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SCAF Workshop
“The Impact of Brexit on the Costing Community”

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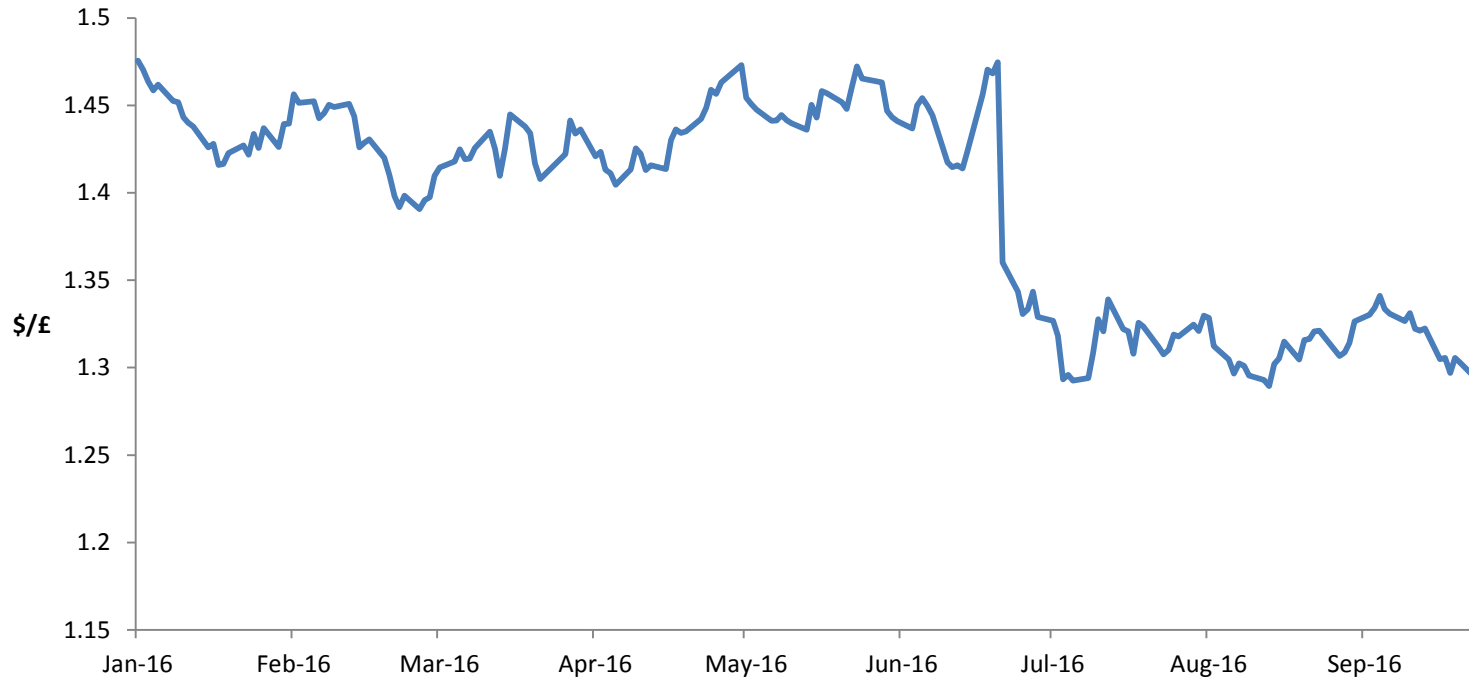
Ministry
of Defence

The Impact of Brexit – Value for Money

John Ogilvie
Senior Economist

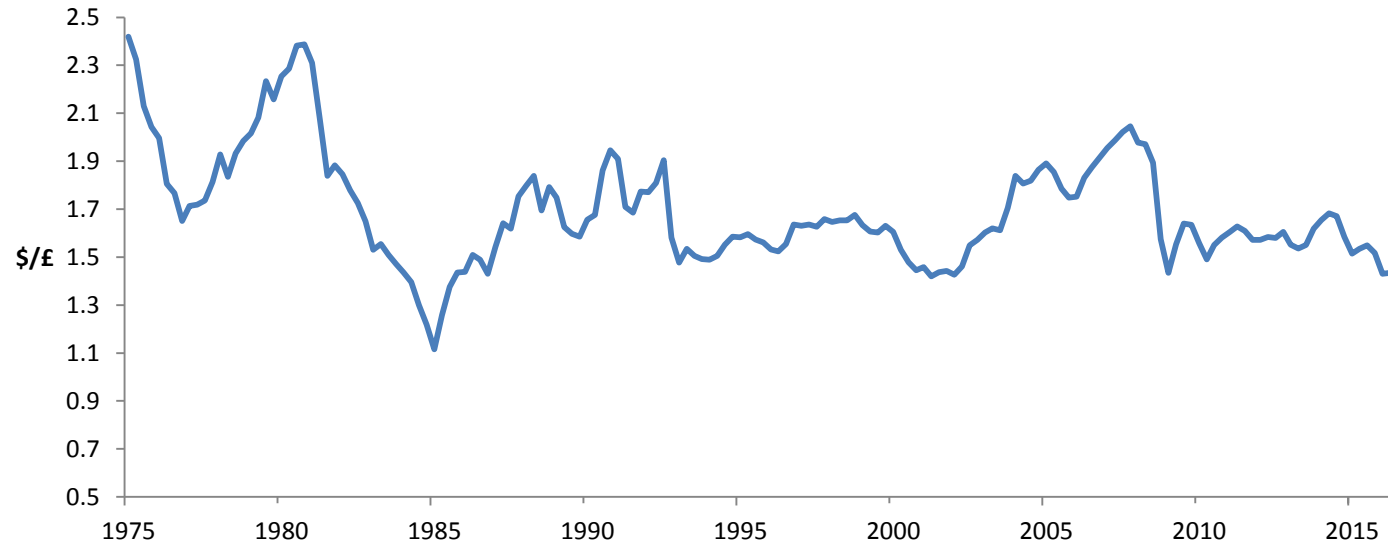


The initial shock





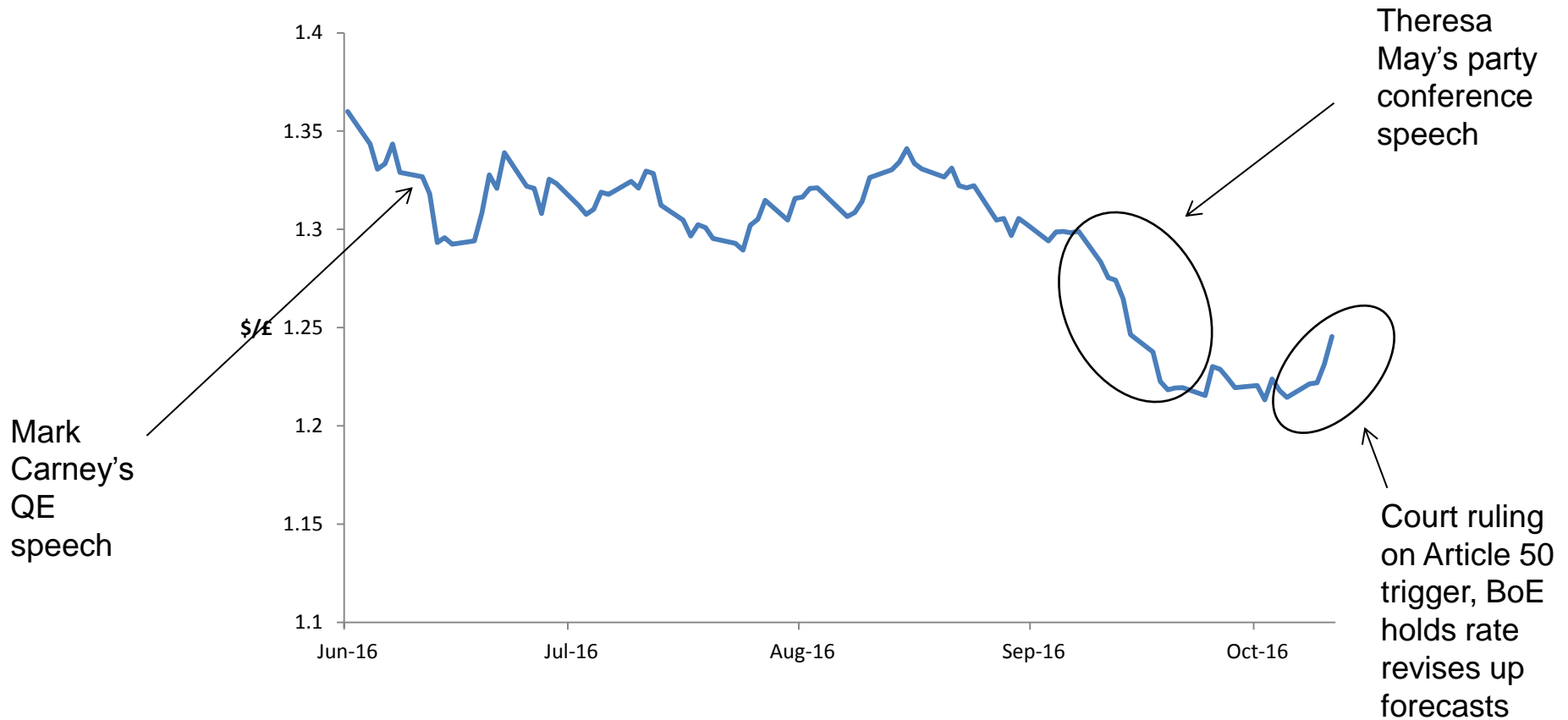
A bit of perspective



Markets have been volatile but not at an unprecedented level



The impact of information





Managing the volatility

■ Issues

- **Uncompetitive exchange rate assumptions in bids**
- **Bidders not pricing in GBP even when specified in a tender**
- **Budgetary pressure from previously agreed contracts**

■ Management

- **MOD aims to place contracts in GBP – subject to vfm**
- **Any FOREX components are properly modelled and made explicit in approval limits**
- **Exposure for largest currencies (euros and dollars) is hedged**



MOD Departmental Plan 2015 - 2020

■ Vision

3. Promote our prosperity

- ‘We will continue to seek vfm in defence procurement, recognising the important contribution that the UK defence industry makes to our prosperity’



Challenges to VfM assessment

- **MOD does not apply HM Treasury Green Book in its investment appraisals;**
- **MOD applies HM Treasury Green Book differently to other Departments;**
- **MOD should consider weighting domestic solutions more favourably in vfm assessments as other countries do;**
- **MOD overlooks tax implications in its procurement decisions;**
- **Factors such as the number of UK jobs should be considered in procurement decisions.**



What makes Defence different?

- **Defence is a pure public good**
- **Most MOD appraisals take the form of a cost effectiveness analysis (CEA)**
- **Small number of potential suppliers**
- **Significant barriers to entry**
- **Defence strategic considerations**



MOD's contribution to prosperity

- **Protecting UK residents, their property rights, and the global economic system.**
- **Prosperity is maximised by using Green Book Value for Money (VFM) methodology**
 - **VFM: optimal combination of economy, efficiency and effectiveness;**
 - **Full assessment of costs and benefits to society, enabling UK economy to pursue comparative advantage, maximising economic growth**



Defence imports and prosperity

- **When VFM to do so, MOD purchases from foreign contractors boosts UK prosperity.**
 - MOD obtains capabilities at lower cost to the economy than if they are produced domestically.
 - Stops UK assets being tied up producing defence goods when this is not their most productive use.
- **Purchase of US goods enables MOD to obtain cutting edge technology at a fraction of the research and development costs.**



Employment effects

- **Can only include supply side effects.**
- **Proposals claiming increases to UK employment must also consider substitution and displacement effects to identify the true level of additionality.**
- **Proposals resulting in reduced employment need to consider realistic allowances for the time taken for individuals to re-enter the workforce taking account the availability of employment, skills and demographic factors as well as potential changes in income.**



Output multipliers

- **Multipliers acknowledge that all parts of the economy are inter-linked.**
 - One company's output spurs supply chain activity
 - The workers employed purchase some UK goods
- **Not applicable for Green Book VFM decisions.**
- **When buying from abroad, any lost “multiplier impact” on the UK economy is balanced out as resources are put to other uses – creating new multiplier effects.**



Exportability

- **MOD may benefit for three reasons:**
 - **Lower prices if the products MOD buys are also sold overseas.**
 - **Safeguarding defence critical productive capacity which would otherwise be lost.**
 - **Strategic security alliances with other countries**

- **The effects of export demand are included in investment appraisals to the extent that industry is prepared to reduce development costs charged to MOD.**



R&D spillovers

- **Can be included in an investment appraisal.**
- **Little consensus over the size of any defence R&D spillovers.**
- **Any net effects could be positive or negative.**
- **In practice productivity effects are difficult to measure reliably.**



Taxation

Foreign taxes and subsidies represent opportunity costs and must be included in the assessment of the market price of goods and services.

- **Corporation tax is a tax on shareholders, and it is not possible to determine necessarily where those shareholders are domiciled.**
- **Income tax. The resources needed to produce an input, or import it from abroad, represent the input's true cost to society. Gross labour costs are therefore included in an investment appraisal because the tax taken is part of the output of labour.**
- **VAT. UK VAT, whether recoverable or non-recoverable, should be excluded from an investment appraisal.**



Summary

- **Challenges to MOD vfm assessment not supported by evidence**
- **No plans to change HMT / MOD approach to vfm assessment**
- **Desire to assist UK / UK regions will present challenges**
- **Brexit may lead to changes in procurement law**