A New Direction for the Ministry of Defence’s Budget?
Implications of the November Spending Review
Malcolm Chalmers
On 19 November 2020, Prime Minister Boris Johnson announced that he was ‘increasing defence spending by £24.1 billion over the next four years’, a commitment that was subsequently confirmed by Chancellor Rishi Sunak in his Spending Review.¹

But what does this mean for the Integrated Review, due to appear soon? Defence Secretary Ben Wallace recently stated that ‘all of us have got used to SDSRs that looked good at the press launch but faded by tea-time’.² So why might it be different this time round? Will the Ministry of Defence (MoD) grasp the opportunity, at last, to move beyond the financial troubles that have plagued it during successive Conservative-led administrations, ever since the cost-cutting Strategic Defence and Security Review (SDSR) in 2010?

Given the wider pressures facing the public finances as a result of the coronavirus crisis, most commentators were pleasantly surprised by the size of the financial settlement.³

The Treasury’s agreement to guarantee MoD funding for four years was a particularly significant, and hard won, victory for Defence Secretary Wallace. It is not entirely clear what swung the debate between the MoD, Number 10 and the Treasury, concluded only days before Johnson’s 19 November announcement. The importance of the ‘levelling up’ agenda (a central plank of Johnson’s political platform in the 2019 general election) seems to have played a role, with companies able to point to the important role of the military shipbuilding and aerospace sectors in some of the more deprived parts of the UK.⁴ A concern to start off on the right foot with US President-elect Joe Biden, whose victory had become clear only days before, may also have helped.

Confirmation of additional long-term funding for defence also coincided with the prime minister’s agreement to cut the Official Development Assistance budget from 0.7% of national income to 0.5% from 2021, with any prospect for a longer-term reversal of the cut to be left until ‘the fiscal situation allows’.⁵ Fiscal hawks in the Treasury could therefore be reassured

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⁵ HM Treasury, Spending Review 2020, p. 70.
that, taken as a whole, the cross-government Integrated Review of Security, Defence, Foreign Policy and Development would be financially neutral.

THE IMPORTANCE OF COMPOSITION

The allocations announced in the Spending Review, published on 25 November, confirmed that the MoD would receive some £24.1 billion extra over the next four years, calculated as the sum of the extra amounts (in cash terms) provided for each year over and above the amount provided for this year (2020/21). The review also revealed two further details, not discussed in the prime minister’s statement, that together make the defence element of the forthcoming Integrated Review quite unlike any defence review since the early 1950s.

First, the entire real-terms increase announced in the review – amounting to some 9.2% over the five years from 2019/20, an average of some 1.8% per annum – has gone into capital spending (or CDEL), which is due to grow by 43% in real terms over this period. In contrast, spending on day-to-day running expenses (RDEL) is set to fall in real terms over the same period, by around 2%.

This is a marked break from the trend after the 2015 SDSR, which was finalised after then Chancellor George Osborne had agreed to a partial reversal of the cut in the defence budget during the earlier years of the decade. As a consequence, and with some later one-off adjustments, total spending grew by 6.4% in real terms between 2016/17 and 2019/20. This amounted to an average growth rate of some 2.1% per annum, roughly equivalent to the projected growth for the five years up to 2024/25. But the composition of this growth was quite different from what is now planned, with capital spending growing only slightly faster (11.5% in real terms) than recurrent spending (4.8% in real terms – see Table 1).

The 2020 Spending Review, therefore, is much more generous than in the past in its allocation for capital investment while, simultaneously, squeezing recurrent spending more tightly than in recent years. According to Treasury rules, the MoD will have no ability to reallocate spending from CDEL to plug a funding gap in RDEL. 

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6. Ibid., p. 68.
Second, this concentration of all additional resources on the capital budget has been accompanied by a remarkable front-loading of the spending increase. In 2021/22, the MoD’s total spending allocation increases by 10.8% over 2019/20 levels, and by a further 1.7% in 2022/23, before falling by 1.5% and 1.6% (in real terms) in the next two years respectively (see Table 2). Capital spending rises from an estimated £10.3 billion in 2019/20 and £10.5 billion in 2020/21 to £14.4 billion in 2021/22 and £15.6 billion in 2022/23: a cash increase of some 49% over only two years. Not since Korean War rearmament has there been a comparable increase in UK defence investment spending over such a short period of time.

Source: See Tables 1 and 2.
A significant part of the spending increase will go on closing the large funding gap in the MoD’s procurement plan for defence equipment, which has been the subject of much criticism from the National Audit Office in recent years.9 Further spending increases are likely to come from moving payments from an overcrowded 2020/21 programme into next year. In addition, part of the spending increase will go to modernising the defence estate, which it is hoped can unlock future savings in running costs.10

Even so, there will be some scepticism among informed observers as to whether the MoD and its suppliers will have the capacity - administrative and industrial – to gear up spending levels as rapidly as currently assumed, while preventing wasteful escalation in military specifications and contractor costs. The challenges of delivering a £4-billion increase in capital spending in one year, starting just three months from now, will be further increased if coronavirus-related restrictions continue through to summer 2021.

Yet it should not be a criticism of the MoD if it falls somewhat short of its projected capital spend for 2021/22. The quality and sustainability of procurement should be a higher priority.

The MoD now has a once-in-a-generation opportunity to raise its annual capital budget permanently to the higher level that has been agreed through to 2024/25 and ensure that this level becomes the baseline for subsequent years. If it is to retain political support for this increase beyond 2024, however, it will need to show that it has managed it wisely. If the MoD finds itself returning to the Treasury in 2022 pleading for more resources – as it did scarcely two years after the 2015 SDSR – it is unlikely to gain a sympathetic hearing. If contractors take undue advantage of the additional cash injection to increase prices, or if MoD customers succumb to the temptations of specification escalation, then the sceptics will have been proven right.

Whether history repeats itself in this way will depend, most of all, on the decisions now being taken on the defence element of the Integrated Review, due to be published alongside that review in early 2021.

The MoD at its highest levels, led by both the defence secretary and the Chief of the Defence Staff, has been clear on the need to retire ‘sunset capabilities’ in order to invest in the technological transformation which, they argue, the armed forces need in order to be competitive into the 2030s.11 This is likely

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to require hard choices on all the main elements of the MoD’s recurrent budget: spending on personnel (half of the total); spending on equipment support; and spending on inventory and infrastructure maintenance. The chancellor’s decision to pause pay increases for most public sector employees next year will help in this regard, but further pay restraint, alongside reductions in payroll numbers (military and civilian), is on the cards. The prospect of a more active global force posture – most visibly through the deployment of carrier task forces, but across the services – will add further cost pressures.

**THE RIGHT BALANCE?**

The MoD has a strong case for prioritising capital spending in its part of the Integrated Review. By doing so, it implicitly recognises the need to ensure that the armed forces prepare themselves for what is likely to be an increasingly competitive threat environment in the 2030s, and beyond, even if some risks have to be taken in retiring some older current capabilities to do so.

The MoD would also be right to argue that, over time, it makes sense to assume that military capability is becoming more automated, with progressively fewer people (especially on the frontline) needed to deliver any given effect. Far from being a revolutionary statement, this reflects a longstanding trend in most technologically advanced militaries (ally and adversary alike). The wave of new technologies now being developed will, if anything, accelerate this trend. This does not, in any way, negate the central role that highly skilled and adaptive personnel have at the heart of national defence and security capabilities. But they will need to have different skills, and be organised in different ways, if they are not to be outsmarted by future foes.

Yet not all investment in new equipment delivers commensurate increases in capability. All too often, military requirements are driven by the institutional imperative to replace ageing kit on a one-for-one basis (or as near to this as can be afforded). Additional resources can, all too easily, be eaten up by more ‘exquisite’ equipment specifications rather than accelerating the reform and innovation which is needed.

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CONCLUSION

Taking full advantage of the government’s decision to award the MoD a multi-year spending settlement will not be easy. The government has chosen to devote the additional £24 billion for defence almost entirely to increasing defence investment, while simultaneously reducing real-terms running costs. It will therefore have to make difficult decisions on where to reduce day-to-day spending: a process made politically harder by the perception that the Spending Review now allows the MoD to embark on a ‘spending spree’. Until the full results of the Integrated Review are known, it remains unclear whether the MoD will be allowed to make these decisions. If not, it is still possible that the curse of budgetary overcommitment, which has overshadowed UK defence planning for the last decade and more, will remain alive and well.

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ANNEX

Table 1: Recent Real Terms Trends in Defence Spending, 2016/17–2019/20

<table>
<thead>
<tr>
<th></th>
<th>2016/17 (£m)</th>
<th>2019/20 (£m)</th>
<th>Change (£m)</th>
<th>Change (%)</th>
<th>Change (% per annum)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource</td>
<td>28,163</td>
<td>29,501</td>
<td>+ 1,338</td>
<td>+ 4.8</td>
<td>+ 1.6</td>
</tr>
<tr>
<td>Capital</td>
<td>9,202</td>
<td>10,261</td>
<td>+ 1,039</td>
<td>+ 11.5</td>
<td>+ 3.7</td>
</tr>
<tr>
<td>Total</td>
<td>37,365</td>
<td>39,762</td>
<td>+ 2,397</td>
<td>+ 6.4</td>
<td>+ 2.1</td>
</tr>
</tbody>
</table>

Note: All figures refer to outturn spending covered by the Departmental Expenditure Limit (DEL) and exclude Annually Managed Expenditure (AME). Figures for Resource DEL exclude depreciation. Cash figures have been adjusted to 2019/20 price levels using the GDP deflator.


Table 2: Future Real Terms Trends in Defence Budgets, 2019/20–2024/25

<table>
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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Resource</td>
<td>29.7</td>
<td>30.3</td>
<td>30.2</td>
<td>29.4</td>
<td>29.0</td>
<td>- £0.7 bn</td>
<td>- 2.3</td>
<td>- 0.5</td>
</tr>
<tr>
<td>Capital</td>
<td>10.3</td>
<td>13.9</td>
<td>14.9</td>
<td>15.0</td>
<td>14.7</td>
<td>+ £4.4 bn</td>
<td>+ 42.6</td>
<td>+ 7.4</td>
</tr>
<tr>
<td>Total</td>
<td>40.0</td>
<td>44.3</td>
<td>45.1</td>
<td>44.4</td>
<td>43.7</td>
<td>+ £3.7 bn</td>
<td>+ 9.2</td>
<td>+ 1.8</td>
</tr>
</tbody>
</table>

Note: All figures refer to spending covered by the Departmental Expenditure Limit (DEL) and exclude Annually Managed Expenditure (AME). Figures for Resource DEL exclude depreciation. All figures refer to estimates before departmental transfers and are not directly comparable to the outturn figures used in Table 1. These figures exclude possible additional spending if the MoD accesses the Dreadnought contingency fund, which is provisioned for up to £1.3 billion for 2021/22 to 2024/25 in the HM Treasury Reserve. Real-terms figures for 2020/21 have not been included because of the distortions caused by the large increase in assumed GDP deflator growth in this year. For discussion of the methodological issues involved, see Chris Giles, ‘UK’s Poor GDP Performance Rooted in Weak Household Spending’, Financial Times, 16 November 2020.

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