



House of Commons
Scottish Affairs Committee

**The Referendum on
Separation for
Scotland: How would
Separation affect jobs
in the Scottish defence
industry?: Government
Response to the
Committee's Eighth
Report of Session
2012–13**

1st Special Report of Session 2013–14

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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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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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First Special Report

The Scottish Affairs Committee reported to the House on *The Referendum on Separation for Scotland: How would Separation affect jobs in the Scottish defence industry?* in its Eighth Report of Session 2012–13, published on 8 April 2013. The Government response to the Report was received on 28 May 2013.

Government response

The UK Government is pleased to present its response to the House of Commons Scottish Affairs Committee's (SAC) Eighth Report of Session 2012-13, "The Referendum on Separation for Scotland – How would Separation affect jobs in the Scottish defence industry" (HC 957), which it welcomes as a valuable contribution to the referendum debate.

As made clear in previous evidence provided to the Committee, including in response to its Seventh Report of Session 2012-13, "Separation shuts shipyards", the UK Government recognises the significant contributions made by the highly skilled workforce based in Scotland, which allows the defence industry in Scotland to play a pivotal role in equipping and supporting the UK armed forces. There is a substantial defence industrial footprint in Scotland, ranging from the design, manufacture, assembly and maintenance of complex warships, to the latest high-tech innovations in aerospace engineering, defence electronics and electro-optical systems in companies based throughout the country. Ministry of Defence (MOD) contracts sustain thousands of skilled jobs and generate billions of pounds for the economy of Scotland.

The organisation, management and delivery of defence on a UK-wide basis provides substantial economies of scale through single, integrated Armed Forces and supporting organisations and infrastructure. An independent Scotland would need to develop for itself many of these structures, including a new head office, procurement organisation and supporting services. These could only be developed at a considerable cost to an independent Scotland, compounded by the probable loss of the economies of scale enjoyed by the UK.

The UK's annual defence budget currently stands at £34 billion, the fourth largest defence budget in the world, and it is our view that companies in Scotland benefit significantly from being part of the UK defence industry. Indeed, as mentioned in our response to the SAC Seventh Report, "Separation Shuts Shipyards"¹ - the Queen Elizabeth Class Aircraft Carrier programme, as a single example, has resulted in the MOD spending over £1.5 billion on work at Scottish yards (as at 30 November 2012), with around 4,000 jobs in the shipyards on the Clyde and at Rosyth directly linked to the programme; and over £300 million of sub-contracts placed with Scottish-based companies by the Aircraft Carrier Alliance. The UK is one of the largest defence exporters in the world and many of the MOD's largest suppliers have sites in Scotland.

¹ www.publications.parliament.uk/pa/cm201213/cmselect/.../1045/1045.pdf

In a recent speech, the Defence Secretary, Phillip Hammond, stated² that as a result of the basing plan for the Regular Army there will be around £100 million of additional investment in Scotland, building on the £85 million to develop Lossiemouth as an RAF Main Operating Base for Typhoon, and the £140 million that the MOD spends annually on maintaining the defence estate in Scotland, and the hundreds of millions of pounds of planned future investment in Faslane.

The size and shape of the defence industry and the approach to industrial policy in an independent Scotland would be a matter for the Scottish Government at the time to decide and define. However, it is important to understand that, while companies in an independent Scotland might continue to make strong bids for contracts, including UK defence contracts, they would then be competing for business in an international market.

The National Security Through Technology White Paper, published in February 2012, set out the circumstances where we would take action to protect the UK's Operational Advantage and Freedom of Action. This approach recognises the dynamic environment within which such decisions are made: requirements change, resources become more constrained, threats and technologies emerge and dissipate, opportunities to work with allies develop, there is rapid technological innovation, and changes occur in the supply chain with an increasingly global distribution of manufacturing. Hence the intent within this White Paper is to be as precise as possible in defining those aspects of capability (critical technologies, sub-systems and specialist expertise) that we need to protect. Decisions will be taken on a case-by-case basis, taking account of affordability and value for money.

This approach ensures that we can focus scarce resources on the capabilities that are essential to protecting the UK's national security. How we choose to protect these capabilities will always involve a balance of risk and innovative thinking about the most cost effective solution (for instance working with Allies, sharing military capabilities, or entering arrangements to ensure appropriate levels of technology sharing and security of supply). However, in many cases, we determine that it is appropriate to source the aspects of capability we need for our freedom of action or operational advantage only from within the United Kingdom.

European Union (EU) procurement law is designed to open up public procurement to competition among all suppliers in the EU, effectively preventing "buy national" policies. There is, however, a well established exception to this position that permits a national procurement procedure. Article 346 of the Treaty on the Functioning of the European Union (TFEU) allows any EU Member State to take measures it considers necessary to protect its essential interests of security with regard to the warlike stores listed in Council Decision 255/58. This encompasses, for example, warships and their specialist equipment, tanks and specialist fighting vehicles, artillery, military aircraft and electronic equipment. It is for EU Member States to define their essential security interests. The UK sets a high priority on retaining the ability to develop and support through their entire life those key military capabilities, which enable us to mount operations independently from the UK base. We are therefore committed to using the Article 346 TFEU exemption to retain an

² "Stronger and Safer together" speech delivered by Defence Secretary Philip Hammond on Thursday 14 March 2013 at Dundas and Wilson, Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EN

industrial capability in the UK to protect our Operational Advantage or Freedom of Action where it is strictly necessary for national security. As the Article 346 TFEU exemption is currently applied, Scottish suppliers may not be eligible to bid for such contracts if Scotland was to become independent.

Defence and security are areas in which the US-UK relationship is especially close. The UK has invested considerable resource understanding and negotiating the regulatory challenges associated with the US defence marketplace. To give one example, the US-UK Defence Trade Cooperation Treaty, in force since April 2012, is a bilateral treaty that aims to improve access to US origin equipment for UK front line troops, increase operational flexibility for UK MOD and enhance the long term interoperability between US and UK forces. Alongside this is the collaboration on over 20 defence equipment programmes between the US and UK to aid capability development, including the UK being the only Tier One partner for the Joint Strike Fighter programme, and work on the replacement for the Vanguard Class ballistic missile submarines. As part of the United Kingdom, companies in Scotland currently benefit from a privileged level of access to the US market, for example, through the UK-US Defence Trade Cooperation Treaty and the UK-US Reciprocal Defence Procurement Memorandum of Understanding.

It is difficult to assess the impact Scottish independence would have on the work share of existing joint programmes. There are currently fifty companies that hold List X status in Scotland. This is required for companies to undertake classified defence work on their premises at Confidential level. An independent Scotland would be required to develop its own national security regulations or continue to apply the Security Policy Framework and to develop the required and appropriate security infrastructures to perform the necessary security activities. Further complications may arise in the context of current MOD procurement and access to material classified for 'UK Eyes Only'. This material cannot be shared with a foreign country or its nationals.

So far as participation in future international programmes is concerned, we look to encourage the participation of UK industry in a manner consistent with the principles set out in our White Paper, National Security Through Technology as outlined above. These include, in particular, seeking to fulfil our procurements through open competition, while also taking such action to retain the UK's Operational Advantage and Freedom of Action where essential for our national security. As set out in the White Paper, there are two main reasons for working with other countries on defence and security procurement: firstly, to take advantage of the larger economies of scale; and secondly, to maximise our capabilities through sharing technologies and aspects of capabilities that would not otherwise be available to the UK. With an independent Scotland, the Scottish Government might wish to take a similar approach but clearly this would be a matter for them.

The Committee raises important questions that are understandably a matter of concern, not just to the Scottish defence industry itself, but also to wider industry and to the supply chain based in Scotland. We believe that integrated defence is best for all of the UK, including Scotland. However, the current industrial structure and outlook may be affected should Scotland become independent. As such, we urge the Scottish Government to consider carefully the issues highlighted in this report and clearly set out how their proposals would affect jobs across the defence sector as part of their future plans for an independent Scotland.