# Unlocking the Full Value of UK Defence Spending

How defence spending can better help the UK achieve its national security and economic ambitions

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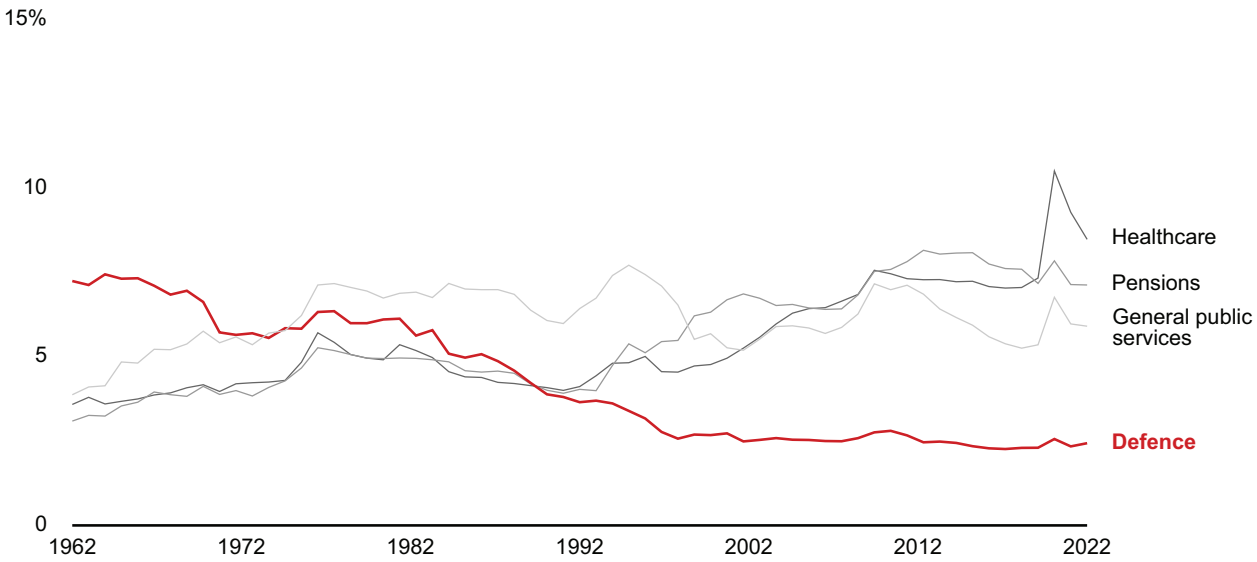
## At a Glance

- In a world of increased geopolitical uncertainty, resource constraints, and rapid technological development, more than ever before, the UK needs a focused, coherent, and unified national defence industrial strategy that unlocks the full value of its defence spending.
- Defence investment can be a powerful contributor to raising the UK's economic growth rate—each £1 billion of defence spending generates £2.2 billion of gross output and approximately 15,000 jobs.
- Achieving these benefits will require an updated approach, with an overhaul of how the UK approaches procurement, secures its supply chains, and enhances the value and competitiveness of its industrial base.

As with many across the West, the UK's defence budget as a proportion of GDP has fallen steadily since the 1950s, from 7.4% to a low of 2.2% in 2018 (see *Figure 1*). Of the 2022–23 UK defence budget of approximately £53 billion, capital costs, including acquisition of arms, accounted for 35% of the budget, service and civilian personnel 23%, and equipment support 15%.

**Figure 1:** UK defence spend as a percentage of GDP has fallen to approximately 2% today

**UK public sector expenditure on services as a percentage of GDP**




Source: UK public spending data (underlying data from Office for Budget Responsibility, British Historical Statistics, PESA, Measuringworth.com)

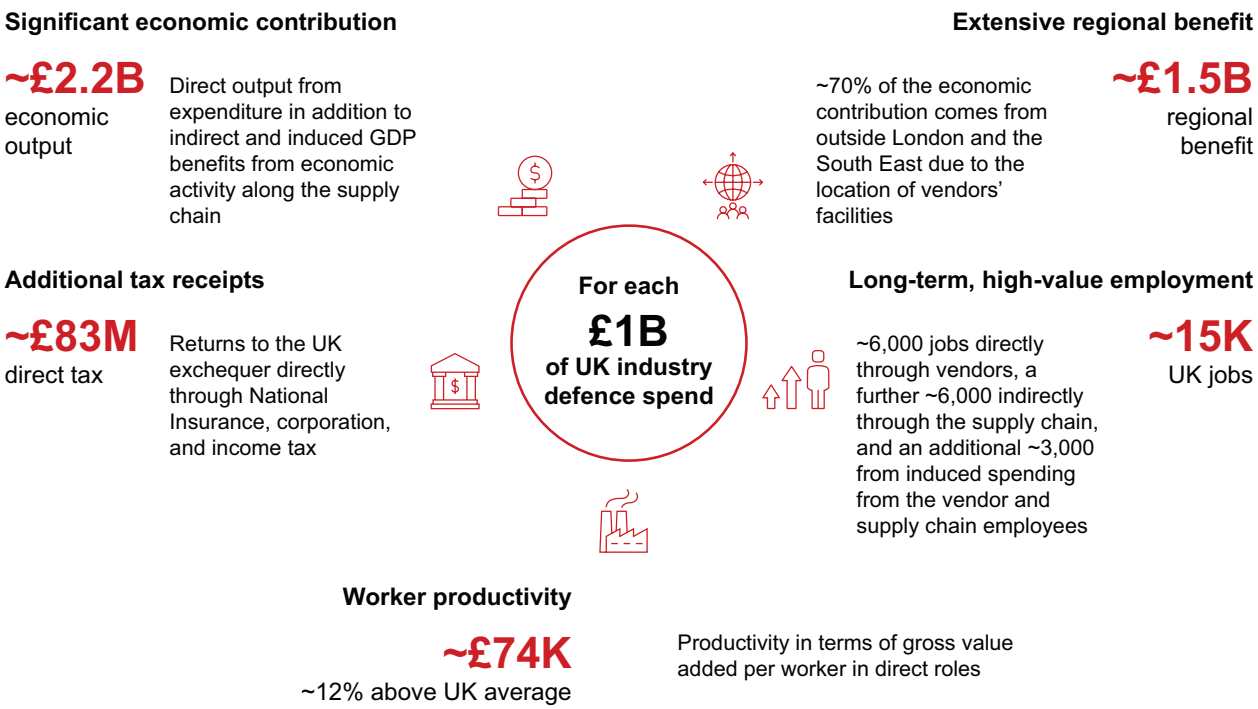
In a world of increased geopolitical uncertainty, government resource constraints, and rapid technological development, there is a need to maximise the benefits that the UK can achieve from its defence spending. The opportunity is significant, given the increasingly critical security and economic outcomes at stake. While the 2023 Integrated Defence Review and 2021 Defence Industry Policy provide a strong starting point from where to proceed, the UK has yet to fully articulate an overarching, integrated plan to fully capture its desired strategic outcomes.

An updated approach can unlock the full value of the UK's available defence budget; the critical questions are where to invest, how to optimise defence spending, and how to implement effectively and at pace.

## Defence expenditure brings significant returns to the UK

Our research, based on the latest Office for National Statistics and Ministry of Defence figures, highlights how defence spending can be of central importance to the UK's growth mission. Our analysis indicates that every £1 billion of UK industrial defence spending leads to an approximately £2.2 billion gross output increase, an additional £83 million in returns to the UK Exchequer (through National Insurance, corporation, and income tax), and about 15,000 jobs across the supply chain at approximately 12% higher productivity than the UK average (*see Figure 2*).

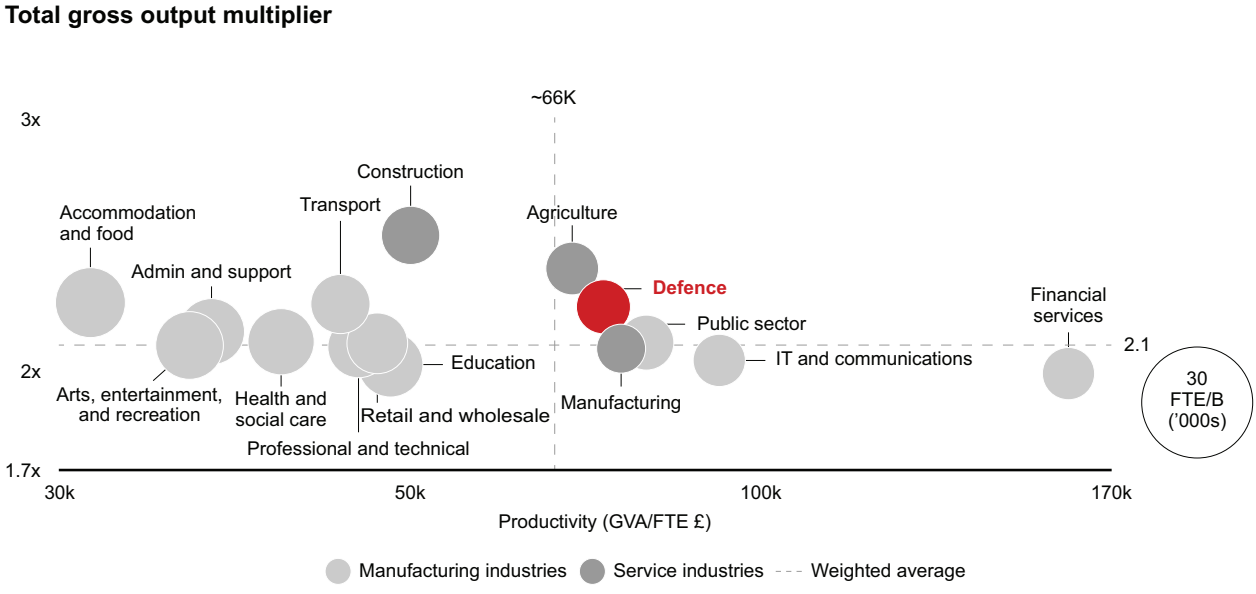
**Figure 2:** Defence spending has significant economic benefits



Across the UK economy, defence spending achieves top quartile gross output and productivity returns (*see Figure 3*). But not all elements of defence are equal: The strongest economic contributors range from building cutting-edge aircraft and spacecraft to manufacturing weapons and ammunition, pointing to some of the strategic choices that can be made to drive economic benefits of defence spending (*see Figure 4*).

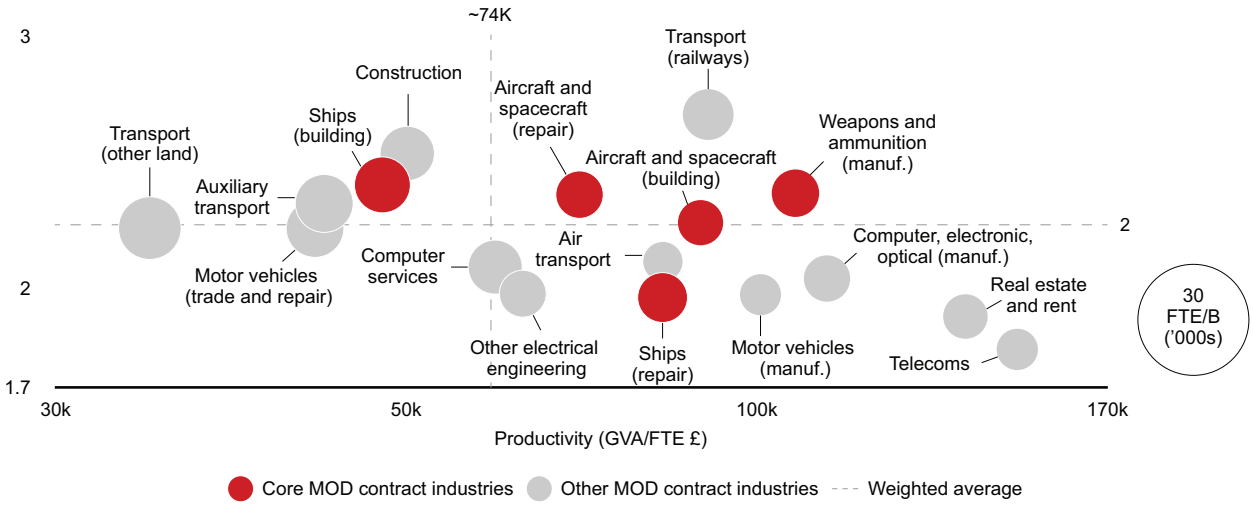
Furthermore, defence spending has substantial economic benefits across all corners of the UK. Approximately 70% of the current economic benefits and jobs from defence spending accrue to regions outside of London and the South East (*see Figure 5*). Of these regions, Yorkshire and the Humber, Scotland, and the North West have the highest gross output multipliers (i.e., the impact of each pound of defence investment on gross output of the region) due to their mix of defence industries (predominantly shipbuilding and repair).

**Figure 3:** Defence delivers top quartile gross output and productivity returns vs. other UK industries




Notes: Total multipliers calculated using truncated Type II Leontief values using latest ONS Input-Output tables, derived from annual SUTs for 2019; "Defence" is weighted by percentage of MOD spend for 2018–19 (current prices), excluding: "Other manufacturing," "Other services (Technical, FS, Edu, Health)," Agriculture / Fishing / Mining, Gas (supply), Electricity (supply), Water (supply), Postal and Courier Services due to unavailable disaggregation of data by SIC line item spend
Sources: ONS Input-Output tables (data released 27/03/2023); MOD regional expenditure with UK industry and commerce and supported employment 2021/22

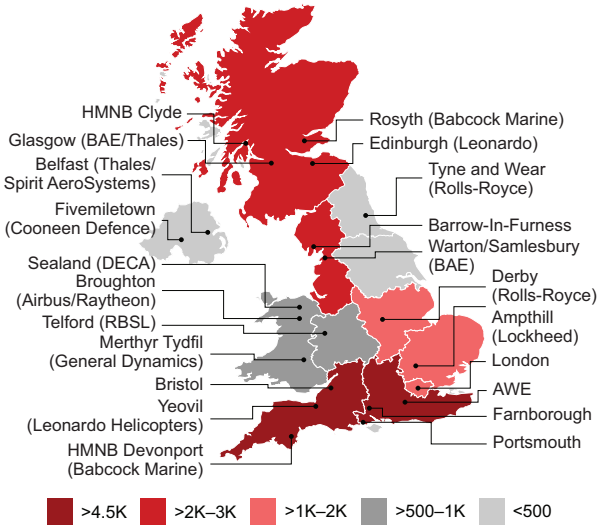
**Figure 4:** Impact of defence spend varies by contract categories




Notes: Total multipliers calculated using truncated Type II Leontief values using latest ONS Input-Output tables, derived from annual SUTs for 2019; "Defence" is weighted by percentage of MOD spend for 2018–19 (current prices), excluding: "Other manufacturing," "Other services (Technical, FS, Edu, Health)," Agriculture / Fishing / Mining, Gas (supply), Electricity (supply), Water (supply), Postal and Courier Services due to unavailable disaggregation of data by SIC line item spend
Sources: ONS Input-Output tables (data released 27/03/2023), MOD regional expenditure with UK industry and commerce and supported employment 2021/22

**Figure 5:** Current defence spending distribution across industries drives outsized regional economic and employment outcomes

**Total gross output** multipliers across UK regions




**Economic impact** of £1B spend by region

| | Total MOD Spend | Total gross output multiplier[1] | Total FTEs per £1B[1] |
|---|---|---|---|
| South West | £6,092m | 2.19x | ~15.1k |
| South East | £4,518m | 2.18x | ~14.9k |
| North West | £2,554m | 2.26x | ~16.6k |
| Scotland | £2,010m | 2.27x | ~16.9k |
| London | £1,479m | 2.19x | ~15.2k |
| East Midlands | £1,130m | 2.25x | ~15.5k |
| East of England | £1,119m | 2.23x | ~13.7k |
| West Midlands | £802m | 2.21x | ~16.7k |
| Wales | £744m | 2.13x | ~13.5k |
| Yorkshire and The Humber | £331m | 2.29x | ~14.1k |
| North East | £165m | 2.09x | ~15.8k |
| Northern Ireland | £109m | 2.33x | ~14.0k |

Notes: 1) Calculated using latest ONS Input-Output tables, derived from annual SUTs for 2019; percentage of MOD spend for 2018–19 (current prices), excluding: "Other manufacturing," "Other services (Technical, FS, Edu, Health)," Agriculture / Fishing / Mining, Postal and Courier Services, Hotels / Catering / Restaurants due to aggregation of SIC codes in MOD spend data
Sources: ONS Input-Output tables (data released 27/03/2023); MOD regional expenditure with UK industry and commerce and supported employment 2021/22

This highlights the greatest regional opportunities for economic benefits—North East, Northern Ireland—where opportunities exist for the government to leverage defence spending to stimulate growth in a more equitable manner.

The economic dividends from defence spending go beyond the immediate economic impacts:

- **Advancing innovation:** Historically, 3%–6% of UK Ministry of Defence (MOD) spending is allocated to R&D, fuelling high-value job creation and product innovation. Notable advancements include battlefield medicine and counter-Improvised Explosive Device technologies. The current portfolio of projects includes the PULSAR project, which explores defence and security uses of ultra-intense lasers, high-speed weapons, and development and demonstration of future hypersonic concepts and technologies.
- **Upskilling for tomorrow:** MOD sponsors up to 10,000 jobs through programmes funded by the Defence Science and Technology Laboratory, nurturing critical skills for defence and adjacent industries.
- **Creating a repeatable model for growth:** Defence exports contribute approximately 2%–4% of the UK's total exported goods, making the UK a top 10 global exporter of defence goods.
- **Strengthening the domestic supply chain:** The Ajax programme had more than 230 UK companies integrated in the supply chain across industries from raw materials to manufacturing sites.
- **Building strategic capabilities:** Building self-sufficient capability to domestically manufacture the latest next-generation technology and hardware (e.g., Dreadnought class SSBNs).
- **Generating inbound investment:** Military spending can bring in investment from other countries (e.g., Storm Shadow missiles).

## Which strategic outcomes does the UK want to achieve with its defence spending?

Defence spending can drive five interdependent strategic outcomes (*see Figure 6*).

**Figure 6:** Defence spending plays a critical role in achieving five interdependent strategic outcomes for the nation-state

| | National security | International influence | Economic growth | Social benefit | Industrial strength |
|---|---|---|---|---|---|
| |  |  |  |  |  |
| **Objective** | Protect national sovereignty and maintain peace using military and security forces, equipment, and intelligence | Enhance influence of national interests abroad, diplomatic efforts, and international peace and stability | Increase national wealth through economic policies, defence industry growth, and trade partnerships | Boost social prosperity through sustaining and creating domestic skilled, high-value jobs across the country | Strengthen domestic industries with growth opportunities through technological advancements and strategic planning |
| **Secondary Outcomes** | | | | | |
| | **Deterrence & defence** | **Power projection** | **Gross output** | **Skilled jobs** | **Innovation** |
| | Negate potential future threats | Ability to project military strength | Direct, indirect, and induced economic benefits | Defence and supply chain jobs supported and created | Ensuring relative advantage in high-technology sectors |
| | **Resilience** | **Diplomacy** | **Increased tax receipts** | **Diverse teams** | **R&D** |
| | Robust domestic industrial base and supply chain | Engagement in global affairs | Additional returns to the exchequer | Promoting equity and representation for all | Investing in new and critical technologies |
| | **Adaption** | **Influence** | **Trade relations** | **Regional development** | **International ventures** |
| | Ability to rapidly meet changing defence priorities | Ensure representation of national and supranational goals | Build wider trading relationships with allies through defence | Equitable regional distribution of economic benefits | Strategic involvement in joint ventures and programmes |
| **Measured by** | | | | | |
| | Significant percentage of GDP spent on defence | Key strategic assets (e.g., aircraft carriers, overseas bases) | Significant private defence sector as percentage of GDP | High number of (regional) jobs within defence economy | Large proportion of defence budget spent domestically |
| | Large active armed forces | Membership in international alliances and groups (e.g., UNSC, NATO) | Sizeable defence exports | Policies to ensure defence contracts are carried out domestically | Leading private sector defence players |
| | Nuclear capabilities | Active involvement in global conflict resolution/military operations | National defence champions with strong exports | Diversity, equity, and inclusion (DEI) | Significant proportion of defence spend dedicated to R&D |

Maintaining strength across all five areas is not trivial, and only global superpowers such as the US and China have been successful in doing so over extended periods of time. The UK's strategic position can have a greater strategic coherence and focus. Relative to peers with similar defence spending, the UK has not been as efficient in enhancing its military strength and can do more to put in place the systematic funding and collaboration that differentially delivers domestic production, job creation, and value of defence exports. Given constrained resources, the UK will struggle to be a full-spectrum military force and should consider investment decisions that are strategically complementary to its partners and that maintain its sophisticated defence capabilities. While ensuring national security is and will remain the core objective for UK defence spending, the UK faces decisions on what its related and complementary strategic defence spending priorities should be.

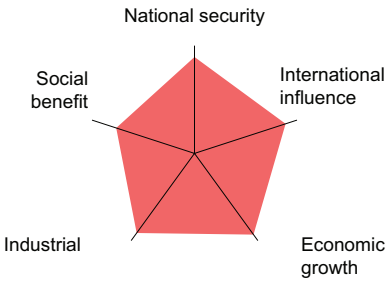
In this, it can take inspiration from two archetypes with substantially different focuses: security-focused countries, such as Israel, Saudi Arabia, and India, or economy-focused countries, such as France, Germany, and South Korea (*see Figure 7*).

**Figure 7:** Countries can be categorised as one of three profiles based on their primary strategic focus and objectives

## Global leaders

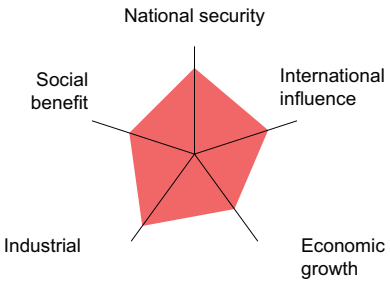
Countries with large defence budgets that are strong across all five strategic dimensions

### USA
($877B)



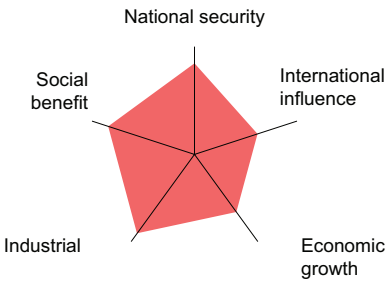

*#1 military, leading on most dimensions*

### China
($292B)




*Growing superpower, economic growth and geopolitical ambitions driving military*

### Russia
($86B)

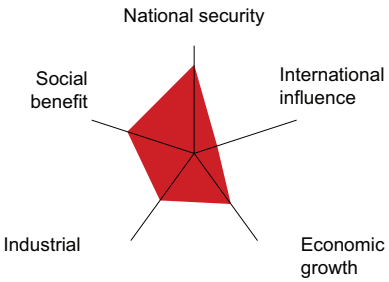



*Stagnating military superpower; status upheld through increased state militarisation*

## Security-focused

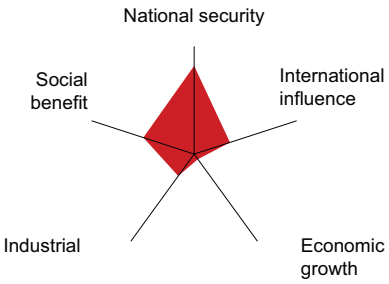
Countries that prioritise security measures

### Israel
($23B)



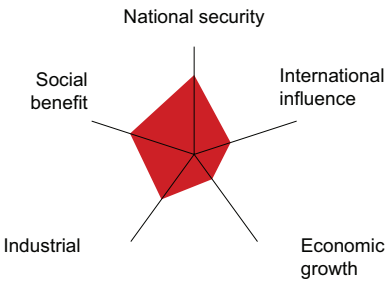

*Close proximity to military adversaries and high regional volatility*

### Saudi Arabia
($75B)




*Involvement in regional conflicts and military build-up to counter regional powers*

### India
($81B)

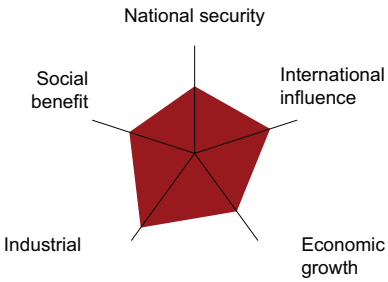



*Current and historical tensions with militarily strong neighbours*

## Economy-focused

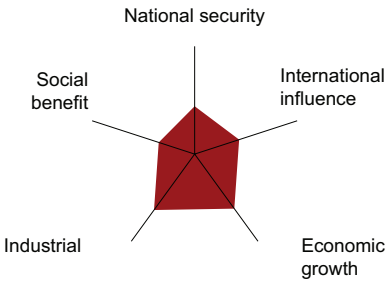
Countries with a focus on domestic defence industry across social, industrial, and economic growth

### France
($54B)



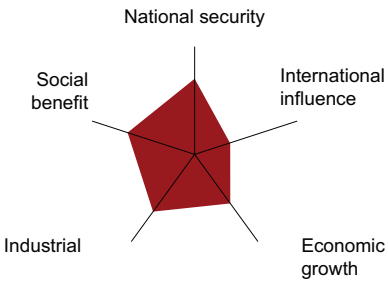

*Advanced defence industries with strong export capabilities*

### Germany
($56B)




*Land-focused defence industry with strong exports*

### South Korea
($46B)




*Economy largely governed by industrial policy*

Note: All figures in US$
Source: Bain analysis

## What actions should be taken to optimise defence spending?

To unlock the full value of defence spending, the UK must consider four critical and coherent decisions and look to develop an integrated and measurable plan against each.

1. **Determine the strategic capabilities the UK wants to prioritise, relative to our critical allies, and allocate spend accordingly.**

The UK has broad capabilities across each arena in defence; it has access to all key defence capabilities, except hypersonic missiles (*see Figure 8*). Within Maritime, the UK is recognised for its advanced expertise in both submarines and ships. Within Air, the UK has a strong track record of exporting the Eurofighter Typhoon and being the only Tier 1 partner to the US on the F-35. However, Air is very exposed to rapid technological advances, as in the areas of artificial intelligence and unmanned aerial vehicles (UAVs); therefore, maintaining cutting-edge capabilities requires being agile and leveraging innovation. Cyber is a leading area for the UK, with world-leading cyber defence companies. The UK also has a long and established expertise in satellites development and operations.

**Figure 8:** The UK has broad domestic defence production capabilities

| | | Sea | | | Land | | Air | | Nuclear/missile delivery | | | Misc. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Aircraft carriers | Submarines | Destroyers | Tanks | Artillery | Attack helicopters | Fighter jets (4th/5th gen) | Hyper-sonic | Super-sonic | Nuclear weapons | Satellite production and delivery |
| **Global leaders** | US | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| | China | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| | Russia | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| **Security-focused** | Israel | ✗ | ○ | ✗ | ✓ | ✓ | ○ | ✓ | ✗ | ✓ | ✓ | ✓ |
| | Saudi Arabia | ✗ | ✗ | ✗ | ○ | ○ | ○ | ○ | ✗ | ○ | ✗ | ✓ |
| | India | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| **Economy-focused** | France | ✓ | ✓ | ◐ | ✓ | ✓ | ◐ | ✓ | ✓ | ✓ | ✓ | ✓ |
| | Germany | ✗ | ◐ | ✗ | ✓ | ✓ | ◐ | ◐ | ✗ | ◐ | ✗ | ◐ |
| | South Korea | ✗ | ✓ | ✓ | ✓ | ✓ | ○ | ✓ | ✗ | ✓ | ✗ | ✓ |
| **Unclear focus** | UK | ✓ | ✓ | ✓ | ✓ | ✓ | ○ | ◐ | ✗ | ✓ | ✓ | ✓ |
| | Japan | ✗ | ✓ | ✓ | ○ | ✓ | ○ | ✓ | ✗ | ✓ | ✗ | ✓ |
| | Australia | ✗ | ○ | ✓ | ○ | ○ | ○ | ○ | ✗ | ○ | ✗ | ◐ |

**Capability** ✓ Domestic capability ◐ Joint development ○ Imported from abroad ✗ No capability

Sources: Ministries of Defence; International Atomic Energy Agency; Global Firepower 2023 Database; OECD; NASA; Centre for Arms Control and Non-proliferation

Given the realities of its defence budget, however, the UK is unlikely to match the strength of full-spectrum military powers like the US, China, or Russia. The implication is that the UK should select the domains in which it can most effectively maintain world-leading capabilities domestically, and where to rely on others for strategic partnership or access. This prioritisation must incorporate both those technologies where the UK requires sovereignty (or resilience) and where it can best generate the economic benefits cited above.

Nuclear is one of the most critical areas where current UK policy is seeking to ensure it has domestic capability. In its long-standing role as NATO's nuclear backstop (only the US, the UK, and France have nuclear weapon capabilities in NATO), the UK will seek to maintain a robust nuclear deterrent against strategic threats. Related to this, the UK has identified the need for domestic capability for submarines (critical to delivering a continuous at-sea deterrent) and continued investment in offensive cyber and crypt-key, which are paramount given emerging threats and where the UK has a strong track record.

Beyond these critical capabilities to be maintained domestically, it is apparent that there are important decisions to be considered about where the UK should prioritise. A clear and aligned set of desired defence strategic outcomes is essential for the UK to guide these decisions.

A security-focused approach (as per Israel, Saudi Arabia, and India) would necessitate a greater allocation of spending towards bolstering the UK's core attack and defence capabilities. Large naval vessels have been a historical strength of the UK, although these are capital-intensive to deliver domestically. Ground warfare is being transformed with integration of artificial intelligence-enabled autonomous exploration and movement, with drone/UAV warfare surging.

The dynamics of the Armenia-Azerbaijan conflict and the invasion of Ukraine highlight a challenge to the role of all traditional land and support vehicles, including tanks and helicopters. A new age of warfare, with increased use of drones, sensors, and long-range artillery and air attacks, will increasingly require cutting-edge capabilities. Achieving a leading domestic technological and hardware position across each of these arenas implies the requirement for large capital programmes, which may be significantly greater than the potential benefits.

For an economy-focused approach, the flow of capital should shift to areas with the highest commercialisation potential and foreign-purchasing interest. For instance, the global space economy is projected to grow from an estimated £430 billion in 2022 to £606 billion in the next five years (a 7% annual growth rate). Accelerating the delivery of the UK's space strategy could provide attractive opportunities for new exports enabled by technological reuse and military-civilian spillovers. Furthermore, investment in advanced technologies such as UAVs can drive lasting economic benefits.

The UK has the potential to leverage its strength in Maritime to boost export potential, such as the new Type 26 and Type 31 frigates, which offer an outsized benefit to the UK economy due to export demand. Optimal allocation of UK defence spend would enable it to fulfil its international role within NATO and Five Eyes alliances while delivering against its clear strategic objectives.

**2. Decide on our sovereignty posture across prioritised technologies (Nuclear, Combat Air, Cyber, etc.)**

For a given strategy, the UK needs to determine the balance of developing domestic capabilities, producing jointly with allies, or procuring internationally. Notwithstanding the need for clearer defence outcomes definition, the capabilities that the UK must develop domestically are set out in the 2021 Defence and Security Industrial Strategy (DSIS) report.

Nuclear deterrence capabilities, submarines, cryptography, and offensive cyber are considered strategic imperatives that must be sustained domestically, as they are either fundamental to the UK's national security, or international law and treaties limit what can be obtained from overseas.

Additional high-priority capabilities identified in DSIS as being required for operational independence (i.e., they enable the UK to continue to conduct military operations at will without external political interference and protect the sensitive technologies that underpin those capabilities) include complex weapons, novel weapons, test and evaluation capabilities, CBRN (chemical, biological, radiological, and nuclear), general munitions, and space.

The 2021 DSIS also highlights Air, Maritime, and Land more broadly as domains to be analysed under the lens of operational independence, but also acknowledges that "operational independence is not the same as 'procurement independence'—or total reliance on national supply of all elements." A comprehensive strategy across Air, Maritime, and Land will inform restrictions in the defence supply chain, including supplier nationality considerations. Less critical capabilities, such as non-critical military textiles, can be opened to procurement from strategically allied countries or outsourced entirely, leveraging lower-cost international supply chains.

Consider the following international examples of India's domestic production of tanks and helicopters, and Australia's joint procurement and production of frigates with allied countries.

## Case Study: India



Prior to 2021, India relied on imported Russian tanks such as the T90 for its ground forces. However, the "Make in India" push in 2021 resulted in 108 complex systems, including tanks and helicopters, being listed for indigenisation. As a result, 68% of India's defence capital budget was reserved for production by the domestic industry. This brings capabilities critical to national security into domestic production, reducing the risk of dependence on foreign countries. India has since stopped importing Russian tanks and now produces Arjun MK1Aur through AVANI, a state-owned company.

## Case Study: Australia

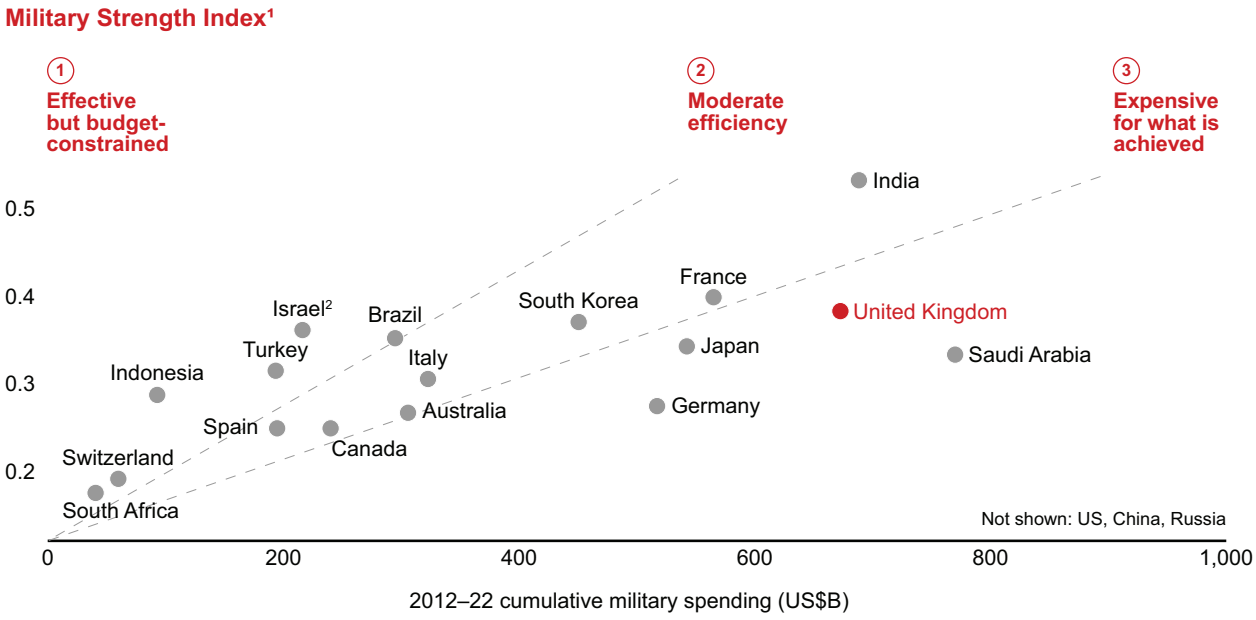


Australia decided to import a variant of the Type 26 Frigate built for the Royal Navy from the UK following a competitive tender amongst three European shipbuilders. Australia had limited domestic capabilities to meet the need for a fleet of new frigates. As Australia went through foreign procurement, it was able to leverage strong international relations with key partners. Planning strategically for the long term, Australia required all relevant technologies to be transferred into the country and the ships to be assembled in Australian shipyards to ensure future development capabilities.

### 3. Transform defence procurement holistically to deliver the greatest military strength for the given level of spend available

Countries that organise their defence procurement optimally achieve the ideal military strength with economic efficiency. The UK is currently performing relatively poorly in relation to peers (*see Figure 9*). Over the last decade, the UK has spent almost 300% more than Israel and 50% more than South Korea for comparative levels of military strength. With a similar budget, India has realised significantly greater levels of military strength. The UK may therefore have significant scope to buy better and spend better, as its capabilities are rated expensive for what is achieved.

**Figure 9:** Elevated defence spending should boost military output, but inefficiencies often obscure this correlation




Notes: 1) Military strength calculated in the Country Power Index that combines external indices with military statistics; 2) Israel Military Strength Index interpolated from other sources
Sources: SIPRI; The Changing World Order Dataset

*The Equipment Plan 2023–2033* report by the National Audit Office calculates that the forecast costs of MOD will result in a £17 billion deficit, which indicates the ongoing challenges faced by UK defence equipment programmes as they mature.

Organising defence procurement more effectively can help unlock the full value of the UK's significant military spending. This implies that all elements of the procurement system to work in sync: the government setting clear and steady direction, the MOD and Armed Forces articulating needs in a coherent and stable fashion, Defence Equipment & Support (DE&S) delivering world-class procurement support, and industry providing value for money and innovation.

The status quo has considerable potential for enhancement. At the heart of the challenge is DE&S, established in 2007. Successive parliamentary reviews have highlighted how DE&S procedures have become increasingly bureaucratic and complex, reducing the speed of execution, and how DE&S may lack the organisational culture to drive to successful outcomes on a consistent basis.

The facts suggest a more nuanced picture. DE&S has improved significantly since 2009, reducing cost overruns from 15% to 4% and length of delays from 28% to 15% for projects completed between 2017 and 2022. All these improvements have happened while reducing the workforce by over 50% from approximately 25,500 to 11,400. However, around 30% of the 44 largest programmes since 2017 were completed beyond the P90 schedule approval, and around 20% were completed beyond the P90 cost estimate. Major issues like Ajax continue to undermine confidence.

DE&S initiated a major transformation programme in 2023 that aims to make procurement faster, leaner, and more agile, and to foster more competition and innovation. To do so, DE&S is seeking to drive a mindset shift within the industry ecosystem while also improving internal operations. DE&S sees the need for an urgent adaptation to a higher threat environment, with more emphasis on timely delivery. The aims and objectives of the new Defence Suppliers Forum Executive Group 2025 are oriented towards a stronger industrial ecosystem. This includes actions such as including exports considerations during problem-setting and capability analysis, maintaining a capability priority list, ensuring increased SME spend by both MOD and industry, and leveraging private capital by increasing the attractiveness of the UK defence sector as an investment proposition. DE&S should be empowered to lead industry change at this important time of heightened threats.

The changes at DE&S will take time to play out, and outcomes are uncertain. What is certain is that without broader change beyond DE&S (e.g., a simplification of the MOD structure, which includes more than 20 individual organisations, each providing individual, ever-changing requirements that are sometimes in conflict and create multiple interfaces and more onerous internal complexities), the system will not fundamentally improve.

**4. Create the right conditions to foster innovation, rigour, and competition in the industry**

UK spending on defence equipment and support is currently focused on a concentrated market across the main domains of Maritime, Air, and Land. The top five defence contractors combined provide about 90% of the 2021–22 procurement spend in Maritime, and around 40% of Air and Land.

Of this market, approximately 30% of contracts above £5 million are sole-sourced. Sole-sourcing is often justified by claiming that only one contractor can meet the requirements, or through the need to preserve critical capabilities in the UK. While sole-sourcing offers a simpler and faster procurement process and enables a close partnership with the supplier, it has been seen across industries and geographies that creating a more competitive market typically drives better outcomes. It can lead to lower costs and greater innovation, and offers protection against complacency.

Greater competition would potentially better align incentives of defence contractors with the objectives of the MOD. It should also encourage contractors to be more innovative, which can be mutually beneficial. Anduril Industries, which uses artificial intelligence and machine learning to develop systems such as air-objects tracking, took just 31 months to go from sketches of a prototype to a $1 billion contract with the US Department of Defense (DoD). The DoD is able to add cutting-edge capabilities due to its modern approach to procurement and collaboration.

The UK has the potential to expand its industry and invest in the skills of the workforce (including in the diversity of the workforce, where more than 70% of positions at top A&D firms are in engineering or technology; women make up less than 30% of roles at top A&D firms, similar to the 30% of female graduates in STEM subjects), be at the forefront of future technologies and capabilities, and push innovation to the fullest. There is an opportunity for the UK to position itself extremely well in the global market and establish itself as a world leader in fields such as autonomous capabilities or artificial intelligence. Expected high-budget programmes like AUKUS and the Global Combat Air Programme represent significant, generational opportunities.

To capitalise on these, the UK should ensure that investments within its defence industrial base help foster a broad range of capabilities. Enhancing the availability of investment and opportunities across the wider industry can be achieved by promoting increased competition and collaborating with more SMEs that are pioneering innovative technologies.

From the outset, the MOD and DE&S have a critical role to play in designing the shape of UK industrial capability for generations to come.

There are a range of opportunities to increase innovation, rigour, and competition in the industry:

- **Decrease the use of cost-plus contracts:** Shifting more responsibilities to suppliers aligns incentives and minimises waste. Use of cost-plus contracts has recently fallen by 20% but still accounts for 50% of contract value in 2023.

- **Decrease subsequent contract modifications:** In UK defence procurement, a historical acceptance of contract modifications prevails. A cultural shift is required to not accept revisions as "inevitable." Peers such as France demonstrate that this is possible, with specific ministerial approval required to materially amend original terms.

- **Promote competition in the subcontracts:** Mandating a competitive procurement process for subcontracts, rather than allowing the prime contractors to make the decisions, can prevent subcontractors from dictating prices on critical subcomponents. For large contracts, the MOD could also embed its own contract staff to supervise the subcontracts, applying the same rigour as for its own prime contracts.

- **Maintain robust diligence and engage deeply down in the supply chain:** Competitive and sole-sourced programmes both require robust diligence from inception until delivery. Organisations in other countries manage and engage with several levels down the supply chain, while DE&S normally engages with the prime contractors only. A deeper engagement with the supply chain would drive positive outcomes and help to manage the skill base.

- **Encourage private sector investment to boost suppliers' capabilities to compete for major contracts:** The MOD can raise awareness with investors on the unique and attractive characteristics of defence investment. Fast-growing needs are outpacing spend projections, with limited ties to market cyclicity. The requisites of specialised expertise and trustworthiness create niches of opportunity within both innovative R&D and subsystems integration in areas such as artificial intelligence/machine learning, autonomy, C4ISR (command, control, communications, computers, intelligence, surveillance, and reconnaissance), space technology, training, and logistics. Government defence departments are seen as a long-term buyer that values great delivery and outcomes. Increasing private sector investment means more defence suppliers will have the critical capabilities required to compete for contracts, creating greater diversity in the supply chain.

## Summary: Actions to take now

Defence spending delivers a significant economic contribution that supports high-value, high-skill employment with outsized productivity contribution and strong pan-UK dividends. The following actions would help to unlock the full value of defence spending in the UK:

1. Determine the strategic focus for defence and allocate spend accordingly
2. Decide on domestic vs. foreign supply chain for critical capabilities, such as Nuclear, Air, and other frontier technologies
3. Optimise defence procurement to deliver the greatest military strength for the given level of spend available
4. Increase competition and foster the industrial supply base in alignment with the strategic focus and spending plans

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