explain what it would contribute, if not the submarine base, if it wanted to avoid the accusation of free loading on the security offered by NATO.

Defence policy and the defence industry

79. Over the course of the inquiry, several witnesses stressed the importance, for any country, of developing a defence policy first before deciding on defence industrial policy. For example, Ian Godden told us:

We have to recognise that the game, in terms of an industry and a policy around industry, relates to Government, to Government defence policy and purchasing. You start with defence policy. You don’t start the other way round, which is how we protect jobs by doing this. You have to start with the defence policy. For me, assessing it as an industrialist, defence policy comes as number one. What are we trying to achieve with our defence and what is the capability we require to do that?¹³⁶

80. We believe the defence industry in Scotland would benefit from more information on the future defence policy of a separate Scotland and how it would relate to Scottish industry. The SNP Foreign, Security and Defence policy, agreed at its conference in October 2012, said:

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.¹³⁷

A separate Scotland may wish to build or buy frigates, submarines or maritime patrol aircraft; but it needs to explain how that will affect the industry, which currently is tailored to meet the needs of the UK and the joint enterprises that the UK is a part of. Those proposing a separate Scotland need to explain to those who currently work in the defence industry in Scotland what it would do to retain defence jobs and skills in Scotland once the MoD withdrew its spending power.

135 Q 1988

136 Q 1996

137 SNP Foreign, Security and Defence Policy update, October 2012

81. The SNP policy accepted the benefits of a joint procurement strategy:

Joint procurement will be pursued with the rest of the UK and other allies as well as shared conventional basing, training and logistics arrangements, fulfilling shared priorities in 'Smart Defence'. This includes sharing conventional military capabilities, setting priorities and better coordinating efforts providing economic synergies, job stability and taxpayer value for money.¹³⁸

As we have said, to pursue joint procurement with the UK or any other NATO member, then Scotland would need to provide more information on where it would assert policies that are different to those of the UK or the rest of NATO, and accept that those policy differences may make joint working very difficult. For example, Smart Defence is a NATO initiative,¹³⁹ so a separate Scotland would have to apply to join NATO to take advantage of that. Entry to NATO would not be automatic, particularly given that a separate Scotland would want to undermine the collective security of its intended NATO partners by evicting Trident.¹⁴⁰ In addition, it would need to demonstrate a consistency of policy to build relations and persuade key allies and NATO partners that joint procurement or foreign investment could be possible. Otherwise, we believe that the defence industry that is currently such an important sector in Scotland would be very seriously damaged and diminished if Scotland was a separate country. This may not take place overnight, but we believe this would lead to considerable loss of employment in Scotland at places like Selex, BAE Systems, Vector Aerospace, Thales and DM Beith.

82. Our next report will look at some of the issues of affordability and force structure for a separate Scotland to fulfil its foreign policy objectives.

138 SNP Foreign, Security and Defence Policy update, October 2012

139 Smart Defence is a NATO concept encouraging allies to cooperate in developing, acquiring and maintaining military capabilities with the aim of undertaking NATO's core tasks as agreed in the strategic concept—the strategic concept being collective defence including nuclear weapons.

140 Written evidence from the Ministry of Defence, to the Defence Committee, Session 2012-13, Defence implications of possible Scottish independence, HC 483, para 44

Conclusions and recommendations

Implications of a smaller budget

1. The population of Scotland is 8.5% of the United Kingdom. A budget of £2.5 billion would represent 6.5% of the UK defence budget. A procurement budget of £1 billion would represent about 6% of the UK defence procurement budget. This is before costs associated with intelligence and the transition period are taken into account. A defence industry in a separate Scotland would have a substantially smaller domestic market. (Paragraph 25)
2. The budget for research in the defence sector is an important indicator of intent. At the moment, the UK research budget is £400 million where estimates of a future research and development budget for Scotland vary between £20 million and £30 million. The high-tech nature of the defence industry in Scotland means it would be sensitive to changes in the level of investment in research. The reduction in research opportunities would be a factor in determining whether defence industries remained in Scotland. It would also affect the amount of research funding for universities in Scotland. We urge the Scottish Government to provide more information on their commitment to funding defence-related research after separation. (Paragraph 26)

What this would mean for the Scottish defence industry

3. In the event of separation, the Ministry of Defence would reassess its current contracts in Scotland and, as appropriate, withdraw the work to within the UK. The Ministry of Defence has said that the cost of severing contracts as a result of separation would be factored into any separation negotiations. (Paragraph 32)
4. We cannot see a situation where a future UK Government would sign a new contract for defence work in a separate Scotland, unless it was one for which there was an international open competition and Scotland provided better value for a readily available **product**. (Paragraph 33)
5. The defence industry that is currently in Scotland is within the UK and is largely attuned to provide equipment and supplies required by the UK. As much as 80% of defence sales in Scotland are directly to the Ministry of Defence. Separation would remove the single biggest customer, and one with the fourth largest defence budget in the world. (Paragraph 34)
6. There is a strong correlation between the size of a country's defence budget and the location of major defence employers. There are several factors that impact upon industrial location, but size of the domestic budget is one of the most persuasive. The defence industries, and particularly the high-tech sector, tend to locate in countries that have high defence budgets, invest in research and technology, and buy sophisticated equipment, often intended for high intensity operations. (Paragraph 35)

Operational Advantage and Security of Supply

7. For reasons to do with operational advantage and maintaining security of supply, the UK will seek to place defence contracts within the UK. Such operational advantage is often related to high-tech equipment developed through expensive research. The UK protects such assets by closely guarding the design and production process. The UK also wants to guarantee that, when needed, it can secure the equipment it needs. To do so, it commonly chooses to place certain contracts within the UK. This would exclude a separate Scotland, unless an agreement between the two countries could be negotiated. (Paragraph 43)

Article 346

8. EU law requires major procurement contracts to be offered for open competition. Individual states can use various exemptions to place contracts with domestic suppliers. One such exemption, Article 346, allows countries to exempt defence procurement on the grounds of national security, and has consistently been used by the MoD where it wishes to keep defence programmes within the United Kingdom. (Paragraph 44)
9. If the Ministry of Defence did not protect defence contracts domestically, then any such offer would be subject to rules on open competition and Scottish firms would have to enter international competition without favour. (Paragraph 45)

Security vetting in the defence industry

10. The regulation of any defence industry seeking to operate beyond its national borders is complex and requires extensive protracted negotiation. A separate Scotland could not rely on existing arrangements continuing with the UK Government, or provided through the UK Government with other countries. (Paragraph 52)

Regulation and the US

11. The UK currently enjoys a highly privileged defence relationship with the US. Scotland could certainly not presume to inherit this relationship. First, it would have to set up a regulatory regime for its defence industry, including the ability to security vet personnel, and have it in operation on the first day after the UK regulations stopped. Secondly, the United States would be nervous of a new state and would want to understand the defence policy of a separate Scotland before being persuaded that it could do business with companies in Scotland. These relationships can take time to build. (Paragraph 55)

Active defence industrial policy and supporting Scottish industry

12. It is inevitable that the defence industry in a separate Scotland would be different from the current one. A future Scottish military would not want to buy most of what the defence industry in Scotland currently provides for the UK. There is no guarantee that the UK and others would place the same level of orders. A separate

Scotland would have to develop an industrial policy that would assist the industry to adapt to provide for the domestic market, generate products for export, and diversify into products for civilian use. (Paragraph 68)

Joint procurement

13. The joint procurement programmes in which the UK currently takes part include detailed agreement on the share of work allocated to the UK defence industry. The Ministry of Defence might expect that share of work to remain within the UK, if necessary transferring it from Scotland so that it stayed in the UK. Multi-national companies would want to locate where they knew, with some certainty, that they could benefit from any such joint procurement programme. (Paragraph 72)
14. If a separate Scotland wanted to establish any future joint procurement programmes, then these would be for Scotland to seek to negotiate. Such programmes are agreed most commonly between countries which cooperate militarily, and where military as well as financial benefits can be gained from joint procurement. (Paragraph 73)

Annex

The defence employers we visited in the defence industry in Scotland and their vulnerability to Separation	
Vector Aerospace, Almondbank, Perth	Vector Aerospace carries out maintenance and repair on aircraft parts. It is over 80% reliant on contracts to maintain components for the Ministry of Defence's aircraft fleet of over 40 Chinooks and 130 Tornados. It is unclear whether the Perth site would be awarded any such contracts when Vector has an alternative site in Hampshire. The question remains whether a separate Scotland would have Chinooks or Tornados in such quantities and how that would provide equivalent work to replace that lost if the MoD withdrew.
Selex Galileo, Edinburgh	The future of the Selex Galileo site in Edinburgh is very much at risk under separation. Their radar work on Typhoon and the Joint Strike Fighter is a division of work negotiated by the UK with other partner countries. The UK would exempt the contract from open competition and definitely want to retain it within the UK. It receives a considerable amount of research funding from the MoD to help it maintain its reputation as a cutting edge high-tech manufacturer, but this funding would be redirected to a facility in the UK. Selex is a List X site with access to confidential information which the MoD would not want outside the UK. In addition, Selex work on joint projects with the US would be highly vulnerable if a separate Scotland could not assure the US that its policies would not adversely affect US interests.
Thales, Glasgow	Thales is an international firm who specialise in the development and manufacture of the latest defence technology. They provide a range of electronic and optronics equipment to the Ministry of Defence and export customers, including on an Urgent Operational Requirement basis. Thales is a List X site, cleared by MoD to access confidential information. If the MoD withdrew its custom, and was not willing to place orders in a separate Scotland, then it would put a big question mark over the viability of the Glasgow site.
Chemring, Ardeer	Chemring is a List X site and receives a considerable amount of work from the MoD, won through open competition, and extensive export orders. We do not expect separation will have a substantial impact upon their operations in Scotland, although their share of MoD contracts may be at risk.

Raytheon, Glenrothes	Raytheon design and manufacture components, predominantly exported to the US, for guidance systems used in weapons like the Tomahawk missile—a missile the UK buys. Raytheon would be at risk, unless a separate Scotland could introduce the necessary export and security regulations to the satisfaction of their potential US partners.
DM Beith (Defence Munitions), Ayrshire	The Ministry of Defence has eleven munitions stores spread across the UK, including three in Scotland. DM Beith also carries out maintenance and upgrade work on complex weapons such as Spearfish, Tomahawk, Brimstone, and AMRAAMs. Some are used by the nuclear submarines operating out of Faslane so if the fleet leaves, then the weapons and the work leave too. Philip Dunne MP, Minister for Defence, told us “We have facilities south of the border to handle the sort of maritime munitions that presently are mostly handled at Beith, which could be moved south”.
BAE Systems, Clyde	BAE Systems build Royal Navy complex warships at the two shipyards on the Clyde: Govan and Scotstoun. The UK has not built a warship outside the UK for 200 years. A separate Scotland would not be eligible for orders restricted to the UK.
Babcock, Rosyth	Two Queen Elizabeth aircraft carriers, the largest surface ships ever constructed for the UK, are being assembled in a specially built dock at Rosyth. The same rules for building warships in the UK apply for maintenance within the UK, and UK Defence Ministers have said that security concerns could stop Rosyth being given work, spread over the next 50 years, to maintain the carriers in a separate Scotland.

Formal Minutes

Tuesday 26 March 2013

Members present:

Mr Ian Davidson, in the Chair

Mike Crockart
Mrs Eleanor Laing
Jim McGovern
Graeme Morrice

Pamela Nash
Sir Jim Paice
Lindsay Roy

Draft Report (*The Referendum on separation for Scotland: How would separation affect jobs in the Scottish defence industry?*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 82 read and agreed to.

Annex and Summary agreed to.

Resolved, That the Report be the Eighth 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 16 April 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
Seventh Report	The Referendum on Separation for Scotland: Separation shuts shipyards	HC 892