



National Audit Office



REPORT

The Equipment Plan 2023–2033

Ministry of Defence

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Key facts

£305.5bn

the Ministry of Defence's (MoD's) estimated cost of equipment procurement and support projects in the Equipment Plan 2023–2033 (the Plan)

£16.9bn

the MoD's central estimate of the most likely funding shortfall in the Plan

£7.6bn to £29.8bn

the MoD's estimate for the potential range of the funding shortfall, depending on whether risks or opportunities materialise

Costs have risen faster than the available budget

£65.7 billion increase in total forecast costs for the 2023 Plan, compared with the Plan for 2022–2032 – a 27% increase

£46.3 billion increase in the budget for the 2023 Plan, compared with the Plan for 2022–2032 – a 19% increase

Nuclear and Royal Navy costs show the greatest increase compared with 2022

£38.2 billion forecast cost increase at the Defence Nuclear Organisation, a 62% increase

£16.4 billion forecast cost increase for the Royal Navy, a 41% increase

Economic pressures are affecting the delivery of military capabilities

£10.9 billion the MoD's estimate of the cost increase in the Plan which is due to inflation, over the ten years from 2023-24 to 2032-33

Unknown the forecast costs if the Plan included all capabilities outlined in the 2023 update of the Integrated Review and the associated Defence Command Paper

Summary

1 The Ministry of Defence (MoD) publishes its Equipment Plan (the Plan) each year, setting out its intended investment in equipment and support projects over the next 10 years. The Plan assesses whether the intended investment is affordable within the available budget. It covers a 10-year period because of the long-term nature of large, complex defence projects.

2 The latest Plan, for which the supporting analysis is published alongside this report, covers the period 2023–2033. It shows that the MoD has allocated a budget of £288.6 billion, 49% of its entire forecast defence budget, to fund the Plan. This is a larger proportion than last year's 46%. This year's Plan includes more than 1,800 projects, including the future nuclear deterrent, F35-B Lightning II aircraft and new information and communication technologies. It also includes budgets to support and maintain military capabilities.

3 The MoD introduced the Plan in 2012, intending to assure Parliament that its spending plans were affordable. Each year since the Plan was introduced, the National Audit Office has published a report in parallel, examining the MoD's assessment of the Plan's affordability and its response to the financial challenges it faces.

4 Managing equipment programmes is the responsibility of:

- the four Front Line Commands: the Royal Navy (Navy), the British Army (Army), the Royal Air Force (RAF) and the UK Strategic Command;
- the Defence Nuclear Organisation (DNO); and
- the Strategic Programmes Directorate.

These organisations are known as the Top Level Budgets (TLBs) and are required to deliver their agreed defence outcomes within delegated budgets. The delivery organisations such as Defence Equipment & Support, the Submarine Delivery Agency, and Defence Digital, manage and deliver the equipment and support programmes on behalf of the TLBs. The MoD's Head Office aggregates the information provided by the TLBs to establish the departmental position on the affordability of the Plan.

5 The MoD manages the objectives and affordability of its capability requirements through two processes:

- In 2021, the government published an Integrated Review which set out the UK's national security and international policy, and it refreshed this in 2023. The MoD responded to both the initial and refreshed integrated reviews by publishing Defence Command Papers that set out how it would design and equip its forces for the decades ahead.
- Each year the MoD sets out how it intends to manage its funding over the next 10 years to deliver its equipment programmes, in its Equipment Plan.

The Integrated Review does not consider the affordability of the plans it sets out. The Plan reports on the extent to which aspects of the capability set out in the Integrated Review are affordable within MoD's current budget.

6 In July 2023, the MoD wrote to the Committee of Public Accounts to explain that it would not publish a full Equipment Plan report this year. The MoD explained that it needed to understand further how to mitigate the impacts of inflation, and to work through the consequences of the 2023 Defence Command Paper, published earlier in July. The Command Paper set out which of MoD's priorities in the 2021 Defence Command Paper had been vindicated, what needed to be done more quickly and what needed to be done differently. However, the MoD has undertaken the same depth of financial analysis as in previous years. It has published its affordability analysis for 2023–2033, which provides an assessment of the affordability of equipment and support projects, with supporting cost and budget data. We examine the MoD's analysis in this report. The MoD's affordability assessment is based on financial information available at the start of the 2023-24 financial year and includes the additional funding announced in the Spring Budget 2023.

Our report

7 This report examines:

- the MoD's assessment of the affordability of its 2023–2033 Equipment Plan (Part One); and
- cost pressures affecting MoD, and the implications of these for the Plan (Part Two).

8 This report does not consider the value for money of the MoD's equipment expenditure or of the specific projects mentioned, nor does it comment on the policy choices that the MoD makes to develop a Plan which meets its future needs. This report also does not consider the UK's support to Ukraine, the additional costs of which have to date been funded by HM Treasury through the Reserve. Our review examines the MoD's approach to producing the Plan. We focus on its approach to cost forecasting and the reasonableness, consistency and reliability of the assumptions underpinning its assessment of affordability. Our methodology is shown in Appendix One.

Key findings

The affordability of the 2023 Equipment Plan

9 The Plan is unaffordable, with the MoD estimating that forecast costs exceed the available budget by £16.9 billion (6%). Forecast total costs at 31 March 2023 were £305.5 billion, compared with the budget of £288.6 billion. This is the largest deficit in the Plan since the MoD first published it in 2012 and contrasts with the previous year's Plan, for 2022–2032, when the MoD assessed that costs were £2.6 billion less than the available budget. Forecast costs have risen by £65.7 billion (27%) compared with the previous Plan, outstripping a budget increase of £46.3 billion (19%). Costs to support the nuclear deterrent exceed budget by £7.9 billion, and the budget for conventional equipment is £9 billion less than forecast costs (paragraphs 1.6 to 1.9).

10 The MoD estimates that the funding gap could range between £7.6 billion and £29.8 billion, depending on whether risks or opportunities materialise. The MoD recognises that delivering complex, long-term projects is uncertain and it produces a range of outcomes using best-case and worst-case estimates for some adjustments. These include programme costs being larger or smaller than the central estimate and foreign exchange rate movements. The Plan's estimated £16.9 billion budget deficit is a central estimate, based on a range of assumptions. For example, the MoD has increased forecast costs by £22.8 billion to reflect risks it judges will probably materialise in some projects. Conversely, it has reduced the total forecast costs by £35.9 billion through various adjustments, based on cost reductions that the MoD expects the TLBs to make and on the TLBs' expectations about whether they will be able to deliver their projects as planned (paragraphs 1.15, 1.23 and 1.28):

- The Plan's forecast costs have been reduced by £18 billion due to realism adjustments where the TLBs expect that programmes will be delivered slower than planned, due to supply chain challenges and insufficient staffing at both the TLBs and the delivery organisations. These realism adjustments are concentrated in the early years of the plan (paragraphs 1.21 and 1.22).
- The MoD has reduced the Plan's forecast cost by £1.7 billion, to reflect 'planned cost reductions'. Of this, £1.2 billion are 'assumptions', which are cost reductions for which the TLBs have no specific or detailed plans. The MoD is looking to deliver £0.2 billion of these assumptions in the next two years (paragraphs 1.16 and 1.17).
- The MoD has reduced the Plan's forecast costs by £16.2 billion to reflect efficiency savings, of which £13.0 billion are already being delivered by projects and £1.8 billion have been identified but are not yet in delivery. The remaining £1.3 billion of efficiencies have very low maturity plans, £0.3 billion of which the MoD is looking to deliver in the next two years (paragraphs 1.18 and 1.19).

While the MoD includes some risks in its forecast costs, the estimated funding gap does not include all risks that the MoD has identified. For example, risk that the MoD is tracking but it judges will probably not occur, so does not include in cost forecasts, amounts to £36.7 billion (paragraph 1.29).

11 TLBs have taken different approaches to preparing their forecasts in the Plan: some include the full predicted costs for the capabilities that the government expects the MoD to provide, while others only include those they can afford. The Plan does not reflect all the cost pressures to develop new and support existing capabilities set out in the 2021 Integrated Review and Defence Command Paper, which were broadly endorsed in the 2023 refresh of these. Some TLBs, such as the RAF and the Navy, have unaffordable plans because they include full predicted costs for the capabilities government expects them to deliver, while others, such as the Army and the Strategic Programmes Directorate, have developed affordable plans by accepting greater risks that their capabilities will not meet government’s objectives. Some projects are not included in costs, therefore, which means that the Plan does not disclose the full funding gap between the cost of expected capabilities and the budget available, so it underestimates the cost pressure that the MoD faces. Omitted projects include the operational extension of Warrior and Challenger 2 armoured vehicles, and the programme to deliver long-range ‘land precision strike’ weapons. Other project costs are included in the plan but are not fully funded. For example, the Navy has included the full predicted costs of new entries into the shipbuilding pipeline – including Multi-Role Ocean Surveillance ships, Type 32 frigates, Multi-Role Support Ships, Type 83 destroyers, and Future Air Dominance System – which are forecast to cost £5.9 billion more than the currently allocated budgets; and Commando Force is not currently funded to operate from the sea in a high-threat maritime environment, which would cost £0.7 billion (paragraphs 1.11 to 1.13 and Figure 5).

Factors contributing to the Plan’s unaffordability

12 The largest cost increases are in nuclear and naval programmes, whose combined costs have risen by £54.6 billion. The MoD’s decision to prioritise delivering the replacement nuclear deterrent on schedule has brought forward costs at the DNO, where costs have increased by £38.2 billion (62%) compared with last year’s Plan, to £99.5 billion. Forecast costs for the Navy, which delivers parts of the nuclear capability, have risen by £16.4 billion (41%). The Navy has reconsidered its previous policy of only including forecast costs it can afford, resulting in it reporting a deficit of £15.3 billion in this year’s Plan, compared with a surplus of £0.7 billion in 2022 (paragraphs 1.8, 1.12 and 1.13).

13 Inflation has contributed to the Plan’s increased costs. Inflation is having an impact on costs in all areas of spending, but the MoD has not received additional funding for inflationary pressures so TLBs must manage the effects within their existing budgets. In August 2023, the MoD estimated that inflation would account for £10.9 billion of the Plan’s cost increases. Current contracts provide some short-term protection from inflation, but the MoD expects that costs will catch up with inflation when contracts are index-linked or renewed. The MoD is working to improve its understanding of defence inflation and has identified around 200 industry-specific indices to support commercial officers when negotiating escalation rates in contracts (paragraphs 2.2 to 2.4).

Implications for the TLBs and their capabilities

14 None of the six TLBs has an affordable equipment plan, and their overall forecast costs, including workforce and estates as well as equipment, also exceed their budgets. All the TLBs have deficits in their individual equipment plans, ranging from £1.1 billion at the UK Strategic Command to £36.7 billion at the DNO, although the DNO deficit does not take account of centrally held funding for the new Defence Nuclear Enterprise (DNE).¹ Financial pressures have also affected costs in other areas. The MoD forecasts that during the 10 years to 2032-33, total defence spending will exceed the total defence budget by £42.5 billion, compared with a £4.3 billion shortfall last year. All six TLBs have total forecast costs over the 10-year period which exceed their total budgets (paragraphs 1.10, 2.7, 2.8 and Figure 4).

15 Supply chain issues have constrained delivery. The MoD faces supply chain risks and industry capacity constraints, due to skills gaps, shortages of key components and an increased demand for defence equipment in other countries in response to the war in Ukraine. These constraints have delayed the delivery of projects, which can produce short-term savings, but the MoD expects they will add cost pressure in the future, including the cost of maintaining existing equipment in service for longer when the replacement has been delayed (paragraphs 2.5 and 2.6).

16 The creation of a ringfence around nuclear funding helps protect the MoD’s highest defence priority but puts greater pressure on programmes not included in it. Maintaining the nuclear deterrent is the MoD’s highest priority. At the Spring Budget 2023, the Chancellor of the Exchequer said there was a need for “enduring additional investment” and allocated an additional £3 billion to the nuclear enterprise across 2023-24 and 2024-25. HM Treasury has agreed that the MoD should ringfence all direct elements supporting the deterrent programme and nuclear-powered attack submarines, including the entire DNO budget, in-service submarine support elements from the Navy and related programmes in the UK Strategic Command. These form the DNE, which has a £109.8 billion budget over the 10 years to 2032-33. Some capabilities not included in the ringfence have a role in supporting the nuclear deterrent, such as the Navy’s frigates and minehunters. The Navy told us that it would prioritise its supporting capabilities for funding, which would mean cost savings to address the deficit in its equipment plan would need to come from other areas. Cost savings to address the overall budget deficits in the Plan and in the total defence budget will need to come from areas of TLB spending which do not contribute to the nuclear deterrent (paragraphs 2.15 to 2.19).

¹ At 31 March 2023, following the Spring Budget 2023, the MoD had retained an additional £34.5 billion funding for the DNE as centrally managed expenditure, rather than delegating it to the TLBs included in the DNE: the DNO, the Navy and the UK Strategic Command.

The MoD's response

17 The MoD is not planning to make major decisions about cancelling programmes until after the next Spending Review. The MoD has started 'balance of investment' work on the whole defence budget, where there is a £42.5 billion ten-year deficit. However, it told us that ending programmes now would limit the choices available to decision-makers at the next Spending Review, which it expects is likely to occur in 2024. The Government may make more funding available in future through its ambition to increase defence spending to 2.5% of gross domestic product (GDP), when economic and fiscal circumstances allow. In 2022, defence spending was 2.1% of GDP. Since this ambition is uncertain, the MoD has not included it in its forecast budgets. During the 2023 budget cycle, the MoD has been focusing on living within its budget for 2023-24 and 2024-25 through a series of short-term measures. The MoD is considering using an extra £1.95 billion provided in the Spring Budget 2023 for improving resilience and readiness, to offset its funding shortfall in 2023-24 and 2024-25 (paragraphs 2.22 to 2.25).

Conclusion

18 The MoD acknowledges that its Equipment Plan for 2023–2033 is unaffordable, with forecast costs exceeding its current budget by £16.9 billion. This is a marked deterioration in the financial position since the previous Plan in 2022, which the MoD judged to be affordable. In part, this is because inflation, which we highlighted last year as not being fully reflected, is now showing its effect. But more importantly, the costs of delivering major priorities have increased significantly as the MoD has sought to show more clearly the gap between the available budget and the ambitions expressed in the 2023 update of the Integrated Review and the associated Defence Command Paper, the consequences of which MoD is still working through. Deficits between forecast costs and budgets have increased in the DNE because MoD has brought forward costs to deliver the nuclear deterrent to schedule, and also in non-nuclear areas including the RAF, the UK Strategic Command, the Strategic Programmes Directorate, and the Navy's conventional capabilities. Only the Army has not shown an increased deficit, although this is because the Army has only included forecast costs that it can afford, which means it is accepting greater risks that its capabilities will not meet government's objectives.

19 The MoD is using the 2023 Equipment Plan to set the baseline for its capability requirements ahead of the next government-wide Spending Review, which it expects is likely in 2024, and has chosen to defer any choices on spending priorities until then. This approach, while understandable given the ambitions expressed in the updated Integrated Review, risks poor value for money if spending continues in the meantime on programmes which are then cancelled, descoped or deferred because they are unaffordable. It also means that the Plan does not provide a reliable assessment of the affordability of MoD's equipment programme or demonstrate to Parliament how it will manage its funding to deliver equipment projects.

Recommendations

20 This year we recommend that the MoD should:

- a** assess the effect of delaying major decisions on each TLB and ensure that both decision-makers and Parliament understand the financial and capability impacts of this delay; and
- b** ensure greater consistency in the approach of each TLB to producing their equipment plans. It should provide clear guidance on whether each TLB should include the full predicted costs of the capabilities they are being asked to provide to fulfil defence commitments, regardless of the budget available. This would enable the MoD to use next year's Equipment Plan to establish the baseline for its negotiations with HM Treasury during the next Spending Review.